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Saskatchewan Prosperity: Taking the Next Step

Jason Clemens, Joel Emes, and Nadeem Esmail

Foreword by Dr. Barry Cooper, Professor of Political Science, University of Calgary

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Editor & Designer: *Kristin McCahon*

For media information, please contact Suzanne Walters, Director of Communications,
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Foreword

Academic comparisons between Alberta and Saskatchewan began well over a half-century ago. In the past, the major issue was to find an explanation for why two fundamentally similar agrarian provinces chose such seemingly different political paths. Both inherited Liberal governments in 1905 when they finally became provinces. Both showed considerable discontent with the fact that, unlike any other provinces in Canada, they had no control over the chief source of provincial revenue, royalties on their abundant natural resources, especially land. Both had serious issues with the National Policy and objected to having to go to Ottawa, cap in hand, to receive budget grants. Both were discontented with the economic position of the railways, the elevator companies, and the grain companies.

And yet, Saskatchewan (with one brief interlude) remained Liberal until 1944 when it took a sharp left turn and elected the first social-democratic government in North America, the Co-operative Commonwealth Federation, predecessor to today's NDP. In contrast, Alberta threw off the Liberals shortly after World War I and began a series of experiments, electing first the United Farmers of Alberta, and then Social Credit, which has been followed by a generation of quite distinct Conservative governments.

With pardonable simplification (for most of the early academic analysts came from far-away places such as New York or Toronto), the early studies spoke easily of left- and right-wing populist responses to the economic disruptions of the Great Depression. Fortunately, the catch-all notion of Western alienation had not yet been invented. Such simplifications are less pardonable today, but they are still being made. More recent conventional analyses of the differences between Alberta and Saskatchewan, or more precisely, of the much better economic performance of Alberta, explain all by referring to the great mineral reserves of the province.

No doubt resource revenues have played a part. It is also important, however, to remember two things. First, even Alberta governments can squander large sums of money and create structural debts that require serious remedies to fix. It happened during the 1980s and early 1990s; it also happened that the government of Alberta took steps in the mid-1990s to fix what was clearly broken. And second, the oil-equals-prosperity school should remember that Alberta's mineral wealth does not end at 110 degrees west longitude, the border with Saskatchewan.

There is plenty of oil and gas in that province, too, along with the most significant uranium and potash deposits in the world, and an abundance of diamonds, sodium sulfite, copper, gold, kaolin, bentonite, coal, calcium chloride, and many other rare and valuable minerals. So long as resources are sitting underground, however, they do nothing for the people on the surface. Alberta is more prosperous than its neighbours in large measure because it has embraced the kinds of policies that encourage prosperity by rewarding initiative and risk-taking, while ensuring that the hand of government is as light as possible.

Of the many merits of this study by Jason Clemens and Joel Emes, probably the most important is to have pointed out that the relatively poor economic performance of Saskatchewan compared to Alberta is a consequences of choices made by their own successive governments. One of the results of government choices in Saskatchewan that has been of direct benefit to Alberta is the out-migration to Alberta of so many young, ambitious, and well-educated former residents of Saskatchewan.

Anyone who attends a football game in either of the two Alberta CFL cities will notice the large number of green Saskatchewan Roughrider sweaters in the crowd, and most of those wearing them live in Edmonton or Calgary. On a whole range of issues, from high public sector employment to an investment-killing tax structure, Saskatchewan has put in place a wide range of incentives for innovative, skilled, entrepreneurial, young people to leave. Not surprisingly, they have responded rationally to those incentives: their hearts may back the Riders, but their heads are at work in Alberta.

One of the differences between the two provinces that immediately strikes an Albertan visiting Saskatchewan is that province's vast range and variety of crown corporations and government enterprises. The phone company, liquor stores, even a bus line are owned by government in Saskatchewan! Many of the tall buildings in downtown Regina and Saskatoon house government-owned businesses. As Clemens and Emes show beyond a reasonable doubt, crown corporations have sopped up a great deal of scarce investment capital in the province that could be employed much more effectively and efficiently in the private sector. Indeed, it is hard to avoid the conclusion that the main consequence of so many crown corporations and government enterprises in the province is that they have done a great deal of harm. Far from being a source of pride, the plethora of crown corporations is properly Saskatchewan's shame.

The other grave structural defect that has hurt the province in countless ways is Saskatchewan's punitive taxation of business. Possibly the worst tax that human beings have yet invented is the capital tax—essentially a tax on investment. The effect of this tax is that before the government permits you to invest and bring jobs and other benefits to Saskatchewan, you have to pay a tax on your investment. It is hard to think of a better reason to invest in Alberta. Other taxes, as Clemens and Emes point out, constitute major disincentives for entrepreneurial activity of any kind. Risk-taking, business development, and innovation, if the tax-system guides your decision, are all unwelcome in Saskatchewan.

Even the darkest cloud, however, has a silver lining, and here, too, there is some good news. As with another recent study of Saskatchewan, *This Year Country*, written by Graham Parsons and published by the Prairie Centre—a new and welcome Saskatchewan think-tank—*Saskatchewan Prosperity: Taking the Next Step* contains optimistic expectations for the province. Saskatchewan is at present at the top of the list of the have-not provinces (assuming that BC has but temporarily joined the ranks of the under-performers) and has the best chance of leaving a group that no government should long wish to belong to.

Clemens and Emes have indicated clearly enough what needs to be done to awaken this sleeping giant. Many of their recommendations are so evident to common sense that their appeal is transparent. Others will carry with them some short-term dislocation, but the beneficial results are as obvious as they are bound soon enough to follow.

—Barry Cooper, Director,
Fraser Institute Calgary Policy Research Centre

Overview

The following is an overview of the findings of this study divided into its four sections: economic performance, government spending and the size of government, government tax policy, and policy recommendations.

Economic performance

The first section of this study assesses Saskatchewan's overall economic performance over the last 20 years. The analysis is based on three broad measures of economic performance: income, labour markets, and investment.

Income performance

Gross Domestic Product

Saskatchewan's aggregate real (inflation-adjusted) GDP growth was 59.9 percent between 1981 and 2000, 16.7 percent less than the national average. Compared with the Prairie provinces, Saskatchewan's aggregate GDP growth exceeded that of Manitoba by 21.5 percent but trailed Alberta's by 43.6 percent.

Saskatchewan's per capita GDP performance was slightly better. Its real per capita GDP now stands at 93.5 percent or $2,151 less than the national average. This represents an improvement; in 1981, it stood at 83.9 percent or $3,861 less than the national average. Saskatchewan's real per capita GDP exceeds that of Manitoba but is substantially less than Alberta's.

Personal Disposable Income

Saskatchewan fares much worse in its personal disposable income performance than in its GDP performance. Between 1981 and 2000, Saskatchewan managed to grow real personal disposable income by only 7.6 percent. This is in stark contrast to the national average of 36.8 percent, Alberta's growth of 34.6 percent, and Manitoba's growth of 18.8 percent.

Saskatchewan's real per capita personal disposable income performance was even weaker than its aggregate performance. The gap between Saskatchewan's real per capita personal disposable income and the national average grew over the 20-year period from $1,011 in 1981 to $2,464 in 2000. Saskatchewan failed to remain competitive with the other Prairie provinces in this measure; in fact, its real per capita personal disposable income now ranks eighth in the country.

Overall, Saskatchewan's income performance is mixed to poor. Saskatchewan's real per capita GDP has improved marginally compared with the national average but still remains below it. More ominously, Saskatchewan's real per capita value of personal disposable income has deteriorated relative to the national average and to its Prairie neighbours. Although the province has achieved some moderate income improvements over the last two decades, Saskatchewan has generally not kept pace with the rest of the country and further improvements are, therefore, required.

Labour market performance

A second measure of economic performance employed by this study is labour market performance, specifically the ability of a jurisdiction to increase employment and decrease unemployment. In addition, we examine the composition of the labour market and inter-provincial migration.

Job-Creation and Unemployment Rates

Saskatchewan has not performed well in job creation. Between 1981 and 2000, total employment grew by 12.5 percent, less than Alberta's 34.3 percent, or Manitoba's 18.1 percent, or that of Canada as a whole, which experienced 32.0 percent employment growth. In fact, the only Canadian jurisdiction that Saskatchewan outperformed on employment growth was Newfoundland.

Paradoxically, Saskatchewan performed quite well with respect to its unemployment rate. Its unemployment rate has been among the lowest in Canada over the last 20 years, consistently below the national average for the entire period.

Explaining what happened

A number of factors partly explain this seemingly paradoxical performance. One factor is population growth. Saskatchewan's population has grown little over the last two decades. Over the 20-year period examined, Saskatchewan's population grew 4.7 percent, ahead only of Newfoundland. Meanwhile, Manitoba's population grew 10.7 percent, Alberta's 31.2 percent, and nationally population grew 24.0 percent.

Another, linked explanation is labour force growth. Saskatchewan's labour force grew weakly over the last 15 years. Since 1985, the growth in Saskatchewan's labour force has been well below the national average, and generally below the rates for the other Prairie provinces, particularly Alberta. In fact, between 1986 and 1990, the size of Saskatchewan's labour force actually declined.

Another strain on Saskatchewan's labour market force is migration. Saskatchewan has experienced a net outflow of residents over the last 20 years, most strongly in the 15 years between 1986 and 2000. In fact, Saskatchewan's out-migration rate is second in magnitude only to Newfoundland.

Equally ominous is that Saskatchewan had the second highest outflow of knowledge workers and the highest outflow of high-income individuals relative to the other provinces. In addition, the ratio of workers to dependents—those under 14 years of age and those older than 65—is worsening; Saskatchewan's dependency ratio is high relative to both the other Prairie provinces and the national average.

The final labour market factor to assess is the division of employment between the private and public sectors. Although the public sector has been cut in Saskatchewan, its size, both compared to total population and total employment, still remains well above the national average. Specifically, Saskatchewan employs 6.5 percent of the population in the public sector compared with a national average of 4.7 percent. Similarly, public sector positions comprise 13.8 percent of Saskatchewan's total employment compared with a national average of 9.8 percent. Clearly, the public sector employs a higher proportion of Saskatchewan's labour than is the case in the rest of the country.

Over the last 20 years, Saskatchewan has had low population growth, the second-worst job creation record in the country, and the lowest labour force growth. In addition, more of its people moved out of Saskatchewan, on average, than any other province except for Newfoundland. In particular, the province seems to be losing its most talented, skilled, and high-income workers. In addition, the province continues to maintain a higher ratio of public sector employees than the rest of the country, and well above the level in Alberta. The only bright spot is the province's relatively low unemployment rate. Together, these factors indicate that Saskatchewan's labour market is relatively weak—and deteriorating.

Investment performance

The third area of performance assessment is investment. This section includes an analysis of Saskatchewan's investment performance and its use of government-owned enterprises or Crown Corporations.

Of the three areas analyzed thus far, Saskatchewan performs worst in its investment-attracting ability. Many of Saskatchewan's economic problems lie in its near complete lack of business development and investment over the period examined.

Business Investment

The last two decades have been dismal for Saskatchewan's net business investment (the private sector's investment in fixed assets after accounting for depreciation). On average, growth in real net business investment shrank by 59.9 percent between 1981 and 1985, decreased by 25.4 percent between 1986 and 1990, and contracted an astounding 145.6 percent between 1991 and 1995.

Real fixed business investments did increase by 30.6 percent between 1996 and 2000 in Saskatchewan. Unfortunately, this increase significantly lagged the level of investments made elsewhere. The Canadian average for the same 5-year period was 151.6 percent. Manitoba recorded an increase in real net fixed business investments of 89.7 percent, while Alberta experienced an incredible 273.0 percent increase. In a ranking of real net fixed business investment in the Canadian provinces in 2000, Saskatchewan ranked third last.

Another way of looking at net fixed business investment is to examine the cumulative per capita value of investment over time. Over the 19-year period from 1982 to 2000, Saskatchewan and Manitoba managed to accumulate $10,635 and $11,133 respectively in real per capita net fixed business investment. This contrasts dramatically with the experience of Alberta and Canada as a whole, which accumulated $34,823 and $27,163, respectively. Thus, Saskatchewan could only accumulate 30.5 percent of Alberta's, and 39.2 percent of the whole country's, real per capita next fixed business investment.

Crown Corporations in Saskatchewan

One reason for Saskatchewan's poor business development and investment record is its relatively high reliance on Crown Corporations, or government business enterprises (GBEs). Saskatchewan has the highest proportion of government business enterprises as a percent of the economy in the country. Spending by Crown Corporations represents 11.7 percent of provincial GDP, an astounding 36.0 percent more than the second-ranked province, New Brunswick. GBE spending in Saskatchewan ranged between 9.8 and 14.6 percent of GDP between 1990/91 and 1999/00. On average, GBE spending in the other provinces is much lower, ranging from 5.4 to 6.2 percent of GDP. GBE spending in Saskatchewan is well above the levels maintained in any of the other Prairie provinces.

One way to look at the impact of GBEs is to consider the number of GBE employees relative to total employment. In each of the 5-year periods examined, GBE employment as a percent of total employment in Saskatchewan was more than twice as large as the provincial average, and larger than any other jurisdiction considered except for the 1991-95 period where Saskatchewan and Manitoba tied. This supports the conclusions reached above that Saskatchewan relies heavily on government business enterprises. That reliance, coupled with the general trend of GBEs undercapitalizing, having lower productivity, and allocating their resources less efficiently, implies dramatic economic consequences for Saskatchewan.

Investment Conclusion

Saskatchewan lags behind the whole nation, including the other Prairie provinces, in business investment. In addition, the structure of the Saskatchewan economy is significantly tilted towards government business enterprises and thus government intervention. This model of business development has not served the province well either in terms of income growth, labour market development, or business investment.

Economic Performance Conclusion

Over the last 20 years, Saskatchewan's economic performance has been mixed to poor, with the latter more characteristic of its overall performance. In per capita GDP growth and unemployment rates, Saskatchewan's economic performance is mixed. However, in such areas as GDP growth, personal disposable income (both aggregate and per capita) growth, employment growth, out-migration, reliance on the public sector, investment performance, and reliance on and use of Crown Corporations, its performance is predominantly poor. Clearly, the model of business development based on government business enterprises has not served the province well in terms of aggregate economic performance. Although the province has seen some mild improvements, it has a long way to go if it is to achieve its full economic potential.

Government Spending and the Size of Government

This section evaluates the size of government in Saskatchewan based on government spending. It measures government spending by examining both provincial-only and consolidated provincial-municipal spending. In addition, it uses three measures to gauge the extent of spending: aggregate, per capita, and compared with the size of the economy. Each method generally indicates that the size of government in Saskatchewan has improved, but that additional restraint is required to achieve optimally-sized government.

Province-only spending

Aggregate Government Spending

Total real government expenditures in Saskatchewan increased significantly during the 1980s. The province increased real government expenditures by 31.9 percent between 1981/82 and 1990/91 compared with a national average of 30.6 percent, and increases in Manitoba and Alberta of 39.5 percent and 15.0 percent, respectively.

In the second decade, Saskatchewan showed substantial restraint. It was the only Prairie province to actually decrease real government expenditures over the decade—which it did by 9.9 percent between 1990/91 and 2000/01. Real spending in Canada as a whole increased 10.3 percent, while real spending in Alberta increased 6.4 percent.

