

HAS NEO-CONSERVATISM FAILED?



William Watson

In the 1990s all Canadian governments experienced a fiscal crisis. In the government sector as a whole, taxes were raised to all-time record levels and the rate of growth of spending was cut in order to eliminate deficits and stabilize the debt-to-GDP ratio. It would be wrong, however, to interpret this period of retrenchment as having represented the triumph of neo-conservatism. Canadians have not converted to the small-government philosophy that is at the heart of that political doctrine. How money that formerly went to debt service is allocated will be the true test of current Canadian ideology. There is every chance it will be spent.

Durant les années 1990, tous les gouvernements, au Canada, ont vécu une crise financière. Dans l'ensemble du secteur gouvernemental, les impôts ont atteint des sommets jamais vus et l'on a freiné le taux de croissance des dépenses publiques. L'objectif était partout le même : éliminer les déficits et stabiliser le ratio entre dette publique et PIB. On aurait cependant tort de voir dans cette période d'austérité le triomphe du néo-conservatisme. Les Canadiens, en effet, n'ont pas fait leur la philosophie qui est au cœur du néo-conservatisme et qui consiste à réduire le gouvernement à sa plus simple expression. La façon dont on utilisera l'argent jadis affecté au service de la dette sera le véritable révélateur de l'idéologie qui a cours au Canada. Il y a tout lieu de croire que cet argent sera dépensé.

Something in the Canadian soul loves defeat. This paper was originally written for the University of Manitoba's "Delta Marsh retreat." Presenting it last October in a former hunting lodge perched on the bleak and windy shore of Lake Manitoba, I found myself surrounded by left-leaning economists (some of whom had tipped all the way over) who, almost despairingly, consider themselves to be living through the dark ages of neo-conservatism. My message to them, an equally glum one from my point of view, was that the triumph of neo-conservatism, like reports of Mark Twain's death, is greatly exaggerated. It was a classic Canadian confrontation between opposing camps each persuaded of the hopelessness of its cause.

Perhaps "hopelessness" is not quite correct. Although the Manitoba economists certainly believe that their preferred vision of the world, which might loosely be called "social democracy," had fallen on hard times, in spending just a day with them I did not learn whether, in their hearts, they were still hopeful of its eventual restoration. As for my own heart (if the concept of an economist's heart is not oxymoronic), I am pessimistic. Unlike Twain's death, neo-conservatism's eventual triumph is not foreordained. My own

view is that it has probably peaked and is now starting the long, slow slide into the ideological oblivion of seminar rooms, political memoirs and nostalgic recollection.

Begin with definitions. What is neo-conservatism? These days, it seems, conservatism has more varieties than Starbucks has coffee. This is not to say conservatism is as popular as coffee (another acquired, addictive and energizing taste that went through hard times in the 1960s and 1970s but has done better in recent years). There are also many varieties of liberal, Liberal, social democrat and New Democrat, and, paradoxically, almost numberless versions of what is usually called "the Third Way." (Two roads diverged in the political wood and, these days, almost every-one is tramping off across the field between them.)

The term "neo-conservative" is American in origin, as its Canadian critics never fail to mention, and in that origin it had almost nothing to do with what went on in Canada in the 1990s. The original neo-conservatives were mainly Democrats, some of them lapsed Democrats, upset with their party's equivocation in its a. anti-communism, b. support for Israel, and c. enthusiasm for defence expenditure.

Figure 1

		Social issues	
		More paternalism	Less paternalism
Fiscal issues	More paternalism	High Tories Social democrats	Chrétien Liberals
	Less paternalism	Canadian Alliance Ontario Tories	PCs Martin Liberals Libertarians

Surprisingly—shockingly even—the Progressive Conservative Party is probably the Canadian political party that, at least in its own view of itself, comes closest to libertarianism (a fact that is itself an index of how big the problem is).

Domestic policy played a subsidiary role in their thinking, although they did ultimately carve out a position based on tough love, common sense and greater use of private charity.

Foreign policy being much less important here, the different variants of liberalism and conservatism have been distinguished mainly by their approaches to domestic policy—although the Canadian Alliance’s strong condemnation of the government’s support for the UN resolution denouncing Israel for the latest Intifada represents an interesting attempt to persuade traditionally Liberal voters to give the Alliance a look. Canadian conservatives, whether neo- or other, have also long been annoyed by this country’s essentially adolescent insistence on tweaking its nose at the United States—as, for instance, by our longstanding dalliance with Fidel Castro, the hemisphere’s last remaining totalitarian.

Many points of demarcation obviously are possible, but if for a moment we deal with fiscal and social issues and distinguish schools of thought according to whether they favour greater or less state regulation, a matrix along the lines of that displayed in Table 1 may suggest itself.

Which kind of conservative, or Conservative, goes where in this matrix? A few possibilities have been suggested, though it is hard to agree on what is a more paternalistic (or interventionist or activist) policy and what isn’t, and even harder to tie down party-political philosophies in this way. That doesn’t mean it is impossible: The commonplace view that the old labels of “right” and “left” don’t mean anything anymore is not

right: They are in fact very useful, and usually very accurate, if admittedly not perfectly accurate, predictors of people’s opinions.

Libertarians pretty clearly belong in the bottom-right-hand corner. They believe in minimalist government. Or perhaps I should say “we” believe in minimalist government, since, like many market-oriented economists, my own inclinations lie in this direction. Libertarians want governments to stay out of all personal questions that don’t involve violence against others; we want tax rates reduced to what is necessary to support the vital functions of the state, nothing more; and we want the tax system to be as neutral as possible with respect to economic and other choices: It shouldn’t favour one form of economic or social activity over another and it certainly shouldn’t tax some forms of income—saving, for example—twice.

