A BANKER'S BUDGET

Marcel Côté

Paul Martin has an impressive record as a keeper of Canada' books. His clever innovations in accounting and money management have guaranteed that his budgets always balance. But the country needs more than prudent bookkeeping. If we are not to fall further and further behind the United States in real income per capita, we need significant tax cuts now, not five years from now. When economic performance, not budget balance, is the standard, Mr. Martin is in danger of being judged by history, along with Michael Wilson and John Crow, as an economic under-achiever.

Paul Martin affiche une feuille de route impressionnante en tant que grand argentier du Canada. Ses habiles innovations en comptabilité et en gestion financière lui ont permis de toujours équilibrer le budget. Mais il faut au pays beaucoup plus qu'une prudente comptabilité. Pour freiner le déclin qu'accuse, au Canada, le revenu réel par habitant, par rapport aux États-Unis, il nous faut dès maintenant réduire considérablement les impôts. En prenant pour mesure la performance économique, plutôt que l'équilibre budgétaire, la performance de M. Martin risque de passer à l'histoire dans la catégorie des demi-succès, aux côtés des Michael Wilson et des John Crow.

He did it again. For the seventh time in a row, Paul Martin delivered a banker's budget, prudent, solid, with no over-promising, and with a lot of chestnuts carefully stored for hard times, if ever they come. Probably his best budget, from this particular vantage point.

But whether this budget is what the country needs is another story.

When he took over the Finance portfolio in late 1993, Paul Martin probably swore that he would succeed where his Tory predecessors had failed. He inherited a fairly good tax-raising machine, particularly for personal income taxes. De-indexation, clawbacks on most transfers to individuals, and relatively hefty personal tax rates for taxpayers earning more than $50,000 (who contribute the bulk of tax revenues) translated into billion dollar annual silent structural tax increases, creating a taxman's dream machine. In his seventh year as finance minister, this tax machine was probably generating close to $10 billion more in constant dollars than when he had taken over. Moreover, at the same time, Paul Martin was quite good at keeping the big spenders at bay, and successfully built a consensus, both inside the government and across the land, around the paramountcy of reducing the deficit.

Another skill Paul Martin will be remembered for is his ability to skew the numbers. His first budget showed the way, shifting numbers around to both maximise the Tories' 1994 deficit to a record $42 billion and build a cushion into the 1994-95 budget. (Mind you, the Tories were probably doing the opposite, and most finance ministers know how to shovel expenditures and revenue back and forth across the March 31st fiscal-year end. Paul Martin just does it better than anybody else.)

During his tenure, Mr. Martin has also pioneered many practices. First, the use of foundations and in-trust accounts to store monies for future use, and the concept of net revenues, subtracting fiscal expenditures from gross tax revenues. (These accounting innovations led to a running feud with the Office of the Auditor General.) Second, for the past three years, Paul Martin has introduced the February spending spree as a key component of his budget speech, announcing major expenditures booked in the current year but actually reinjected into the economy in the next fiscal year. The final innovation is the mid-year mini-budget, introduced in December 1999, a $1.7 billion new expenditure tap to reduce the bulging surplus before the year-end.

These innovations make the assessment of the real budgetary situation somewhat more complicated. Before the Feb. 28 accelerated spending spree, and taking into account the December spending announcements, the 1999-2000 surplus was probably on the order of $10 billion — always keeping in mind that this excluded about $3 billion which was spent in 1999-2000 but recorded in previous years. On Feb. 28, $4.5 billion in new expenditures were booked in the 1999-2000 year, to be spent after March 31, 2000. The "official" surplus, which will be known only next summer, should be in the $4 billion range, although the Department of Finance still maintains it will be $3 billion. Thus, the 1999-2000 tax structure yielded a macroeconomic surplus on the order of $6 billion.

For next year, that surplus should be higher. Despite a GDP increase of six per cent, the *Budget Plan* argues that net revenues should reach $162 billion, a mere $2 billion over the previous year because of de-indexation and the tax reductions announced Feb. 28. Program expenditures booked in 2000-01 are unchanged at $116 billion. Adding $42 billion for debt financing yields the forecast $4 billion surplus. Correcting for the usual end-of-the year fudging and taking into account the traditional prudence of Paul Martin's forecasts yields a true surplus in the $8 billion range, some 0.8 per cent of GDP.

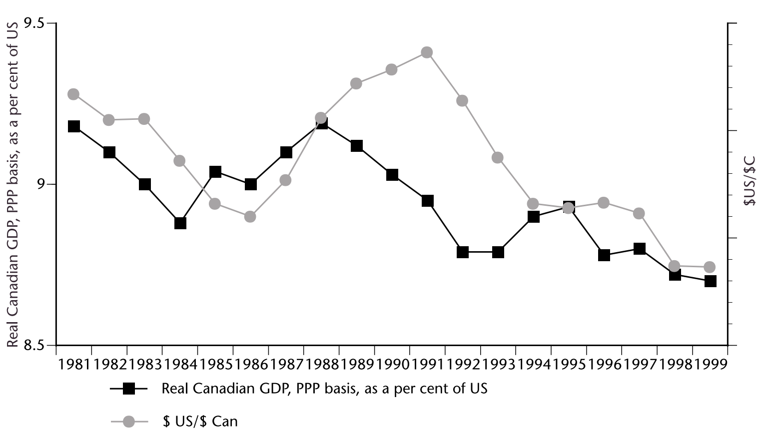
Is such a policy good for Canada at this time? Fiscal orthodoxy strongly supports Paul Martin's fiscal stand, if not his accounting, as surpluses should be recorded in the good years, especially toward the end of the business cycle. But Canada has a major tax structure problem, which has a significant impact on the growth of its economy. Indeed, from a policy perspective, this is probably the Minister of Finance's most important challenge. The negative impacts of this higher taxation level, diffused throughout the economy, probably explain much of the discount of the Canadian dollar below its purchasing power parity with the US, where close to a third of our GNP is sold. At the end of the day, Canadians end up poorer. This we all know, including Paul Martin. Fixing this structural taxation imbalance should be at least as important as cooling overall demand through an anti-cyclical fiscal policy, especially in an economy as open as ours.