Per Capita Government Spending

Saskatchewan shows a clear and distinct trend in its real per capita spending: there is a steady increase in spending up to the 1991/92 peak, after which it declines until 1996/97 when the trend again increases, but marginally. Saskatchewan, along with Alberta, most dramatically reduced its real per capita spending in the 1990s. Saskatchewan spent $6,736 per capita in 2000, $176 above the national average, but $785 below its 1990/91 spending level.

Government Spending as a Percent of GDP

Government spending as a portion of the economy had increased quite dramatically for all three Prairie provinces in the decade prior to 1990/91. However, in the decade following, Saskatchewan

ended the period at essentially the same level where it began 20 years before: at 20.5 percent. Unfortunately, the gap between Saskatchewan and the national average increased from 0.3 percentage points (1.5 percent) in 1981/82 to 1.4 percentage points (7.3 percent) in 2000/01.

In terms of government spending compared with the size of economy in 2000/01, Saskatchewan maintained the third smallest provincial government behind Alberta and Ontario.

Consolidated Provincial-Municipal Government Spending

Ignoring the different mix of provincial and municipal spending (or taxation) can artificially bolster a jurisdiction's performance. This study consolidates provincial and municipal spending to avoid this possibility.[1] The consolidation barely affects Saskatchewan's performance, which remains essentially the same as when only provincial expenditures were examined.

Per Capita Government Spending

Real consolidated per capita spending fell by $565 from $9,453 in 1990/91 to $8,888 in 2000/01 in Saskatchewan, a decline of 6.0 percent. This compares with a decline of 14.4 percent in Alberta and an increase of 0.5 percent in Manitoba over the same period. In terms of the *value* of its consolidated per capita government spending, Saskatchewan ranks third. However, it still exceeds the national average in real per capita consolidated spending by some 3.0 percent.

Government Spending as a Percent of GDP

Saskatchewan reduced the size of its government by 25.0 percent—from 36.1 percent in 1990/91, to 27.1 percent in 2000/01. Unfortunately, the size of the province's government remains above the national average of 25.1 percent by 2.0 percentage points, or roughly 8.0 percent. On a consolidated basis, Saskatchewan currently has the fourth smallest size of government.

Government spending conclusion

Although Saskatchewan's restraint program was not as strict or as deep as that undertaken in Alberta, it nevertheless constrained the size of government relative to the economy, and decreased the amount spent on a per capita basis. Over the last decade, Saskatchewan did exercise some measure of fiscal restraint, although more will be needed if the province is to pursue long-term prosperity.

Government Tax Policy

The third section of this study evaluates Saskatchewan's tax policy. First, it evaluates the government's use of deficits and accumulated debt. It then assesses overall tax policy along the same lines as in the spending analysis section. Finally, the study endeavours to evaluate Saskatchewan's specific tax mix, as well as profiling four specific taxes for incremental analysis: personal income tax, provincial sales tax, corporate income tax, and the corporate capital tax.

Debts and Deficits: Deferring the Inevitable

Saskatchewan's real net debt peaked in 1993/94 at $12.4 billion. Through fiscal restraint coupled with lower interest rates and higher than expected revenues, the province has reduced its net debt to $10.3 billion as of 1999/00, a 17.1 percent reduction.

1 The analysis period is restricted to 1990/91 to 2000/01 due to a lack of available consistent data.

Saskatchewan posted a real per capita surplus of $228 in 1981/82. Unfortunately, this was the last year in which a surplus existed until 1994/95. Between 1982/83 and 1993/94, Saskatchewan consistently posted deficits; this steady flow of red ink resulted in an increase in the province's accumulated debt. However, beginning in 1994/95 and continuing to 2000/01, Saskatchewan regularly posted real per capita surpluses averaging $308 per capita over the period.

Saskatchewan's debt-to-GDP ratio continued to grow throughout the late 1980s and early 1990s, reaching a peak of 47.5 percent in 1993/94. Debt as a percentage of GDP dropped sharply between 1994/95 and 1996/97, decreasing 29.8 percent from its peak. Saskatchewan currently has the fifth highest ratio of debt-to-GDP among the provinces.

Real debt-servicing costs have declined from a peak of $1.9 billion in 1993/94 to $1.0 billion in 2000/01, a reduction of 45.7 percent.

Through a combination of relative fiscal restraint, lower interest rates, and generally higher than expected revenues, Saskatchewan has been able to reduce its accumulated debt and the accordant debt burden.

Measuring the Burden of Taxation

Aggregate taxation

Real government revenues in Saskatchewan have increased from roughly $6.0 billion in 1981/82 to $7.1 billion in 2000/01. Real (inflation-adjusted) government revenues in Saskatchewan increased 19.6 percent between 1981/82 and 2000/01 compared to an average national increase of 56.6 percent, and increases in Manitoba and Alberta of 53.1 percent and 32.4 percent, respectively.

Although the study examines both provincial-only and consolidated provincial-municipal taxation, this summary includes only the consolidated analysis for the sake of brevity.

Per Capita Government Revenues

Saskatchewan is the only province whose real per capita consolidated revenue declined; it fell by 1.6 percent from $9,307 in 1990/91, to $9,157 in 2000/01. That said, all three Prairie provinces extracted more real per capita consolidated revenue than the national average in 2000/01, although the gap had narrowed since 1990/91.

Government Revenues as a Percent of GDP

Saskatchewan experienced the largest percentage drop in government revenues as a percent of GDP, falling from 35.6 percent in 1990/91 to 27.9 percent in 2000/01, a decrease of 7.7 percentage points, or a 21.6 percent decline. Despite this marked decline in the percentage of GDP extracted in consolidated revenues, Saskatchewan still ranks above the national average; it placed fourth among the provinces in the percent of the economy consumed by consolidated revenues in 2000/01, behind the three traditional "have" provinces: British Columbia[2], Alberta, and Ontario.

Four Critical Taxes

Personal Income Taxes

The changes to personal income taxes (PIT) enacted in the 2000 Budget and continuing on into 2003 have improved Saskatchewan's personal income tax system. Once the reforms are fully implemented in 2003, Saskatchewan will maintain three statutory tax rates: 11 percent on in-

2 British Columbia was recently deemed to be a "have not" province and thus eligible for equalization payments.

comes up to $35,000, 13 percent on income between $35,000 and $100,000, and 15 percent on income in excess of $100,000. Also, Saskatchewan will maintain the third lowest top marginal tax rate, behind only Alberta and British Columbia. In addition, capital gains on small businesses and farms are taxed at the lowest statutory tax rate.

These changes, in addition to the re-indexation of the personal income tax system, represent an important and substantive improvement in Saskatchewan's personal income tax system. However, further reductions are required at the top end to reduce the gap between Saskatchewan's top marginal personal income tax rate and that of Alberta.

Provincial Sales Tax

As part of its personal income tax reforms, Saskatchewan broadened the base upon which the provincial sales tax is levied. The provincial government did not reduce the applicable sales tax rate as recommended by the review, although it still maintains the lowest sales tax rate of any province that levies a sales tax.

Even with the sales tax base broadening, Saskatchewan still uses these taxes and general consumption taxes less than most other provinces. This presents an opportunity for the province to reconfigure its tax system away from capital taxes to the inherently more efficient consumption taxes.

An additional problem associated with the provincial sales tax is that it currently applies to business inputs. Sales tax is meant to be a tax on consumption. Taxing business inputs essentially means the province is taxing production and investment. This technical point is important since Saskatchewan generally taxes businesses and capital to a much higher degree than other Canadian jurisdictions.

Corporate Income Tax

Saskatchewan currently has the highest corporate income tax rate for general corporations and one of the highest rates for manufacturers and processors. This punitive level of corporate income taxes is representative of a larger government policy favouring the taxation of capital. As other provinces, notably British Columbia, Alberta, and Ontario, aggressively reduce their corporate income tax rates, the statutory high rates in Saskatchewan will become increasingly harmful.

Corporate Capital Tax

Saskatchewan is the largest user in the country of corporate capital taxes, often called Canada's worst tax. The province uses the corporate capital tax more than any other province; this is measured by corporate capital tax as a percentage of: own-source revenue, GDP, and corporate income tax. In fact, Saskatchewan is the only province to regularly collect more corporate capital taxes than it does corporate income taxes. Given the tremendous disincentive corporate capital taxes create against capital formation, coupled with their rarity outside of Canada, along with Saskatchewan's clear difficulties in attracting investment and business development, it seems patently obvious that the province should stop its high use of this type of taxation.

Business Taxation in General

The Marginal Effective Tax Rate (METR) is a way to assess the overall combination of various business taxes in one simple tax rate. A METR analysis identifies one of the major problems facing Saskatchewan: high business taxes. Saskatchewan maintains the highest METR for service companies, and the third highest METR for manufacturing firms. Given British Columbia's business tax reductions in 2001, it is highly likely that in 2002, Saskatchewan will have the second highest METR for manufacturers.

The combination of punitive business taxation, both in an absolute and relative sense, combined with a heavy reliance on Crown Corporations implies a serious capitalization problem for the province both now and in the future. There can be little doubt that one of Saskatchewan's principal priorities must be reducing the burden of business taxation.

Policy Recommendations

Given the specific challenges facing Saskatchewan, this study includes both immediate and longer-term recommendations.

Immediate Policy Recommendations

Saskatchewan must immediately reduce per capita expenditures so that they are in line with the national average. Also, it must concurrently review all Crown Corporations, or government business enterprises (GBEs) so as to identify those GBEs that can be privatized quickly, and those that may require more time to privatize. The government must specifically and exclusively apply proceeds from the privatization of GBEs to reducing the province's accumulated debt.

The savings that accrue from both reductions in spending and the reduced debt-servicing costs that are achieved through debt reduction must finance business tax reductions. Specifically, the following tax changes must be implemented immediately:

- a dramatic reduction in the general corporate capital tax;
- a reduction in corporate income tax rates (both general and manufacturers and processors (M&P)) to 13.0 percent;
- a harmonization of the provincial sales tax (E&H tax) with the federal goods and services tax (GST).

In addition to these spending, taxing, and privatization initiatives, Saskatchewan should begin to cut public sector employment so that it quickly reaches a level commensurate with the national average. Some of these cuts can be achieved by privatizing Crown Corporations, but that alone will not be sufficient for the province to reach a level that will make it competitive with the rest of the country.

Two addition structural changes should also be implemented. First, all unexpected surpluses arising from lower than expected interest costs, lower than forecasted spending, or higher than anticipated revenues must be specifically and exclusively applied to reducing the province's debt.

Second, Saskatchewan should be the first Canadian province to implement strong and effective Tax and Expenditure Limitation laws (TELs). TELs have proven successful in stemming the growth of government and ensuring fiscal responsibility in the United States. They effectively constrain governments from increasing taxes or spending without popular approval. Specifically, expenditure limitation laws require any spending increase in excess of inflation and population growth to be specifically approved by referendum. Such a system has forced several US states to focus on those goods and services actually required of them, rather than the pet projects of special interest groups.

Longer-term Policy Recommendations

Some reforms will take more time to implement than others, but nonetheless, they need to be adopted if the province is to achieve its full economic potential. The first longer-term reform is to reduce the real size of government, as measured by consolidated government expenditures relative to GDP (size of the economy), to a level commensurate with the "have" provinces. Currently,

consolidated government expenditures (provincial and municipal) in Saskatchewan consume 27.1 percent of the economy (GDP). Alberta and Ontario, Canada's two "have" provinces, consumed 18.6 percent and 22.7 percent of the economy, respectively, in 2000/01. Saskatchewan must implement a program of fiscal restraint coupled with economic growth in order to reduce the size of government (and its accordant burden) to a comparable size.

Another area of reform that may take more time to accomplish is the wide-scale privatization of Crown Corporations in Saskatchewan. The second phase of privatization should include those government business enterprises that, for one reason or another, need more time for privatization. Again, all the proceeds from these privatizations must be specifically reserved for debt reduction.

The savings from both spending reductions and debt-servicing cost reductions from debt repayment should finance additional business and personal tax cuts. Specifically, Saskatchewan should aim to reduce the following taxes as soon as possible:

- corporate capital taxes should be completely eliminated, both for general corporations and financial institutions;
- corporate income tax rates must be reduced to 8.0 percent for both general and M&P corporations via a multi-year legislative plan;
- the top statutory marginal tax rate, scheduled to be 15 percent on incomes over $100,000, should be phased out.

If the province needs additional funds to finance either the immediate or intermediate (longer-term) tax cuts outlined above, it should consider raising the provincial sales tax rate.

Rationalized, focused government spending combined with a smarter tax system that re-introduces incentives for work, investment, risk-taking, and innovation, form the path that will lead to increased prosperity and wealth creation for Saskatchewan.

Saskatchewan Prosperity: Taking the Next Step

Saskatchewan can be prosperous and can emulate the achievements of provinces such as Alberta and Ontario if it is willing to undertake reforms. Decades of mixed to poor economic performance could be just memories if the province were to adopt a bold agenda focusing on business development supported by a lean, focused government. The real question for the province is not how to achieve prosperity, but rather, whether or not it will undertake the policies necessary to achieve it.

Introduction

The main body of this study is divided into four sections. The first section examines Saskatchewan's economic performance, in both an absolute and relative sense, over a 20-year period. It assesses the province's performance in and of itself as well as compared with other Canadian provinces, in particular the other Prairie provinces. The second section focuses on government expenditures. It also examines the size of government in Saskatchewan, which it does by comparing the size of the provincial government to both the optimal historical data, and to the size of government in neighbouring provinces. The third section assesses the revenue (taxation) side of the government's ledger in the form of debts and deficits. This section also evaluates both the size of the tax burden and the structure of government revenues in Saskatchewan. Finally, section four presents a relatively detailed set of recommendations for Saskatchewan to take if it wants to become truly prosperous.

Section I: Economic Performance: Mixed Results

How has Saskatchewan performed economically over the last 20 years? How does Saskatchewan's performance compare with that of the other Prairie provinces, Alberta and Manitoba, as well as with Canada as a whole? This section attempts to provide an overview of the province's past and current economic performance.

Three core areas are analyzed: income, employment, and investment.

Income Performance

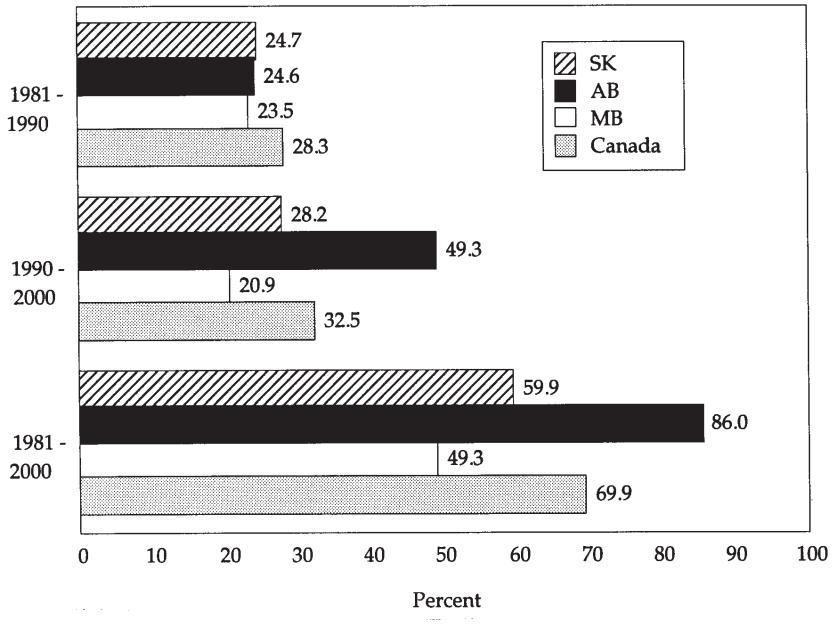
This study uses two principal measures to assess Saskatchewan's performance in enlarging the income of the province's residents: gross domestic product and personal disposable income. Gross domestic product (GDP) refers to the total value of goods and services produced in a specific jurisdiction. Personal disposable income is a measure similar to GDP, except that it only includes income available to citizens after deductions for direct taxes, such as income taxes. This study will examine both income measures in several different ways.

