



**Calhoun: The NPS Institutional Archive**  
**DSpace Repository**

---

Faculty and Researchers

Faculty and Researchers' Publications

---

2011-08

## Canada's Budget Triumph

Henderson, David R.

---

FCPP (Frontier Center for Public Policy) Series No. 112, August 2011

<http://hdl.handle.net/10945/43114>

*Downloaded from NPS Archive: Calhoun*



Calhoun is a project of the Dudley Knox Library at NPS, furthering the precepts and goals of open government and government transparency. All information contained herein has been approved for release by the NPS Public Affairs Officer.

**Dudley Knox Library / Naval Postgraduate School**  
**411 Dyer Road / 1 University Circle**  
**Monterey, California USA 93943**

<http://www.nps.edu/library>

# POLICY SERIES

FRONTIER CENTRE FOR PUBLIC POLICY • POLICY SERIES NO. 112 • AUGUST 2011



## Canada's Budget Triumph

By David R. Henderson

Originally published by The Mercatus Center 2010. Reproduced here with permission.



For over 25 years, the Mercatus Center at George Mason University has been the world's premier university source for market-oriented ideas. Our mission is to generate knowledge and understanding of how institutions affect the freedom to prosper and find creative solutions to overcome barriers that prevent individuals from living free, prosperous, and peaceful lives. Bridging the gap between academic ideas and real-world problems, Mercatus brings scholarly research to bear on policy questions, acquaints scholars with the real-world complexities of market and political processes, and trains graduate students in how sound economics offers solutions to society's most pressing problems. For over a decade, we have shared how academic knowledge addresses current issues in seminars, lectures, courses, and consultations for policy makers, opinion shapers, and the public. Located on George Mason University's Arlington campus, the Mercatus Center is a 501(c)(3) tax-exempt organization.

#### About the Author



**David R. Henderson** is an associate professor of economics in the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, California. He is also a research fellow with the Hoover Institution at Stanford University. He was born and raised in the Canadian province of Manitoba. He acknowledges helpful conversation with Professor Thomas Courchene of Queen's University and Canada's Ambassador to the United States, Gary Doer, and especially helpful comments and suggestions from Professor William Watson of McGill University. He also appreciates the highly competent and timely research assistance of Jerrod Anderson, a master's student in the Economics Department at George Mason University and a graduate fellow at GMU's Mercatus Center.



[www.fcpp.org](http://www.fcpp.org)

Email: [newideas@fcpp.org](mailto:newideas@fcpp.org)

MB: 203-2727 Portage Avenue,  
Winnipeg, Manitoba Canada R3J 0R2  
Tel: 204-957-1567

SK: 2353 McIntyre Street,  
Regina, Saskatchewan Canada S4P 2S3  
Tel: 306-352-2915

AB: Ste. 1280-300, 5th Avenue SW  
Calgary, Alberta Canada T2P 3C4  
Tel: 403-995-9916

The Frontier Centre for Public Policy is an independent, non-profit organization that undertakes research and education in support of economic growth and social outcomes that will enhance the quality of life in our communities. Through a variety of publications and public forums, the Centre explores policy innovations required to make the prairies region a winner in the open economy. It also provides new insights into solving important issues facing our cities, towns and provinces. These include improving the performance of public expenditures in important areas like local government, education, health and social policy. The author of this study has worked independently, and the opinions expressed are therefore their own, and do not necessarily reflect the opinions of the board of the Frontier Centre for Public Policy.

Copyright © MMXI by the Frontier Centre for Public Policy.

Date of First Issue: August 2011.

Reproduced here with permission of the author. Any errors or omissions and the accuracy and completeness of this paper remain the responsibility of the author.

ISSN 1491-78

FCPP Policy Series No. 112 • August 2011

# Canada's Budget Triumph

By David R. Henderson

## Table of Contents

Title	Page
Executive Summary	4
The Setting	5
The 1993 Election	7
Policy Proposals	8
The Education Campaign	9
The 1995 Budget	11
Later Budgets	13
Opposition to Cuts	15
Tax Increases	17
Tax Cuts	18
Lessons for the United States	19
The Road Ahead	21
Appendix: The Fiscal Arithmetic	22

Note to reader: Some words in this document may appear in blue and are underlined. Clicking on these words will direct the reader to relevant sites or documents using your associated web-browser.

# Executive summary

A federal government runs a large deficit. Deficits are so large that the ratio of federal debt to Gross Domestic Product (GDP) approaches 70 per cent. A constituency of voters have gotten used to large federal spending programs. Does that sound like the United States? Well, yes. But it also describes Canada in 1993. Yet, just 16 years later, Canada's federal debt had fallen from 67 per cent to only 29 per cent of GDP. Moreover, in every year between 1997 and 2008, Canada's federal government had a budget surplus. In one fiscal year, 2000–2001, its surplus was a whopping 1.8 per cent of GDP. If the U.S. government had such a surplus today, that would amount to a cool \$263 billion rather than the current deficit of more than \$1.5 trillion.

We often think of Canada as a more-socialist and a higher-tax country than the United States, and for good reason: to some extent it's true. For instance, Canada has a single-payer healthcare system, few private universities, and a five-per cent federal tax on goods and services. So, what happened? How did the Canadian government do it? You might think that the Canadian government achieved the budget surplus by 2000–2001 with major increases in taxes, but it didn't. Part of the fiscal improvement was due to high economic growth. But economic growth is, in part, a *result* of policy, not a policy itself.

The main policy actions that the Canadian government took to shrink its budget deficit and turn deficits into surpluses were cuts in government spending. Moreover, the Canadian government didn't just cut the growth rate of spending, a favourite trick of U.S. politicians who want to claim the mantle of fiscal conservatism. It also cut absolute spending on many programs in dollar terms.

And because the inflation rate in Canada, though low, was greater than zero over the whole time period, these cuts in dollar terms were even larger in inflation adjusted dollars.

There are two morals of this story. First, the Canadian experience shows us that a large budget deficit *can* be turned into a budget surplus with ten years of fiscal discipline, mainly with spending cuts. It can happen here in the United States. We do not have to accept the idea that we have only two grim choices: living with huge budget deficits and a federal debt that both increase as a per cent of GDP, or accepting our current spending but reducing the budget deficit with major tax increases.

The second moral of the story is that the Canadian experience does not support the Keynesian view that policymakers should not cut government spending during an economic slowdown. The Canadian experience, just like the U.S. experience during the 1920–21 recession and in the first two years following World War II, shows that cutting government spending even during low-growth years can be good for long-term economic results.

Following is the story of how Canada achieved fiscal discipline, turned a budget deficit into a surplus, and in the process became one of the healthiest economies in the G-7.

