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Dividing Up the Surplus

How big a tax cut do you want? Sorry, that's the wrong question.

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Last November, Paul Martin announced that the projected surplus for the 1999-2000 fiscal year would be \$9.5 billion and that the cumulative surplus over the next five years would be about \$90 billion. With such an enormous fiscal dividend on the horizon, it is no wonder that the ongoing debate—tax cuts versus more spending—has reached a fever pitch. Too bad the debate tends to be guided more by opinions than by fundamental principles.

The two ends of the political spectrum naturally disagree about what should be done—but it's a debate that's generating more heat than light. People on the right argue that taxes should be reduced. They emphasize the debilitating effect of high taxes, recently focusing on the damage from a supposedly high-tax-driven brain drain. At the heart of the right's position is the argument that high taxes undermine incentives for work and investment and thus reduce the prospects for economic growth. People on the left argue that instead of reducing taxes the government should be spending more on health care, education, and a broad range of social services—programs hit hard by federal cuts in 1995 and 1996. At the heart of the left's position is the argument that the government needs to worry more about equity than it has in recent years.

There are good points on both sides—efficiency and equity are clearly both important. But as so often happens in public debates of this kind, each side ends up overstating its case and failing to admit that the other side makes any sense at all. As a result, both end up looking like extremists.

I could discuss how to add a little balance to the existing debate—why the right should remember that some taxes are necessary and why the left should realize that increases in efficiency mean more possibilities for redistribution—but the main point I want to make is more fundamental. The current debate over how to spend Canada's fiscal dividend is one that we

should not yet be having. Why not? Because there are two logically prior questions that have to be addressed. First, what things should the government be doing? Second, how much should the government be spending? These are probably the two most important questions that we could ask about government. Maybe the answers are so obvious as to be implicit in the current public debate, but I don't think so. I think they're missing altogether. Would you trust a contractor who claimed he could build a house without a proper foundation? Me neither.

Let's start at the beginning. Governments don't collect taxes just for the fun of it. Governments in all countries, of whatever political stripe, collect taxes for one reason: to finance spending. What should government be doing and how much should it spend? These are difficult questions to answer. But discussing how much less tax you'd like to pay before deciding how much more (or less) you'd like Ottawa to spend is to put the cart before the horse, the receipt before the purchase.

What is interesting in the Canadian context is that the Liberals were asking exactly the right questions when they were first elected six years ago. At that time, they instituted what they called Program Review—a ministry-by-ministry re-evaluation of the role of government. I remember Paul Martin saying “government should do what *only* government can do”. It is surely far easier to make a statement like this than to carry it out, but the idea is bang on. Government should limit itself to doing those things that the private market cannot do efficiently. So national defence presents an obvious role for government, as does the setting of environmental standards and the provision of roads and, probably, primary education. It becomes murkier in those areas where the market may be able to play a significant role if only we would give it a chance, like health care and post-secondary education, and perhaps even unemployment insurance. But is there any good reason for government to establish dairy quotas, offer industrial subsidies, grant special tax treatment for Canadian films, or maintain the CMHC? Not likely.

If you're a typical reader of this magazine, you agreed with some parts of the last few sentences and disagreed with other parts. That's as it should be, and it proves that questions about the appropriate level and pattern of government spending are not easy to answer. And I'm not going to push my answers in this column. All I'm arguing here is that all of us have to start asking the right questions. The sad thing is that this is precisely what the Liberals and the other parties are *not* doing. They've all got themselves sucked into the narrower debates over tax rates,

health-care spending, and the brain drain. As far as the right is concerned, taxes are always too high; as far as the left is concerned, social spending is always too low. Anything this predictable can hardly be informative.

If we had a real debate about the appropriate level and pattern of government spending, we would then have a framework for an intelligent discussion of appropriate tax rates. We would start off by recognizing that the tax system as a whole would have to raise sufficient revenue to finance our total expenditures, allowing perhaps for some deficits during recessions and surpluses during economic expansions. Then we'd have to figure out how to most efficiently raise the money. Do we tax income, consumption, wealth, or some combination of the three? What about corporate tax? And how progressive—academic-speak for taxing higher-income earners at higher rates—do we make the tax system?

At this point, the right's concerns about efficiency and the left's concerns over equity would come to centre stage. But until we ask the more fundamental questions about appropriate government spending, the current debate about how to spend the fiscal dividend is producing far too much heat and far too little light.