Gross Domestic Product (GDP)

Aggregate Real GDP

The simplest way to view GDP is in aggregate. What changes occurred in the total, or aggregate, value of goods and services in a specific jurisdiction? Economic Figure 1 depicts these changes in

Economic Figure 1: Real GDP Growth



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

GDP from 1981 to 2000 for Alberta, Saskatchewan, Manitoba, and Canada as a whole.

As Economic Figure 1 indicates, Saskatchewan fared well compared with Manitoba. Saskatchewan's growth in real GDP over the 20-year period exceeded Manitoba's by 10.6 percentage points (representing 21.5 percent). However, Saskatchewan's rate of real GDP growth was less than the national average by some 10.0 percentage points.

Further, Saskatchewan noticeably under-performed Alberta in its expansion of the total value of provincial goods and services produced. Alberta's real GDP grew 26.1 percentage points more than Saskatchewan's over the 20 years.

A closer look at the data shows that between 1981 and 1990, Saskatchewan's GDP growth rate was close to Alberta's. In fact, Saskatchewan's rate of real GDP growth was comparable to both its neighbours (Alberta and Manitoba) and only under-performed the national average by 3.6 percentage points.

As Economic Figure 1 depicts, the pattern of real aggregate GDP growth during the 1990s was much more disparate. Saskatchewan's real GDP growth exceeded Manitoba's by 7.3 percentage points, representing 34.9 percent. However, its rate of real GDP growth was below the national average by some 4.3 percentage points. Not surprisingly, Alberta significantly outperformed Saskatchewan in increasing the value of goods and services it produced. Alberta's rate of real GDP growth was 21.1 percentage points, or 74.8 percent, greater than in Saskatchewan's during the 1990s.

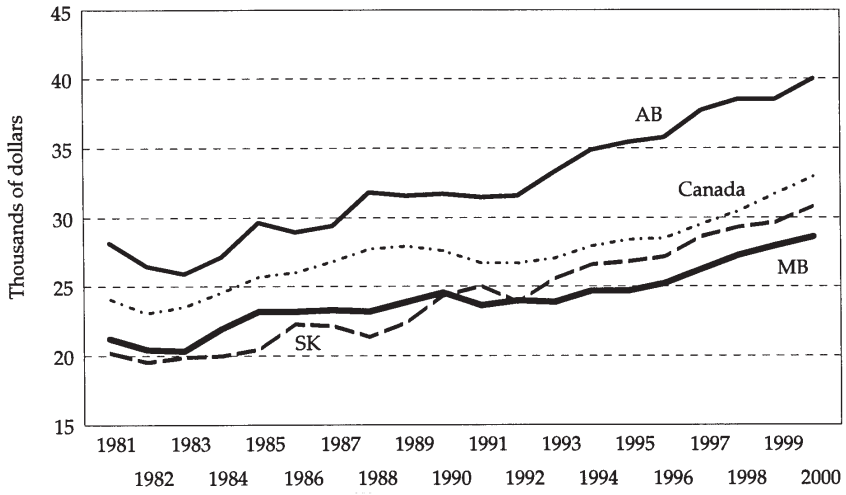
Real Per Capita GDP

Of course, simply examining changes in total GDP can be overly simplistic. For instance, such data ignore changes in population. It is entirely possible that a region's GDP can increase at the same time as its residents are becoming poorer.[3] This occurs when growth in GDP is insufficient to account for population growth.

Economic Figure 2 illustrates the real per capita GDP values for Canada as a whole, Alberta, Saskatchewan, and Manitoba between 1981 and

3 This phenomenon of increasing aggregate GDP coupled with declining per capita incomes is exactly what British Columbia experienced during the 1990s.

Economic Figure 2: Real GDP per capita



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

2000. In that time, Saskatchewan showed significant improvement in real per capita GDP. In 1981, the first year examined, Saskatchewan's real per capita GDP was $20,152, $3,861 below the national average (or only 83.9 percent of the national average). It was also $1,083 less than Manitoba's GDP, and an astonishing $8,078 less than Alberta's GDP.

By 2000, Saskatchewan had narrowed the gap with the national average. Its real per capita GDP in 2000 was $2,151 less than the national average (or 93.5 percent of the national average), an improvement of $1,710, or 44.3 percent. Furthermore, beginning in 1990, Saskatchewan consistently bettered Manitoba's real per capita GDP performance such that by 2000, the former's real per capita GDP exceeded the latter's by $2,106.

Saskatchewan's real per capita GDP performance has generally improved compared with that of the country. During the early 1980s, Saskatchewan generally had the sixth highest per capita GDP. By 2000, its ranking on this indicator had improved to third behind only Alberta and Ontario.[4] Despite its improvement, Saskatchewan could not close the gap with Alberta in the 1990s. Alberta's real per capita GDP now exceeds Saskatchewan's by $9,271, an increase of $1,193. Interestingly though, the percentage increase in Saskatchewan's real per capita GDP actually exceeded Alberta's and Manitoba's, as well as the national average. Specifically, between 1981 and 2000, Saskatchewan's real per capita GDP increased 52.7 percent while Alberta and Manitoba experienced increases of 41.8 percent and 35.0 percent, respectively.

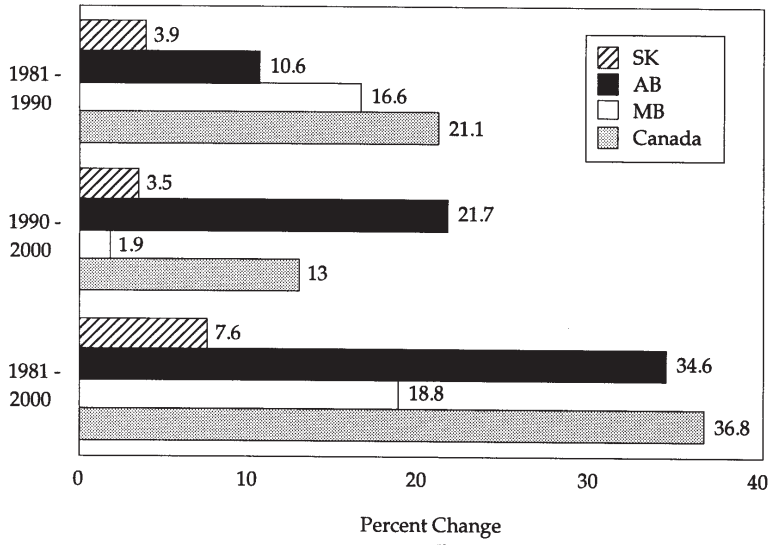
Saskatchewan's historic performance in increasing the value of goods and services produced in the province, as measured by per capita GDP, is relatively positive. Saskatchewan has improved its rankings relative to the other provinces, and has overtaken Manitoba in terms of real per capita GDP.

What Does the Future Hold?

There is very little agreement among organizations that specialize in economic forecasting regarding Saskatchewan's future. The Bank of Montreal generally has the most optimistic forecast for the province. It believes real GDP in the province will grow by 3.0 percent in 2002 and 3.5

4 Part of the explanation for Saskatchewan overtaking British Columbia in the real value of per capita GDP relates to British Columbia's poor performance during the last decade.

Economic Figure 3: Percent Change in Real Personal Disposable Income



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

percent in 2003 (O'Neill, 2001). Alternatively, the Bank of Nova Scotia has the most pessimistic forecast, anticipating that real GDP will expand by a mere 0.7 percent in 2002 and increase to 3.0 percent by 2003 (ScotiaCapital, 2002).

The remaining estimates lie somewhere in between. In its Autumn 2001 *Provincial Outlook,* the Conference Board of Canada estimated that real GDP in Saskatchewan would grow by 2.0 percent and 3.2 percent, in 2002 and 2003, respectively (Conference Board of Canada, 2001). The Toronto-Dominion Bank's *Provincial Economic Outlook* estimated the province's real GDP growth at 1.4 percent in 2002 and 3.2 percent in 2003 (TD Economics, 2001b). Finally, Saskatchewan's 2002 *Budget* includes estimates of real GDP growth of 1.5 percent in 2002, 2.9 percent in 2003, and 2.8 percent in 2004 (Province of Saskatchewan, 2002).

Three aspects of the forecasts should be noted. One, there is little agreement regarding the estimates of future GDP growth in Saskatchewan. Two, there is general agreement that the state of the economy will improve, as measured by Saskatchewan's real GDP growth. Three, Saskatchewan's real GDP growth is generally expected to lag behind the country as a whole for both 2002 and 2003.

Personal Disposable Income: From Relatively Good to Relatively Bad

Aggregate Real Personal Disposable Income

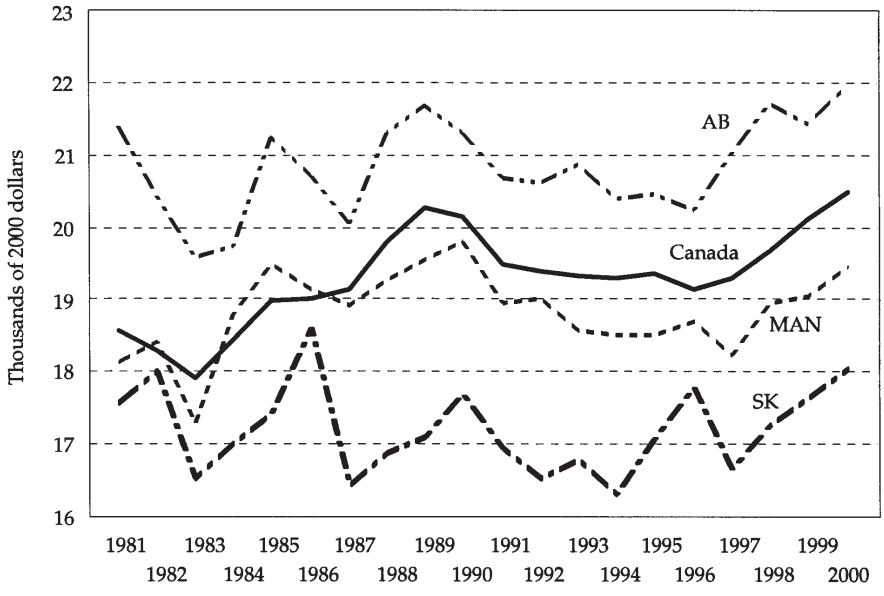
Personal disposable income measures income available to residents by calculating personal income adjusted for direct personal taxes. Economic Figure 3 presents the growth in real personal disposable income between 1981 and 2000 for the three Prairie provinces and for Canada as a whole.

Saskatchewan performs significantly worse using this measure of income compared with real GDP growth (as shown in Economic Figure 1). Over the entire two-decade period, Saskatchewan managed to grow real disposable income by only 7.6 percent, compared with 36.8 percent for Canada as a whole, 34.6 percent for Alberta, and 18.8 percent for Manitoba. Put differently, real personal disposable income in Canada as a whole grew 5.0 times more than in Saskatchewan, 4.5 times more in Alberta than Saskatchewan, and 2.5 times more in Manitoba.

Real Per Capita Personal Disposable Income

As with aggregate GDP, aggregate personal disposable personal income can be too simplistic a measure as it ignores population changes. Eco-

Economic Figure 4: Real per capita Personal Disposable Income



nomic Figure 4 depicts real per capita personal disposable income between 1981 and 2000.

Saskatchewan and Manitoba begin the period with similar levels of per capita personal disposable income, $17,567 and $18,131, respectively. The difference between the two provinces is $564, with Manitoba maintaining the higher level. Both provinces also maintained per capita personal disposable incomes close to the national average of $18,578. Specifically, Saskatchewan's per capita personal disposable income was 94.6 percent of the national average; Manitoba's was 97.6 percent of the national average. The real per capita personal disposable income of the remaining Prairie province, Alberta, was $21,415, significantly above the other two provinces and above the national average.

Economic Figure 4 reveals two obvious trends. First, neither Saskatchewan nor Manitoba were able to reduce or even maintain the gap between themselves and the national average. In fact, the gap between Saskatchewan and the national average rose from $1,011 in 1981 to $2,464 in 2000, an increase of 143.7 percent. The gap between Manitoba and the national average also increased, from $447 in 1981 to $1,042 in 2000. Second, Saskatchewan was unable to maintain its competitiveness with Manitoba in the value of real per capita personal disposable income. In 1981, Saskatchewan's real per capita personal disposable income was 96.9 percent that of Manitoba's, a difference of only $564. By 2000, the real per capita personal disposable income difference between Saskatchewan and Manitoba had widened to $1,422. Saskatchewan's real per capita personal disposable income had fallen from roughly 97 percent of Manitoba's level in 1981 to 92.7 percent in 2000.

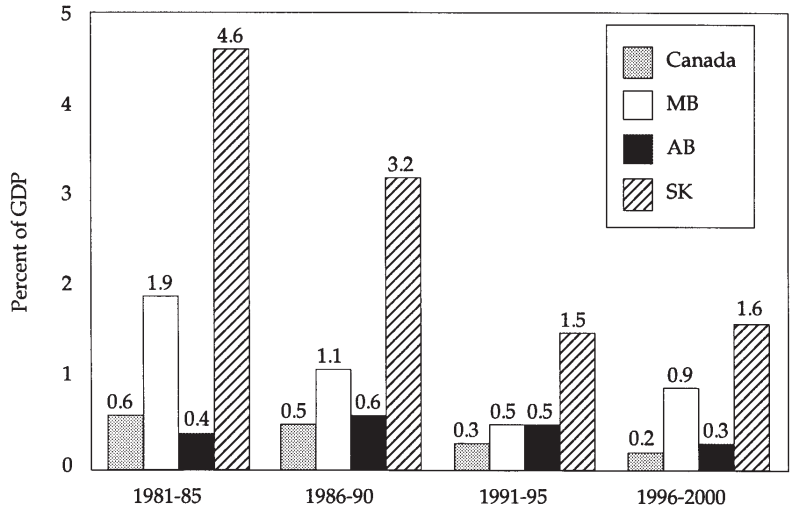
Saskatchewan's decline relative to the national average and to Manitoba is indicative of the province's more general decline in Canada. During the early 1980s, Saskatchewan's real per capita personal disposable income generally ranked fifth among the provinces. By 2000, this ranking had deteriorated to eighth position, ahead of only Newfoundland and Prince Edward Island.