# The Setting

*"Things bad begun make strong themselves by ill."*

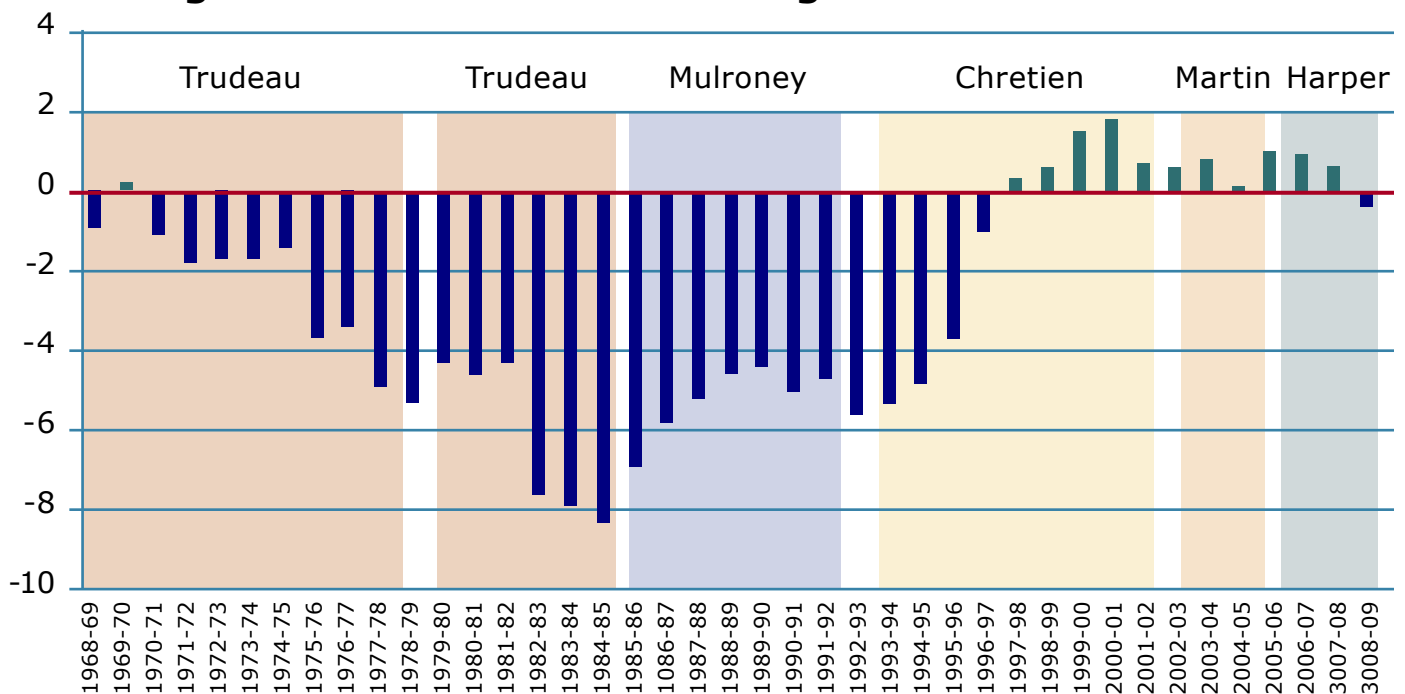
This line from *Macbeth* applies to Canada's federal government budget. During the fiscal year 1967–68 (Canada's fiscal year runs from April 1 to March 31), the last fiscal year before Pierre Elliot Trudeau became Prime Minister of Canada in April 1968, spending by Canada's federal government was 17.1 per cent of GDP. Trudeau, who had studied at the London School of Economics under Marxist Harold Laski, was, to put it mildly, a strong believer in big government. Trudeau was also a Keynesian, believing that the government should run deficits when the economy has less than full employment. Trudeau was Prime Minister of Canada from April 20, 1968 to June 30, 1984, with only a lapse of nine months from June 4, 1979 to March 3, 1980, when Joe Clark of the Progressive Conservative Party was Prime Minister.

Possibly more than any other person in Canada's history, Trudeau brought "big government" to Canada. In fiscal year 1984–85, Trudeau's last year in office, government spending had zoomed to 22.9 per cent of GDP, an increase of almost five percentage points, and the budget deficit was 8.3 per cent of GDP (see Figure 1).

For every year of Trudeau's time in office, except for 1969–70, the federal government's budget was in deficit. Budget deficits over Trudeau's fifteen years in office averaged 3.6 per cent of GDP. But this average is misleading. Budget deficits steadily worsened while he was Prime Minister, averaging 7.9 per cent of GDP for his last three fiscal years in office (see Figure 1).

One main reason for the growth in deficits as a per cent of GDP was that interest on the debt accounted for a growing portion of federal spending. By fiscal year 1984–85, interest on Canada's federal debt was 5.5 per cent of GDP.

**Figure 1: Deficits as Percentage of GDP 1968–2009**



Shortly after Trudeau resigned in 1984, Canada held a federal election in which Brian Mulroney of the Progressive Conservative Party emerged as prime minister. While in office, Mulroney signed a free-trade agreement with the United States and also got federal-program spending under control. During the first fiscal year of Mulroney's time in office, Canada's federal budget had an operating deficit of 1.2 per cent of GDP; that is, tax revenues were 1.2 percentage points of GDP below spending on government programs, not including interest on the debt. By the time he left office in 1993, he had achieved an operating surplus of 0.3 per cent of GDP. But between 1985 and 1993, interest rates on 3-month Treasury bills averaged 9.0 per cent and on 10-year bonds averaged 9.8 per cent. Because these substantially exceeded the 5.4 per cent growth of nominal GDP, the amount the federal government spent on interest on the debt ballooned. As a result, Mulroney failed to reduce Canada's budget deficit and, through the power of compounding, the ratio of federal debt to GDP rose substantially. Mulroney was Prime Minister from September 1984 to June 1993. For the fiscal years 1985–86 through 1993–94, the ones over which he had the most control, federal spending as a per cent of GDP stayed high, averaging 22.6 per cent of GDP and never falling below 21.9 per cent. The federal budget deficit during that time averaged 5.3 per cent of GDP (see Figure 1). During Mulroney's time in office, federal debt rose from 46.9 per cent to 67.0 per cent of GDP.

Because of the rising federal debt, something had to change. Surprisingly, the two agents of that change were from the same political party that had caused most of the fiscal damage: the Liberal Party. One of them had done some of the damage; the other was the son of a politician who had done even more of the damage. These two agents of change were Jean Chretien, the Prime Minister from 1993 to 2003, and Paul Martin, Jr., Chretien's Minister of Finance from 1993 to 2002. (The Minister of Finance in Canada is the equivalent of the Secretary of the Treasury in the United States, except that he is also an elected Member of Parliament, unlike the U.S. Treasury Secretary, who is appointed.) Chretien was an extremely unlikely agent of change. He had been in the Cabinet of every Liberal government since 1967 and was regarded as the political heir of Pierre Trudeau. His main political rival was Paul Martin, Jr. Paul Martin Jr.'s father, Paul Martin, Sr., had been a cabinet minister in four Liberal governments and was one of the most left-wing members of the Liberal cabinet. He had been Minister of National Health and Welfare from 1946 to 1957. In 1957, in that role, Martin helped implement nationalized insurance for hospital coverage, officially named "Hospitalization".<sup>1</sup> Later, the Trudeau government implemented a single-payer plan for hospital and doctor care, a plan still known today as Medicare.

Because of Martin Sr.'s early role in the struggle for federal control, he is sometimes referred to as "the father of Medicare".

# The 1993 Election

In February 1993, Prime Minister Brian Mulroney—his approval rating having fallen into the teens—announced his resignation. In Canada, when the prime minister resigns, the party holds a leadership contest. Kim Campbell won that contest and became Canada's first, and still its only, female prime minister. Under Canadian election law, the party in power must call an election within five years of the previous one, and so Campbell called an election for September 1993. Although the Progressive Conservative Party's poll numbers started to improve, her party was hampered by two big economic negatives. The first was the seven per cent federal Goods and Services Tax (GST) that Mulroney had initiated in 1991. The tax had replaced a narrow, hidden 13.5 per cent tax on manufacturing. The GST was set to be revenue-neutral or even revenue-losing for the federal government, but that didn't matter to many voters: The 13.5 per cent tax that was about to disappear was one that few voters knew about, whereas everyone was keenly aware of the highly visible 7 per cent GST.

The second negative for the Progressive Conservative Party was that Canada's economy was in the doldrums. The unemployment rate for 1993 averaged a whopping 11.4 per cent, and Canada's growth rate of GDP had been -2.1 per cent in 1991, an anemic 0.9 per cent in 1992, and a below-average 2.3 per cent in 1993.

For those reasons and because of some key errors in campaigning, Canada's Progressive Conservative Party went down to a crushing defeat in the September 1993 election. The Progressive Conservative Party, which had held 151 seats of the 295-seat Parliament, was reduced to only two seats, a 99 per cent reduction.

In fact, the defeat was so great that the Progressive Conservative Party, in 2003, merged with another party, the Canadian Alliance, to become, simply, the Conservative Party.

The Liberal Party under Jean Chretien took over the reins. But it wasn't business as usual for Chretien. In fact, in a daring move that presaged the Republican Party's "Contract with America" during the 1994 Congressional elections, the Liberal Party published the Red Book—so called because of its red cover—which laid out in some detail a set of promises. Arguably the most important of these was the Liberal Party's promise to reduce the budget deficit. As we shall see, the newly elected government actually kept this promise.



# Policy Proposals

On February 22, 1994, Minister of Finance Paul Martin rose in the House of Commons to move that the House approve the budget for the next two fiscal years. Once the House of Commons passes the budget, Canada's Senate, which, by tradition, has very little power, typically rubber-stamps the budget. Here are some excerpts from Martin's budget speech.

This budget sets in motion the most comprehensive reform of government policy in decades. We are putting in place an agenda for innovation in the new economy. We are responding to the needs of small business. We are launching a strategy through which government knows both when it can lend a helping hand and, as important, when it should stand aside.