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A true moral de-regulationist believes the state should not use tax preferences or pension rules to encourage people to take their income in the form of benefits for their spouses or partners: If compensated wholly in cash, they are perfectly capable of making such allocations themselves.

On the question of lifestyle choices, all the mainstream parties say they favour tolerance, or to use a word briefly popular during the last federal election “respect,” but in fact they would all have the state continue to regulate such things as marriage and divorce. Left-wing Liberals and PCs would probably countenance state approval for homosexual marriages, and certainly for “domestic partnership contracts.” Libertarians, by contrast, would probably argue that if an adult wants to get married to one or more adults of one or more genders, there’s no reason for the state to either sanction or not sanction this highly personal choice. There is such reason at the moment, of course, because all manner of tax favours and public benefits accrue to spouses, but a true moral de-regulationist believes the state should not use tax preferences or pension rules to encourage people to take their income in the form of benefits for their spouses or partners: If compensated wholly in cash, they are perfectly capable of making such allocations themselves. The state may have an interest in enforcing any contract a couple or group arrives at but, so long as they are adults of sound mind acting freely, it should be indifferent to the contract’s terms. It is evident that, by this standard, no major Canadian party could really be classified as non-paternalistic socially, even if the goals and objects of their paternalism differ.

Although the “fiscally conservative, socially progressive mix” has a surface similarity to libertarianism, it’s obvious that mainstream proponents of it, from the Clark PCs to the Martin Liberals, stray from the core doctrine in many, many ways. The PCs have their favourite candidates for tax preferences, while Mr. Martin, for all his good work over the last seven years, still has the air about him of a tinkerer, especially in industrial policy. As an ex-businessman, he seems an instrumentalist by nature. On social issues, I have put the Martin Liberals to the less interventionist side of the Clark PCs mainly because the Tory base is now so rural. When urban sophisticates from Montreal ran the party, as they may yet do again, it would have had the same social values as both main factions of the Liberal Party.

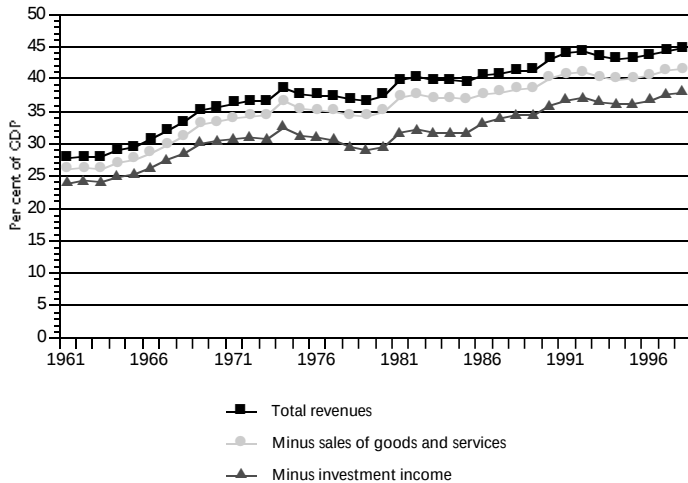
If pressed, I would probably classify the Alliance and the Mike Harris Tories as fiscally conservative, socially paternalistic. These days, social paternalism means you favour traditional social values and don’t mind using the power of the state to enforce them—though in a very mild way, since hardly anyone any longer believes homosexuality or divorce should be discouraged

by the law, let alone outlawed. Except on the question of not volunteering to give state sanction to homosexual marriages, the Harris Tories have not been terribly aggressive in advancing a social agenda. They want teachers to spend more time in the classroom; they’d like the public school curriculum to be more traditional, with greater emphasis on the basics, and they presumably don’t want a “homosexual agenda” advanced in the classroom. If this accords with the wishes of parents, it is hard to quarrel with it. (Paternalism from parents is just fine.) More recently, the Harris Tories have announced they will make prison inmates cut their hair and refrain from tattooing themselves—mainly to improve their chances of getting a job upon release. This is a form of paternalism, though paternalism in prisons is *sui generis*. The Tories’ early initiatives on boot camps and workfare seem to have gone essentially nowhere.

Where the Harris Tories depart most seriously from core conservative principles is in their methods: In two years I spent in Ontario (1997 and 1998, as editorial pages editor of the *Ottawa Citizen*) it seemed to me all power was gravitating—or being gravitated—to the premier’s office. The apparent rationale (in good Galbraithian terms, though Galbraith no doubt would have been horrified) was that centralized public power was necessary to countervail the centralized power of the public sector unions. That may be true, but top-down is not most conservatives’ view of how the world should be run. In fact, Table 1’s matrix should probably be at least three dimensional, with a vertical axis for political institutions. When he was Alliance leader, Preston Manning always argued that Canada’s fault-lines ran three ways: social, fiscal and constitutional. On this fault-line the Alliance and the Martin Liberals probably have more in common with each other than with the Chrétien Liberals.

While still in the “fiscally conservative, socially paternalistic” cell of the matrix, it might be worth mentioning that I would not expect the Alliance to be very aggressive in advancing its social agenda. They presumably would repeal many of the more touchy-feely practices of Corrections Canada and see to it that convicts spend a greater proportion of their possibly longer sentences behind bars, but, despite what the federal Liberals said about them during last fall’s election campaign, I doubt they would restrict access to abortion or curb the rights of homosexuals.

Table 1
All-government revenue, Canada, 1961-99



And if the Supreme Court were to authorize gay marriages, I would be surprised if the Alliance used the notwithstanding clause to over-ride it. (I would also be surprised, of course, if they did not appoint more-conservative judges.)

