A PRE-PRE-ELECTION BUDGET

Barry Gorman

Mr. Martin's budget tax cuts are too cautious and phased in too slowly. Moreover, several are really new spending in disguise. Tax relief at the top end of the income distribution is not great enough to make any significant dent in the brain drain. With his forecast $100-billion planning surplus over five years, Mr. Martin has lost an important opportunity to both jump-start Canadian economic growth and reduce the interest burden that the federal debt imposes on us all. On the other hand, his decision to spread the wealth rather than focus it where it will do the greatest economic good may well pay off politically.

Les réductions d'impôts que contient le budget de M. Martin ne sont pas assez marquées, et elles seront introduites de manière trop graduelle. Plusieurs de ces réductions ne sont d'ailleurs, dans les faits, que de nouvelles dépenses déguisées. Les baisses d'impôts consenties aux contribuables qui se situent au sommet de la pyramide salariale ne sont pas suffisantes pour mettre un frein à l'exode des cerveaux. Avec son surplus anticipé de 100 milliards de dollars pour les cinq prochaines années, M. Martin a manqué une belle occasion à la fois de relancer la croissance de l'économie canadienne et de réduire le fardeau que la dette fédérale nous impose à tous. Cependant, son choix de distribuer la richesse plutôt que de la concentrer là où elle serait le plus économiquement utile pourrait se révéler une excellente décision politique.

Paul Martin's seventh budget continues the political and fiscal strategies of his first six — that is, widely sprinkling benefits in a non-critical manner, changing existing policies incrementally, initiating few new policies, injecting the odd surprise to trip up the opposition, and deferring fiscal payoffs as far into the future as possible. In short, it is a politically safe budget designed with an eye to political costs and benefits and intended to carry the government successfully to and through the next election.

The annual budget is not only the paramount political event of a finance minister's year, it is a significant indicator of the future direction of public policy. Even with sizeable projected surpluses to play with, this budget not only carries on in policy directions already established in previous budgets, it clearly signals that the future direction of Canadian public policy will also be more of the same, within a carefully designed political safety net.

Rather than fresh approaches, the budget relies on old ideas (the deferral of capital gains taxes for investors who re-invest in small businesses); on obvious ideas (the personal tax proposals); on safe and narrowly focused ideas (the enhancements to the disability credit and to the scholarship threshold); and on ideas vetted and approved by the consensus-building, media-leaked and poll-driven pre-budget consultation process. It is not that these measures aren't needed or won't benefit their recipients, but will they stimulate the economy or add greatly to the after-tax income of significant numbers of Canadians?

Where are the bright new ideas and the bold initiatives? A completely separate capital gains tax system, for example; or corporate group loss relief, in which the loss of one member of a corporate group is transferred to, and deducted by, another member of the corporate group; or the option for taxpayers of filing as a family unit, rather than as a collection of individuals. Any of these would have injected new life into a tax system sorely in need of stimulating new ideas. They would have constituted real, structural change, not tinkering.

Reducing the capital gains inclusion rate to two thirds is a step in the right direction, but, like many of the budget proposals, it does not go far enough. The new inclusion rate still leaves our effective capital gains tax rates higher

than US rates. To achieve real stimulation by unlocking pent-up capital gains, the rate should have been reduced to 50 per cent.

Where are the long overdue enhancements to out-dated measures? The small business deduction has not been raised for over two decades. An increase in the limit from its current $200,000 to $400,000 or $500,000 would have done more good than the proposed reduced rate on active business income over $200,000. A deduction or credit for dependent children would have done more than anything (except the possibility of a family election) to balance the distortions in family taxation. The $40,000 alternative minimum tax threshold remains pitifully low in today's economy and unfairly traps individuals never intended to be caught by it.

To be fair, although it was obvious that inflation-induced bracket creep had to be addressed, Mr. Martin's decision to eliminate it all at one go and immediately is both surprising and gratifying.

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Why wasn't the budget more decisive on the tax side? The absence of an effective opposition virtually ensures a Liberal win in the election widely expected to take place next year. The right is fragmented and engaged in a self-destructive organizational and policy debate. The left is invisible — even with aid of a periscope, binoculars or telescope — and hence is largely ineffective. The Bloc is a single-issue party of little consequence to the great majority of Canadians. Given these weaknesses, why is Mr. Martin unwilling to pull the trigger and restore Canadians' after-tax incomes to pre-deficit-fighting days?

A strong and competitive economy is vital to the long-term prosperity of Canadians at all income levels. When the economy is competitive, employment increases. The under-employed gain meaningful employment. Those on social assistance acquire an incentive to enter the work force. Increased after-tax disposable income translates into greater consumption, a growing economy, and inevitably, higher tax yields. The tax reduction agenda should therefore have been front-loaded, not back-loaded; the allowances should have been increased; and the high-income surtax eliminated immediately. Given that approximately 80 per cent of Canadians earn $40,000 a year or less, and another 18 per cent earn between $40,000 and $90,000 year, the bracket splits should have been increased to $40,000 and $90,000, respectively, to more accurately capture the reality of who is a "high-income" Canadian. The $35,000 and $70,000 thresholds that Mr. Martin chose merely return taxpayers to their 1988 levels in real terms.