Unlike its positive GDP performance, the province did poorly at increasing the personal disposable incomes of its citizens in the two-decade period. This poor performance exists regardless of whether aggregate or per capita figures are examined.

What Does the Future Hold?

Only the provincial budget and the Conference Board of Canada forecast estimates for growth in personal disposable income. The Conference

Economic Figure 5: Accrued Net Income of Farm Operators from Farm Production (Percent of GDP, Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

Board of Canada expects nominal personal disposable income (not adjusted for inflation) to grow by 2.8 percent in 2002 and by 4.3 percent in 2003, indicating strong growth in this measure (Conference Board of Canada, 2001). The estimates by the government of Saskatchewan, contained in the 2002 *Budget*, indicate growth in nominal personal disposable income of 2.3 percent in 2002, 4.5 percent in 2003, and 4.3 percent in 2004 (Province of Saskatchewan, 2002). Both forecasts indicate that the province expects its performance in personal disposable income to improve.

Farm Income: No Explanation for the Mixed Results

Compared to the rest of the country, farm income is relatively important to Saskatchewan in terms of personal income and GDP, although in absolute terms it is still a relatively small portion of these two aggregate income measures. Over the 1981 to 2000 period, the accrued net income of farm operators represents, on average, 3.5 percent of personal income and 2.7 percent of GDP. Farm income is not nearly as important to the other provinces. In fact, the net income of farm operators is responsible for only 0.5 percent of personal income and 0.4 percent of GDP for the country.

Economic Figure 5 shows the accrued net income of farm operators as a percent of GDP for the Prairie provinces and for Canada as a whole. It is quite clear from Economic Figure 5 that Saskatchewan, more so than any other Prairie province, or even relative to the nation as a whole, has a relatively large farming industry.

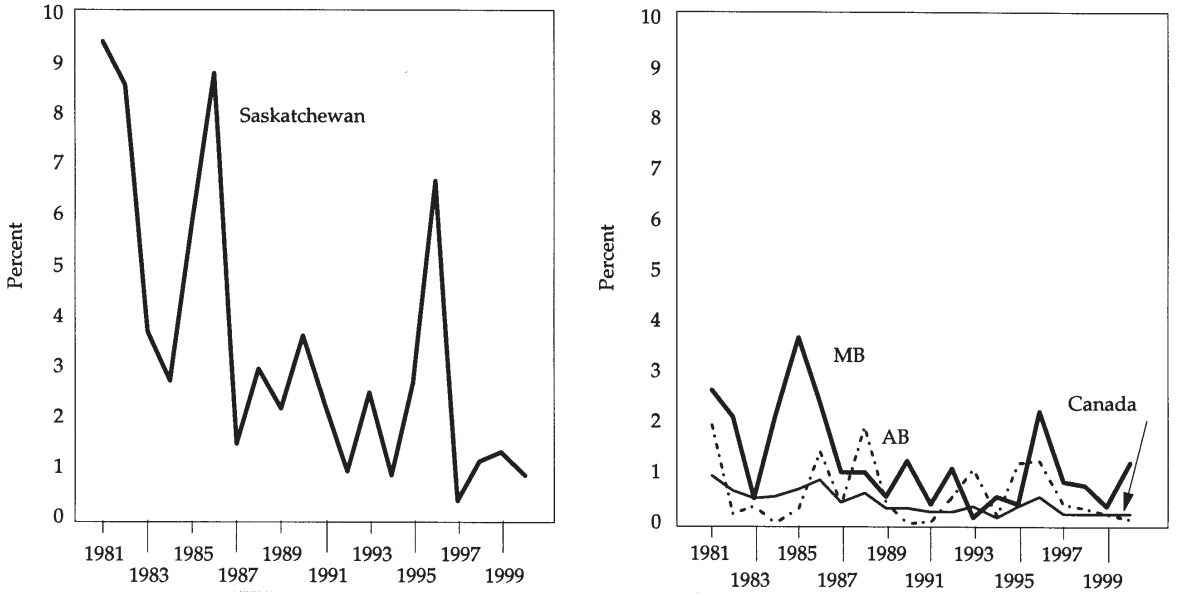
Farm income in Saskatchewan is also more volatile than in other provinces. Economic Figure 6 illustrates the volatility in accrued net farm income in Manitoba, Saskatchewan, Alberta, and Canada. Over the 1981 to 2000 period, the variance in accrued net farm income as a percent of personal income in Saskatchewan is 7.98 compared to 0.05 for Canada.[5] Similarly, over the same period, the variance in accrued net farm income as a percent of GDP in Saskatchewan is 4.95 versus 0.04 for Canada.[6]

In addition, there is a relatively weak negative correlation between accrued net farm income and personal income and between accrued net farm income and GDP. In other words, farm income and the performance of the farming industry as a whole cannot explain the mixed to poor results in Saskatchewan.

Income Performance Conclusion

Saskatchewan's performance in increasing the incomes of its citizens is mixed. When aggregate GDP is measured, the province performs relatively well. On the other hand, it fares quite poorly when aggregate personal disposable in-

Economic Figure 6: Accrued Net Income of Farm Operators from Farm Production (Percent of Personal Income)



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

come is assessed. Stronger measures of real performance are per capita gains in GDP, and personal disposable income. Saskatchewan's real per capita value of GDP has improved marginally compared with the national average, but still remains below it. More ominously, Saskatchewan's real per capita value of personal disposable income has deteriorated relative to the national average and to its neighbour, Manitoba. Although the province has made moderate improvements over the last two decades, much more improvement is required. Saskatchewan's intermediate goal should be to meet the national average for both per capita GDP and personal disposable income. The province's longer-term goal should be to increase both per capita GDP and per capita disposable income to levels comparable with the "have" provinces, although this will take longer to achieve.

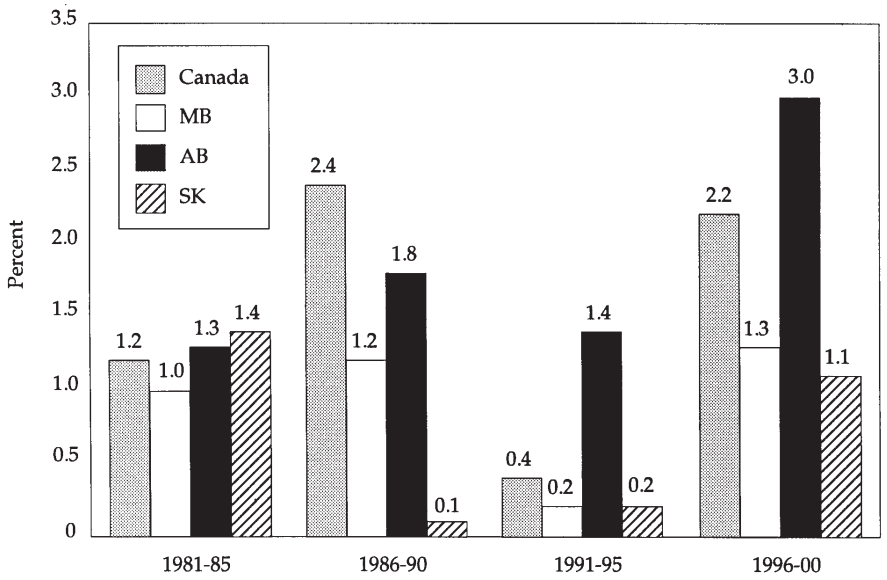
The Labour Market

The second measure of economic performance is employment. In order to gauge Saskatchewan's success in creating and maintaining an environment conducive to a strong, productive, and growing workforce, this study examines several indicators of employment, specifically, employment growth, unemployment figures, and public sector employment.

5 The final period (1996-2000) is conspicuous only for the massive spike in farm income that occurred in 1996. This sudden expansion of farm income was a result of the elimination of the "crow rate" subsidies, which provided farmers subsidized transportation costs until 1995. The removal of the "crow rate" was accompanied by large payouts from the federal government to ease farmers off the subsidized transport and into a subsidy-free environment and resulted in large cash payments to farmers in Saskatchewan. Post-1996 farm income performance continued the previous decline over the period.

6 Statistical analysis completed by the authors.

Economic Figure 7: Average Growth in Employment



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

Employment: Creating Jobs

Saskatchewan's employment growth has generally been weak since the early- to mid-1980s. Economic Figure 7 shows the average growth in employment between 1981 and 2000 for Manitoba, Saskatchewan, Alberta, and Canada. In absolute terms, Saskatchewan's performance in this area was especially poor from the mid-1980s through the mid-1990s.

Relative to other jurisdictions, Saskatchewan performed reasonably well in the 1981-'85 and 1991-'95 periods, although the province's—and the nation's—average annual employment growth was weak during the latter period. Most notable was Saskatchewan's poor performance between 1986 and 1990 when the province's average employment growth was close to zero, whereas nationally, employment growth was 2.4 percent on average.

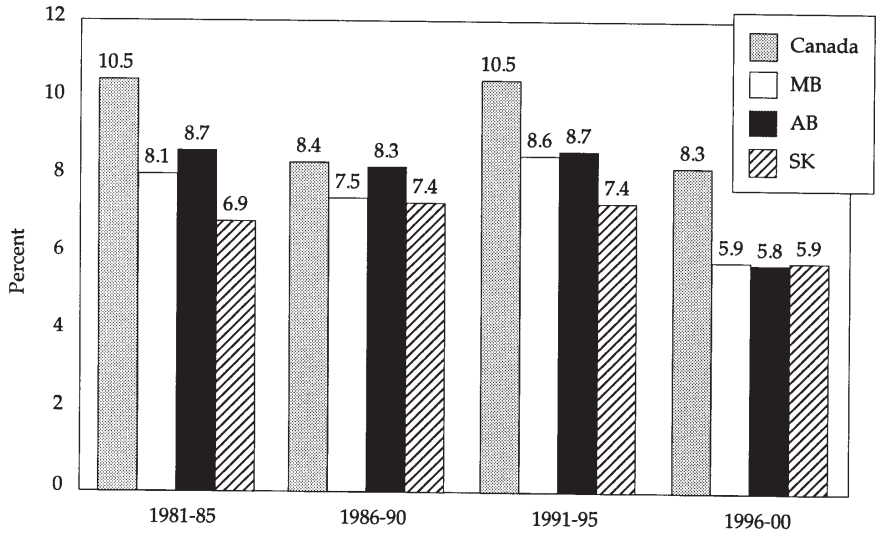
One positive note from Economic Figure 7 is that Saskatchewan was quite competitive with the other jurisdictions during the early 1980s (1981-1985). It maintained the highest average employment growth for the Prairies, and surpassed the national average by 0.2 percentage points. Unfortunately, that was 15 years ago.

Not surprisingly, given the weakness of employment growth in Saskatchewan during each of the four five-year periods examined, total employment growth over the two-decade period was relatively weak. Saskatchewan recorded total employment growth over the 20-year period of 12.5 percent, which was less than Alberta's 34.3 percent, Manitoba's 18.1 percent, and Canada as a whole, which experienced 32.0 percent employment growth. In fact, the only jurisdiction in Canada that Saskatchewan outperformed in employment growth was Newfoundland. Saskatchewan has clearly failed to produce a competitive employment growth rate compared not only with the Prairie provinces, but with all the provinces.

What Does the Future Hold?

Economic forecasters generally agree that Saskatchewan's employment growth will be weak over the next few years. The Bank of Montreal's economics department estimates employment growth in the province in 2002 at 0.1 percent and at 0.8 percent the following year (O'Neill, 2001). The Bank of Nova Scotia's forecast is even more pessimistic; it believes that Saskatchewan's employment will shrink by 0.8 percent in 2002 and then expand slightly in 2003 by 0.6 percent (ScotiaCapital, 2002). The Conference Board of

Economic Figure 8: Average Unemployment Rates (Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

Canada expects much more robust growth in employment in 2003, although it echoes the bank estimates for modest employment growth in 2002. Specifically, it expects Saskatchewan's employment to grow 0.2 percent in 2002, and 2.1 percent in 2003 (Conference Board of Canada, 2001). The 2002 Provincial *Budget* indicates employment growth of 0.6 percent in 2002, 1.2 percent in 2003, and 1.1 percent in 2004 (Province of Saskatchewan, 2002). All of the forecasts generally agree that employment growth will improve after 2002.

Unemployment Rates: A Bright Spot

Contrary to Saskatchewan's employment performance, its unemployment rate performance is relatively positive. Economic Figure 8 shows the average unemployment rates for the four five-year periods between 1981 and 2000. Saskatchewan's unemployment rates have continuously ranked among the lowest in Canada over the last 20 years. In all but the final period (1996-2000), Saskatchewan has had the lowest unemployment rate of any of the Prairie provinces. In the final period (1996-2000), Saskatchewan's unemployment rate of 5.9 percent was marginally above Alberta's 5.8 percent, and matched Manitoba's rate. Saskatchewan's unemployment rate has consistently been below the national average over the entire 20-year period.

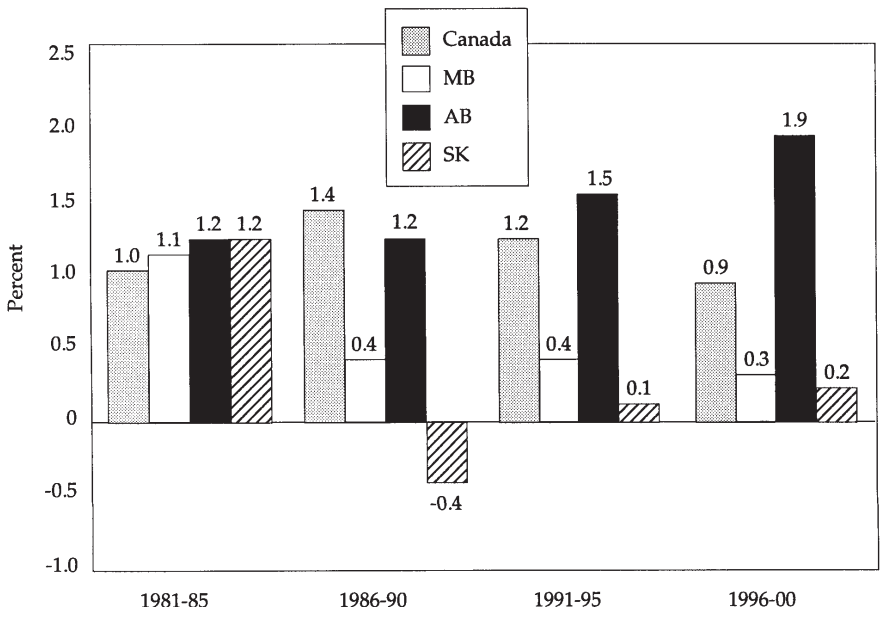
What Does the Future Hold?

There is consensus among forecasters that Saskatchewan's unemployment rate will worsen in 2002. However, they do not agree on the forecast for unemployment rates in the province beyond 2002. The Bank of Nova Scotia expects the unemployment rate to increase to 5.9 percent in 2002 and then fall back to 5.5 percent in 2003 (ScotiaCapital, 2002). This contrasts with estimates from the Bank of Montreal indicating a worsening rate in both 2002 and 2003: 5.7 percent and 5.8 percent, respectively (O'Neill, 2001). The Conference Board of Canada sees the unemployment rate increasing much more significantly in 2002, reaching 6.6 percent and then falling in 2003 to 5.8 percent (Conference Board of Canada, 2001). Finally, the 2002 Provincial *Budget* predicts an unemployment rate of 5.5 percent in 2002, improving to 5.2 percent in 2003, and decreasing again in 2004 to 5.0 percent (Province of Saskatchewan, 2002).