The only conservatives I have put in the “fiscally paternalistic, socially paternalistic” cell are High Tories, such as those who write in *The Spectator* every week. Many of its contributors, who are British High Toryism’s leading lights, show no great love of the market—although they certainly would not replace it holus-bolus with state monopolies: They prefer many centres of power. (See Andrew Gimson’s “Tories: Don’t be slaves to the free market,” *The Spectator*, 26 August 2000. Gimson is the magazine’s foreign editor. Its publisher, Conrad Black, I would also categorize as a High Tory.)

Neither do High Tories exhibit any real reluctance to legislate morality, or at least try to. (All law, they would say, is an attempt to legislate morality.) As for public matters not involving morality, John A. Macdonald’s kind of Tory clearly did not shrink from government action when the market was wanting—as in the case, most famously, of the railway, which unfortunately became the icon and template for subsequent Canadian policy-making—including several railway disasters, from which we should also have drawn instruction, but did not. There may not be many Canadian conservatives who would publicly own up to being happy practising both fiscal and social interventionism, but many Red Tories clearly have no aversion to large-scale govern-

ment. Nor do social democrats, not to mention New Democrats, who are in their way the Highest Tories of all.

If there are as many kinds of conservative as the chart suggests, which ones exactly are the “neo-conservatives.” The Harris Tories probably get that label most often, but, as mentioned, are determined centralizers, which seems utterly inconsistent with core conservative principles. The Klein Tories are also frequently referred to as neo-conservatives, but after dramatic fiscal retrenchment in their first years in office, have recently been very generous in increasing public expenditures. My having included capital-L Liberals in the chart (mainly for purposes of illustration, in fact) may have

suggest that “we are all conservatives now.” That was not the intention. In fact, my thesis is that very few of us are true conservatives.

What is a “true” conservative? To my mind, someone who believes, with the libertarians, though perhaps not with such consistent ruthlessness as they, that, in virtually all domains, government should do less. Certainly, when the term “neo-conservative economic policy” is used smaller, less activist government is generally what people have in mind. On the social side, neo-conservatives may be much more activist than live-and-let-live libertarians, but in economic policy, they presumably favour minimalism. Less is not more; less is less, and that’s good. As government goes, small is beautiful.

Using this definition, *has* neo-conservative doctrine triumphed in Canada? Hardly. Will it prevail? I very much doubt it.

My first piece of evidence is tax rates. The Canadian Taxpayers’ Federation was founded in 1991. To hear the CBC, a tax revolt has been underway since and we have all suffered the consequences—principal among them, of course, what we are as bed to believe is a vastly reduced budget for the CBC. And yet where do Canadian taxes stand after this decade of neo-conservative pillage? As a share of GDP, as Figure 1 shows, they have never been higher. That bears repeating: According to the latest available OECD data, Canadian taxes are at an all-time high. The chart does not go back past 1961, but in fact not even in World War II were Canadian tax rates as high as they are today.

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That said, there is universal agreement among public finance economists that aggregate tax ratios are not very informative about the extent of government involvement in an economy. What counts, as Nick Rowe pointed out in an article in last September's *Policy Options*, is the net effective tax rate at the margin, where "net" includes the effects of both taxes and public expenditures. For example, a family allowance programme delivered through cash payments financed by taxes will show a larger government than one where the allowance is given in the form of a tax credit.

On the other hand, in some circumstances the aggregate tax ratio probably does contain useful information. If there has been no systematic shift from tax credits to cash payments over time, then an increase in tax revenues as a ratio of GDP probably does indicate an increase in the net effective tax rate. And if there is a shift in the opposite direction, from cash to credits, as was the case with family allowances in the early 1990s, an increase in the aggregate tax ratio almost certainly means an increase in the effective marginal tax rate.

Ideally, we would have estimates of the kind of marginal effective tax rate that Nick Rowe wrote about for all income classes, for all years, past and present, and for all countries with which it is natural to compare Canada. Unfortunately, such data series, which require comprehensive knowledge of tax and social expenditure policies and are therefore very hard to construct, do not yet exist. In their absence, we must make do with imperfect substitutes.

In a 1998 paper for the C. D. Howe Institute, James Davies of the University of Western Ontario estimated the average marginal effective tax rate paid by Canadians, calculating the average first by weighting it by the number of taxpayers and then by the number of dollars exposed to it. He began by looking only at the effect of income taxes. The average marginal rate of income tax, weighted by taxpayers, he put at 21 per cent in 1994. Weighted by income, it was 36.5 per cent. Both numbers represent substantial increases since the 1950s. (The income-weighted average marginal tax rate had been 12.2 per cent in 1950.) Davies then went on to consider the effects of other taxes, including the usually unintended tax imposed by the clawbacks of social benefits. Adding these in brought the taxpayer-weighted average marginal effective tax rate to 44 per cent and the income-weighted number to 51 per cent.

None of this is news. Quite the contrary, there is now widespread recognition that marginal effective tax rates over 50 per cent, and sometimes substantially over 50 per cent, are not at all uncommon in Canada today. It is also increasingly understood that such high rates of tax are not exclusively or even primarily paid by the highest-income Canadians. In fact, people in the highest income ranges usually see their marginal effective tax rates max out at the highest statutory tax rate: They are beyond clawbacks. Those in the middle and lower ranges of income, by contrast, face the consequences of cascading clawbacks of social benefits. The effect of such clawbacks was the main reason the federal government decided to withdraw its proposal for an income-tested Seniors Benefit, which would have taken marginal rates in some income brackets well over 60 per cent. That we prudently declined to enter the tax stratosphere does not of course mean neo-conservatism has broken out all over.