We are undertaking a major effort to build a responsible social security system that is fair, compassionate and affordable, and that means making fundamental changes to our unemployment insurance system. It means overhauling the structure of federal-provincial transfers for social programs. It means doing so in a co-operative way with predictability built in, setting aside the old tactics of stealth and surprise.

The cold war is over. This budget sets out immediate actions attuned to the 1990s, actions that will be followed by a comprehensive review of Canada's defence policy.

To succeed we must get monetary and fiscal policy right. We have done the first. We are a low-inflation country. We will stay that way.

We are and we will remain a low-inflation country.

It is now time for government to get its fiscal house in order. For years governments have been promising more than they can deliver and delivering more than they can afford. That has to end and we are ending it.

The actions taken in this budget will reduce the deficit from \$45.7 billion this year to \$39.7 billion in 1994-95 and \$32.7 billion<sup>2</sup> the year after.

This is a two-stage budget. Therefore, detailed fiscal projections are presented to 1995-96 only. However, in terms of deficit reduction we are not waiting for the second stage. The decisions taken today by themselves set us on a clear path to achieving the government's deficit target of three per cent of GDP in three years.

We will achieve this by using reasonable economic assumptions, not rosy forecasts. We believe that it is more important to meet a target than to declare an illusion and then fall short.

Canadians have told us that they want the deficit brought down by reducing government spending, not by raising taxes, and we agree. The era of tax and spend government is gone.

Over the course of the next three years, for every \$1 raised in new revenues, we are cutting \$5 in government expenditures.<sup>3</sup>

The speech also specified particular budget cuts that included:

(1) a reduction in unemployment insurance benefits brought about by reducing the duration of benefits, increasing the amount of time people needed to be employed to qualify for the benefits, and reducing the benefit for most recipients to a maximum of 55 per cent of previous pay;

(2) a substantial reduction in the operating budgets of various federal departments;

(3) cancellation of the EH-101 helicopter program for the Department of Defence and additional cuts in defense spending totaling \$1.9 billion over the next years;

and

(4) cuts in subsidies for businesses.

The rest of the speech specified some small tax increases and, as in U.S. presidents' State of the Union speeches, a laundry list of promises for more spending. What's striking, though, is that the promised increases in spending were much less than the promised cuts.

## The Education Campaign

Before this speech, Martin had shifted away from the usual pattern of budget consultations. Previously, governments had consulted with the various interest groups one by one, each presenting its wish list. But Martin changed the dynamics by having four regional consultations in which various interest groups, experts, and citizens met together and contested with each other.<sup>4</sup>

Martin also undertook a campaign to educate the public about what was needed to turn Canada's budget around. In October 1994, his Department of Finance published an 87-page report, *A New Framework for Economic Policy*,<sup>5</sup> which contained two highlights. The big-picture highlight was its clear exposition of the fiscal arithmetic. Given the size of the debt, and given that, at the time, the interest rate on the debt exceeded the growth rate of GDP, the government had to run a substantial surplus on its program budget (that is, have tax revenues exceed expenditures on government programs) in order to reduce the ratio of debt to GDP. A numerical example similar to the one the Department of Finance used will help clarify.

At the time—remember that this was 1994—the average interest rate on the federal debt was about 8 per cent.

The growth rate of nominal GDP was about 4.5 per cent. The ratio of federal debt to GDP was approaching 75 per cent. That meant that in a given year, the government was spending eight per cent of 75 per cent of GDP, which is 6 per cent of GDP, *just for interest on the debt*. So, simply cutting back spending on programs to equal revenue would leave a deficit of six per cent of GDP. With GDP rising by only 4.5 per cent, the debt/GDP ratio would rise. How could the government prevent this ratio from rising? You might think that the answer was to have the deficit equal "only" 4.5 per cent of GDP. But remember that the interest rate on this new addition to the debt would be eight per cent, which means that the debt/GDP ratio would still rise. The only way to keep the debt/GDP ratio from rising, it turns out, was to get the deficit down to 2.625 per cent of GDP (see Appendix, Fiscal Arithmetic). So, why did Paul Martin choose a deficit goal of 3 per cent rather than 2.625 per cent? Most likely because, as Martin's boss, Prime Minister Chretien, pointed out,<sup>6</sup> the rule for European countries entering the European Union was that their budget deficit could be no more than three per cent of GDP.<sup>7</sup>

The other notable item in Martin's speech was his promise to reform the unemployment insurance program. Under the Unemployment Insurance Act of 1971, a Canadian could receive unemployment insurance (UI) benefits for a maximum of 50 weeks if he lived in a high-unemployment area and had been employed for enough weeks. (The maximum benefit period in the United States during normal times is a much-lower 26 weeks.) In Canada, someone could qualify for UI by having been employed for only eight weeks. And if this person lived in one of regions of the country with a high unemployment rate, he could, after working for eight weeks, receive 42 weeks of benefits. This was particularly a problem in regions with seasonal industries such as fishing.<sup>8</sup> Workers would fish for a couple of months and then get "on the pogy" (the Canadian term for being on UI) for the rest of the year.

Under some minor reforms made in 1977, someone had to be unemployed for 10 to 14 weeks (the lower number applied to those living in regions of the country with higher unemployment rates) before getting UI benefits. In 1994, Martin raised the threshold a little, making the range 12 to 20 weeks.

In the U.S. political system, when it comes to domestic economic policy, the President proposes and Congress disposes. But in Canada's parliamentary system, the legislative and executive branches are the same. Therefore, as long as the government has a majority of the seats in the House of Commons, the budget proposals it makes will pass. Thus, Martin's budget proposals were implemented.

Martin's Department of Finance also "sold" the budget changes to Canadians with the aforementioned *New Framework*. One of the issues highlighted in this document was the disincentives caused by the UI system.

For example, the authors wrote:

The rules of the program have encouraged chronic, repeat use. For example, almost 40 per cent of people receiving UI in 1993 had claimed benefits at least three times during the past five years and the number of frequent repeaters has been rising. The average duration of spells on UI has also increased steadily. Moreover, the attractiveness of the program has induced people to enter the labor force in order to qualify. Studies estimate that these factors have combined to raise the unemployment rate in Canada by 1 to 2 percentage points (p. 52).

Or, as Obama economic advisor Lawrence Summers put it in *The Concise Encyclopedia of Economics*:

The second way government assistance programs contribute to long-term unemployment is by providing an incentive, and the means, not to work. Each unemployed person has a—reservation wage—the minimum wage he or she insists on getting before accepting a job. Unemployment insurance and other social assistance programs increase that reservation wage, causing an unemployed person to remain unemployed longer.<sup>9</sup>

Martin seemed to have prepared the public so well that many were disappointed that he didn't cut government spending more. According to Canadian economist Thomas J. Courchene:

Canadians were deeply disappointed with the budget: they were ready for much more in the way of meaningful fiscal belt-tightening and Paul Martin had let them down. He would not make that mistake again. The politics of stiffening the budget stance were made much easier (than was the case for the Mulroney Tories, for example) because the principal opposition to the governing Liberals came from the fiscally conservative Reform Party.<sup>10</sup>

One of Martin's main problems in getting the budget under control was getting his colleagues who were ministers of the other departments under control. So the education campaign that he undertook with them was similar to the one with the public. Also, Martin formed a program-review committee to which a Cabinet minister had to appeal if he objected to cuts. But the ground rule was zero-sum: that is, if a Cabinet minister wanted a smaller cut in one program, he had to come up with a bigger cut in another program.<sup>11</sup> As Martin wrote in his memoirs, "[I]f a minister did not identify the cuts necessary to reach the target, the committee would do it for him." Two factors strengthened both Martin's resolve and his power within the Cabinet. First was a pair of articles in the *Wall Street Journal* on January 11 and 12, 1995. The January 11 article referred to the Canadian dollar as the "northern peso". At the time, the Canadian dollar was worth a measly 71 cents. This was a currency that had been worth a few per cent more than the U.S. dollar for much of the 1950s and only about eight cents less than the U.S. dollar for most of the 1960s. The January 12 article referred to Canada as "an honorary member of the Third World".

The second factor that strengthened Martin's hand was that two weeks before he introduced the February 27, 1995 budget for the next fiscal year, Moody's Investors Service put the Canadian government on a "credit watch" because of Canada's high debt/GDP ratio.

