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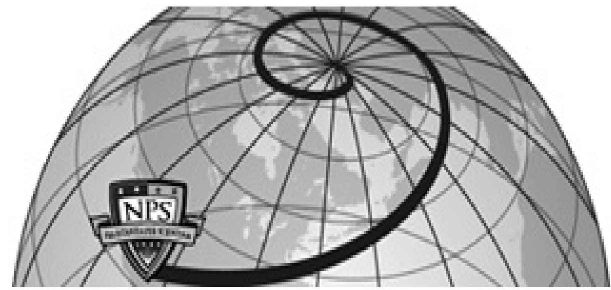

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If Canada can do it... slashing the state in the Great White North

Henderson, David R.

Reason, November 2010, Vol. 42, No. 6, pp. 47-48
https://hdl.handle.net/10945/46098

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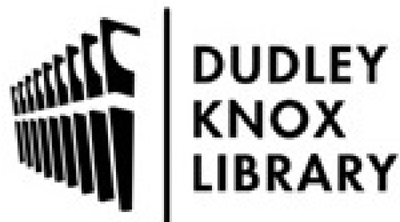

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Welfare policy: We now aimed not just to shrink the state but to reduce the number of people dependent upon it. Welfare had evolved into an entitlement to state support for social circumstances such as solo parenting, unemployment, health problems, and other forms of dependency. Under the new approach, resources were devoted to *resolving* health problems, education problems, social problems, and poor work skills. This approach moved 300 percent more people from dependency to independent living. It was a carrot-and-stick approach, though: If work was available and a citizen was capable of doing the job, he or she had to take it or forgo benefits.

As the New Zealand example demonstrates, it is possible to meet a crisis with serious, substantial reforms. All it requires is a good plan and strong political leadership. ■

Maurice McTigue (mmctigue@gmu.edu) helped guide New Zealand's reforms as a member of parliament, cabinet minister, and ambassador. He is currently the director of the Government Accountability Project at the Mercatus Center at George Mason University.

If Canada Can Do It...

Slashing the state in the Great White North

David R. Henderson

IN 1994 GOVERNMENT debt was 68 percent of Canada's GDP. By 2008 that number was down to 29 percent. Finance Minister Paul Martin Jr. and Prime Minister Jean Chrétien, both of the Liberal Party, are the two unlikely stars in this heroic tale of fiscal discipline.

Paul Martin's father was also known as "the father of Medicare," Canada's federally mandated single-payer health care plan, so revered by American liberals. Chrétien was the political heir of Pierre Trudeau, prime minister of Canada for all but nine months between 1968 and 1984, who bore a great deal of the responsibility for accumulating all that debt to begin with.

In the 1993 election, the Liberal Party promised to reduce the deficit. Almost unbelievably, its candidates actually kept this pledge after winning office. Chrétien and Martin accomplished the task with large budget cuts—not cuts in the growth of spending, but cuts in nominal dollars spent—and only small increases in taxes.

In assembling these cuts, Paul Martin didn't follow the usual pattern of consulting interest groups one by one. Instead, he held four televised regional consultations in which various lobbyists, experts, and ordinary citizens contended with one another. Martin also spoke directly to the public about what was needed to turn Canada's budget around. In October 1994, his Department of Finance published a report, *A New Framework for Economic Policy*, showing that in order to keep the ratio of debt to GDP from rising, government had to run a substantial surplus on its program budget—that is, have revenues significantly exceeding state expenditures.

Martin and Chrétien enforced discipline on other cabinet members with a zero-sum ground rule: If a cabinet member wanted a smaller cut in one program, he had to propose a bigger cut in another.

Martin's 1995 budget remains a shining example of how

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to deliver on promises of aggressive fiscal discipline. Government spending didn't just grow more slowly; it actually shrank. Spending on programs (as opposed to debt service) was lower in dollar terms, and therefore even lower when adjusted for inflation, than spending in 1993-94. Indeed, program spending was lower as a percentage of GDP than it had been at any time since 1951. The 1995 budget also privatized a number of government corporations, including a railway, a uranium company, and the air traffic control system; and it tightened Canada's unemployment insurance program.

In this and later budgets, Martin used conservative assumptions to make sure he achieved his goals come "hell or high water," an expression he used so often it became the title of his autobiography. Because his assumptions often turned out to be too pessimistic—a refreshing change from the usual budgetary wishful thinking—the ratio of debt to GDP fell even faster than projected. Martin also had a "no-deficit rule": Once he had managed to get rid of the deficit, he pledged to avoid future deficits by keeping spending in check.

From 1992-93 to 2000-01, Canadian spending on federal programs fell from 17.5 percent of GDP to 11.3 percent. The Canadian economist Thomas Courchene notes that the latter figure was the lowest "in more than half a century."

Not everything Martin did would meet with universal libertarian approval. Although there were six to seven dollars in budget cuts for every dollar of tax hikes, he did raise taxes. Virtually all of these increases were announced in the 1994 and 1995 budgets, and most were nickel-and-dime stuff: a reduction in the deductibility of meal and entertainment expenses, elimination of the $100,000 capital-gains tax exemption that a taxpayer could claim cumulatively over a lifetime, a 5.7-cent-per-gallon increase in the gasoline tax, a reduction of the upper limit on deductible contributions to Registered Retirement Savings Plans (Canada's version of a deductible IRA), an increase in the corporate income tax rate from 39.14 percent to 39.52 percent, and a few others.

Martin did not raise individual income tax rates. He did, however, increase the degree of means testing for various federal benefits. Within some income ranges, benefits ended up falling for every additional dollar of income, so the implicit marginal tax was several percentage points higher than the explicit rate.

As a result of this fiscal discipline, in every year between 1997 and 2008 Canada's federal government ran a budget surplus. In one fiscal year, 2000-01, its surplus was a whopping 1.8 percent of GDP. If the U.S. government had such a surplus today, it would amount to a cool $263 billion rather than the current deficit of more than $1.5 trillion.

Chrétien and Martin's efforts were so successful that in 2000 they reduced the corporate tax rate by seven percentage points, cut income taxes, decreased the amount of capital gains subject to taxation, and increased the contribution limit for retirement accounts. Through most of this time period, Canada's economy boomed, thus belying the Keynesian view that large budget cuts reduce economic growth. If the Canadians can do it, maybe, just maybe, we can too. ■

Contributing Editor David R. Henderson (davidrhenderson1950@gmail.com), a former Canadian, is an associate professor of economics in the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, California, and a research fellow with the Hoover Institution at Stanford University.

David R. Henderson: In the 1993 Canadian election, the Liberal Party promised to reduce the deficit. Almost unbelievably, its candidates actually kept this pledge after winning office.

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