The economic costs of such high rates of taxation naturally are a matter of dispute. Estimates of the supply elasticities of effort and investment vary. On the other hand, the commonplace theoretical result that the efficiency cost of taxation increases with the square of the tax means that even with relatively small elasticities the marginal costs of these taxes can be very high. This is especially true with high-income surtaxes, as the University of Alberta economist Bev Dahlby found in a 1993 study, also for the C. D. Howe Institute. He calculated that, under not very extreme assumptions about the supply elasticity of effort, a number of provinces' high-income surtaxes very likely put them on the wrong side of the Laffer Curve: Raising them further would bring in less revenue, not more. In his C. D. Howe paper, James Davies calculated excess burdens running at 45 cents per dollar of revenue raised and estimated that had the Seniors Benefit gone through, this would have risen to 58 cents on the dollar, once the Benefit clawbacks were combined with the new CPP/QPP premium rates.

The non-economic costs of such taxes may be even more serious. When all taxes are included, income taxes, property taxes, school taxes, sales taxes and so on, my own average tax rate—my *average* tax rate—is greater than 50 per cent. In fact, my average tax rate is now virtually the same as my marginal tax rate. Many people at my income, which is above average, but hardly puts me in the plutocracy, are in the same posi-

tion. Hard-working people paying more than half their income to government have a tendency to think, when solicited by charitable institutions of one kind or another, or even when confronted by scenes of obvious economic hardship, "I gave at the office"—or, as Scrooge would say if he were alive now, "Are there no social workers?"

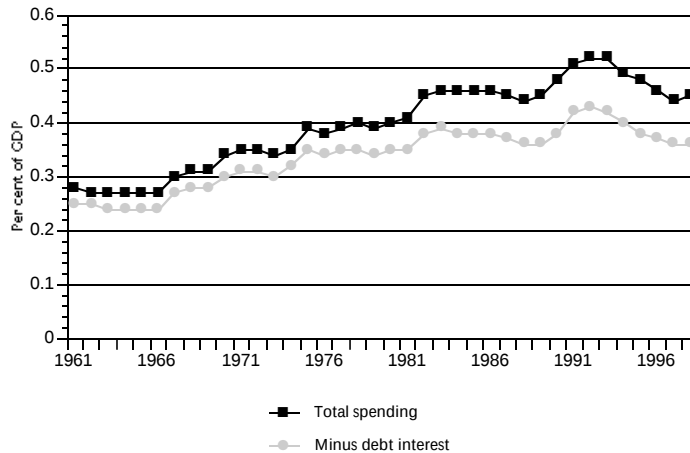
Thus do high taxes reduce "social cohesion," the maintenance of which is the Left's latest rationale for large government. If such cohesion requires that citizens not feel abused by the social order, that presumably is just as true for high-income citizens as for the poor. The feeling that, with all that it takes from us, government should see to our social problems may be one reason why Canadians give just \$C4.5 billion a year to charity while Americans give \$US200 billion. High marginal tax rates may create a price incentive to engage in deductible charitable acts, but high average tax rates create an offsetting income effect.

The point here, however, is not to debate the costs of high taxation but simply to stress that while a tax revolt may be on the way in Canada, it clearly has not arrived yet. To repeat, tax revenues are at an all-time high as a ratio of GDP. Had the supposed neo-conservative revolution been even half-way successful, this would not be the case.

It is true, as Figure 2 shows, that, unlike taxes, public spending is no longer at an all-time high. As a share of GDP, it peaked in 1992 and 1993 at 52 per cent. (The previous record had been 1944, when, while liberating Europe, we spent just over 50 per cent of GDP through the public sector.) By 1998, we were spending "only" 45 per cent of GDP through the public sector. John Kenneth Galbraith wrote in the 1950s about private affluence amid public squalor. At that time public expenditures were less than 30 per cent of GDP. I suspect even Galbraith would have trouble categorizing 45 per cent GDP as public squalor.

It will immediately be argued that this total includes debt interest payments, which reached 10 per cent of GDP in 1995 and were still running at around 8 per cent of GDP at the end of the 1990s. That is true, of course. Public expenditures on real goods and services and on non-

Figure 2
All-government spending, 1961-1999



interest transfers were therefore substantially less than total public spending, and they experienced their sharpest drop over the entire almost-40-year period during the early 1990s. But note that there have been other periods of decline in this measure of government—the early 1960s, for example, and the early 1980s, also periods of recovery from recession—and that these declines eventually ended and were followed by increases, usually associated with a new recession, that took spending to a still higher plateau. Whether the decline in the expenditure share of GDP observed in the 1990s is permanent therefore depends very much on what happens in the next recession. In fact, by the second half of the decade the decline seemed to be over, as spending ticked up again.

Taking the two tables together, what appears to have happened in the 1990s is that a large debt build-up created a massive interest burden that was absorbed by a mild increase in taxes and a more substantial reduction in programme spending. Whether this constitutes a "neo-conservative revolution"—in the sense of a permanent change in Canadians' attitude toward the appropriate role of the public sector—obviously remains to be seen. If the interest burden declines over the next few years and the money that no longer has to be spent on debt service goes almost exclusively to tax reduction, then we will indeed have observed a significant—that is, a 5- or 10-point—reduction in the relative size of government in Canada, though even that would hardly constitute the withering away of the state that the Left commonly invokes, or even a reduction to below its importance in the 1970s—hardly an era of

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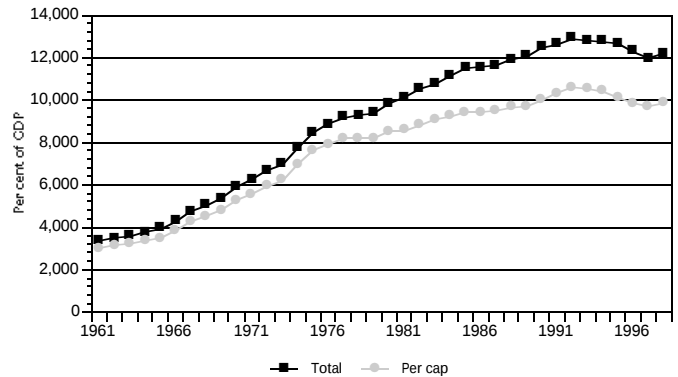
Dickensian privation in the public sector. For what it is worth, my own guess is that there has not been a fundamental change in Canadians' view of the state and that in the long run programme spending will win out. For the moment, of course, guesses are all that is possible.

