Jim Flaherty's legacy of failure iPOLITICS INSIGHT

By Scott Clark and Peter DeVries | Mar 20, 2014 8:59 pm | 3 Comments

When Jim Flaherty announced he was stepping down as minister of Finance earlier this week, he'd held the job for eight years — only a few months shy of Paul Martin's term in the job.

*More from **Scott Clark and Peter DeVries** available **here***

Take a look at photos taken of Mr. Flaherty and Mr. Martin the day they took the post and compare them with how they looked the day they left. Minister of Finance is a gruelling, 24/7 job — the pressures are relentless and they take a physical toll. Anyone who does it — especially for eight years — deserves the respect and thanks of all Canadians.

No doubt there will be comparisons made between Mr. Flaherty and previous finance ministers — particularly Mr. Martin under Jean Chretien, and Michael Wilson under Brian Mulroney. Both Mr. Wilson and Mr. Martin established

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credible policy legacies during their tenures.

Mr. Wilson introduced major reforms to the personal and corporate income tax systems, replaced the federal manufacturers' sales tax with the Goods and Services Tax, privatized several Crown corporations and helped negotiate NAFTA. These were major structural reforms which had positive impacts on economic growth, especially over the medium and long term. Many questioned the timing of these initiatives, given the economic and fiscal environment of the day. But he persisted, believing in their long-term economic benefits.

Mr. Martin averted a major fiscal crisis, eliminated the deficit in three years, reduced the government's debt by $80 billion, strengthened the Canadian banking system and reformed the Canada Pension Plan. With the deficit eliminated and with growing budget surpluses, he also implemented major structural reforms — especially in education, research and innovation and health care. He also put transfers to the provinces on a more sustainable basis and began the progress of lowering personal and corporate income taxes in the 2000 budget.

Both men were lucky. They both worked for prime ministers who trusted their judgment and delegated to them almost full responsibility for developing fiscal policies and preparing budgets.

Mr. Flaherty was not so lucky. His work was made more difficult by the fact that Prime Minister Stephen Harper didn't allow him the policy independence a finance minister must have to do the job well. This was also the case for bureaucrats in his department, who must provide the independent analysis and research on which a finance minister depends.

An intrusive, meddling prime minister made Mr. Flaherty's job very difficult. With greater policy independence and responsibility, Mr. Flaherty's legacy would have been much stronger — as would the record of the Harper government. So Mr. Flaherty's policy legacy does not put him in the same league as Mr. Wilson and Mr. Martin.

In analyzing Mr. Flaherty's record, journalists tend to point to his management of the 2009-10 recession and his absolute commitment to eliminating the deficit that resulted. They applaud his steady hand on fiscal policy.

But what did Mr. Flaherty actually *do*? We should remember that Mr. Flaherty inherited a $14 billion structural surplus from the Liberal government. Within two years, he had wiped it out with a two-point cut in the GST, which cost the federal treasury $14 billion annually. This was a political decision that went against the advice of virtually all economists — including the ones in the Department of Finance. It would end up costing the government $115 billion between 2006-07 and 2015-16 — which forced Mr. Flaherty to impose a policy of expenditure restraint.

In the fall of 2008, both Prime Minister Harper and Mr. Flaherty denied that Canada was going into

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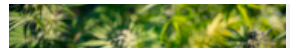
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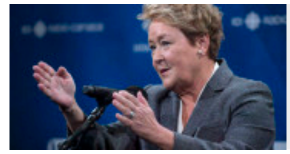
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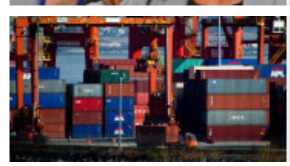
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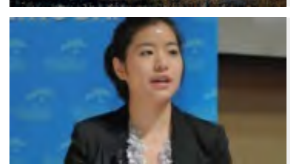
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recession. They also promised that Canada would have surpluses as far as the eye could see. No Finance minister of has *ever* been that wrong.

With greater policy independence and responsibility, Mr. Flaherty's legacy would have been much stronger — as would the record of the Harper government.

After Prime Minister Harper returned from an emergency G-20 meeting, at which there was unanimous support for temporary stimulus spending, Mr. Flaherty was forced to drop his conservative fiscal principles and become a 24-month Keynesian. The government adopted the largest temporary stimulus-spending and tax reduction package ever.

He introduced spending increases of about $45 billion over the period 2009-10 to 2011-12, along with personal income tax reductions of over $3 billion per year. This amount of 'temporary stimulus' was well above what the International Monetary Fund recommended. It accounted for more than half of the $55 billion deficit in 2009-10 — our largest federal deficit ever — and nearly half of the $33.4 billion deficit in 2010-11.

Mr. Flaherty has constantly reminded Canadians that Canada weathered the economic downturn well, compared to other G-7 countries, because of the government's strong fiscal situation and Canada's stable banking sector. But the Conservative government had nothing to do with either factor. It was the Liberal government which created a sustainable fiscal structure — the federal debt-to-GDP ratio had fallen from a post-war high of 67.1 per cent to 34.1 per cent in 2005-06. By 2008-09, it had fallen to 28.2 per cent, the lowest among the G-7 countries. The Liberal government also strengthened the banking sector when it rejected bank mergers and increased bank capital requirements in 1998.

Nevertheless, by the time of the G-20 meeting in Toronto in November 2010, Mr. Flaherty and Prime Minister Harper were eager to return their conservative ideology of deficit-cutting as the solution to all economic problems. From then on, the *only* thing that would matter would be the elimination of the deficit, despite the fact that the economic recovery was still quite fragile.

