
THE HOWE REPORT

The C.D. Howe Institute: Approaching a half-century of public-policy leadership

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The President's Digest

by Jack M. Mintz

Is the Tax-Cutting Era Dead in Canada?

After recently speaking in Ottawa, I came away with a depressing view that the federal government has given up on additional tax cuts as part of its fiscal agenda. I say depressing because we seem to have quickly forgotten that Ottawa billed the FY2000 tax-cut package as only the first of many more to come.

As it is, we have created so many distortions in our tax system in the past decade and a half in the interest of raising revenue to cover our debt burden that it will take years to return sanity to the system.

Federal, provincial and municipal governments take in fully 42.7 percent of GDP as tax and non-tax revenues, according the latest OECD publication. This is not only high historically but it soars above the fiscal burdens in many countries in the developed world. And despite the recent tax cuts, we still have significant distortions that discourage innovation and investments caused by the insatiable thirst of governments for money to fund public expenditures from earlier years. In a January *Backgrounder*, Bill Robson showed that the drive to initiate or expand public programs has not waned. Federal non-defence program spending since 1999 is, in fact, rising twice as fast as GDP — with double-digit annual growth during the past two years alone.

In a June *Backgrounder*, “Taxing Investments: On the Right Track, But at a Snail’s Pace,” Duanjie Chen and I showed that the recent corporate tax cuts — welcome as they are — will fail to achieve a competitive level with the United States by 2008, when the reductions are fully implemented. Canada’s 2008 effective tax rate on capital investment will still be one-third higher than the current U.S. effective tax rate: 27 percent, compared with 20 percent. Even though Canada’s federal-provincial corporate income tax rate will be lower than the U.S. federal-state corporate tax rate, Canada’s corporate tax system remains uncompetitive because we have less favourable treatment of depreciation and inventory costs, higher capital taxes and higher sales taxes on capital components than does the United States.

In short, we have not only failed dismally to create a level playing field, we have fallen far short of creating a Canadian advantage when it comes to corporate taxation. And as many experienced business leaders know, the personal tax disadvantages in Canada remain substantial. We have higher marginal tax rates for most income levels, reaching as much as 47 percent at the top end, almost 7 points higher than in the United States. However, the highest marginal tax rate — in excess of 75 percent — is the burden carried by workers with modest incomes in the \$30,000-to-

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“This Institute is the gold standard for intellectual thought and analysis on economics, social policy, and a lot of related subjects”

– Jim Blanchard,
Former Michigan
Governor and
Ambassador to
Canada

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C.D. Howe Institute

Scanning the Landscape of Demographic Change

by Bill Robson,
Senior Vice President and Director of Research



Sometimes the toughest public policy challenges arise not from fast-breaking events, but from crises that develop over decades or generations. The reshaping of health, pension and labour-market policies to serve a slower-growing, older population is a stark example of this phenomenon, and the response to it has been a centrepiece of recent C.D. Howe Institute work.

On health care, for example, I pointed out in two C.D. Howe Institute Commentaries that older Canadians' tendency to absorb more health-care resources and generate less taxable income threatens Canada's provinces with a fiscal scissors. Governments could avoid a relentless squeeze on other programs and upward pressure on taxes by emulating reforms to the Canada and Quebec Pension Plans, setting funds aside in the near-term that would stabilize the tax cost of critical health programs in the future.

That aging will increase demands for income-support payments and other elderly benefits is hardly news. Less well known, however, is that means-testing these benefits severely erodes the rewards many seniors and near-seniors reap from working and saving. Social policy analyst Richard Shillington notes in a recent *Commentary* that by discouraging work and saving, governments may ultimately increase dependency on public benefits. My colleague Finn Poschmann has advocated retirement saving plans offering tax relief on distributions rather than contributions as one way out of this problem, an idea the federal government promised to examine in the spring 2003 Budget.

