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World faces crisis over taxation

Western governments in untenable fiscal bind

Paul Vieira, Financial Post

Corporate Germany should be rejoicing as the recent election produced the type of tax-cutting, market-friendly government it has longed for.

Alas, this right-leaning regime, led by re-elected chancellor Angela Merkel, won't have the fiscal wherewithal to deliver the type of tax cuts business craves.

As it happens, corporate Germany won't be the only business community to be disappointed in the post-crisis landscape when it comes to the subject of taxation.

With few exceptions, most industrialized Western governments find themselves in an untenable fiscal bind, the result of spending binges in the years leading up to the recession, together with the hundreds of billions dished out to ward off a possible depression and an aging population poised to demand more health care and pension payouts from government.

Those bills will come due. And experts fear increased taxes are the only way to pay the piper.

Nowhere is this fear more pronounced than in the United States, which is recording trillion-dollar annual deficits, and its estimated government debt, combined with unfunded public health and pension liabilities, could equal a whopping 300% of its gross domestic product (GDP).

"I would guarantee that taxes are going up in the United States," said Andrew Busch, senior foreign exchange strategist at BMO Capital Markets.

"The tax base will need to be increased or the tax level will go up. I expect both to happen globally. Can bell-bottom jeans, men's facial hair, and 1970s stagflation be far behind?"

The buildup of U.S. debt has led some U.S. economists and policy advisors to begin mulling about the need for a national sales tax, much like Canada's GST. Such a value-added tax, analysts say, could accomplish two things: raise needed revenue for the government and get Americans to save more (and reduce the country's massive trade deficit).

"The budget battles we are going to have down here [in the United States] are going to be bigger and bloodier than we have ever seen," said Chris Edwards, director of tax policy at Washington-based Cato Institute.

Fireworks could kick off in earnest soon, as tax cuts introduced by the George W. Bush administration are set to expire next year. There's some debate as to whether the measures -- which reduce levies on capital gains and such -- will be extended.

Mr. Edwards said the Obama administration appears keen on raising taxes on corporations while continuing to give tax subsidies to low-income earners. This would follow in line with what was done in Britain, where marginal income tax rates above the 50% mark for the country's highest wage earners.

"I am not for raising taxes, but you could certainly raise taxes in a lot less damaging way," Mr. Edwards said of the path taken by Britain.

Canada's federal government is mired in red ink and appears to be stuck in deficit until at least 2014-15 fiscal year, with the debt-to-GDP ratio projected to peak at 35.5% in 2010-11. As bad it sounds, though, the country's public finances are in far better shape than those in the United States.

Still, some provinces -- notably Ontario and Alberta -- are at risk of running permanent deficits, warns Jack Mintz, public policy professor at the University of Calgary and a top tax expert. Ontario's hit from this recession was deep, whereas Alberta's revenue base has shrunk considerably because of lower commodity prices, especially natural gas.

"Tax increases will be inevitable if governments don't contain their spending habits," Mr. Mintz said.

"Governments will have to turn the tap off and really constrain spending -- well below GDP growth or something like that."

Booming Asian economies, such as those in China and India, have smaller public sectors and tax levels not nearly as high as the Western world. This, he warns, will put pressure on Western economies to keep tax levels competitive -- or face losing tax-paying corporations to the Asian countries.

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