It is an interesting curiosity that most of those who favour using the surplus to reduce public debt hail from the conservative side of the political fence, and that a prompt reduction in the debt is what would create the possibility that interest payments would be turned into new spending. Perhaps debt hawks feel that if the political war on the debt can be won, then the war after that—to turn interest payments into tax cuts—is also winnable. Perhaps. Though perhaps not: When the deficit got high enough, reducing it received wide, multi-partisan support. The cause of reducing the debt may potentially rally the same sort of campaign: At least some people in all parties are willing to view debt reduction as a moral question involving the present generation's relationship with its children. But once that campaign is over, I doubt whether the campaign to reduce taxes will have such widespread appeal. And, of course, there are many more net recipients of public redistribution than there are contributors to it, even if the payers tend to be more active politically.

Figure 3 shows the course of per capita, all-government public expenditures since 1961, expressed in 1992 dollars. Despite a decline between 1991 and 1996, we are still above the levels experienced in all of the 1970s and all but the last years of the 1980s. To be sure, it would be interesting to compare the evolution of this series with the changing demographics of Canada's population. Per capita spending may have fallen as per capita need has risen. On the other hand, while the very young and the very old are the principal users of public services, and their combined weight in the population will soon begin to increase, we are for the moment in the baby-boomers' most productive and therefore presumably least dependent years. And yet total public spending per family of four is almost \$50,000 a year, and total programme spending almost \$40,000 per year.

Does the flattening out and even decline in this series in the first half of the 1990s constitute a neo-conservative revolution? In view of the fact

Figure 3
Per capita all-government spending (\$1992)



that, on average, people's private incomes largely stagnated over this period, it is hardly alarming that their public incomes did not grow at the rate to which we had all become accustomed in the three previous decades. Nor, in view of the genuinely alarming increase in public debts, was a degree of austerity surprising or illegitimate. Quite the contrary.

But neo-conservatism is a state of mind as much as a set of ledger entries. Have Canadians undergone a change of heart regarding the appropriate role of the market in their society? It seems to me not. Perhaps the best example of that is the mid-1990s reform of the Unemployment Insurance system. The harmful effects in Atlantic Canada of long-term dependence on UI are as close to a proven fact as social science gets. And yet, in the mid-1990s, with deficits running over \$20 billion a year, and after extensive controversy within the Liberal caucus, the best that could be done in terms of discouraging repeat use of UI was to impose a one percentage point penalty for every 20 weeks of UI drawn over a five-year period, with an upper limit of five points. One hundred weeks of UI is essentially two years' worth. Rely on UI for two years out of five and the penalty you faced was a cut in benefits from 55 per cent of your weekly wage to 50 per cent. In the United States during this same period, a Republican Congress, with the acquiescence and at times explicit approval of a Democratic President, was imposing a lifetime ban—a *lifetime* ban—on access to welfare by people who used it more than five years in total.

And yet even that small penalty for repeat use of UI proved too harsh for Canadians. Having suffered serious losses in Atlantic Canada in the

1997 federal election, the federal Liberals decided last September, just before calling the election, to drop the “intensity rule.” Correlation does not necessarily imply causality, but two months later their fortunes improved greatly in Atlantic Canada—and the rest of the country failed to rise up in protest against this restoration of the *ancien UI régime*. It is true that some small pieces of the reform survive. You still cannot get EI (the name change remains) if you quit, and eligibility is still somewhat more difficult for new entrants to the labour market. But any and all talk of moving the system to pure insurance principles is gone. Even the leader of the Canadian Alliance, the supposed Mongol horde of Canadian politics, announced during the election that he did not intend to change EI. A conservative is bound to ask: “Is that all there is?”

I don’t want to be completely blinkered. There have been some notable changes in outlook in Canada. The Canada-US Free Trade Agreement was negotiated and approved in a federal election (even if it has had majority support in the polls only for a very few months before and after the 1988 election). NAFTA also made it through and the WTO, too, in 1995, though no further trade deals have, and, given the current feistiness of anti-globalization activists, none seems likely to.

Deficit reduction was a success, though believing the country could not sustain a \$45-billion deficit hardly qualifies a person as bred-in-the-bone neo-conservative. The same is true for debt reduction: When the all-government net debt is over 100 per cent, and the country is not at war, very few people will argue the debt should not come down. It is curious that we went from concern about deficits running at over 10 per cent of GDP to apparent agreement that we should not run deficits at all any more. But zero is an obvious (if not necessarily optimal) focal point. And even traditional Keynesians, who believe in balancing budgets over the business cycle, would probably agree that, given the recovery’s current age, we probably should have been in surplus in 1997, 1998 and 1999.

The idea that the government should be responsible for the production of purely private goods such as airplane trips, gasoline, railway transportation, and television programming is more under challenge than it used to be. There has been considerable progress in privatization—thanks in large part to Doug Young, whose defeat in the 1997 election is, for the average politician, chilling evidence that many voters still do not

approve such changes. (The same conclusion will be drawn even if his demise is thought to have had more to do with the UI reforms than his halving of the Ministry of Transport’s budget.)

