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Oh Canada! ... Role-Reversal in North America?

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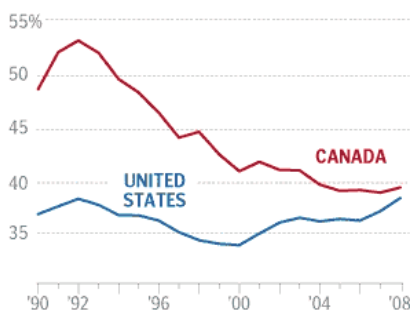
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Stereotypes are often rooted in some current or past reality, but they can also become outdated. While the USA and Japan have for a long time been regarded as small-government countries, among industrial countries, Canada has long been considered more 'socialistic' and closer to the big-government model of Western Europe. However, a careful look at the relevant economic data casts serious doubt on that old stereotype. That is exactly what three economists did in a recent article in The Washington Post (*Chris Edwards, Jason Clemens and Niels Veldhuis, [Great Right North](#), Sunday, May 17, 2009*), using data from the Organization for Economic Cooperation and development (the OECD, which is specialized in constructing 'comparable data' for industrial countries) as well as on national data from the USA and Canada. Consider the following 7 criteria for judging the degree of socialism in North America (excluding Mexico).

1) Government Spending

Government spending as a percentage of GDP



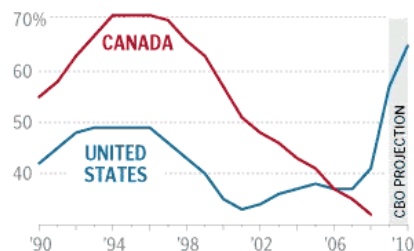
Over the last twenty years or so, consolidated *general* government spending, i.e. spending at ALL levels of government (federal, state/provincial, local) has steadily declined in **Canada** from a peak of about 53 percent of GDP (gross domestic product) in 1992 to just below 40 percent in the last few years (2004-08).

By contrast, in the **USA**, over most of the same time period, general government spending has tended to fluctuate narrowly around 35-36 percent. However, in recent years (2006-08) it has turned sharply upwards to reach the current 'Canadian level' of just below 40 percent of GDP.

So, the (downward) Canadian trend line is now breaching this year the (upward) American one and, given what we know today about the fiscal intentions of the Obama Administration and the dramatic (if not absurd) size of its misnamed "stimulus package" which should more accurately be called "government-expansion package"), we can reasonably assume that the size and role of government (as measured against the size of the overall economy) is now larger in the USA than in Canada. It is also reasonable to expect that the size of this gap is going to widen further over the next few years, with the USA on the road to 'West-European' government spending levels and with the Canadians maintaining more fiscal sanity.

2) Government Debt

Federal public debt as a percentage of GDP



The contrasting trends are even starker when comparing government debt levels, rather than government spending levels. The general implication is that Canadians are more responsibly financing their public spending with taxes rather than borrowing, compared with Americans.

Canada's FEDERAL public debt peaked in the mid 1990's around 70 percent of GDP, and has steadily declined EVERY year since, to reach 32 percent in 2008. In the **USA**, the federal debt peaked also in the mid 1990's around 50 percent of GDP and some fiscal consolidation was achieved in the economic boom period of the late nineties. However, the effort stalled during the first term of the GW Bush Administration, and the federal debt level shot up sharply during the second Bush term to reach nearly 60 percent of GDP in 2008. One can safely predict that over the next few years the American public debt level will be more than double the Canadian one in relation to their respective GDP's.

3) Government Deficits

Naturally, the respective trends in (annual) government deficits are mathematically linked to the trends in spending and debt described above. The most remarkable feature is that Canadian governments have managed to at least balance their budgets EVERY year SINCE 1998, and even managed to have small surpluses most years. By contrast, the US government has incurred renewed deficits of several percentage points of GDP most years over the past decade, and is now projected to reach an 'astronomical' deficit level of over 10 percent this year, and perhaps next year as well.

4) Social Security

Today, both Canada and the USA spend about the same percentage (4.5 percent of GDP) on publicly-funded retirement benefits. However, the US system is not solvent and has large unfunded liabilities, which will require difficult policy actions – most likely higher taxes, and/or benefit cuts - in the future. The Canadian system is considered solvent as its government has been building up assets to pre-fund future retirement benefits (just like private pension plans do).

While retirement benefits have always been a major component of 'social security', in many countries today there are other major components as well that relate to a variety of 'welfare' payments, to unemployment benefits and especially to health care. The Obama Administration's plans concerning health care are clearly moving in the direction of the Canadian system.

5) Federalism

In recent decades, federal power has been growing in the USA at the expense of the individual states. In Canada, the trend has been in the opposite direction. Contrary to what many might think, the share of federal government spending in general (or total) government spending is about 20 percentage points (of GDP) higher in the USA compared with Canada (about 60 percent versus 40 percent). Obviously, the issue of autonomy/independence for Quebec-in-Canada has been a major underlying factor, but also Canadian provinces have greater control over their natural resources (e.g. Alberta) which helps to explain relatively larger (average per capita) income differences between Canadian provinces as compared with US states.

Obviously, many factors might be considered under the heading of 'federalism versus centralism'. Education is often one of the largest expenditure components of lower government levels. Over the past decade, the Bush Administration has continued to expand federal control over primary and secondary education in the USA. In Canada that remains in the domain of the different Provinces.

6) Corporate Income Taxes

At the beginning of this decade, the Canadian and US corporate tax rates were nearly the same. Today, the US (federal) corporate tax rate remains unchanged at 40 percent, whereas the Canadian federal rate has been lowered over the decade to 28 percent. In Canada provincial corporate rates vary, but the joint (federal+provincial) rate for the largest Province (Ontario), at just above 30 percent, compares favorably with the US rate. Obama is planning to increase the latter.

7) Individual Income Taxes

Canada still has higher income tax rates than the USA. However, after the 'Bush tax cuts' will expire at the end of next year, the top marginal tax rates in the US (state and federal combined) will be on average about 46 percent, the same as in Canada today. For investors, the federal capital gains tax rate is lower in Canada than in the USA.

Conclusion

The old stereotype of Canada as being more socialistic does no longer appear valid, at least from an economic perspective. At the same time, some might argue that Canada remains more socialistic than the USA from other perspectives. For example, freedom of speech is clearly still more protected south of the world's "longest undefended border". But, formal restrictions on freedom of speech are not the special preserve of socialist societies and regimes. They can be found in countries with both leftist and rightist regimes. By contrast, the share of general government spending in total spending of an economy is a simple but clear economic measure of socialism. It is a measure of the relative size of the resources in an economy that the government controls directly. This is not to deny that governments can indirectly exercise control over nominally 'private' resources in other ways.

The current Canadian government is a 'conservative' one, but its hold on power is tenuous because it is also a 'minority' government (in Parliament). It has little to do with the positive trends outlined above, since it came only to power fairly recently. That means that the credit for these positive trends goes largely to the center-left governments that have governed Canada for much of the past two decades and who have implemented major fiscal and some structural economic reforms that have made these numbers possible. And there are also indications that the Canadian banking system is in much better shape than the American one. Meanwhile, in the USA, many Republicans have been profligate with the public purse in recent years, and much of the political left marches today in the opposite direction from the one taken by recent Canadian center-left governments. And Obama-mania on the part of the mainstream media is not going to make matters better...before the next election cycle.

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