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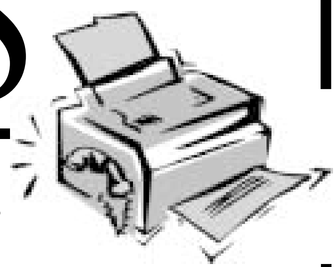

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Balanced Budget Legislation, Tax Cuts Threaten Prosperity

Anyone looking for a reason not to abandon Manitoba for the West Coast need look only as far as the headlines in this morning's papers. The BC government has implemented massive tax cuts. It intends to pay for these cuts by cutting provincial services—in some departments, staff will be cut by more than one half. Unemployment, already the worst in the country at nearly 10%, is sure to climb.

As is being made abundantly clear in BC, tax cuts are not the economic panacea claimed by business and "taxpayer" lobby groups. Evidence shows that, in terms of macro economic stimulus, tax cuts come out a poor second to spending increases on a dollar for dollar basis. While it is, of course, possible to stimulate the economy using tax cuts, the current provisions of Manitoba's balanced budget legislation ensure that tax cuts will actually reduce economic activity as tax cuts must be accompanied by spending decreases.

In order to illustrate the effects of alternative macro policies, we have used an economic model developed by the Ottawa-based forecasting firm Informetrica Ltd to estimate the impact of three alternative tax and spending scenarios:

1) The impact of selected tax cuts in the 01/02 budget.
2) The impact of an equivalent increase in spending on goods and services.
3) The impact of a balanced budget decrease in taxes and spending.

For illustrative purposes, let's use an amount equal to all the major income and business tax reductions that took effect in 2001/02. This foregone tax revenue from these is quite substantial, totalling about $182 million.

Option 1

If the above tax reductions were unaccompanied by decreases in spending, which is nearly impossible under the balanced budget legislation, it would provide some benefits for the Manitoba economy. GDP would increase by 33 million and 590 jobs would be created in the Manitoba economy. However, it is also worth noting that this reduction creates 630 jobs in Ontario and increases their GDP by 42 million. In fact, Ontario receives 30% of the total benefit of the tax reduction, while Manitoba only gets about 26%. This is because Ontario has a large manufacturing sector, so many of the goods people buy in Manitoba are imported from Ontario. It illustrates the problem with tax cuts: much of the hoped-

Effects of Tax Cuts / Spending Options	Employment		GDP (mils)	
	Man	Ont	Man	Ont
Tax cuts of 182 mil	590	630	33	42
Spending Increase of 182 mil	1340	865	75	57
Balanced budget decrease of 182 mil	-755	-240	-42	-16

for economic boost "leaks" out of the provincial economy.

The entire stimulus from a tax cut depends on people spending that money, and spending it in Manitoba, on Manitoba goods and services. If people save it, or use to purchase goods manufactured out of the province, the economic impact is squandered. However, if the government wants to insure that money gets spent, there is an easy way to do so: spend it. Which takes us to our next scenario.

Option 2

Running a deficit by increasing spending on goods and services instead of tax cuts will yield a much more desirable macro outcome. If the government were to spend $182 million rather than give away that much through tax cuts, employment in Manitoba would increase by 1,340 and GDP by 75 million -- more than double the benefit from the tax cut. Manitoba would also gets about 37% of the benefits of this form of stimulation, while Ontario would only receive about 26%.

Option 3

The situation becomes more problematic if spending is cut back to compensate for the tax decreases, an inevitability given the balanced budget legislation. If spending on goods and services purchasing by the government matched the tax cut, it would cost Manitoba 941 jobs and 52 million in GDP.

There are important points to be drawn from these simulations. The first is that, dollar for dollar, stimulating the economy through spending generates more bang for the buck. This means that the government can spend money to meet very important social needs, such as housing, child care, and social assistance, and in so doing also help fire up the provincial economy.

Second, it is important to highlight that Manitoba's balanced budget legislation points the government in the direction of spending cuts, which is precisely the wrong way to go in the face of a recession. Because they require spending cuts to pay for them, it is virtually guaranteed that the tax cuts will actually create an economic contraction, hardly a desirable result when the economy is entering what seems likely to be an increasingly severe recession.

—Ian Hudson

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