The net effect of a significant tax cut now is likely to be compensated by additional revenues, especially if the tax cuts are biased toward upper-income taxpayers. If there is a lesson to be learned from the various US tax cuts, it is the surprisingly strong revenue effect associated with tax cuts among the top brackets. Indeed, a tax cut targeted at upper- income earners may actually increase revenues as wealthy taxpayers rearrange their finances and move away from unproductive tax shelters.

So why doesn't Paul Martin reduce taxes significantly now, since he has a good safety margin for reducing them? The impact on the economy will be positive immediately. Why wait? Why do it only half-heartedly, spreading the tax reduction over five years?

This is why I call Mr. Martin's budget a banker's budget. He is not managing the economy. He is managing an account, the account of the Government of Canada, and he is determined never to go back into the red. So he does not mind overshooting, as long as he stays in the black.

Canada's relative performance



The above chart presents as good an indicator of the performance of the Canadian economy as one can get. It tracks the ratio of Canadian to US GDP on a purchasing-power parity basis. It also shows the fate of the Canadian dollar. The chart suggests that there have been three periods recently when Canada's macroeconomic policies failed the Canadian people, and we regressed compared to the US. In 1980

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to 1985, we were mesmerised by inflation-spiked numbers. We lost control of our fiscal situation, both in Ottawa and in the provinces as we tried to spend our way out of the recession. As a result, we fell behind the US, which picked the lesser evil, Ronald Reagan's economics. The hangover was to last 15 years.

Then, in 1989-90, Michael Wilson did not dare to challenge the Savanarolan angst of John Crow, which passed among the Canadian banking crowd as deep-thought economics. John Crow charged ahead unhindered and inflicted on Canadians the most stupid and hurtful recession Canada has known since Herbert Hoover was at the helm in Washington. Collectively, we again fell behind the US.

Finally, there is the more recent period. Since 1996, we have slowly been losing ground. Why did Paul Martin choose the banker's approach and balance the accounts by raising taxes by $2 for every $1 of expenditures cuts? The Americans pursued the same deficit-reduction policy we did, but chose not to raise taxes to do it. The results can be seen on the chart. Canadians lost again.

The Canadian economy is seriously underpowered, choked by high taxes. Unemployment is 50 per cent higher in Canada than in the United States. Can a banker realise that today Canadian taxpayers' monies will be much more productive if left in the economy, rather than being used to reduce the national debt, or to be stashed away in short-term notes "just in case." Reducing taxes by an additional $5 billion will yield much higher returns than paying down the debt by an extra one per cent.

The banker's approach appears safe. But in the end, Paul Martin's tenure as Finance Minister will be assessed on objective performance indicators, not on today's headlines. So far, he is just one more under-performer who has caused Canada to trail farther and farther behind our neighbours to the South.

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Bernard Smith-Blair-O'Landry

Nous croyons à cette fameuse main invisible d'Adam Smith — économiste écossais — faut-il le préciser. Mais nous croyons tout autant à la main visible et solidaire de l'action collective que préconisent les gouvernements progressistes. Tony Blair, le premier ministre socialiste de Grande-Bretagne, disait récemment que, si les socialistes se sont trompés en voulant niveler le succès, ils ont sûrement eu raison en cherchant à le rendre accessible à tous. C'est ce que nous croyons aussi. ...

Notre fiscalité des entreprise est en général tout à fait compétitive. Mais pour décrocher de nouvelles implantations, notre régime fiscal n'est pas encore au niveau de plusieurs pays et États qui nous font concurrence. Nous aurions avantage à suivre par example les traces de la République d'Irlande, un petit pays de 3,7 million d'habitants, qui connaît depuis peu de temps une expansion phénoménale. Parmi les facteurs explicatifs, on note une approche fiscale aggressive, avec un taux d'imposition des profits des entreprise de 10 p. 100, qui s'est traduite par une augmentation directe non pas seulement des investissemnts mais également des revenus du gouvernement.

Bernard LANDRY, *Discours du budget*, 14 mars 2000

Yes, we believe in the famous invisible hand of Adam Smith, a Scottish economist. But we also believe in the clearly visible and supportive hand of collective action advocated by progressive governments. Tony Blair, the socialist Prime Minister of Great Britain, recently stated that, if socialists were wrong in trying to bring success down to a common denominator, they were certainly right to try to put success within everyone's reach. We are of the same belief ...

Our corporate tax system is, in general, very competitive. But there are a number of countries and states with which it still cannot compete when it comes to attracting new companies. We would do well to follow in the footsteps of the Republic of Ireland, for instance, a small country of 3.7 million people that has experienced phenomenal growth recently. One of the factors that contributed to this success is an aggressive taxation philosophy with a 10 per cent tax rate on corporate earnings, which translated into a direct increase in both investments and government revenues.

Bernard LANDRY, *Budget Speech*, 14 March 2000