In fairness, consumer spending will increase due to the increases in the Canada Child Tax Benefit and the GST rebate. But these are social spending programs, not, as the budget documents claim, tax reductions. And they will be eaten away by projected increases in Canada Pension Plan contributions.

Will Mr. Martin's tax changes enhance Canada's competitive position, encourage investment, stimulate economic mobile Canadians to flee to the US? The personal and corporate cuts and the reduction in the capital gains inclusion rate will increase the after-tax return of domestic businesses, while changing the tax treatment of stock options does address one part of the brain drain. However, it is debatable whether these measures will be sufficient to attract incremental foreign investment and stem the brain drain. Not only are the corporate rate cuts spread over several years, and hence unlikely to have a major immediate impact, they do not go far enough. Mobile capital seeks, not just a country in the middle of the corporate-tax-burden pack, but the best return on its investment. Without further reductions at the upper-income levels, many highly-skilled individuals will continue to leave Canada in search of better opportunities south of the border. Many such individuals — university researchers, for instance — do not work in the private sector, and hence cannot benefit from the reformed treatment of stock options.

While Mr. Martin should be roundly applauded for his adept handling of the deficit crisis, his continuing insistence on prudence and contingency reserves, and his relative success in containing total program spending, he is unlikely to find a better time to act decisively and inject economic stimulation than when projected five-year surpluses are estimated to exceed $100 billion.

Although the budget plan, if fully enacted, will significantly benefit many low- and middle-income Canadians, it contains three glaring holes: It fails to introduce significant tax relief for upper-income Canadians. It does not address the non-rate business tax issues addressed by the Mintz report, including the burden of profit-insensitive capital taxes. And it commits only the contingency reserve to debt reduction.

The budget does little to benefit those individuals most susceptible to the siren call southward — that is, the upwardly mobile $100,000+-a-year folks. With top US rates coming into effect at approximately C$350,000, many of these individuals will still be attracted to American employers. True, the focus of personal tax relief has been nudged upward to include middle-income taxpayers in this budget, so perhaps more-decisive relief for upper-income Canadians will come in the first post-election budget, which will afford ample time for low- and middle-income voters to forget it!

Except for the corporate rate cuts and the amendments to one or two technical items, the bulk of the recommendations of the Mintz report on business taxation remain essentially in limbo. For instance, the Mintz report recommended a review of the capital cost allowance (CCA) system, reductions in CCA claims in certain classes of investment, and reduced scientific research and experimental development incentives. Among its more controversial recommendations were proposals to adopt a dividends distribution tax and eliminate the $500,000 capital gains exemption on the disposition of small business shares and farm properties. The report recommended that the latter proposal be balanced by an enhanced RRSP contribution system. Budget 2000 does not so much as mention any of these possibilities

As far as the national debt is concerned, the debt-to-GDP ratio is falling nicely, but more concerted action is needed to reduce the absolute amount of the debt and the crippling interest commitments it produces. More explicit and more substantial debt reduction targets would have been desirable.

On the spending side, while overall spending is up, Mr. Martin is clearly signalling his intention not to be perceived as a spendthrift Liberal. Projected spending increases have been strategically targeted to areas in obvious need — the military, for example. Yet, surprisingly, health care, the spending issue reported to be of greatest concern to the electorate, receives only a small, last-minute spending supplement. No doubt next year's budget — which will be quite literally a pre-election budget — will be heavily weighted to health-related spending initiatives. The lack of detail in the spending plans, and the recent HRDC disaster together suggest that the spending proposals should have been accompanied by procedural measures to guarantee accountability and transparency.

The budget is, of course, as much a political document as it is a fiscal forecast. Mr. Martin can therefore be forgiven for referring to his rather modest budget measures as "important structural changes," and for boasting of his tax rate reductions as the first in 12 years. In fact, the 12-year claim is true, though rate cuts were a no-brainer and should have gone farther, while talk of structural change is extravagant. Furthermore, most of the "tax reductions" are either promises not to allow future taxes to rise, or spending programs wrongly labelled as tax reductions.

But the budget has a little for everyone, not too much for any group or sector, and lots of promise of good things to come. Like a political Santa Claus, Mr. Martin has made each Canadian a little bit better off, and has started down the long road to tax fairness, but he has yet to ensure that the bulk of the promises will be enacted. It seems clear that the next budget will a health budget. What is not clear is whether the health in question is that of the average Canadian or the federal Liberal party.

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Web-age taxation

Well-informed taxpayers will not afford governments the luxury of using a growing economy to adjust rates of taxation to their own political advantage without any reduction in the overall burden of public expenditures. Tax decisions will no longer be secondary to expenditure decisions reached by democratically elected governments. Rather, as taxation becomes to some extent voluntary, the ends of government will be adjusted to the means, rather than the means to the ends — assisted perhaps by privately organized referendums on the Internet. Lobbyists for higher public expenditure, including politicians, will be forced to sell their pet schemes directly to the public and explain precisely how they would be financed. The political marketplace will become more like the real marketplace.

Dominic HOBSON, *The Spectator*, 26 Feb. 2000