And yet ... the CRTC does still hand out licenses for television services. Spectrum scarcity is gone, but the regulatory melody lingers on. Ryerson’s Matthew Fraser did a brilliant and courageous piece in the *National Post* last fall, naming names on which firm would get which license, and which commissioner would swing which way on which votes, and why. The former head of Teleglobe Canada told a C. D. Howe Institute lunch crowd last year that the way business used to be done in his industry, you made your submissions to the Commission, you did all the lobbying you could and then—he was speaking in French but the following phrase appears here as it did there—“On est riche! Act of God.” God, of course, had nothing to do with it, as I’m sure the Auditor-General would confirm. In the TV industry, rent-seeking is still the way of the world. Acts of commissioners, or ministers, or other regulators—still abound.

The airlines were deregulated, admittedly, but are in the process of being re-regulated, since the federal government refuses to encourage competition by letting foreigners in. Ontario does now have a user-pay superhighway, though only one, but New Brunswickers rejected the idea—decisively—in their last provincial election. Private provision of municipal water services is not widespread, is controversial wherever it is proposed, and suffered an obvious setback—for no good reason, since the private lab reportedly did its job—as a result of the Walkerton tragedy.

In other cases, the public seems persuaded of the virtues of *laissez-faire*, but somehow the change never takes place. There can’t be many people outside CUPE who sincerely believe alcohol must only be sold by governments, and yet privatization of the liquor business continues at a glacial pace, where it continues at all. Two other examples from Quebec: In my home province, margarine still—at the dawn of the 21st century—must be coloured differently from butter. There is all but universal recognition—dairy farmers excepted—that this is idiotic, and yet the regulation remains. Similarly, though the Blue Laws have been dramatically reformed, grocery stores that are open on Sundays are still restricted to having only four employees, with the result that check-out lines are discouragingly long if you are a customer, gratifyingly long if you are the owner of a *dépanneur*—our term for the small

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There was a massive new regulation of the labour market in the 1980s and 1990s. Pay equity and employment equity have forced businesses to undertake micro-regulation of their activities so as to fend off bands of marauding lawyers from human rights commissions and ministries of justice.

corner store that is the intended beneficiary and indefatigable defender of this rule. If there really had been a neo-conservative revolution, if Canadians truly did relish “a never-ending scrabble for free-market survival,” to quote my friend Jim Stanford, silliness of this sort would long since have been swept away. But it lives on, like the cockroach.

And it is not just a question of old forms of rent-seeking surviving. There was a massive new regulation of the labour market in the 1980s and 1990s. Pay equity and employment equity have forced businesses to undertake micro-regulation of their activities so as to fend off bands of marauding lawyers from human rights commissions and ministries of justice. Just how thoughtlessly this regulation came about can be appreciated by recalling that it was born as the result of a spur of the moment double-dare-you in the 1984 federal leaders’ debate on women’s issues. Leaders who clearly did not understand the difference between “equal pay for equal work” and “equal pay for work of equal value” signed up their parties for the latter. Perhaps 1984 was a little early for neo-conservatism—although Margaret Thatcher had been in office for five years by then, and Ronald Reagan for four—but a country in which appreciation of the market’s virtues was strong (as was in fact the case in this country until mid-century: See Bruce Hutchison’s *The Unknown Country*, 1943) would not have seen important public policies determined in this way.

In areas other than wage regulation, the advent of the *Charter of Rights and Freedoms* has also led to new regulation. Strictly speaking, the *Charter* need not have led to judicial activism, but for reasons Ted Morton and Rainer Knopf describe in their recent book, *The Court Party*, the judiciary has generally taken an interventionist view of its new mandate. This didn’t have to be. In previous eras, as Morton and Knopf point out, judicial activism tilted strongly in the direction of corporate interests—which is why they would prefer that the tool be put away: It’s not strictly clear which way it will be used, and it moves the political system toward zero-sum results, rather than the compromises legislatures typically favour.

Finally, in the case of private goods like education and health care that in this country have traditionally have been supplied by the public sector—if, in the case of health care, 30 years is long enough to be a tradition—I don’t see any serious move toward the neo-conservative ideal

of privatization. Alberta has introduced charter schools, but backed off sharply on private clinics—even though provision, as opposed to production, would have been strictly public. Ontario’s neo-conservative revolution did very little, if anything, to further competition in elementary and secondary education. No federal political party has yet endorsed the privatization of health care or, to the extent that Ottawa is involved, education. It is often argued on the left that *de facto* privatization has been caused by budget cuts—or, more accurately—reductions in the growth rates of budgets, but the point of a neo-conservative revolution would be that governments no longer had to do privatization by stealth. They would propose it proudly in election campaigns and a general public infected by neo-conservative ideology would happily endorse it. Putting it mildly, that does not yet appear to have happened.

What about macroeconomic policies? Has there been a neo-conservative revolution on the macro side? I’ve already talked about fiscal policy. The apparent political consensus that we should not run deficits any longer obviously does not prevent fiscal policy from moving back and forth between bigger and lower surpluses. Since active Keynesianism requires only that the difference between expenditures and revenues move up and down in a counter-cyclical way, not that it be centred on any particular average value, whether positive, negative or zero, active fiscal management is obviously not out of the question—though it remains as difficult a trick as ever.

