A TEXTBOOK BUDGET

Patrick Grady

A finance minister's two most important obligations are to balance the books and then watch out for the taxpayer's interest. Paul Martin's first six budgets put the country's balance sheet in order. His seventh addresses the needs of taxpayers, and it largely delivers. These two achievements make him the most successful finance minister in memory. He may also have set the present government's agenda for its third mandate.

Les deux principales obligations d'un ministre des Finances consistent, d'une part, à équilibrer les dépenses et les revenus et, d'autre part, à veiller aux intérêts des contribuables. Par ses six premiers budgets, Paul Martin a mis de l'ordre dans les comptes publics. Par son septième budget, il entendait répondre aux besoins des contribuables : mission accomplie. Ces deux réussites font de lui le ministre des Finances qui, de mémoire d'homme, s'est le mieux acquitté de ses fonctions. Peut-être a-t-il par là tracé la ligne d'action pour le troisième mandat de son gouvernement.

The first thing any finance minister has to learn upon taking over the portfolio is that his job is to manage the nation's finances prudently. If this isn't done, the economy can hardly be expected to prosper. Nobody believes anymore that governments can merrily spend their way to prosperity by racking up ever-growing deficits.

Every new finance minister should be given a sign to put on his (or, one day, her) desk saying "It's the deficit and taxes, stupid." This would serve as a constant reminder of the two most important tasks facing any finance minister. The first is to make sure the government does not irresponsibly finance excessive spending by issuing too much debt, the second to see that the taxes levied to pay for expenditures do not become overly burdensome, either through discretionary increases or fiscal drag — the natural tendency for taxes levied on a progressive basis to increase more rapidly than incomes.

A finance minister's role in the government is to be the spokesperson for expenditure restraint and the defender of the beleaguered taxpayer. Ministers from spending departments will always take care of arguing for more spending. A finance minister should understand that he will not get credit for generous increases in spending, however worthy and well directed they may be. That will fall to the ministers doing the spending, and to their boss, the prime minister.

One final rule: While debt reduction may also be a worthy objective, it is unlikely to bring a finance minister much political credit. Better to concentrate on lowering taxes. The public appreciates it much more when their hard-earned money is left in their own pockets, rather than used to pay down the debt.

On taking office in 1993, Paul Martin had to concentrate on the pressing task of putting the country's finances back on a sound footing by eliminating the monstrous $42 billion deficit he inherited from the previous government. This he did with distinction, largely by curtailing spending. Since 1993-94, the reduction in program spending has accounted for the lion's share of the decline in the deficit as evidenced by the relative shifts of program spending and revenues as a percentage of GDP The current fiscal year will mark the third in a row in which he has been able to report that there would be no deficit. As a consequence, the debt-to-GDP ratio is now securely on a downward track, already having fallen from

71.2 per cent of GDP in 1995-96 to a projected 61.1 per cent this fiscal year, with comparable decreases in store over the next five years.

Mr. Martin's prudent approach to budgeting has clearly been working. It consists of rolling two-year budgets based on prudent economic assumptions and a built-in $3 billion contingency reserve to protect against unanticipated deficit-raising developments. These prudent assumptions have led to unexpectedly large surpluses at year's end that have been spent on one-off programs like last years' Millennium Scholarship Fund or this years' $2.5 billion cash supplement to support post-secondary education and health care. Because it hasn't been needed, the $3 billion contingency reserve has so far been used for debt reduction, as it probably also will be in the future.

Under Mr. Martin's tight rein, program spending has declined from 16.6 per cent of GDP in 1993-94 to 12.2 per cent this fiscal year. By and large, the spending increases Mr. Martin has acquiesced in have been only for the highest priority areas. This year is no exception. Health and post-secondary education, the provision of essential public services, research and innovation, and infrastructure are all worthy initiatives with substantial public support.

Although Mr. Martin introduced modest tax cuts in his 1997, 1998 and 1999 budgets, it's only in the current budget that he has been able to get serious about his second major duty, cutting taxes. The 2000 budget, with its minimum of $58 billion in tax cuts over the next five years, is the most important of this mandate and will set the tone for the government's next mandate. It contains the most significant package of structural changes to the tax system since Michael Wilson's 1987 white paper on tax reform.

To understand the full importance of the 2000 budget, recognize that so far Mr. Martin has been constrained by his government's red book election commitment to allocate half of any fiscal dividend to spending increases and half to tax cuts and debt reduction — the famous "50/50" commitment. That the government takes this commitment very seriously indeed is shown by how carefully the budget documents layout how new spending and tax-cutting initiatives have/will deliver on it for the period 1997-98 to 2002-2003, which loosely corresponds to the current mandate.

The overwhelming significance of the 2000 budget is that it overrides the 50/50 commitment for the next mandate and offers a new commitment for additional tax cuts extending beyond 2002-3 into 2004-2005. The revenue losses from the personal and corporate tax cuts that have been announced are estimated to increase by $10 billion between these two fiscal years, from $7.7 billion to $17.6 billion. This commitment for large additional tax cuts in the out-years is a major departure from the Minister's previous *modus operandi* of only making binding commitments with respect to a rolling two-year budget horizon. It clearly obliges the government to allocate the largest share of next mandate's fiscal dividend to tax cuts rather than spending increases, a change of policy that presumably will have to be reflected in the next campaign red book. Mr. Martin's commitment will pre-empt much of the room for future spending initiatives and keep the government focused on expenditure restraint, even in the face of what may be a surging fiscal dividend.