## The 1995 Budget

Martin came out swinging. The budget cuts he laid out in the 1995-96 budget were more aggressive than in the previous budget. Here are some excerpts:

We have said from the beginning that we would meet our targets come what may. Therefore, those gaps must be closed. With this budget, we are closing them.

We will hit our deficit target for 1995-96. We will hit our target for 1996-97. And of equal importance, the downward track established by the actions taken in this budget will continue in the years thereafter.

Taking the next two fiscal years together, this budget delivers cumulative savings of \$15.6 billion, with spending cuts accounting for \$13.4 billion, more than 85 per cent of the total.

Going beyond, to 1997-98, the reforms we are introducing today will continue to pay-off, with further savings totalling \$13.3 billion, of which spending reductions amount to \$11.9 billion.

That means that over the next three fiscal years, this budget will deliver cumulative savings of \$29 billion, of which \$25.3 billion are expenditure cuts. This is by far the largest set of actions in any Canadian budget since demobilisation after the Second World War.

Over the next three years, the actions in this budget deliver almost seven dollars of spending cuts for every one dollar of new tax revenue.

These measures will have a very significant impact on the level of government spending in the future.

By 1996–97, we will have reduced program spending from \$120 billion in 1993–94 to under \$108 billion.

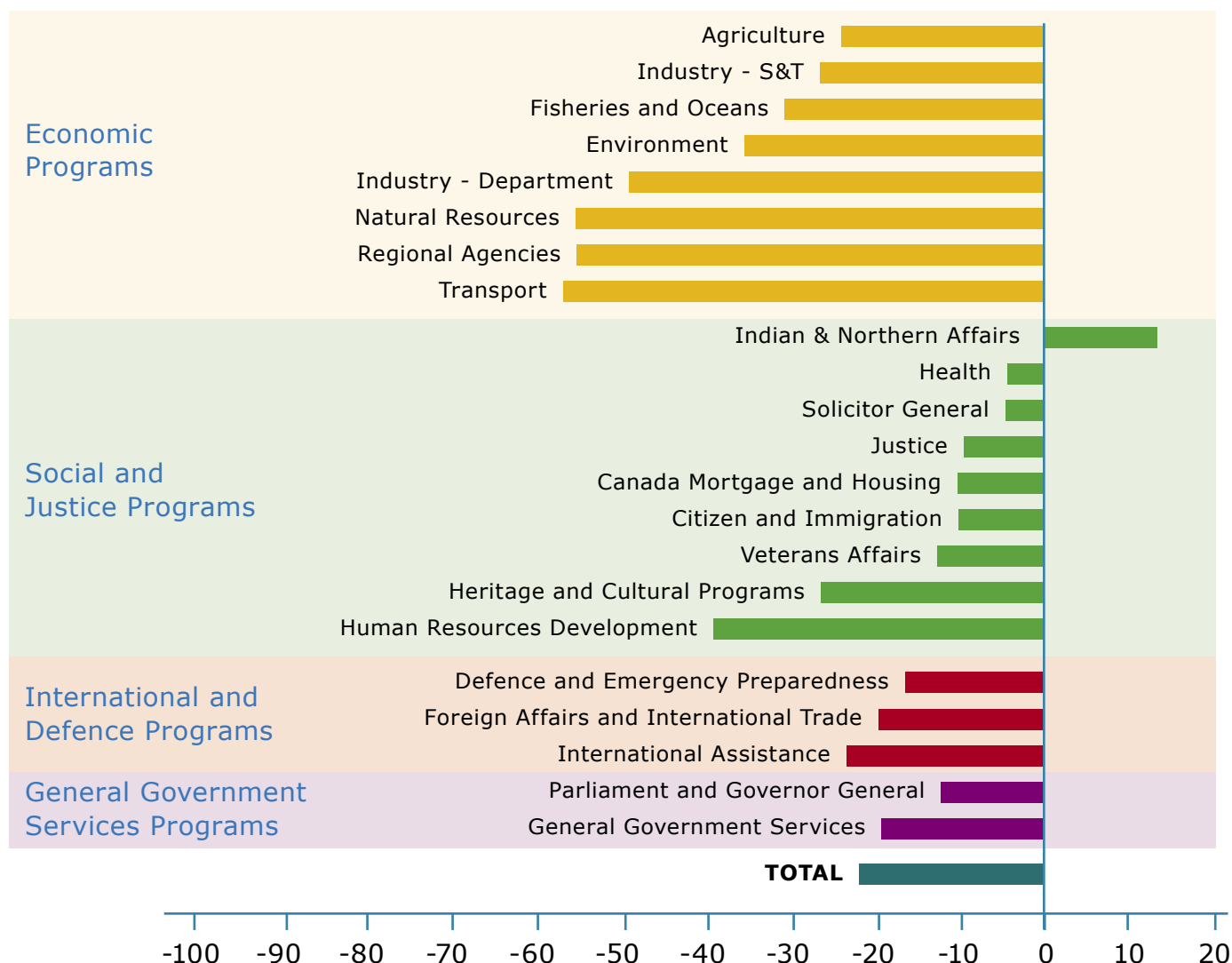
Relative to the size of our economy, program spending will be lower in 1996–97 than *at any time* since 1951.

The budgets of government departments are being reduced dramatically, in several cases halved over the next three years.

Figure 2 shows the sizes of the cuts to various departments' budgets.

Martin also announced steps to privatize and commercialize various government enterprises. The government sold CN, the major railway that it had owned, a uranium company, Cameco, that it had owned with Saskatchewan's government, and a large number of its shares in Petro-Canada, a government energy company started by Pierre Trudeau. By 2004, the government had sold all its shares in Petro-Canada. One particular measure that paid dividends to Canadians way beyond the budget savings was the commercialization of the

**Figure 2: Changes in Federal Department Spending 1997–98 relative to 1994–95 (Percent Change)**



Source: Paul Martin speech to House of Commons, February 27, 1995, Department of Finance, Canada <http://www.fin.gc.ca/budget95/speech/SPEECH9-eng.asp>

Air Navigation System. By selling off the air traffic control system to a private nonprofit company, NAV Canada, the government netted \$1.4 billion and saved \$200 million in annual subsidies.<sup>12</sup> A big benefit beyond this savings is that NAV Canada has revolutionized air traffic control in Canada, putting Canada decades ahead of air traffic control in the United States.<sup>13</sup>

Three things stand out from Figure 1 and from the excerpt from the budget speech:

- 1) The cuts in government spending in various departments were absolute cuts in dollar amounts, not just cuts in rates of growth of spending.
- 2) There were six to seven dollars in budget cuts for every dollar of tax increases.
- 3) Spending on programs—in other words, federal spending other than for interest on the debt—was lower in dollar terms, and, therefore, even lower adjusted for inflation, than spending in the 1993–94. Indeed, program spending was lower as a percent of Canada's GDP than it had been at any time since 1951.

## Later Budgets

In the 1995 budget and in later budgets, Martin built in conservative assumptions to make the probability very high that the deficit would be at or under the promised goals. As he put it at the time, he wanted to achieve these goals “come hell or high water”. Indeed, he was so known for that term during the 1990s that he chose *Come Hell or High Water* as the title of his 2008 autobiography. So, for example, the consensus estimates among private-sector economists for 1999 were nominal GDP growth of 2.7 per cent and interest rates on three-month T-bills and ten-year government bonds of 4.4 per cent and 5.1 per cent, respectively. Martin assumed GDP growth of 2.5 per cent, thus assuming less tax revenue than if the private-sector forecasts were correct. He also assumed interest rates of 5.1 per cent and 5.6 per cent interest on three-month T-bills and ten-year government bonds, respectively. If rates turned out to be lower, the amount the Canadian government would pay on the debt it rolled over would be lower. As it turned out, nominal GDP grew by a whopping 7.4 per cent that year, and three-month and ten-year interest rates averaged 4.8 per cent and 5.8 per cent respectively. In other words, Martin estimated too high for short-term rates and too low for long-term rates.

Interestingly, both of his pessimistic forecasts were closer to the actual numbers than the private-sector forecasts were. Moreover, Martin also planned for a \$3 billion contingency reserve in case his forecasts proved too optimistic. If the forecasts proved not too optimistic, this reserve would go toward paying down the debt.

What's striking is that such conservative assumptions are the opposite of the kind politicians usually make. Politicians usually paint rosy scenarios so that they can justify higher spending than otherwise. Clearly, Martin was a man on a debt reduction mission. Martin also had what he called a "no-deficit rule". That is, once he had managed to get rid of the deficit, he wanted to avoid future deficits.