Population Growth

Overall population growth is an important factor when considering the performance of the economy in general, and the region's ability to attract people and labour markets in particular. Economic Figure 9 illustrates population growth rates for the three Prairie provinces and for Canada as a whole over the last 20 years. Saskatche-

Economic Figure 9: Population Growth Rates (Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

wan's population has grown little over the last two decades. Unfortunately, the province's success in growing its population is poor in an absolute sense, and even worse when compared with other Canadian provinces.

Between 1981 and 2000, Saskatchewan's population grew a total of 4.7 percent, with an annual average growth of 0.2 percent, ahead of only Newfoundland. During the same period, Manitoba's population grew 10.7 percent, Alberta's population grew 31.2 percent, and the whole country's population grew by 24.0 percent.

The Labour Force

Economic Figure 10 shows labour force growth in each of the four five-year periods examined for the three Prairie provinces and Canada as a whole. Saskatchewan is relatively competitive with the other Prairie provinces between 1981 and 1985, matching Alberta's labour force growth and exceeding Manitoba's. Unfortunately, Saskatchewan's success at expanding the labour force, both in absolute and relative terms, is short lived. As Economic Figure 10 demonstrates, Saskatchewan proves poor at expanding the labour force between 1986 and 2000.

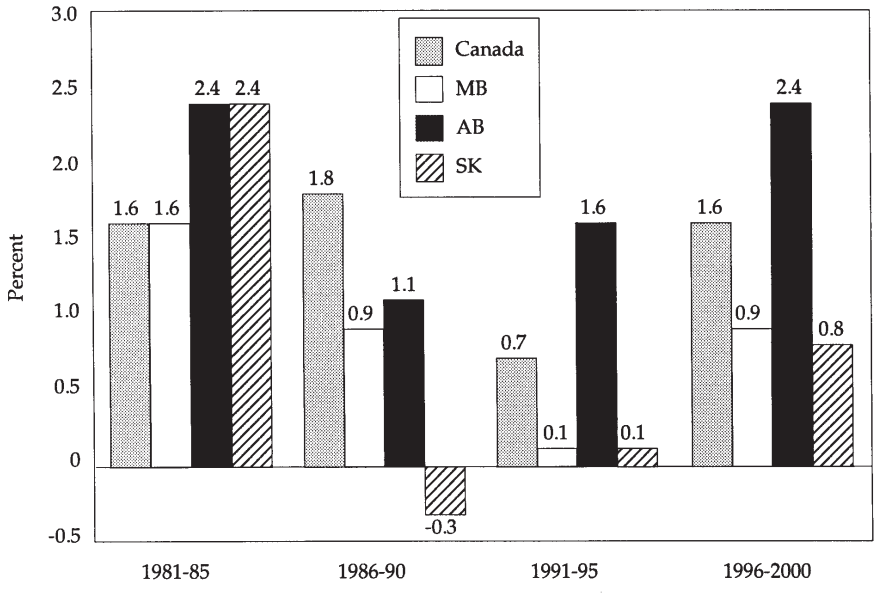
In fact, Saskatchewan's labour force actually shrank between 1986 and 1990, by 0.3 percent per year over the five-year period, on average. Neither could Saskatchewan match Alberta's performance in expanding the labour force for the remaining 10 years, although it did remain relatively competitive with Manitoba.

What Does the Future Hold?

The Conference Board of Canada estimates that the labour force will expand by 1.0 percent in 2002 and 1.2 percent in 2003. This compares with forecast increases of 2.4 percent and 2.3 percent in Alberta, and 0.9 percent and 0.8 percent in Manitoba in 2002 and 2003, respectively. The labour force in Canada as a whole is expected to expand by 0.8 percent and 1.4 percent in 2002 and 2003, respectively (Conference Board of Canada, 2001). So while Saskatchewan is expected to fare relatively well in growing its labour force compared with Manitoba and the national average, it is not as competitive with Alberta in this regard.

Another way to look at labour market expansion is to view expected increases (or decreases) in the number of people of labour force age. The Conference Board of Canada forecasts that in Saskatchewan, the number of people of labour force age

Economic Figure 10: Labour Force Growth



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

will increase by 0.3 percent in 2002 and 0.5 percent in 2003. This compares with forecast increases of 2.1 percent and 1.9 percent in Alberta, and 0.5 percent and 0.6 percent in Manitoba in 2002 and 2003, respectively. The number of people of labour force age in Canada as a whole is expected to increase by 1.1 percent in both 2002 and 2003 (Conference Board of Canada, 2001). Thus, while Saskatchewan will probably match Manitoba in terms of increasing the number of its people who are of labour force age over the next two years, it is not expected to produce growth in that indicator comparable with Alberta or the national average.

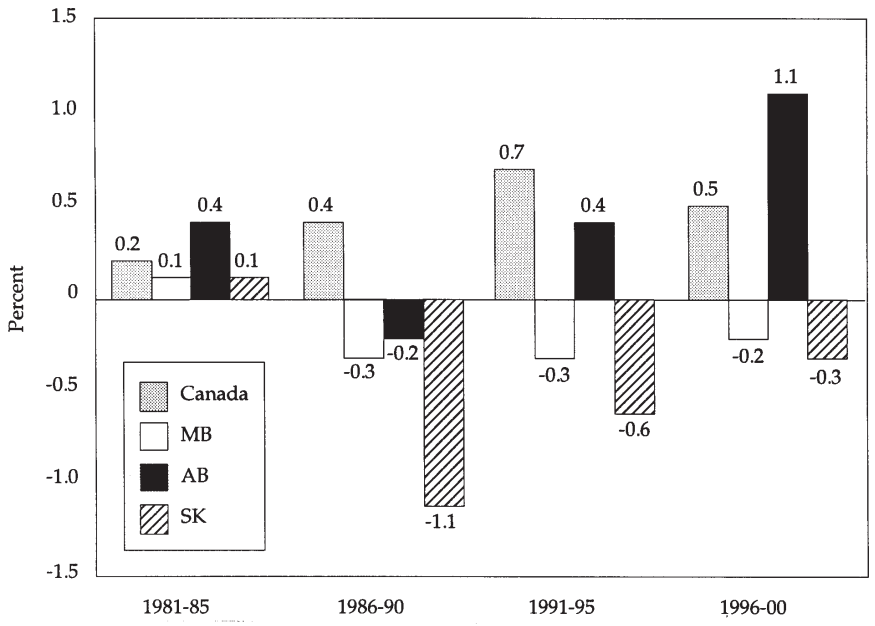
Migration

Saskatchewan's migration record is the second worst in the country over the period examined. Economic Figure 11 shows the net migration as a percent of population for Canada and the Prairie provinces between 1981 through 2000. On average, Saskatchewan lost people in three of the four periods considered. This is consistent with Manitoba's performance; that province also experienced net out-migration for three of the four periods examined. However, it is not at all consistent with Alberta's experience, or that of the national average over the time period examined.

An issue specifically related to migration is the characteristics of the people leaving a particular jurisdiction. In an October 1999 review of the inter-provincial mobility of highly skilled workers, the Royal Bank of Canada found that Saskatchewan had the second highest outflow of knowledge workers, and the highest outflow of high-income individuals relative to the other provinces (Bastarache, 1999). The report listed five indicators of the mobility of highly skilled workers. It found that Saskatchewan had the worst performance on one of the indicators, and the second worst on the remaining four. Saskatchewan, more than any other province except Newfoundland, loses its most highly skilled people and its highest income earners. In addition, the report warned that Saskatchewan, along with Prince Edward Island, "can expect to see an increase in their inter-provincial migration losses" (Bastarache, 1999, p. 4).

An additional issue related to the characteristics of those leaving is the structure of society for those remaining, in particular the ratio of those who depend on others for support due to their age. In a recent report, the Canada West Foundation showed some longer-term inter-provincial migration data that present some troubling information on Saskatchewan's dependency ratio and the age of its population. The report concludes that between 1972 and 1999, Saskatchewan lost

Economic Figure 11: Net Migration as a Percent of Population



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

15.1 percent of its population to migration (Roach and Berdahl, 2001). This was second only to Newfoundland, which lost 17.9 percent of its population over the same period. The authors conclude that, "Saskatchewan and Manitoba each have a strong and very stable history of losing residents" (Roach and Berdahl, 2001: p. 17). The authors also report that Saskatchewan's dependency ratio[7] is high relative both to the western provinces and to the rest of Canada, and that it is expected to worsen. Finally, the report states that, in the west at least, Saskatchewan has a relatively old population.

Public Sector Employment

Another important labour market issue, but one that exists outside the confines of assessing labour market performance, is the structure of the labour market. Specifically, it is critical to assess the mix of private- and public-sector employment within a jurisdiction so as to gauge the health of the overall labour market.

Economic Figure 12 shows the number of provincial public sector employees[8] as a percent of the population in Alberta, Saskatchewan, Manitoba, and for the provinces as a whole between 1985 and 2000.

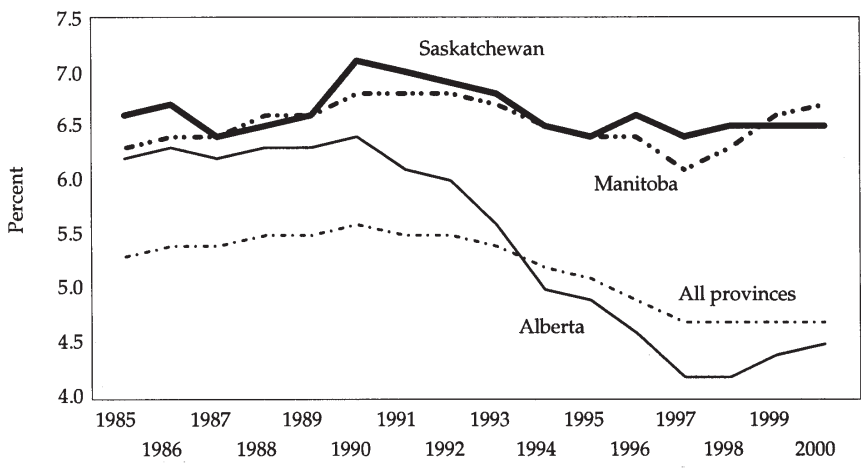
The decline in public sector employees in Alberta is evident from the figure. Alberta reduced the number of its provincial public sector employees from the 1990 peak of 299,958 to 264,940 in 2000, declining from 6.4 percent of the population in 1990 to 4.5 percent of the population in 2000 (Economic Figure 12). Manitoba has similarly reduced the number of public sector employees from a high of 144,681 in 1990 to 133,455 in 2000. However, as a percent of the population, Manitoba still maintains a higher percentage of public sector employees than does Alberta. Specifically, 6.7 percent of the population is employed by the public sector in Manitoba, down marginally from the high of 1990 of 6.8 percent, but still well above Alberta's 4.5 percent (Economic Figure 12).

Saskatchewan's public sector employment follows Manitoba's pattern closely. The number of public sector employees in 2000 totalled 112,848,

7 A jurisdiction's dependency ratio is defined as the number of persons aged 0-14 plus persons aged 65 and older per 100 persons aged 15-64.

8 Including those employed by provincial government business enterprises.

Economic Figure 12: Provincial Public Sector Employment* as a Percent of Population (1985-2000)

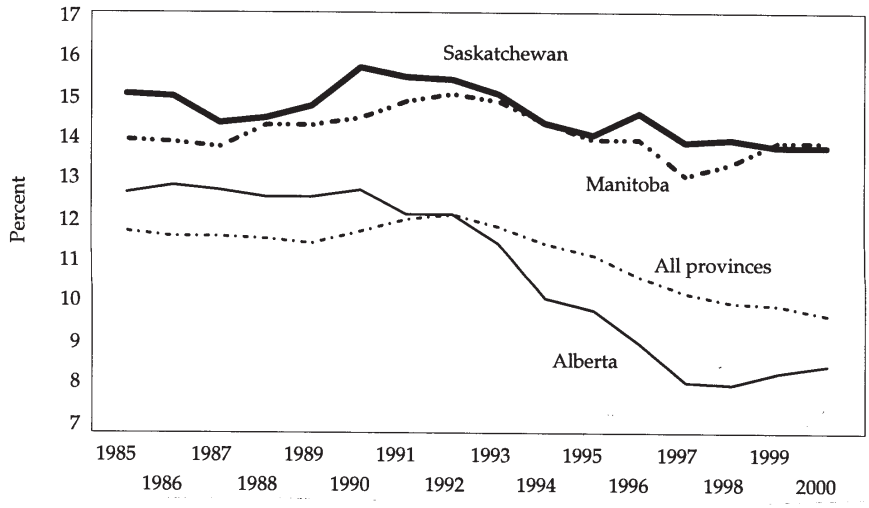


Source: Statistics Canada, Public Institutions Division, Financial Management System.
*Includes provincial government business enterprise employees.

down from the 1990 high of 120,455. However, like Manitoba, the percentage of the population employed by the public sector in Saskatchewan stands well above Alberta's level. Specifically, 6.5 percent of Saskatchewan's population is employed by the public sector, down from the 1990 high of 7.1 percent, but again, still well above Alberta's 4.5 percent (Economic Figure 12). So although both Manitoba and Saskatchewan have reduced some public sector employment, the public sector in those provinces still employs a much higher percentage of the population than it does in Alberta.

Economic Figure 13 presents an alternative measure of public sector employment: public sector employment as a percent of total employment. This figure illustrates the same trend as Economic Figure 12 does: Saskatchewan and Manitoba have slightly reduced the percentage of their labour forces that are employed by the public sector, but the level is still well above that of Alberta and the country as a whole.

Economic Figure 13: Provincial Public Sector Employment* as a Percentage of Total Employment (1982-2000)

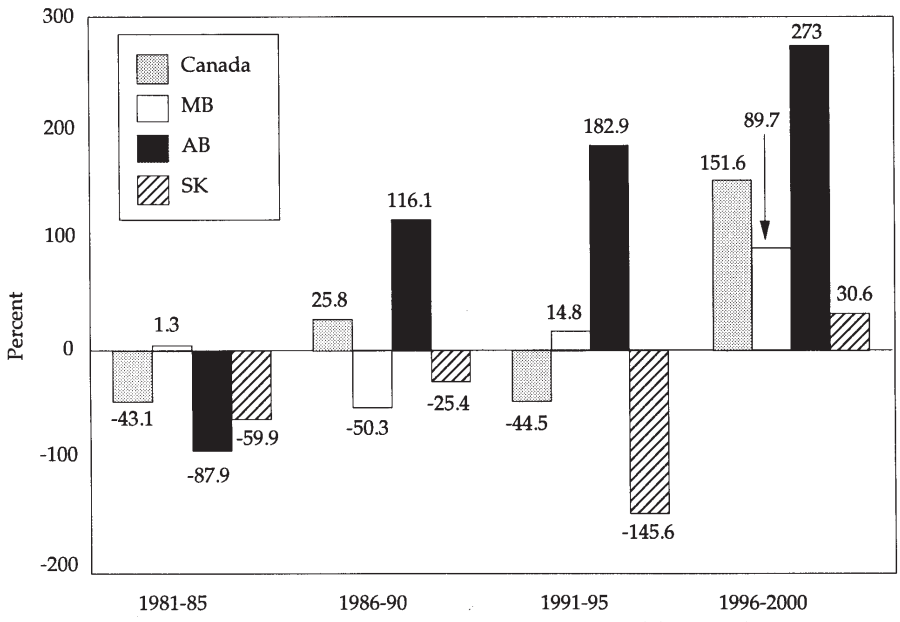


Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.
*Includes provincial government business enterprise employees.