On the monetary side, it probably would be wrong to talk about a political consensus on such an ill-understood policy tool as monetary policy, but the Canadian economic policy community’s consensus certainly would appear to be that a regime of inflation targets goes a long way to removing uncertainty about the Bank of Canada’s policy from the economic mix. And US experience in the 1990s certainly shows that a desire to keep the reins on inflation is not inconsistent with a high average rate of growth of output. Alan Greenspan admittedly has not been as fanatical about low inflation as first John Crow and then Gordon Thiessen, but it is hard to believe, as is sometimes argued, that the average one percentage point or so difference between Canadian and US inflation rates over the last few years explains the (until recently) sharp difference in the two countries’ labour market per-

Figure 4
Redistribution by quintiles



formance. It is always intriguing, by the way, to see friends of labour argue that the key to higher employment is that the real wage concessions unions will not concede in ordinary bargaining must instead be imposed—as surreptitiously as possible, presumably—by the central bank’s creation of more inflation.

Is a desire to keep a tight rein on inflation a core neo-conservative value? I would argue that it is not. An important school of neo-conservative thought, headed by the *Wall Street Journal* editorial page, argues that the Fed should almost never tighten monetary policy. Admittedly, this is not because the *Journal* favours inflation, but because it believes that so long as output is allowed to grow, inflation will not be a problem. Limitless non-inflationary growth evidently is a real possibility. (The editorial page of the *National Post*, though not necessarily of its *Financial Post* section, seems to feel the same way.)

Much as I would enjoy continuing to elaborate this argument that Canada has not yet undergone a conversion to neo-conservatism, perhaps the reader has seen enough—or will never be persuaded: I do understand it is an idiosyncratic view. So suppose for a moment we accept that there has been a rightward shift in Canadian policy, even a “neo-conservative revolution,” if you will. What has been its effect?

By closing the grants window, a neo-conservative revolution should have brought about a reduction in rent-seeking, yet there is little evidence of that. Lobbying continues apace; indeed, it gives every appearance of still being a growth

industry. If globalization has stripped national governments of much of their power, as is so often claimed, no one seems to have told national politicians, who keep legislating frenetically. Trade agreements have caused tariff revenues to decline as a share of GDP, but companies show little disinclination to ask for special favours. Thus Atlantic Canada gets \$700 million in industrial assistance just months before a federal election, while Quebec’s government continues to hand out subsidies and loan guarantees to all and sundry.

In terms of macroeconomic performance, the 1990s clearly were not a great decade for Canada. There are a number of reasons for that: the decision to reduce the average late-1980s rate of inflation of 4-5 per cent to something closer to zero; the adjustment to the FTA and to a lesser extent NAFTA; the US recession of 1990-91; the sustained attack on the deficit; and the continuing constitutional crisis. One might also mention sagging demand for commodities at various points in the decade. But none of these, not even the attack on the deficit (deficits can be eliminated and government remain large), strikes me as fundamental parts of neo-conservatism. If in the next few years there should be a sustained reduction of taxes, then that would constitute a test of neo-conservatism’s macroeconomic effect.

The most common charge against neo-conservatism is that it has increased inequality in Canada. Inequality may have risen in Canada—marginally—but it is difficult to lay this at the door of neo-conservatism.

Figure 4, downloaded from Statistics Canada’s announcement of 1997 income redistribution numbers, shows the pre- and post-tax-and-transfer distribution of income. For ease of typing, let’s just call this pre-government and post-government, even though government also provides important amounts of redistribution in kind. (The chart, by the way, is taken from *The Daily* for July 26, 1999.)

The one thing we do know about Canadian income distributions is that, post-government, they have been rock solid for roughly 50 years. In fact, we now have enough data to posit an iron law of income distribution in Canada: The

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quintile ratios of post-government income almost never change. As is evident from the chart, the top quintile always ends up with five times what the bottom quintile gets. Studies that go back to the 1950s find essentially the same result. The tax-and-transfer system does evidently iron out variations in pre-government incomes. The current top-to-bottom ratio before the influence of taxes and transfers is currently above 20, which is down from its peak in the early 1990s, but still above all levels recorded in the 1980s. Eyeballing the chart suggests there is a cyclical component to movements in the pre-government distribution, which rises from 1981 through 1984, and then doesn't rise again until 1989 through 1992. Since then it has declined slightly.

What to make of this picture? Despite the supposed rise of neo-conservatism, there is actually *more* redistribution in the 1990s than there was in the 1980s. Governments are getting the quintiles to the same final destination despite their starting out with greater inequality.

On the other hand, some would say there is a need for even more redistribution, since the top quintile is making a substantially higher pre-government income, compared to the bottom quintile, than it did in the 1980s. Two comments seem relevant here:

First, it's not obvious just what the optimal or fair final ratio is. Maybe it is five—that certainly seems to be revealed Canadian political preference—but maybe it's more than that. Canadians who earn only a little more than the average income and yet have already reached the top rate of income tax are likely to believe that this is a very redistributive country. It might well do better with less redistribution. This could be true even if some of its citizens would do worse as a result, but there is at least the possibility that every one of its citizens would do better: Even when expenditures are deflated by PPP exchange rates, let alone current exchange rates, the US now spends more per capita on *publicly-delivered* health care than we do, and does so with significantly lower tax rates.