As Martin explained in his memoirs:

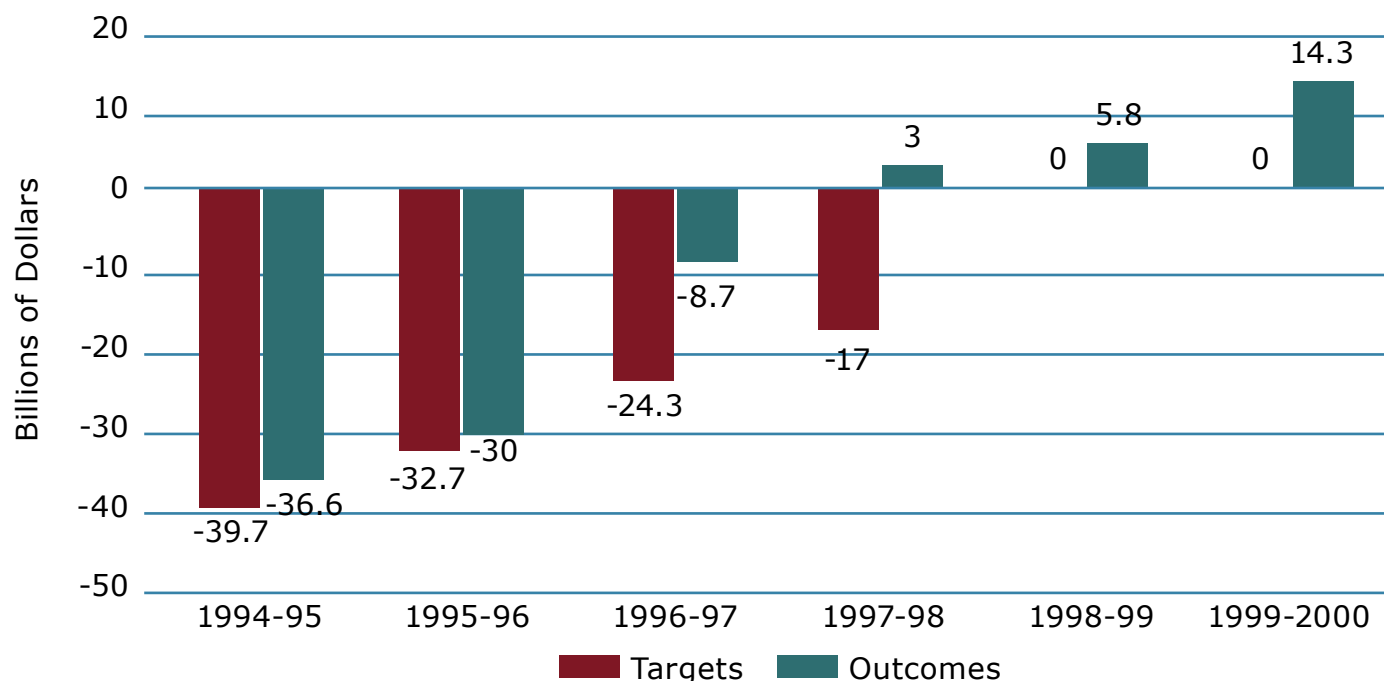
It is important to understand that the no-deficit rule was a sharp break with tradition. In the postwar years, many economists argued that you did not need to be in the black every year, as long as budgets were balanced over the course of the economic cycle, so that deficits during slumps would be paid off with surpluses in good years. Whatever the economic rationale for that approach, it didn't work in the real world of politicians.

Once you break the spell—once governments find that they can get away with borrowing instead of taxing to pay the bills—it is almost impossibly tempting for politicians to do it again and again until the debt is out of control.<sup>14</sup>

What a wonderful summary of fiscal policy for most of Canada's postwar years until the mid-1990s. Keynesians would not have approved; on the other hand, Nobel economics laureate James Buchanan and co-author Richard Wagner would have.<sup>15</sup> They had earlier noted what Paul Martin discovered: without a balanced budget rule, either a formal rule or an informal norm, politicians would consistently run budget deficits.

As it turned out, Martin's assumptions proved overly conservative year after year, but especially in FY 1996–97 and FY 1997–98 (see Figure 3).

**Figure 3: Federal Budgetary Balance: Targets and Outcomes Public Accounts Basis**



Source: Courchene, Thomas. "Half-Way Home: Canada's Remarkable Fiscal Turnaround and the Paul Martin Legacy," although the numbers for outcomes differ slightly from Courchene's numbers. My outcome numbers are taken from Department of Finance, Federal Government Public Accounts at <http://www.fin.gc.ca/frt-trf/2009/frt0901-eng.asp>

In FY 1996–97, Martin planned for a deficit of \$24.3 billion, down from an actual deficit in FY 1995–96 of \$37.5 billion. The actual result for 1996–97: a deficit of only \$8.7 billion. Martin overachieved by \$15.6 billion. That over-achievement alone made the federal debt 2.8 per cent lower than otherwise. For FY 1997–98, Martin planned for a deficit of \$17 billion and the actual result was a surplus of \$3 billion, the Canadian federal government's first surplus since FY 1969–70.

The result of years of cuts in government spending was that, as a per cent of GDP, federal spending on programs fell from a high of 17.5 per cent in 1992–93 to 11.3 per cent in 2000–01. Canadian economist Thomas Courchene notes that this was the lowest per cent “in more than half a century”.<sup>16</sup> Courchene wrote further:<sup>17</sup>

In terms of components of program spending, federal transfers to persons fell from 5.8 per cent of GDP in 1992–93 to 3.6 per cent in 1999–2000, or 2.2 percentage points, while transfers to

provinces fell by 1.4 percentage points of GDP, even with the recent restoration of the cash transfers for the CHST [Canadian Health and Social Transfer, a system of block grants from the feds to the provincial governments.] And along the way, debt-servicing costs have fallen as well, from 5.6 per cent of GDP in fiscal 1992–93 to 4.3 per cent in 1999–2000.

Paul Martin resigned as minister of finance in 2002 and then became leader of the Liberal Party and, therefore, prime minister in 2003, replacing Jean Chretien. His tenure as prime minister lasted until 2006, when the Liberal Party lost the election. From the time he achieved that first budget surplus in 1997–98 until 2006, Martin kept up his policy of running large budget surpluses. The result: The ratio of the federal government's debt to Canada's GDP fell from 67.0 per cent in 1993, when Martin became minister of finance, to 32.2 per cent in 2006, when he lost the job of prime minister. In other words, he reduced the debt-to-GDP ratio by over 50 per cent.

## Opposition to the Cuts

As can be imagined, there was much opposition to the budget cuts, and, not surprisingly, the opposition came mainly from the left part of the political spectrum. At the start of Martin's time as minister of finance, the Official Opposition—i.e., the party with the second-most seats in the House of Commons—was the Bloc Quebecois, a Quebec-based party focused almost entirely on getting favorable deals for Quebec. The party with the third-most seats was the Reform Party, which was based in Canada's West and was filled with strong believers in budget cuts. What also helped Martin was the opposition from conservatives in the Canadian Taxpayers Federation and the National Citizens' Coalition.<sup>18</sup> Both groups were pushing for even bigger spending cuts.

The clear-cut left-wing party was the New Democratic Party, which favoured socialism; however, the party won only nine of 295 seats in the 1993 election and so the left-wing party was not a factor. Thus, the scene was set for a “Nixon goes to China” kind of strategy. Just as Nixon, representing the Republican Party, which was more conservative than the Democratic Party, could more easily risk political capital in reaching out to the Communist Chinese, so Martin and Chretien, representing the more-left-wing of the two major parties could more easily risk political capital on a budget policy that was more conservative. Martin needed to worry more about conservative opposition than about left-wing opposition. Given his power within



his own party, therefore, he was able to fashion more-aggressive budget cuts than otherwise.

One of the biggest causes of opposition was the cut in spending on Unemployment Insurance, which had been renamed Employment Insurance (EI). In a 2001 article,<sup>19</sup> Jim Stanford, the Canadian Auto Workers Union's economist, noted how deep the cuts in EI were. Real (that is, inflation-adjusted) EI benefit payments per unemployed person, he wrote, "were 40 per cent lower in 1999 than in 1990".