Labour Market Conclusion

Over the last 20 years, Saskatchewan's population has grown minimally, it has had the second worst job creation record in the country, and its labour force has grown the least of all the provinces. In addition, more of its population moved out, on average, than any other province except for Newfoundland. In particular, the province seems to be losing its most talented, skilled, and high-income

Economic Figure 14: Growth in Real Net Fixed Business Investment (Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

earning workers. In addition, Saskatchewan continues to maintain public sector employment well above the levels in Alberta and the country as a whole. The only bright spot is that the province has a relatively low unemployment rate. These facts, taken together, indicate a relatively weak and deteriorating labour market in Saskatchewan.

Investment Performance: A Lack of Private Sector Confidence

The third area of economic analysis is investment. Investment in plants, machinery, equipment, and new technologies offers the potential to increase worker productivity and ultimately, real wages. It is also a barometer of future economic prosperity since such investments provide the foundation for future production.

Economic Figure 14 depicts the growth in real net business investment between 1981 and 2000. The data presented are net of depreciation, and thus represent the real growth in investment after accounting for the replacement of out-dated and expired fixed assets such as plants and equipment.

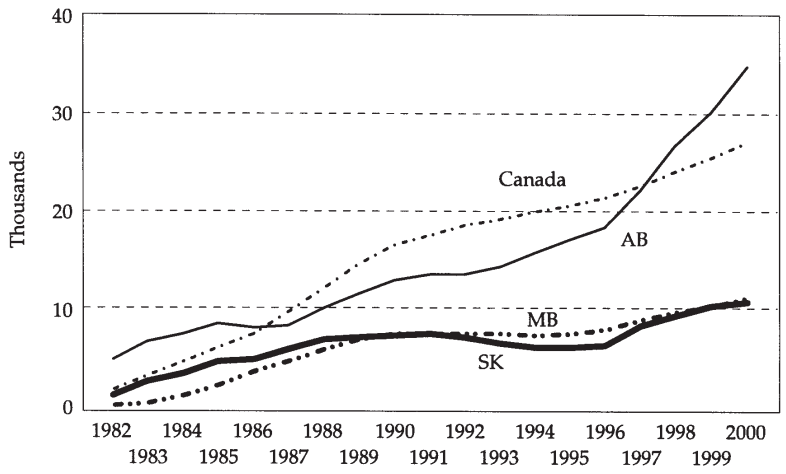
Unfortunately, the amount of real net business investment in Saskatchewan over the last two decades has been dismal. In fact, for most of the last 20 years, the level of investment in the province has not kept pace with the depreciation of past business investments. On average, growth in real net business investment shrank by 59.9 percent between 1981 and 1985, decreased another 25.4 percent between 1986 and 1990, and contracted an astounding 145.6 percent between 1991 and 1995 (Economic Figure 14).

The amount of real net fixed business assets did increase in Saskatchewan between 1996 and 2000 by 30.6 percent. Unfortunately, this increase significantly lagged the level of investments made in other jurisdictions. The Canadian average for the same five-year period was 151.6 percent. Manitoba recorded an increase in real net fixed business investments of 89.7 percent, while Alberta experienced a remarkable increase of 273.0 percent. In fact, in a ranking of Canadian provinces in 2000, Saskatchewan ranked third last.

Per Capita Accumulation: Dismal Performance

Another way of looking at real net fixed business investment is on a per capita basis. Economic Figure 15 presents the real per capita net fixed busi-

Economic Figure 15: Real Per Capita Net Fixed Business Investment



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

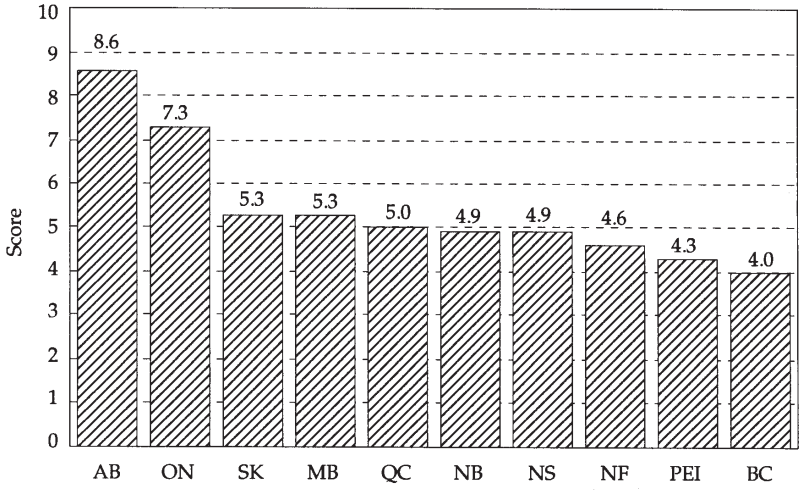
ness investment for the Prairie provinces and for Canada as a whole for the years 1982-2000.

Economic Figure 15 reveals two obvious trends. The first is that Saskatchewan and Manitoba perform similarly in accumulating per capita business assets. Specifically, over the 19-year period, Saskatchewan and Manitoba managed to accumulate $10,635 and $11,133 in real per capita net fixed business investment, respectively.

The second observation is that both Saskatchewan and Manitoba under-perform dramatically compared with Alberta and the nation as a whole. Economic Figure 15 shows an enormous gulf between the jurisdictions in the value of accumulated real fixed business investment over the period. Specifically, Alberta accumulated $34,823 in real per capita net fixed business investment, and Canada as a whole $27,163. In that same time, Saskatchewan was only able to accumulate 30.5 percent of Alberta's, and 39.2 percent of the whole country's real per capita net fixed business investment.

This is a critical measure of economic performance because these investments partly explain and determine labour productivity. Ultimately, labour productivity determines real wages. Thus, one factor explaining Saskatchewan's mixed to poor performance in increasing the incomes of its citizens is likely the lack of business investment and the subsequent poor performance in improving labour productivity.

Economic Figure 16: Provincial Investment Climates (2001)

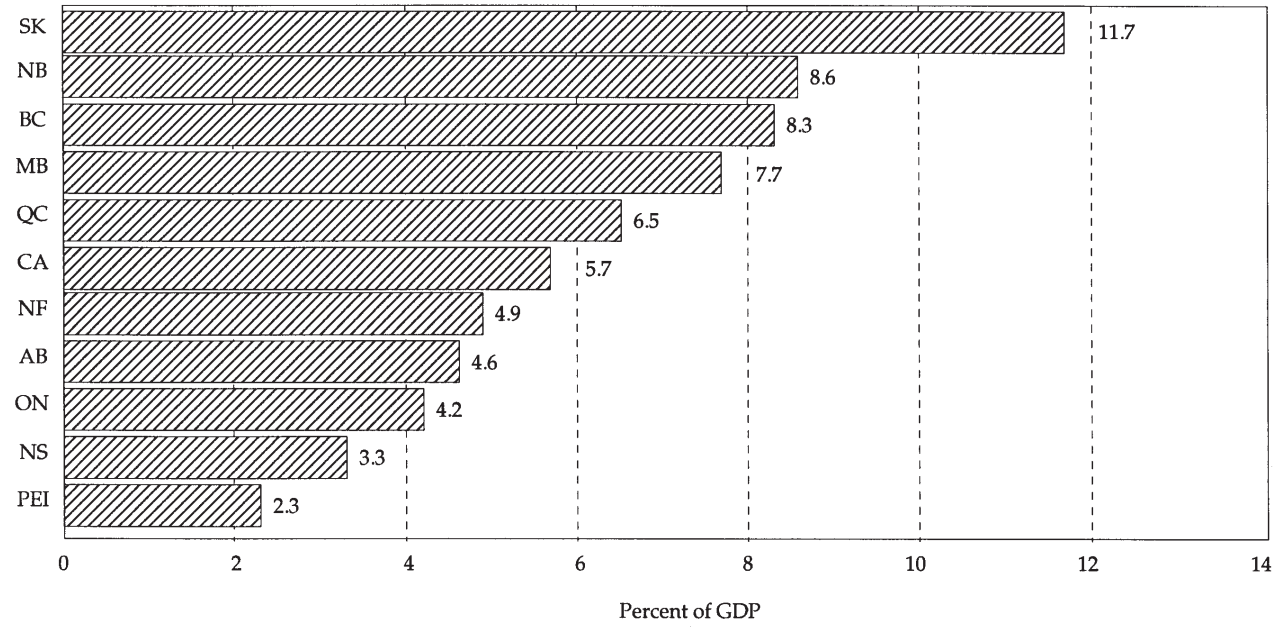


Source: The Fraser Institute, 2001.

Investment Climate

One explanation for Saskatchewan's below average performance in generating business investment may be a poor investment climate. The Fraser Institute

Economic Figure 17: GBE Expenses as a Percent of GDP (2000)



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculation by the authors.

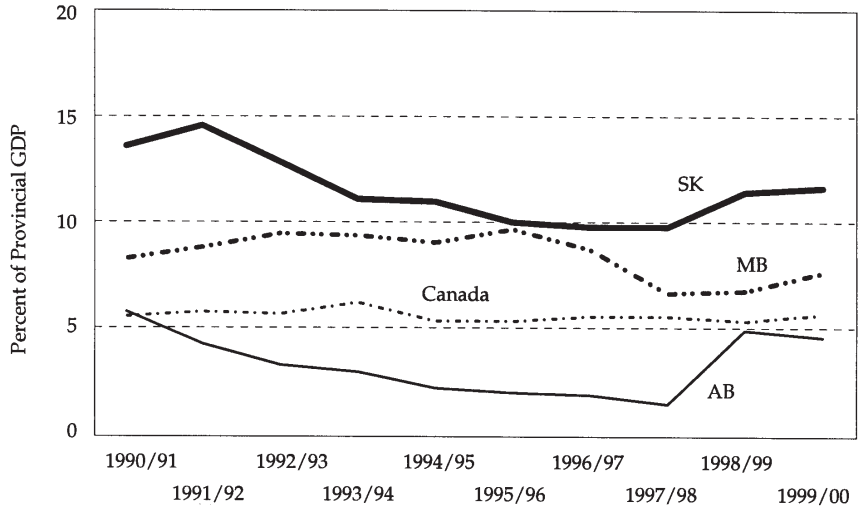
publishes an annual survey of Canada's leading pension and investment managers. As part of the survey, these managers express their opinion about whether each province's investment climate is positive or negative. The survey respondents have consistently rated the investment climate in Saskatchewan below both Ontario and Alberta, and equal to Manitoba. As Economic Figure 16 illustrates, in 2001, Saskatchewan's positive investment climate, along with Manitoba's, led all the provinces with the exception of Alberta and Ontario. These results are consistent with previous years' surveys. However, Saskatchewan has not been able to differentiate itself from the other provinces so as to compete with Alberta and Ontario. This inability to take the next step to compete with the "have" provinces may explain some of Saskatchewan's investment difficulties. Interestingly, in the Spring 2002 survey, which has just come available, Saskatchwan dropped from third to seventh place on the investment climate rating.

Crown Corporations: Amplifying the Investment Problem

Another compelling explanation for Saskatchewan's capitalization problem is its relatively heavy reliance on government business enterprises (GBEs), or what are commonly referred to as Crown Corporations. Economic Figure 17 ranks the provinces according to how much each government spends under the auspices of government-owned businesses. As Economic Figure 17 depicts, of all the provinces, Saskatchewan is by far the largest user of government business enterprises. In fact, Saskatchewan's GBE expenditures as a percent of GDP outpace the second-ranked province, New Brunswick, by 3.1 percentage points, representing 36.0 percent.

Clearly, as a percentage of GDP, Saskatchewan has more Crown Corporation or GBE activity than any other province. Economic Figure 18 presents historical data for the Prairie provinces and for Canada for the last 10 years. GBE spending in Saskatchewan ranged between 9.8 and 14.6

Economic Figure 18: Government Business Enterprise Spending as a Percentage of GDP

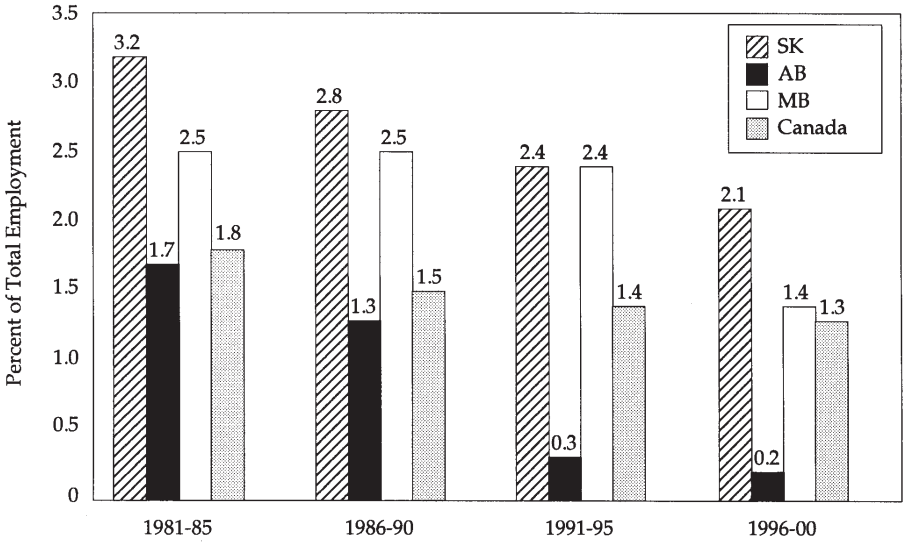


Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculation by the authors.

percent of GDP between 1990/91 and 1999/00. On average, GBE spending in the other provinces is much lower, ranging between 5.4 and 6.2 percent of GDP. In particular, GBE spending in Saskatchewan is well above that in any of the other Prairie provinces.

In addition, consider the number of GBE employees relative to total employment. In each of the five-year periods shown in Economic Figure 19, GBE employment as a percent of total employment in Saskatchewan is more than twice as large as the provincial average, and larger than any other jurisdiction considered except for the 1991-95 period where Saskatchewan and Manitoba tied.

Economic Figure 19: GBE Employment as a Percent of Total Employment (Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

The Government of Saskatchewan owns the Crown Investments Corporation (CIC) of Saskatchewan, which, in turn, owns 10 subsidiary commercial Crown Corporations, as well as a large and varied portfolio of publicly-owned investments. Economic Performance Table 1 lists the specific Crown Corporations and other investments held by the CIC.