Of course, to the extent that the Minister's conservative planning assumptions understate future fiscal dividends, spending increases could be larger than currently implied by the tax-cut commitment — though so could tax cuts. Indeed, Mr. Martin promises in the budget that when the government can afford to provide more tax relief, it will. On the other hand, if the fiscal dividend turns out to be smaller than projected, expenditure reductions would be required. It would be hard for the government to renege on its written promise of tax cuts.

One of the most important tax cuts in the budget is the indexation of tax brackets and credits. This significantly reduces the elasticity of the personal income tax and reduces the government's ability to increase spending in the future. For taxpayers, it's "the gift that keeps on giving."

The other personal tax cuts announced in the 2000 budget are substantial: the reduction in the middle tax rate to 23 per cent from 26 per cent; an increase in the level of income at which the middle rate applies, from $19,590 to at least $35,000; an increase in the level of income at which the top rate applies, from $59,180 to at least $70,000; the elimination of the 5-per-cent surtax; and an increase in the Canada Child Tax Benefit to a maximum of $2,400 for the first child. The goal was clearly to target the package of cuts on middle-income families with children. What's not so clear is whether the cuts will be enough to close the Canada-US personal tax gap, especially if the US introduces further cuts following this year's elections.

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The reductions in the federal corporate income tax rate to 21 per cent from 28 per cent and in the capital gains inclusion rate from three-quarters to two-thirds were designed to make the Canadian economy more competitive. The corporate rate cut implements a key recommendation of the Mintz committee on business taxation — almost to the percentage point: Mintz recommended an overall rate of 20 per cent. At long last, it places the fast-growing high-technology and service sectors on the same footing as manufacturing and processing and therefore mitigates tax-induced distortions in resource allocation that undermine productivity. It will also put the overall Canadian corporate tax rate (including provincial taxes) at about 40 per cent, on a par with other G-7 countries, which should enable Canadian corporations to compete on an equal footing with those based in our major trading partners.

The 2000 budget is a textbook case of what a finance minister should do.

Tax cuts, a balanced budget, a declining debt ratio: Mr. Martin is the first finance minister in recent history to have actually succeeded at the two essential tasks demanded of finance ministers. We've had finance ministers who allowed spending increases to swell the deficit (Alan MacEachen and Marc Lalonde), and a finance minister who raised taxes in an unsuccessful effort to reduce the deficit (Michael Wilson), but Mr. Martin is the first finance minister in a long while who has eliminated a deficit by restraining spending and has then gone on to cut taxes. The 2000 budget is a textbook case of what a finance minister should do.

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Could we go back to quiet courts? Critics troubled by active courts want to restore the relative calm we once enjoyed by resurrecting "traditional judicial review." What do they propose? The Supreme Court has to bring back the old standing requirements, discourage interests from intervening, consider only narrow legal questions raised by live controversies and question the value of extrinsic evidence. They resent judges who allow political adversaries to clutter the courtroom, evaluate policy alternatives with misplaced confidence and try to settle future disputes in a single decision. Conservative critics believe that prudence should replace arrogance. It is too easy for judges to advance their personal preferences, they insist, if the "living tree metaphor" can be invoked as a license to alter the meaning and scope of enumerated guarantees. The Supreme Court has to remember the primary purpose of a liberal democratic constitution: to protect individuals by placing limits on the state. Legal remedies should not increase the presence of the state. Judges should never punish governments for failing to act by filling perceived omissions. They should also resist the temptation to expand services, benefits, regulatory regimes and Aboriginal treaties.

This argument can sound appealing, especially when the Supreme Court delivers a decision that divides the country. Still, the measures that conservative critics propose have a distinct bias that Canadians should know about. Resurrecting traditional judicial review would filter out certain interests and values. Returning to the old rules governing standing and intervenor status would hurt public interests unable to demonstrate a direct stake in a dispute. Excluding extrinsic evidence would make it more difficult for litigants who want to trace the adverse effects of a law. Freezing the meaning and scope of constitutional guarantees would leave judges unable to address new social problems that create discrimination. If courts only placed limits on the state, litigation would be a poor strategy for citizens who want to bolster regulatory regimes or expand social services. Taken together, these obstacles would hinder interests concerned about racism, homophobia, gender inequality, environmental degradation, poverty, the lives of the disabled and the plight of Aboriginal peoples. Traditional judicial review would not, however, frustrate litigants advancing conventional pecuniary claims and legal action would still be an effective strategy for interests that want to resist state intervention.

Although constrained courts would cause fewer disruptions, we would pay a price. Litigation would help corporations but not groups trying to address public problems. Critics of judicial activism stumble here. They want to stop social reformers from seeking the legal remedies that businesses have always requested. Seen from this perspective, the current relationship between citizens, legislators, and judges is attractive because it meets a basic requirement of democracy that many Canadians embrace. Nations composed of diverse interests should not have institutions that respond to some and ignore others.

Gregory HEIN, Department of Political Science, University of Toronto, in "Interest Group Litigation and Canadian Democracy," published March 2000 in IRPP's *Choices/Choix* series, as part of the Institute's research programme "Courts and Legislatures." Available for downloading at www.irpp.org.