Most of this, he noted, was due not to declining real benefits for people who were covered by EI, but, rather, to declining coverage. In other words, a lower per cent of unemployed people qualified for benefits, which, of course, was one of Martin's goals.

The 1997 election results were one test of the popularity of the budget cuts. Prime Minister Jean Chretien, seeing that the Liberal Party was doing well in the polls, called an election for June 2, 1997, only three years and seven months after the previous election. By law, he could have waited a full five years but sensed an advantage in calling the election earlier. Chretien ran on a campaign to continue achieving surpluses, using half of the surplus to pay down debt and the other half to increase spending and cut taxes. Although his Liberal Party lost seats, falling from 175 seats in a Parliament with 295 seats, it still managed to win 155 seats in a Parliament with 301 seats, keeping a bare majority. [Between the two elections, the number of seats in Parliament had been increased by six.]

The Liberal Party won 38.5 per cent of the vote, almost double the 19.4 per cent of its closest competitor, the Reform Party. The Liberal Party did lose seats in the Maritime provinces, probably because of the EI cuts noted earlier: the Maritime provinces, with their high seasonal unemployment, had been disproportionately high beneficiaries of EI and were, therefore, disproportionately large losers from the cuts. Interestingly, though, the Liberal Party kept its majority status despite the fact that the unemployment rate announced in May 1997, the last one announced before the election, was a relatively high 9.6 per cent.<sup>20</sup> As Nadeau et al. noted in a 2000 article,<sup>21</sup> the Liberal Party was the first in recent Canadian history to be reelected despite having such a high unemployment rate. It appears that many Canadians wanted the government to "stay the course".

So why did Paul Martin, who became prime minister in 2003, lose the 2006 election? It had very little to do with the budget cuts. Although Martin had made political enemies with his budget cuts, the main reason his party lost the election was the "Sponsorship scandal", which had nothing to do with the budget cuts. Indeed, the Sponsorship scandal resulted from one costly government program to persuade French Canadians in Quebec to oppose Quebec separation. Interestingly, the scandal was entirely over sweetheart deals between the federal government and Liberal Party supporters, not over whether the government should tax people to pay for propaganda.

# Tax Increases

The bad news, for those who like smaller government, was that Martin did raise taxes. Fortunately, by Martin's count, which seems accurate, taxes were increased by about one dollar for every six or seven dollars of spending cuts. Virtually all of 18 the tax increases were announced in the 1994 and 1995 budgets. Three of the major tax increases in the 1994 budget included reducing the deduction for meal and entertainment expenses from 80 per cent of the expense to 50 per cent;<sup>22</sup> getting rid of the lower small-business corporate tax rate for corporations with capital of \$15 million or more; and eliminating the \$100,000 capital-gains tax exemption that a taxpayer could claim cumulatively over a lifetime. In the 1995 budget, Martin forbade those who earned business or professional income from choosing a fiscal year different from the calendar year; added information requirements to make it easier to tax Canadians on their offshore investments; eliminated tax advantages previously held by family trusts; reduced the upper limit on deductible contributions to Registered Retirement Savings Plans (RRSPs, the Canadian equivalent of a deductible IRA) from \$14,500<sup>23</sup> in 1995 to \$13,500 for 1996 and 1997, with the limit to be allowed to increase in steps to \$15,500 in 1999;<sup>24</sup> increased the surtax on the corporate income tax rate of 38 per cent (the per cent added to the basic rate) from the previously existing three per cent to four per cent, thus raising the corporate income tax rate from 39.14 per cent to 39.52 per cent;<sup>25</sup> and raised the gasoline tax by 1.5 cents per liter, which is approximately 5.7 cents per gallon.

The good news on taxes is that Martin did not raise individual income tax rates. When he became minister of finance, Canada had a graduated tax system with three

tax brackets for individual income taxes per cent, 26 per cent, and 29 per cent. These rates are low compared to what the top half of Americans, the half that pays almost all U.S. federal taxes on individual income—pay because Canada's federal government has a smaller role in the economy than the U.S. federal government has.<sup>26</sup> In Canada, the provincial governments have a much larger role than do state governments in the United States—and the provincial governments have the high tax rates on individual income to prove it.

Canada's three marginal tax brackets for individual income were somewhat misleading for four reasons. First, the Canadian government had surtaxes on the tax rates. So, for example, the surtax rate on people in the 29 per cent bracket was five per cent, making the top marginal tax rate actually 30.45 per cent. Second, the Canadian government, to save money, does means testing for various federal benefits. The term used for this in Canada is "clawbacks." As I wrote in 2000, this is "a wonderfully descriptive term for the gradual phase-out of government benefits as people rise up the income scale".<sup>27</sup> Consider, for example, the Canada Child Tax Benefit (CCTB), a payment given to families with children. For every dollar your income increases after a modest threshold (for example, \$40,726 in "family net income" starting in July 2010), you lose a portion of your CCTB. If you have two or more children, your implicit marginal tax rate from earning an additional dollar after this threshold is 4 per cent. Thus the parent's marginal tax rate in this case is four percentage points higher. When I wrote about the issue in 2000, the clawback added five percentage points to the marginal tax rate of someone in this situation.

Third, although Martin did not explicitly raise tax rates, inflation did the job for him. Inflation puts a bigger per cent of each person's income into a higher tax bracket, thus turning the interaction of inflation with the graduated (progressive) individual income tax system into a money machine for the federal government. It's true that Pierre Trudeau had introduced indexing of tax brackets in 1974, one of the few good economic reforms he made. He did this a full ten years before Ronald Reagan and the U.S. Congress did it with the U.S. individual income tax system.<sup>28</sup> But, beginning in 1986, Prime Minister Mulroney's government deindexed tax brackets by having them adjust only for the part of inflation in excess of three per cent annually.<sup>29</sup> Thus, if inflation were, say, 4 per cent, then the tax brackets adjusted upward only by 1 per cent. This made the government's tax revenues in real terms higher than otherwise.

Fourth, in 1997, Martin and Chretien raised tax rates for the Canada Pension Plan from a combined 6 per cent for employers and employees, in stages, to 9.9 per cent by 2003, and it has stayed there since. The good news is that he shifted the CPP away from a U.S.-style Ponzi scheme to a fund that invested in real assets. In 1997, the CPP fund started with just federal government bonds but is now diversified across asset classes and across countries.<sup>30</sup>

## Tax Cuts

By 2000, the Canadian government's spending restraint had been so successful that many people,<sup>31</sup> including this author,<sup>32</sup> were calling for tax cuts. Martin and Chretien obliged. In 2000, they restored full indexing of tax brackets for the individual income tax so that inflation alone could no longer put people in higher brackets. With an eye on global competition for capital, they cut the flat corporate income tax rate, in stages, from 28 per cent<sup>33</sup> to 21 per cent by January 1, 2004 and excluded 50 per cent of capital gains from taxation, up from only 25 per cent. Also concerned about competition for highly productive labour, Martin and Chretien eliminated the 5 per cent surtax on high-income individuals and added a 26 per cent bracket for the people in the lower-income portion of what had previously been the 29 per cent bracket. By 2010, full indexing, combined with elimination of the surtax and the addition of the 26 per cent bracket, meant that an individual did not reach the 29 per cent bracket until he had \$127,021 of taxable income. Also, Martin and Chretien raised the contribution limit for RRSPs to \$14,500 for 2004, \$16,500 for 2005, and \$18,000 in 2006.

# Lessons for the United States

Throughout the whole period from 1993 until 2006, when he left office, Paul Martin appeared to worry very little about cuts in government spending leading to higher unemployment. There are three possible explanations for this, only the first and third of which are mutually exclusive. The first explanation is that Martin and his advisers didn't believe in the Keynesian model, according to which cuts in government spending unaccompanied by tax cuts will reduce aggregate demand for goods and services and, thus, lead to an economic slowdown. There is evidence for this explanation. Political scientist Timothy Lewis quotes an unnamed senior official in Canada's Finance Department as saying that in the department by the mid-1990s, the Keynesian multiplier, the *sine qua non* of the Keynesian model, was "kind of dead".<sup>34</sup>

The second explanation is that, because Canada's main trading partner, the United States, was in an economic boom, except for the 2001 recession, Canada was, similarly, in an economic boom. Because Canada is a small economy with a thousands-mile-long border with the United States, international trade for Canada, whether measured by imports or exports, is far more important for economic expansion than for the United States. From 1994 to 2006, Canada's annual exports ranged from a low of 33.8 per cent of GDP in 1994 to a high of 45.6 per cent of GDP in 2000. Similarly, Canada's imports ranged from a low of 32.7 per cent of GDP in 1994 to a high of 39.8 per cent of GDP in 2000. Indeed, the bilateral trade between Canada and the United States is the largest between any two countries in the world.