The Crown Investments Corporation (CIC) of Saskatchewan estimated that in 2001 its Crown Corporation and other major investments represented 17.0 percent of the provincial GDP and 9.0 percent of total employment (CIC, 2001). In addition, it valued its investment assets at $7.6 billion. In fact, the

Economic Performance Table 1:
Crown Corporations and Investments

Crown Corporations	Major Investments
Saskatchewan Power Corporation (SaskPower)	Centennial Foods Partnership
Saskatchewan Telecommunications Holding Corporation and Saskatchewan Telecommunications (collectively SaskTel)	CIC Foods Inc.
SaskEnergy Incorporated (SaskEnergy)	CIC Pulp Ltd.
Saskatchewan Water Corporation (Sask Water)	FarmGro Organic Foods Inc.
Information Services Corporation of Saskatchewan (ISC)	Genex Swine Group Inc.
Saskatchewan Government Insurance (SGI)	Meadow Lake OSB Limited Partnership
HARO Financial Corporation (HARO)	Millar Western Pulp Ltd.
NewGrade Energy Inc. (NewGrade)	Primaxis Technology Ventures Inc.
Meadow Lake Pulp Limited Partnership (MLPLP)	Regina Motion Picture Video & Sounds Ltd.
Saskferco Products Inc. (Saskferco)	SGI Canada Insurance Services Ltd.
Cameco Corporation (Cameco)[a]	Western Life Sciences Venture Fund
Saskatchewan Valley Potato Corporation (SVPC)	
Big Sky Farms Inc. (Big Sky)	
Centennial Foods Partnership (Centennial)	
Premium Brands Inc. (Premium)	
Saskatchewan Opportunities Corporation (SOCO)	
Foragen Technologies Management Inc.	
Saskatchewan Government Growth Fund Management Corporation (SGGF)	
Saskatchewan Transportation Company (STC)	
SaskEnergy Incorporated	

[a]Sold subsequent to year-end of 2001.
Source: Crown Investments Corporation (CIC) of Saskatchewan (2002), Information available at *www.cicorp.sk.ca.*

four major Crown Corporations alone had accumulated assets of $6.8 billion (CIC, 2001).

The reason Saskatchewan's heavy use of state-owned businesses or government business enterprises is important is because these businesses do not act or perform like their private sector counterparts.

Differences Between Private and Public Sector Business Enterprises

Kornai (1992) identified a major and unchangeable difference between private sector business enterprises and government: budget constraints. Kornai described government budget constraints as "soft" since it was effectively impossible for government to be de-capitalized. Private sector businesses, on the other hand, face "hard" budget constraints in that if they incur losses on a sustained basis, or even a few large losses, they can face bankruptcy due to the loss of capital.

Kornai argued that this basic and unwavering difference between the two types of entities results in extraordinary differences in operations. Private sector businesses have a strong incentive to provide consumers with demanded goods and services in a timely manner, and at affordable prices that are consistent with their quality. GBEs simply don't face the same constraints. They can consistently lose money by offering goods and

services citizens don't want or don't value, as well as goods and services whose prices do not reflect their quality or timeliness.

Kornai's conclusions carry even more weight when one considers that GBEs often operate in a government-provided monopoly that precludes competition. Not only can they operate as discussed above, but consumers are prohibited from purchasing comparable goods and services from other providers. For example, if the citizens of Ontario are not satisfied with the service, quality, and/or price of liquor products, they cannot seek alternative sellers. Consumers (i.e., citizens) don't have a choice if they're not satisfied with the GBE.

Another pivotal difference—and one highlighted in a recent survey of privatization by Megginson and Netter (2001)—is that GBEs are often preoccupied fulfilling social goals and objectives dictated by the state rather than focusing on the development of their business. GBEs may choose not to spend money improving productivity, expanding market share, or investing in new technologies, and instead focus on achieving other social objectives, such as equity. For instance, the Crown Investments Corporation (CIC) of Saskatchewan, a wholly-owned investment holding company of the Government of Saskatchewan, identifies four business objectives: (1) universal, or available to everyone; (2) reliable; (3) high quality; and (4) offered at a reasonable price (CIC, 2001). Nowhere in its set of goals does the CIC list those objectives normally associated with private sector companies: maximizing the rate of return to shareholders, expanding market share, achieving a certain rate of return on invested capital, developing new products, etc.

Related to the concept of differing goals and objectives is the misallocation of capital. A number of researchers have concluded that private sector companies are much better at allocating capital to its most valuable end use than their government sector counterparts. For instance, Mihlar (1994) and Walker (1984) both concluded that when governments allocate resources, they tend to finance political pet projects that yield few economic benefits. Another reason for this phenomenon, in addition to those highlighted above, is that investors who risk their own capital tend to behave differently from government bureaucrats and officials who risk someone else's money, namely, that of taxpayers. Again, the key problem is one of differing incentives.

Another reason for the overall performance difference between private sector businesses and GBEs relates to capitalization. In their comprehensive review of privatization, Megginson and Netter (2001) found that GBEs tend to develop with less capital,and thus are more labour intensive than their private sector counterparts. In other words, GBEs don't incorporate an optimal amount of capital, which has negative implications for both labour and total factor productivity. Part of this under-capitalization is inherent to the structure of GBEs. GBEs are nearly always restricted—if not forbidden—from raising equity financing, since additional equity financing would dilute the government's ownership. In addition, many GBEs are also restricted in their ability to raise debt-financing, as the debt accumulated by GBEs is ultimately secured by the government. This capital restriction can, and has, precluded GBEs from developing otherwise prudent business plans.

Butler (1992) concurs with the concept of under capitalization in GBEs. Butler found that privatization of state-owned enterprises often results in re-capitalization because governments tend to view capital spending in their businesses to be less important than distributing money in response to audible public demands. In other words, governments view capital spending in GBEs to be less politically productive than direct spending by government on publicly-demanded projects.

Clearly, private sector companies face very different incentives and risks than their public sector counterparts. These structural differences lead to different performance levels.

Privatization Results

Given the stark differences between private sector businesses and GBEs, one would expect dramatic results from privatizing government businesses. The following summarizes some of the findings associated with privatization around the globe.

Megginson and Netter (2001) concluded that selling GBEs yielded both immediate and long-term economic gains for the economy. They found that when government enterprises are sold to the private sector, they not only generate one-time revenues for the government, but also manage to spur economic growth. Specifically, they concluded that privately owned firms are more efficient and profitable than comparable public sector firms. In addition, they concluded that "privatization 'works,' in the sense that divested firms almost always become more efficient, more profitable, and financially healthier, and increase their capital investment spending" (Megginson and Netter, 2001, p. 281).

Isaac Ehrlich *et al*. (1994) quantified estimates of the economic growth effect of privatization. That study found that after privatization, GBEs tended to increase annual productivity growth by 1.6 to 2.0 percent, and reduce the rate of unit cost increases by 1.7 to 1.9 percent.

The National Center for Policy Analysis in Dallas quoted a World Bank study that examined 61 privatized companies in 18 different countries and found that post-privatization profitability soared 45 percent, efficiency rose by 11 percent, output increased by 27 percent, investment in plant and equipment jumped 44 percent, and employment increased 6 percent (NCPA, 1997).

Some Specific Examples

There are also more tangible, specific instances of the benefits of privatization. For example, a recent study of Britain's privatization efforts in defence concluded that by the end of 1998, nearly 200 non-combat defence activities had been privatized for an estimated savings of $685 million, or 33 percent of expenditures (Mitchell, 2002). The privatized defence activities included military bases and ports, personnel recruitment and training, equipment supply and maintenance, administrative services, and research.

Another national example of successful privatization is the prison system in the United States. Privately operated, for-profit prisons tend to use more sophisticated surveillance systems than their public sector counterparts, which enable fewer guards to monitor more inmates (Thomas, 1998). Easton (1998) estimated that Canada could save in excess of $200 million per year by employing similar privatization techniques in Canada's prisons (Easton, 1998).

A successful example of contracting out public sector services at the municipal level exists in Richmond, British Columbia. The municipality enjoyed significant efficiency gains when it began contracting out garbage collection (McDavid, 1988). McDavid estimated that after privatization, the tonnes of garbage collected per person per day increased from 6.2 to 10.25, while the per household cost decreased from $52.71 to $31.72 (McDavid, 1988).

At the provincial level, the 1993 privatization of the Alberta Liquor Control Board (ALCB) has proven to be a great success. The ALCB devolved control of liquor outlets to the private sector. Since privatization, consumers have enjoyed increased access to liquor retailing outlets, improved product choice, and better service (West, 1997).

Crown Corporation Conclusion

The evidence shows that the benefits of privatization are overwhelming. By privatizing companies, governments can reduce their debts by applying the one-time source of funds to debt reduction and, therefore, reduce future debt servicing costs. The companies themselves are usually better off because their capitalization is improved, as is operational efficiency and labour productivity. Consumers are better off because they receive better quality products at lower prices and have more convenience and choice. Coincidentally, workers are also better off because their productivity improves alongside higher capitalization rates. For Saskatchewan, however, the most important benefit is the second one: that privatized firms tend to capitalize more than their public sector counterparts. Privatization of government business enterprises must be a high priority for the government of Saskatchewan within a larger program of reform.

Economic Performance Conclusion

Overall, Saskatchewan has had mixed to poor economic performance over the last 20 years. The province is now clearly at a crossroads; it must decide whether to pursue policies that will improve its economic performance and place it in the league of the "have" provinces, or continue along the path of mediocrity. If it chooses the latter, how sustainable is the status quo over the long term? Clearly, Saskatchewan cannot continue to lose its most highly skilled and highest earning people to other jurisdictions, while its remaining population becomes increasingly dependent. Neither does the province's poor investment performance seem to be sustainable over the longer or even the medium term.

Section II: Government Spending and the Size of Government

A government's fiscal policy includes both its spending and the taxation required to finance it. In Saskatchewan's case, some improvements in the size of government (spending) have been made over the past two decades. However, Saskatchewan still needs to take—and sustain—more dramatic changes so that it can become more prosperous and competitive with Alberta and Ontario.

This section begins with a brief summary of the economics of government spending and what is referred to as the "optimal size of government." It then presents an empirical analysis of government spending in Saskatchewan, along with comparative data from the other Prairie provinces, both historic and current.

The Economics of Government Spending: Achieving the Optimal Size of Government

Governments spend money to accomplish specific goals: to ensure the health of their citizens, to provide military protection, to supply a justice system, and to educate citizens, among other things. Nearly all economists agree that there are a number of functions and services that the government must provide, finance, and/or regulate. Thus, for most economists, there must be some government in place; the optimal size of government is greater than zero. Similarly, most people do not want government to use all of society's resources. So somewhere between 0 and 100 percent there is an optimal size of government. The debate over fiscal policy is most often rooted in determining this optimal size.

Size of Government and Economic Growth

Much research has examined the relationship between the size of government and economic growth. Both Daniel Landau (1983) and Robert Barro (1991) investigated this relationship in a number of countries over multiple time periods. Both their studies concluded that countries with small governments, that is, with less government spending, experienced higher economic growth rates. In fact, a 1990 study by Robert King and Sergio Rebelo found that increasing a country's taxes by 10 percent reduced its economic growth (measured as the annual change in GDP) by nearly 2 percent.

Similarly, research by Keith Marsden (1983) and William Easterly and Sergio Rebelo (1993) found that countries with lower marginal tax rates have faster economic growth than countries with higher marginal tax rates.

A number of Fraser Institute studies corroborate these findings. For instance, the Economic Freedom of the World project, which has now published four international reports along with one provincial report, provides empirical evidence of the relationship between increasing levels of economic freedom (usually implying smaller government) and increased rates of economic growth and income (Gwartney, Lawson, and Block, 1996; Gwartney and Lawson, 1997, 1998, 2000; Arman, Samida, and Walker, 1998). Similarly, research by Johnny Chao and Herbert Grubel concludes that historically, economic growth has been maximized when government taxes and spending equal one-third of national income (Chao and Grubel, 1998).

Smaller governments (measured by spending) impose fewer distortions on economic activity because they are able to levy lower and less distortionary taxes. As a result, economies with smaller governments are likely to be more efficient, and this is reflected in higher rates of economic growth (Easterly, 1993).

Size of Government and Social Progress

The argument that larger government impedes economic growth is not unusual. In fact, it is quite intuitive and is well accepted by economists. Less well known is the growing field of research that suggests that larger governments also fail to achieve greater social progress than smaller governments. For example, a series of studies completed by International Monetary Fund (IMF) economists Vito Tanzi and Ludger Schuknecht concluded that:

> …countries with "small" governments generally do not show worse indicators of social and economic well-being than countries with "big" government—and often they achieve an even better standard. Countries with "small" governments can provide essential services and minimum social safety nets while avoiding the disincentive effects caused by high taxes and large-scale redistribution on growth, employment, and welfare. (Grubel, ed., 1998, p. 70)

More specifically, they found that countries with governments whose expenditures exceed 50 percent of GDP do not materially (statistically significantly) outperform countries with smaller governments—those whose expenditures are less than 40 percent of GDP. In fact, Tanzi and Schuknecht have found that not only do countries with large governments fail to outperform countries with smaller governments, but countries with medium-sized governments (those with expenditures between 40 and 50 percent of GDP) also fail to materially outperform smaller-government countries (Tanzi and Schuknecht, 1995, 1997a, 1997b, and 1998).

Another important study, completed by Professor Gerald Scully of the University of Texas (Dallas), supports the findings of Tanzi and Schuknecht. Professor Scully examined 1995 data across 112 countries for 16 indicators of social progress including literacy, infant mortality, life expectancy, caloric consumption, access to health care, infrastructure, political freedom, civil liberties, and economic freedom. He concluded that there was little or no difference in social outcomes among countries where governments spend less than 40 percent of GDP and those that spend in excess of 50 percent of GDP (Scully, 2000).

Another of Scully's striking conclusions is that government spending ceases to yield any further social progress, as measured by the 16 social indicators, at 18.6 percent of GDP for advanced countries (Scully, 2000). There is some variance among countries; for instance, the rate at which government spending ceases to provide any marginal benefits in Canada is 19.5 percent of GDP. This is particularly striking as the Organisation for Economic Co-operation and Development (OECD) in its December 2001/02 *Outlook* (OECD, 2001/02) estimated that total government spending in Canada would be 38.6 percent in 2002, almost double Scully's optimal estimate.

Mounting research indicates that larger governments do not necessarily achieve increased social progress. Clearly, there is some optimal size of government where social progress is maximized while the level of economic distortions and impediments to economic growth are minimized.

Where Are We Today?

This study will employ three primary sources, as well as supplementary supporting documents, to assess government spending: Statistics Canada's Financial Management System, Statistics Canada's Provincial Economic Accounts, and the Province of Saskatchewan's 2002 *Budget*.

Statistics Canada's Financial Management System is the best source for inter-governmental comparisons because is it standardized across jurisdictions and provides a set of accounts that consolidate the tax and spending actions of provincial governments with those of their dependent local governments. The Financial Management System (FMS) coupled with the Provincial Economic Accounts will be the basis for all historical analysis. The study will use budget information to provide some insight into the government's future plans.