Recent headlines about funding shortfalls in defined-benefit pension plans highlight the need for work and compensation packages that will keep older Canadians happily and profitably on the job. My study for the British North American Committee discussed many steps employers and

governments can take to ease the impact of demographic change on individual businesses and the country as a whole. Institute Policy Analyst Yvan Guillemette recently warned, however, that aging may adversely affect not only work and saving, but also aggregate productivity gains. If, as he and I argued in a recent presentation to the Office of the Chief Actuary, these trends slow economic growth and lower investment returns in the future, a key task facing employers and employees is to design compensation packages that attractively balance work and pay in the present, rather than counting on high investment returns to provide rich benefits in the future.

The long gestation of these problems points to the value of early action to resolve them. ■

Recent Publications...

- Finn Poschmann. "Private Means to Public Ends: The Future of Public-Private Partnerships."
- Danielle Goldfarb. "The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?"
- Duanjie Chen and Jack M. Mintz. "Taxing Investments: On the Right Track, But at a Snail's Pace."

Recent Events...

- Janice MacKinnon, University of Saskatchewan and Paul Boothe, University of Alberta on "The Role of Crown Corporations in Saskatchewan" June 4, 2003
— Policy Roundtable, Saskatchewan
- Michael Vennat, President and Chief Executive Officer, Business Development Bank of Canada on "Small Business and the Economy" June 5, 2003
— Policy Roundtable, Montreal
- David Lindsay, President and CEO, SuperBuild Corporation, and Finn Poschmann on "Public-Private Partnerships" June 23, 2003
— Policy Roundtable, Toronto

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\$35,000 range. They face a bewildering array of taxes that affect their work efforts: personal income taxes, CPP/QPP and Employment Insurance payroll taxes, sales taxes, and clawbacks for such income-tested benefits as the child-tax-benefit program that was enriched in the last budget.

Canadians are also more encumbered than their U.S. neighbours by higher taxes on savings, including dividends and capital gains, and higher sales taxes. Of course, we can claim a handful of tax advantages, though they are few and far between. We provide some targeted tax-relief measures for research and development, lifetime capital gains, registered education savings, labour-sponsored venture capital, small business tax relief and other incentives to reduce some of the tax burdens faced by Canadians in the interest of economic or social policy objectives.

Those few advantages, however, provide no validity for our government's current policy of turning its back on tax cuts. That position is simply not good enough. Instead, the federal — and provincial — governments should aggressively entrench tax reform as part of the economic agenda. I cannot think of a better way to increase incomes and employment in Canada than to remove the distortions now wracking the existing tax system and needlessly discouraging work and investment. Nor can I imagine a worse way to discourage growth than by allowing the present tax regime to stand.

With this inaugural edition of The Howe Report, we are launching a regular series of communications with members, to keep you up to date with what your Institute is doing and planning, and why. For my part, I will provide a regular comment on matters of current public-policy interest. Your thoughts and opinions are, as always, essential to our success in this endeavour and I invite you to contact me at JMintz@cdhowe.org. ■

The C.D. Howe Institute Announces a New Annual Event

One of the C.D. Howe Institute's greatest strengths is its ability to provide a unique forum for discussion of important policy questions. On May 28, the Institute held its inaugural *Directors Dinner*, aimed at providing Chief Executives, and other leading decision makers, with a convivial forum to discuss a major policy issue facing Canada. BMO Financial Group generously sponsored the evening.

Jim Blanchard, former Michigan Governor and Ambassador to Canada, was the speaker, addressing a crowd of more than 100 leading CEOs, Deputy Ministers, journalists and association heads on the issue of Canada-U.S. relations. Mr. Blanchard gave a rousing speech filled with wisdom, insight and common sense on what is clearly turning out to be a defining issue of our time.

Jack Granatstein to Deliver Benefactors Lecture 2003

The success of the *Directors Dinner* demonstrated the strong appeal of this type of event, and that members find the dinner format particularly engaging. With this in mind, the Institute is redesigning its annual *Benefactors Lecture* to reach out to more people.

The lecture is a seminal event for the Institute. Each year, a leading scholar delivers a major address to members, friends and guests of the Institute, including the media. The lecture is also printed and distributed free of charge. With the support of George Weston Limited, this year's sponsor, the Institute will organize a dinner to help celebrate the lecture, which will take place October 21 at the Four Seasons Hotel. Jack Granatstein will be the speaker, and the lecture and the evening is open to all members. Details will follow closer to the date. ■