The third explanation is that Martin and his advisers did believe, to some extent, in the Keynesian model, but thought

that accepting lower growth and higher unemployment was worth it to achieve a lower debt/GDP ratio. As it turns out, low economic growth was not a problem. From 1993 to 2006, Canada's real GDP grew at an annual average of 3.36 per cent, a healthy growth rate.

Whatever the explanation, Americans can learn some lessons from Canada's experience. The most important thing we can learn is that it can happen here—with a decade of fiscal discipline. The United States is in a situation in 2010 similar to that of Canada in 1994. The U.S. government's debt/GDP ratio by the end of 2010 will likely be 62 per cent,<sup>35</sup> only five percentage points below Canada's 1994 ratio of 67 per cent. One advantage the United States has that Canada didn't is low interest rates. Interest rates today are much lower than when the Canadian government altered course. The yield on the ten-year Treasury bond in late June 2010, for example, was only about 3 per cent. So, one thing the U.S. government could do quickly is to convert some of its shorter-term debt to ten-year debt, paying a higher interest rate in the short run but protecting itself against interest rates greater than three per cent over the next ten years. Also, one political factor makes fiscal discipline easier: Canada is more of a welfare state than the United States, and yet Canada's federal government managed to make huge cuts, even in "sacred cow" programs such as unemployment insurance.

The second big lesson is that the Keynesian argument that big cuts in government spending will slow an economy receives no support from Canada's experience. It's true, as noted above, that the Canadian economy was booming in part because the U.S. economy next door was booming.

But with a cut in federal government spending on programs of 4.7 per cent of GDP over seven years and a cut in overall federal spending (program spending plus interest on the debt) of 6.1 per cent of GDP, one would expect, according to the Keynesian model, that the Canadian economy would have slowed somewhat. It didn't. This reinforces the lesson from the far more extreme U.S. experience after World War II: Between FY 1945 and FY 1947, federal government spending was cut by 61 per cent. This was a 27 percentage-point drop from 41.9 per cent of GDP to 14.7 per cent of GDP. Yet the unemployment rate over that same time rose from 1.9 per cent to only 3.6 per cent. The postwar bust that so many Keynesians expected to happen never did.<sup>36</sup>

The third lesson is that if tax increases are needed, they can be a mix of relatively small tax increases on any given sector or group of people. The Canadian government increased taxes by limiting the equivalent of IRAs, increasing the gasoline tax a small amount, increasing the tax rate on the highest-income people by a medium amount, increasing the tax rate on corporations by a small amount, reducing business tax deductions for meals and entertainment, and limiting a few other ways of avoiding taxes.

There is, however, one important political factor that would make reform more difficult in the United States than in Canada: the structure of the U.S. political system. In Canada, once the Prime Minister has decided on the budget, the members of his or her Party almost always vote for it. Moreover, under Canada's Constitution, the government, meaning the ruling party, has sole power to initiate expenditure proposals. Parliament's only power on spending is to approve the government's proposals in full, approve them at a reduced level, or reject them.<sup>37</sup>

In the United States, by contrast, there are three important players, or sets of players: the president, the House of Representatives, and the Senate.<sup>38</sup>

One way to make the budget battle easier to win in the United States is for Congress to return to its roots. One of the lesser-known facts about the U.S. Congress is that for many decades, specifically from 1789 to 1885 and then again from 1922 to 1931, each branch of Congress had centralized budgeting. The U.S. Senate and the House of Representatives each had only one committee with spending authority. Hoover Institution scholar John Cogan has pointed out<sup>39</sup> that during these two eras, the federal budget was balanced except during recessions and wars. Between 1789 and 1885, he notes, the average budget deficit was only 0.26 per cent of Gross National Product (GNP), and between 1922 and 1931, there was an average budget surplus of 0.77 per cent of GNP. From 1886 to 1921 and then again from 1932 until now, the U.S. Congress had decentralized spending authority, with numerous committees authorized to spend. The result? Between 1886 and 1921, the average budget deficit was 0.69 per cent of GNP, and between 1932 and 1989 (his article was written in the early 1990s), the average budget deficit was a hefty 3.61 per cent of GNP.

Why the difference? Cogan explains that the decentralized budget authority created a "tragedy of the commons". Each committee with spending authority knew that if it saved money, the money would simply be spent by another committee. That meant that there was little incentive for any one committee to rein in spending. Centralizing budget authority, by contrast, would give that centralized committee an incentive to make real cuts.

# The Road Ahead

While this list is meant only to be suggestive, the federal government could cut federal spending by over \$350 billion a year by:

- Ending the wars in Afghanistan and Iraq, thus saving about \$170 billion a year.<sup>40</sup>
- Getting rid of the Department of Education and the programs it runs, saving over \$100 billion a year.
- Ending the Department of Agriculture's subsidy programs, saving over \$100 billion a year.<sup>41</sup>
- Privatizing air traffic control, saving over \$10 billion a year.
- Privatizing Amtrak, saving over \$2 billion a year.

If, in 2026, someone writes an analysis of the U.S. government's spending and tax policies of the previous 16 years, what will it say? Will it be that the U.S. president and Congress turned things around and managed to reduce the debt/GDP ratio mainly with spending cuts and only a few tax increases, as Canada's government did?

We don't know and we won't know for years. But what we do know is that if the political will is there and if the political incentives are right, the U.S. budget situation can be turned around with no major increases in taxes.

# Appendix: The Fiscal Arithmetic

Operating surplus (OS) is the difference between government spending on programs and government revenue

$GDP_1 =$   
the GDP in year 1

$GDP_2 =$   
the GDP in year 2

$D_1 =$  the debt in year 1

$D_2 =$  the debt in year 2

To keep the debt to GDP ratio constant,  $D_1/GDP_1$  must =  $D_2/GDP_2$ . If  $g$  is the growth rate of GDP, then  $GDP_2 = GDP_1 * (1+g)$ . Substituting for  $GDP_2$

1.  $D_1/GDP_1 = D_2/[GDP_1*(1+g)]$
2.  $D_2 = D_1 + \Delta D$

•  $\Delta D$  is the increase in debt

3.  $\Delta D = i*D_1 - OS$

- $i*D_1$  is the interest on debt
- Recall that OS is the government's operating surplus
- Substitute  $\Delta D$  into equation (2)

4.  $D_2 = D_1 + i*D_1 - OS$

- Substituting  $D_2$  into equation (1), then cancelling out  $GDP_1$  on both sides.

5.  $D_1 = (D_1 + i*D_1 - OS)/(1+g)$

- Divide both sides by  $D_1$  and multiply both sides by  $(1+g)$

6.  $1+g = 1 + i - OS/D_1$

- Subtract 1 from both sides

7.  $g = i - OS/D_1$

8.  $OS/D_1 = i - g$

If the interest rate is 8 percent and if the growth rate of GDP is 4.5 percent, then  $OS/D_1 = 0.035$ . If  $D_1/GDP_1 = 0.75$ , then  $OS/GDP_1$  must =  $0.035*0.75$ , which equals 0.0265. Therefore the operating surplus must be 2.65 percent of GDP.

