Commentary

Keep Your Eye on the Ball

Judith Maxwell, President

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It is true that incomes have grown more slowly in Canada than in the United States in the 1990s. It is also true that Canadians pay more tax. But we should not leap to the conclusion that the well-being of Canadians is so much worse. We have to probe a little deeper. We need to ask *why* incomes have grown more slowly, *what* the Americans will be doing with their extra income, and *what factors* should be taken into account before we launch a major round of tax cuts.

Why have incomes grown more slowly in Canada?

Canada has spent the past decade getting its fiscal house in order – something vigorously supported by financial and business leaders in Canada in the early 1990s. When governments cut spending and raise taxes, they slow the growth in employment and income. Canadian governments have done this to get rid of public sector deficits (mostly done) and to reduce the public debt (just beginning). Remarkable progress has been made, and the goal is within our grasp.

But we aren't there yet. Interest payments on the net federal public debt of close to $600 billion soak up 27 cents of every dollar we pay in taxes. The total interest bill is still $44 billion. The true "fiscal dividend" can be collected once that bill has declined to acceptable levels. In the meantime, as my tennis partner says, keep your eye on the ball.

What will Americans do with their higher incomes?

First they will buy more health insurance. And the 43 million Americans who do not have insurance coverage (the last estimate I saw) face personal bankruptcy if they get seriously ill.

Then they will pay for private schools and universities for their kids, since they have no faith in the public education system in the United States. Then, if they still have money to spend, they will buy a house in an (expensive) exclusive district, possibly with private security guards, to protect them from the violence associated with inner city life.

The bottom line is that Americans have more money, but they do not necessarily have a better quality of life – in the form of personal safety, clean air and water, reliable public services, and social infrastructure. These dimensions of quality of life are important to Canadians today, but they are also the essential foundation for future productivity growth in the knowledge-based sectors which economists quite rightly identify as the job creators of the future.

One of the side effects of the fiscal correction has been painful cuts to health, education, and other public services. The cuts have driven doctors, nurses, and researchers to take jobs in the United States, where the privately endowed institutions offer higher pay and much better working conditions.

Canadians see our social infrastructure as a national asset. They are appalled by the cuts in public services and by the growing signs of inequality and distress evident in the centre of many Canadian cities. The last thing in the world they want to create are the burned out, no-go areas which scar far too many American cities. And now they are signaling that they have seen enough spending cuts. Polling data by Ekos Research Associates shows that 90 percent of Canadians want governments to maintain or increase existing public services, up from 75 percent in 1995.

What factors should shape the next round of tax cuts?

While everyone likes a tax cut, governments are pulled in three directions. They have to

- make sure that they can fund tax cuts without jeopardizing the public services that citizens value;
- ensure they have the future capacity to balance the books when a recession hits; and
- choose tax cuts that improve the health of the economy.

Tax cuts can influence growth in two ways: The first is by giving money to consumers who will spend more in the near term. The second is by enhancing incentives to work, invest, and save over the medium term.

Think of the excessive tax rates in Canada as a hangover from the battle against deficits and debt. We have reached the dawn of a new era of tax cuts. But the tax reform agenda is both wide and deep. As the public debt declines and the size of the interest bill diminishes over the next few years, we are all in the queue for tax cuts.

After the long siege of deficits and debt here in Canada, a strong case can be made for a wide range of tax reductions affecting low, middle, and high income taxpayers. Low income families face extremely high marginal effective tax rates when their income passes through key thresholds; middle income families hit the highest tax brackets at $60,000 – just above the average family income in Canada; and high income earners are hit by surtaxes and high rates of tax on capital gains and dividends. Also, the Jack Mintz task force makes a case for reform of business taxes.

Difficult choices have to be made. Choices that balance the need for social and economic infrastructure against the need to pay down the debt against the desire for more after-tax incomes in the pockets of Canadians. Choices that balance the legitimate claims for tax relief from low, middle, and high income groups as well as the corporate sector. The final decisions will determine how healthy the economy will be ten years from now.

Most of the economists and business leaders in this country argued long and hard for a frontal assault on deficits and debt. That battle is not over yet. Any government that declares victory too soon, risks losing the long term gains from winning the prize – a country with its economic and social house in order is a country well placed to sustain economic growth *and* the quality of life in the 21st century.

Keep your eye on the ball.

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Judith Maxwell is the President of Canadian Policy Research Networks (www.cprn.org), and is based in Ottawa.