Second, there is the question of how much of the pre-government distribution is “endogenous” to the very significant redistribution that is done. In other words, to what extent does supplying redistribution create a demand for it? Throughout the 1990s, stories periodically made headlines that reported the ratio of average earnings among the top centile of earners to average

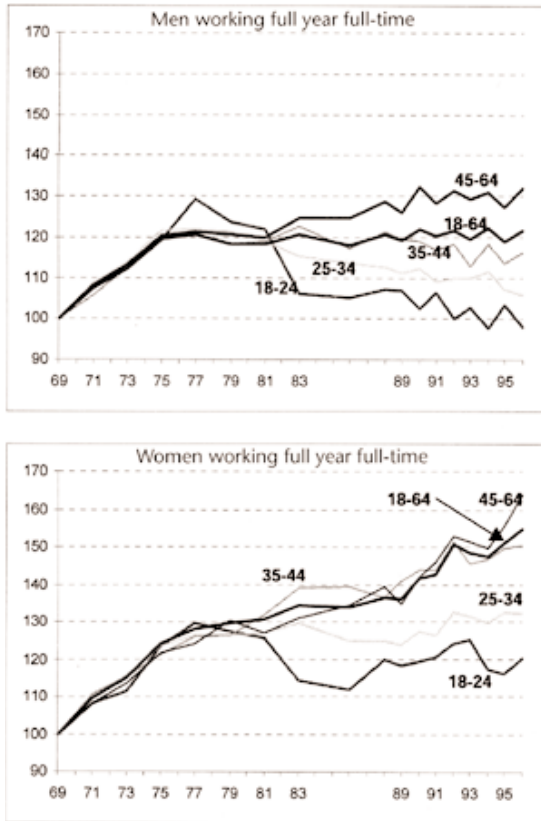
earnings in the bottom centile. The ratio was usually in the hundreds and gave rise to anguished tut-tutting about the evils of, yes, neo-conservatism. Someone invariably characterized the ratio as “obscene.”

In fact, if you looked at the absolute dollar pre-government earnings of the bottom group in these comparisons, it was usually just a few hundred dollars, a number that could be that low only because of the existence of a very generous government. If our governments ceased all redistribution, my bet is that the bottom one per cent of the income distribution would earn considerably more than just a few hundred dollars. They would have to. You simply cannot live in Canada on only several hundred dollars. Either the market or private charity would replace whatever income the government withdrew. The appropriate reaction to reports that the top centile earns hundreds of times more than the bottom centile is: With division by zero what else would one expect? What makes it possible for substantial numbers of people to earn essentially nothing in the market is the fact that governments put a floor under their income. Just as UI creates more unemployment, income redistribution almost certainly creates more recorded pre-government poverty.

This is not to claim, however, that what people get post-government determines the exact shape of the pre-government distribution of income. So what does account for the rise in inequality in the pre-government distribution of income? And can fault for it be laid at the door of neo-conservatism?

Again, two comments seem relevant. First, rising inequality is occurring throughout the income distribution, in virtually all demographic groups, and even within very finely-defined demographic groups (for example, male, university-educated, 35-45). Studies that divide the population into several dozen socio-economic cells find that the majority of the increase in inequality is due to “within-cell” variation rather than “between-cell” variation: Inequality is rising even among people whose observed economic, social, and demographic characteristics are similar. At the same time it is found, not surprisingly, that many of the proximate causes of income inequality—particularly hours worked in a week—also vary substantially within cells. Otherwise similar people apparently are conducting their lives quite differently, with some working relatively few hours a week and others working much, much more. The data don't say how

Figure 5
Riddell's chart on earnings distributions



much of this variance is voluntary, but there is no reason to assume that it is all strictly involuntary.

Second, increasing inequality across families is also unsurprising. Two-earner families in a given demographic group can reasonably expect to make more than single-earner families, especially if the single earner is a single parent. The proportion of single-parent families in Canada has roughly doubled in the last two decades. It would be hard to fault neo-conservatism for this, though no doubt some will try. The greater incidence of family breakup probably has more to do with the liberalization of divorce laws in the late 1960s, and neo-conservatives were not responsible for that—though a famous quasi-libertarian, Pierre Elliott Trudeau, was.

Finally, on the question of timing, I'd like to remind people of a chart that appeared in Craig Riddell's presidential address to the Canadian Economics Association in 1999, reproduced here as Figure 5. Professor Riddell plotted the relative (pre-government) earnings of a half dozen or so demographic groups from 1971 through the mid-1990s. They move in lock-step

through the 1970s: There is almost no variation among them; the different lines that plot their course make up a tightly wound rope. But roughly at the turn of the 1980s (well before the capital-C Conservative revolution of 1984) the rope frays suddenly and its separate strands spread out. By the late 1980s they are about as far apart as they are in the 1990s. What caused this sudden dispersion of market earnings? Not something that happened in the 1990s (unless economic agents truly are forward-looking—and in fact it's not clear that very much that was different happened in labour markets in the 1990s: See Alice Nakamura, Garnett Picot, and Andrew Seisz's article in the July-August issue of *Policy Options* "Were 1990s labour markets really different?" to which their answer is a resounding "No!") Did neo-conservatism begin in Canada in 1980 or 1981? I very much doubt it.

Has neo-conservatism failed? I am afraid so. Not in the sense that it was tried and found wanting, but in the sense that it never took. What may appear to have been neo-conservatism was in fact a traditional, "common sense" reaction to the fiscal crisis of the early 1990s. A political consensus did emerge that deficits had to be reduced. With aggregate deficits approaching ten per cent of GDP it could hardly have been otherwise. This introduced a period of fiscal austerity, but although that experience seems to have created a consensus that large deficits and rising debt loads must be avoided in future, there is nothing like a consensus on what should be done with the interest saved as (and now, in early 2001, it must be said, if) the debt and the debt ratio continue to decline. The country's governing party is officially committed to splitting the difference. The party that was most committed to reducing the size of government now seems convinced it must moderate its message in order to succeed electorally. My bet is that in 25 years we will look back and see a discontinuity in all the major tax and spending indicators in the 1990s, followed by a resumption of their previous growth path toward that decade's end, with the result that neo-conservatism will be regarded as, alas, an historical curiosity.

My hope, of course, is that this is just Canadian pessimism showing.

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