## Endnotes

1. In 1957, Canada's Parliament passed the Hospital Insurance and Diagnostic Services Act. Under this law, the federal government committed to pay 50 percent of the costs for any provincial-government plan that met its standards. Such plans came to be known as "Hospitalization." By 1961, all ten provinces had started such plans. On the web, see: [http://en.wikipedia.org/wiki/Health\\_care\\_in\\_Canada](http://en.wikipedia.org/wiki/Health_care_in_Canada).
2. All amounts mentioned here and elsewhere in this monograph are in Canadian dollars. At the time, the Canadian dollar was worth about 74 U.S. cents.
3. Paul Martin, "The Budget," February 22, 1994, accessed on June 20, 2010 at: <http://openparliament.ca/hansards/1035/236/>.
4. Timothy Lewis, *In the Long Run We're All Dead: The Canadian Turn to Fiscal Restraint*, Vancouver: UBC Press, 2003, p. 158.
5. Accessed at [http://www.fin.gc.ca/Archive/NFrmrkEcPol\\_e.pdf](http://www.fin.gc.ca/Archive/NFrmrkEcPol_e.pdf).
6. Paul Martin, *Hell or High Water: My Life in and out of Politics*, Toronto: McClelland & Stewart, 2008, p. 100.
7. See Marian L. Tupy, "European Union," in David R. Henderson, ed., *The Concise Encyclopedia of Economics*, online at: <http://www.econlib.org/library/Enc/EuropeanUnion.html>.
8. Most of the information on the UI system is from Thomas J. Courchene and John R. Allan, "A Short History of EI, and a Look at the Road Ahead," *Policy Options*, September 2009. On the web at: <http://www.irpp.org/po/archive/sep09/courchene.pdf>.
9. Lawrence Summers, "Unemployment," in David R. Henderson, ed., *The Concise Encyclopedia of Economics*, Liberty Fund, 2008, p. 503.
10. Thomas J. Courchene, "Half-Way Home: Canada's Remarkable Fiscal Turnaround and the Paul Martin Legacy," *IRPP, Policy Matters*, July 2002, Vol. 3, No. 8, pp. 19-20. On the web at: <http://www.irpp.org/about/index.htm>.
11. Paul Martin, *Hell or High Water*, p. 140.
12. Robert Poole, Jr. and Viggo Butler, *NAV Canada: A Model for Commercializing Public Enterprises*. Frontier Centre for Public Policy, 2002, p. 1. On the web at: <http://www.fcpp.org/pdf/series11.pdf>.
13. Dorothy Robyn, in "Reforming the Air Traffic Control System to Promote Efficiency and Reduce Delays", a 2007 report prepared for the U.S. Council of Economic Advisers, writes:
 

In practice, NavCanada, which is effectively a user-owned cooperative, is widely viewed as the best existing model. Since it was spun off of Transport Canada in 1996, NavCanada has significantly lowered its fees (Canada moved from a ticket tax to a user fee when NavCanada was created). It has also reversed its predecessor's poor track record on modernization—a record remarkably parallel to the FAA's but on a smaller scale—and is now selling its technology to other ATC providers.

On the web at: <http://www.brattle.com/documents/UploadLibrary/Upload650.pdf>.

In 2001, Robert W. Poole and Langhorne Bond, in "The Crisis Behind Air Traffic Control," *Blueprint*, September 10, 2001, had pointed out that the United States had a "1950s style air traffic control (ATC) system" and stated that NavCanada:

[H]as accelerated modernization of Canada's ATC system, moving ahead of the United States in introducing "free-flight" technologies and opening up new timesaving polar routes in cooperation with Russia.

On the web at: [http://www.dlc.org/ndol\\_ci.cfm?contentid=3763&kaid=141&subid=299](http://www.dlc.org/ndol_ci.cfm?contentid=3763&kaid=141&subid=299).

It should be noted, though, that NavCanada is thought by many Canadian economists and Canadian travelers to charge monopoly prices and fees for use of airports. I am indebted to William Watson for this point.
14. Paul Martin, *Hell or High Water*, pp. 179-180.



15. See James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*, Academic Press, 1977.
16. This comparison is not quite accurate. The reason is that some subsidy programs were cut but turned into tax credits. That made government spending fall and taxes fall, all other things equal, even though the government, with tax credits, was still directing wealth. I am indebted to William Watson for this reminder.
17. Courchene, *Half-Way Home*, p. 24.
18. In 1997, Stephen Harper, later to be Canada's Prime Minister, became vice president of the National Citizens' Coalition and from 1998 to 2002 was its president.
19. Jim Stanford, "The Economic and Social Consequences of Fiscal Retrenchment in Canada in the 1990s," *The Review of Economic Performance and Social Progress*, 2001, p. 148. Accessed at: <http://tiny.cc/evd2v>.
20. Although this was down from 11.4% when the Liberal Party took power in 1993.
21. Richard Nadeau, Andre Blais, Neil Nevitte, and Elisabeth Gidengil, "It's Unemployment, Stupid! Why Perceptions about the Job Situation Hurt the Liberals in the 1997 Election," *Canadian Public Policy*, Vol. 26, No. 1, 2000, p. 88.
22. President Clinton and Congress had implemented this same measure for the United States with their 1993 tax increase.
23. Ranga Chand, "Registered Retirement Savings Plans" on the web at: <http://www.globefund.com/centre/GettingStarted08.html>.
24. Martin broke this promise. The maximum RRSP deduction allowed stayed fixed at \$13,500 for every year from 1994 to 2003. See RBC, "RRSP Contributions 1968 to 2008 ... and Beyond to 2020," *Current Analysis*, January 2010. On the web at: <http://www.rbc.com/economics/market/pdf/RRSP.pdf>.
25. See Agriculture and Agri-Food Canada, *Corporate Income Tax Rate Database, Canada and the Provinces, 1960-2005*, Appendix A, Table 1, note e, on the web at: <http://www4.agr.gc.ca/AAFC-AAC/displayafficher.do?id=1197301474421&lang=eng#f1>.
26. One might think that the rates on high-income people are low because low income people pay substantial income taxes. But that is not true. As in the United States, high-income people in Canada pay a huge percent of overall income tax revenues collected. For example, in 2005, people with income of \$70,000 or more paid 56.7 percent of all federal income tax revenues collected. See Milagros Palacios, Niels Veldhuis, and Michael Walker, *Tax Facts 15*, Fraser Institute, 2008, p. 28, Table 2.6.
27. David R. Henderson, "The View from the South: Cut Marginal Tax Rates at Every Income Level," *Policy Options*, July-August 2000, p. 57. On the web at: <http://www.irpp.org/po/archive/po0700.htm#henderson>.
28. Reagan and Congress introduced indexation of income tax brackets in the 1981 Economic Recovery and Tax Act, but the indexation did not kick in until January 1, 1985.
29. Courchene, "Half-Way Home," p. 20.
30. See [http://en.wikipedia.org/wiki/Canada\\_Pension\\_Plan](http://en.wikipedia.org/wiki/Canada_Pension_Plan).
31. See, for example, Dale Orr, "Please Mr. Martin, Can We Have Some Tax Cuts?" *Canadian Business Economics*, February 2000, pp. 13-15.
32. See Henderson, *View from the South*.
33. Why 28 percent rather than the previously mentioned 38 percent? Because ten percentage points of the 38-percent tax rate had been allocated for years to the provinces. The provinces were free to take this whole ten percent, take more than ten percent by adding their own corporate tax rate, or tax corporations at a rate lower than ten percent.
34. Lewis, *In the Long Run We're All Dead*, p. 170.
35. According to the Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, p.1.

36. Indeed, virtually everyone who lived through the postwar years regarded that time as an economic boom. Even though official government data show a decline in real GDP, that's due to a decline in the production of the tools of war. The goods and services that the average American valued rose by a large percent. See Robert Higgs, "Wartime Prosperity? A Reassessment of the U.S. Economy in the 1940s," in his book, *Depression, War, and Cold War*, New York: Oxford University Press, 2006.
37. See Jon R. Blondal, *Budgeting in Canada*, OECD, 2001, on the web at: [http://www.internationalbudget.org/pdf/Budgeting\\_in\\_Canada.pdf](http://www.internationalbudget.org/pdf/Budgeting_in_Canada.pdf).
38. Canada has a Senate whose members are appointed by the Prime Minister and are required to leave office when they turn 75. Only occasionally does the Senate do more than rubber-stamp the bills that the House of Commons passes.
39. John F. Cogan, "Federal Budget," in David R. Henderson, ed., *The Fortune Encyclopedia of Economics*, New York: Warner Books, 1993, pp. 243-247, on line at: <http://www.econlib.org/library/Enc1/FederalBudget.html>.
40. Amy Balesco, "The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations since 9/11," Congressional Research Service, July 16, 2010, p. 3, Table 1.
41. See <http://www.downsizinggovernment.org/agriculture/proposed-cuts>.

---

## Further Reading

July 2010

### Public Policy: An Introduction

<http://www.fcpp.org/publication.php/3370>

June 2004

### A Decade of TABOR

<http://www.fcpp.org/publication.php/770>

September 2002

### Nav Canada: A Model for Commercializing Public Enterprises

<http://www.fcpp.org/publication.php/313>

For more see

[www.fcpp.org](http://www.fcpp.org)