Mr. Flaherty believed in the economic theory of "self-levitation" — an old conservative notion that has been proven wrong over and over again. According to this theory, if the government cuts spending and shrinks, the private sector automatically rushes in to fill the gap left by the government. Surprising no one — except perhaps Mr. Flaherty — self-levitation didn't work.

Mr. Flaherty failed, in his eight years as minister, to understand that the job he took on goes beyond merely eliminating the deficit, and that fiscal austerity without economic growth is a recipe for slow growth and high unemployment. His record of fiscal and economic management has been a failure.

During his time as minister of Finance, the government recorded surpluses only in 2006-07 and 2007-08. Debt increased by $160 billion, the country recorded record trade deficits, investment

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growth stalled, economic growth declined year after year, the unemployment rate remained stuck at seven per cent and the labour force participation rate declined, as did the percentage of the adult population employed.

But disappointment with Mr. Flaherty's record goes beyond his management of the government's budget and the economy. It goes also to the basic rules of good institutional governance. He was responsible for the growing lack of transparency in federal budgets, never seen in the previous three decades. Information and data that had always been available to the public in the past became unavailable under the umbrella of 'Cabinet confidence'. Research and analysis done in the Department of Finance was never made public for the same reason.

In his eight years in the job, Mr. Flaherty fought constantly with the Parliamentary Budget Officer and refused to provide data to which the PBO was entitled. To this day, no one knows what programs and services have been cut as a result of actions taken in the budgets since 2010.

Instead of debating the PBO, he chose to ignore him. In the 2007 budget, he promised to publish long-term fiscal projections on the fiscal sustainability for both the federal government and the total government sector. He never did. Research undertaken by the PBO was criticized. It was not until December 2012, shortly after the Office of the Auditor General highlighted Mr. Flaherty's 2007 budget commitment, that the Department of Finance finally began to publish long-term fiscal projections — but only for the federal government. To no one's surprise, the department's results closely mirrored those of the PBO.

Instead of working with the PBO, Mr. Flaherty stooped to the level of personal attacks on the first Parliamentary Budget Officer, Kevin Page, calling his work "unreliable, unbelievable, and incredible". He could have been talking about himself.

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Mr. Flaherty and the prime minister also showed contempt for Parliament and Canadians with their enthusiasm for mammoth budget omnibus bills, designed to avoid in-depth parliamentary review of legislation. In both the 2012 and 2013 budgets, omnibus bills stretching to 1,000 pages were used to change legislation referred to only vaguely — or not mentioned at all — in the budget. Mr. Flaherty had a responsibility to protect the integrity of the budget by refusing to table omnibus bills. He didn't.

In tax policy, he failed to address issues of tax fairness and after-tax equity. Mr. Flaherty cut taxes — the wrong ones. He cut the GST, which was a ghastly mistake. He introduced a whole slew of special tax breaks for targeted groups, which in no way contributed to tax fairness or tax efficiency. They simply added greater complexity to an already complex tax system at a fairly substantial fiscal cost. His only positive tax change was the introduction of the Family Caregiver Tax Credit.

Recently, Mr. Flaherty came to realize that the Conservatives' 2011 political promise to introduce income-splitting for families with children under eighteen would be a bad use of modest surpluses. Mr. Flaherty is, of course, absolutely right — income splitting is *bad* tax policy. **It would benefit only 15 per cent of Canadian families** — almost half of them households earning more than $125,000.

This put him offside with Prime Minister Harper and some of his cabinet colleagues. Rest assured, this will not be a problem for his replacement, Joe Oliver. Even the Tax Free Savings Account is now being criticized as a benefit directed mostly at high-income Canadians with a potential budgetary cost of almost $10 billion annually. (We're not even going to mention the ridiculous 2011 election promise to extend the fitness tax credit to adults.)

Mr. Flaherty did little to strengthen federal-provincial relations. He didn't like federal-provincial meetings; no Finance minister does. But unlike Mr. Flaherty, previous ministers recognized that these meetings are critical to asserting Ottawa's role in management of the federation.

Mr. Flaherty didn't consult with the provinces before he changed the funding formula for the Canada Health Transfer, or before he increased the age of entitlement for Old Age Security by two years. Agreement with the provinces on the Canada Job Grant took over a year to finalize because of the federal government's refusal to talk to the provinces before announcing it in the 2013 budget. Mr. Flaherty stonewalled requests from the provinces to talk about enhancing the CPP. Ontario is now threatening to go it alone. The last thing Canada needs is a fragmented public pension system.

Internationally, we know little about Mr. Flaherty's contribution to the G-7 and G-20 finance ministers' meetings — apart from his constant hectoring about how everyone should do what Canada has done and cut their deficits. It's noteworthy that there was little recognition of his resignation in the Financial Times.

Mr. Flaherty was held on a short leash by the Conservative government he served. Of course, he was well-schooled under Ontario Premier Mike Harris. He would have done much better in a government that allowed — even encouraged — independent policy analysis. To be effective, a Finance minister must be able to take different internal views on policy issues. Effective Finance ministers actually have control over their department, its policy development and recommendations.

In short, to be good at the job, you have to have a prime minister who has your back. What support Jim Flaherty had from Stephen Harper was apparently running out — and that's why it was time for him to go.

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Scott Clark and Peter De Vries have done all of us a good turn with this truthful factual account.
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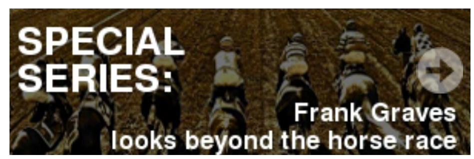

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