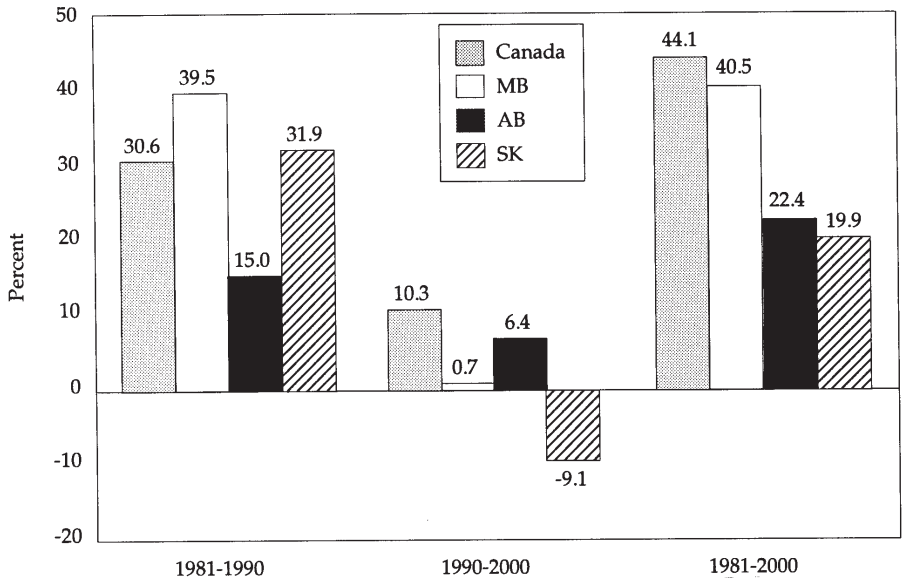
Government Spending in Saskatchewan

The data on real or inflation-adjusted government spending indicates that relative to other provinces, Saskatchewan's spending growth was average in the 1980s, and was well below that of other provinces in the 1990s. Spending Figure 1 illustrates the real growth in total provincial government expenditures between 1981 and 2000 for Alberta, Saskatchewan, Manitoba, and Canada as a whole.

Although the growth in real government expenditures in Saskatchewan was more or less average in the 1980s, these expenditures nevertheless increased significantly—by 31.9 percent between 1981/82 and 1990/91. The increase was slightly more than the national average (30.6), somewhat less than the increase in Manitoba (39.5 percent), and much more than the increase in Alberta (15.0 percent).

In the second decade, 1990/91 to 2000/01, Saskatchewan displayed substantial restraint; it was the only Prairie province to decrease real government expenditures. It reduced real spending by 9.1 percent between 1990/91 and 2000/01, whereas Canada as a whole increased real spending 10.3 percent, and such spending in Alberta increased 6.4 percent.

Spending Figure 1:
Growth in Real Government Expenditures



Sources: Statistics Canada, Public Institutions Division, Financial Management System; calculations by the authors.

The annual average change in real government spending in Saskatchewan during 1981/82 through 1990/91 was 3.3 percent. The national average was slightly less at 3.1 percent. Saskatchewan led the nation in fiscal spending restraint between 1991/92 and 2000/01, as its annual average change in real government spending during that time was -1.0 percent, the lowest in the country.

Overall, government spending increased 19.9 percent in real terms in Saskatchewan between 1981 and 2000. This is significantly less than the increase in Manitoba (40.5 percent) and the Canadian average (44.1 percent). It is also less than in Alberta, which increased total government spending 22.4 percent over the same period.[9]

Government Spending in Context

Examining aggregate increases in government expenditures alone can be simplistic because they ignore important factors such as population growth. A jurisdiction could, for instance, experience shrinking government in both per capita terms and as a share of the economy while total aggregate expenditures increased. In order to effectively measure it, government spending should be analyzed on a per capita basis and/or compared with the size of the economy.

Real Per Capita Spending

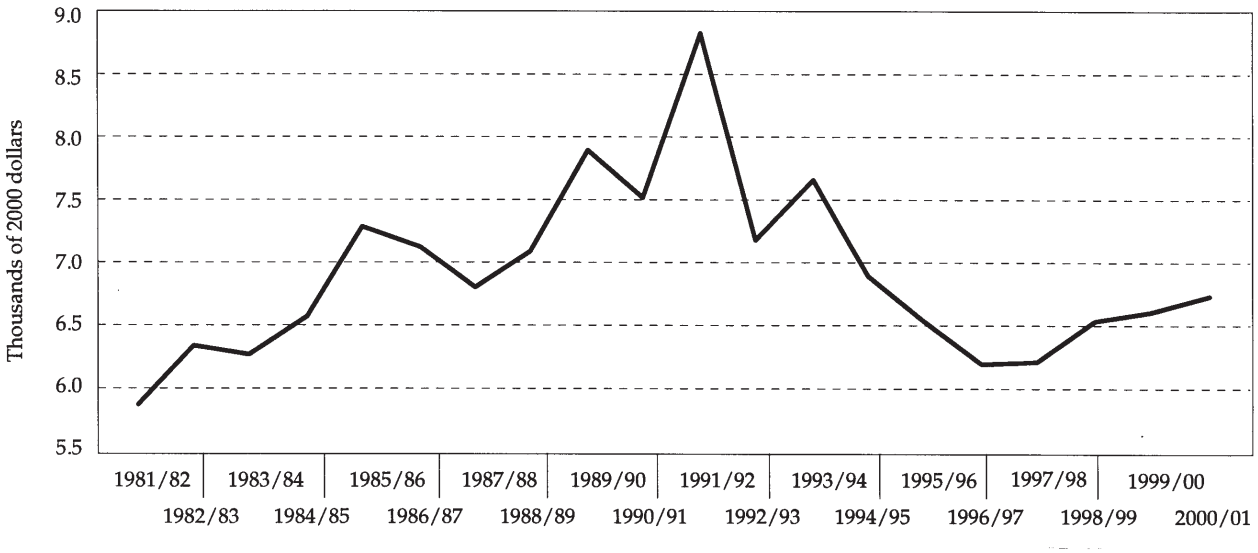
Spending Figure 2 depicts changes in real per capita government spending in Saskatchewan between 1981/82 and 2000/01. A clear and distinct trend is present; it shows a steady increase in spending up to the 1991/92 peak, after which real per capita spending declines until 1996/97. There is a marginal increasing trend after 1996/97.[10]

Spending Figure 3 places the previous data in context by including the real per capita expenditures for the remaining Prairie provinces and for Canada as a whole. In 1981/82, Saskatchewan spent marginally more than the national average. Its real per capita spending was $5,885, versus a

9 Much of the increase in Alberta's spending occurred in the final two years of the decade. The Alberta government had previously restrained fiscal expenditures quite successfully in an attempt to balance the books, reduce taxes, and pay down the province's accumulated debt.

10 The average annual change in real per capita spending post-1990/91 was -0.7 percent, even with the recent increases.

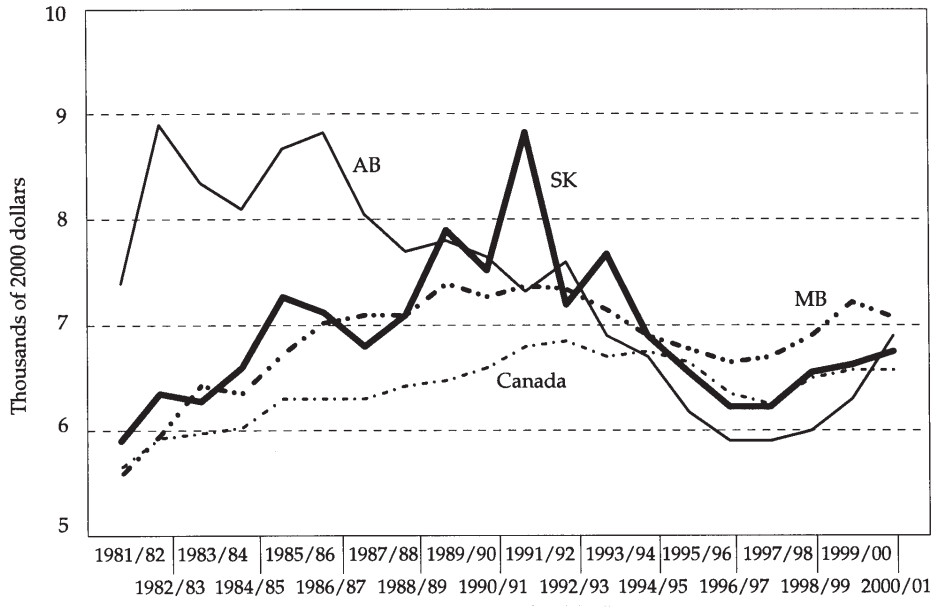
Spending Figure 2: Real Per Capita Provincial Government Expenditures for Saskatchewan



Sources: Statistics Canada, Public Institutions Division, Financial Management System; calculations by the authors.

national average of $5,645. Manitoba spent slightly below the national average at $5,563 per capita. Provincially in 1981/82, Alberta had the highest real per capita spending, Saskatchewan ranked third, and Manitoba fifth.

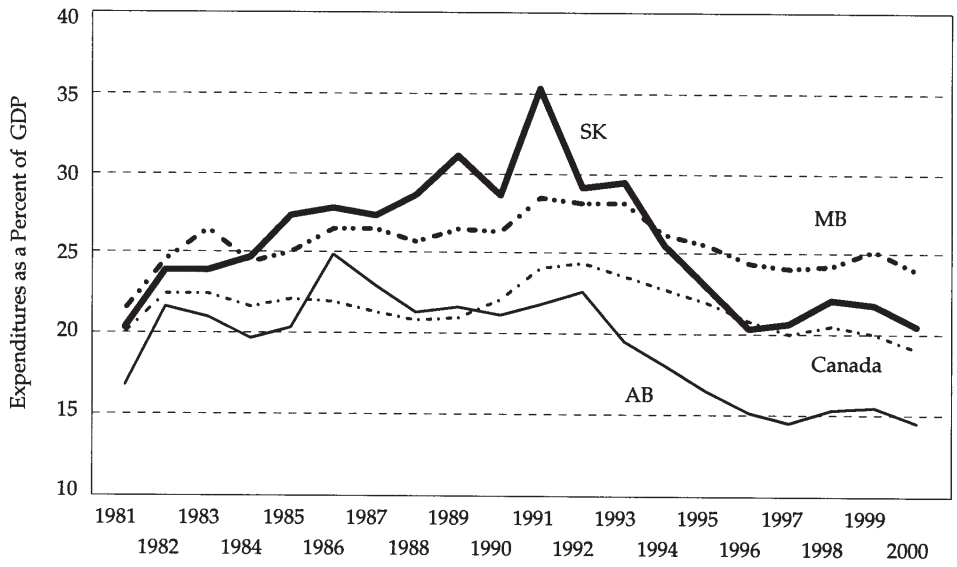
Spending Figure 3: Real Per Capita Provincial Government Expenditures



Sources: Statistics Canada, Public Institutions Division, Financial Management System; calculations by the authors.

By 1990/91, average real per capita government spending was much higher in all three Prairie provinces than in the rest of the nation. Saskatchewan had the second highest real per capita government spending in 1990/91 at $7,522, $917 (13.9 percent), more than the national average of $6,604. Manitoba's real per capita spending exceeded the national average by $665 to rank it third, and Alberta had the high-

Spending Figure 4: Real Provincial Government Expenditures as a percent of GDP (1981/82-2000/01)



Sources: Statistics Canada, Public Institutions Division, Financial Management System; calculations by the authors.

est real per capita government spending in 1990/91 at $7,660.

During the 1990s, the trend changed. All three Prairie provinces reduced real per capita government spending until 1996/97 (Saskatchewan and Manitoba) or 1997/98 (Alberta). Since then, they have generally increased spending. Taken together, the spending decreases outweigh the increases, although all three provinces continue to spend above the national average. Manitoba reduced its real per capita spending to $7,068, placing it fifth among the provinces, but still above the national average of $6,560. Alberta reduced its real per capita spending by $759 to place it sixth highest in the country at $6,901. Finally, Saskatchewan, which along with Alberta made the most dramatic reductions, placed seventh in terms of real per capita government spending. Saskatchewan spent $6,736 per capita in 2000/01, still $176 above the national average but $785 below its 1990/91 spending level.

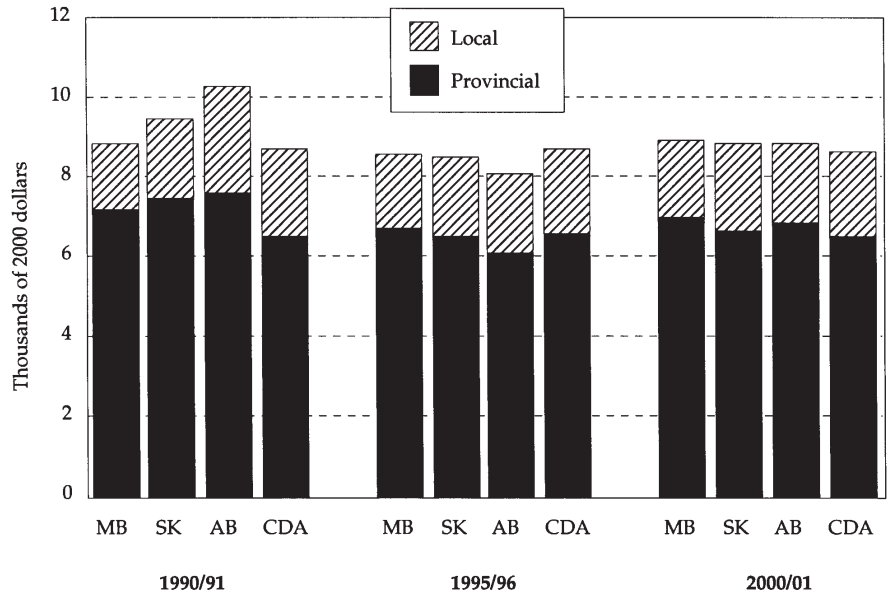
Government Spending as a Percent of GDP

Another way to examine government spending is by comparing it to the size of the economy. Such a measure is the most appropriate one available for estimating the size of government. It is also the best long-term measurement of the tax burden placed on citizens, since government spending ultimately drives taxation. Spending Figure 4 illustrates provincial government spending as a percent of the economy (GDP) between 1981/82 and 2000/01 for Alberta, Saskatchewan, Manitoba, and Canada as a whole.

At the beginning of the period, Saskatchewan's and Manitoba's government spending as a percent of the economy was above the national average: Saskatchewan at 20.4 percent and Manitoba at 21.5 percent, compared to the national average of 20.1 percent. Alberta, on the other hand, spent 16.7 percent of GDP in 1981/82, well below both the national average and the levels maintained by the two other Prairie provinces.

By 1990/91, government spending as a portion of the economy had increased, quite dramatically, for all three Prairie provinces. Alberta, at 21.1 percent of GDP, still spent less than the national average of 22.1 percent of GDP, and less than either of the two other Prairie provinces. Manitoba had increased its spending relative to the size of the economy to 26.4 percent, and Saskatchewan's had increased to 28.7 percent in 1990/91.

Spending Figure 5: Consolidated Real per capita Spending for Select Years



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

Saskatchewan ended the period essentially where it began: at 20.5 percent of GDP. Unfortunately, the gap between Saskatchewan and the national average increased due to general restraint by most other provinces. The gap increased from 0.3 percentage points (1.5 percent) in 1981/82 to 1.4 percentage points (7.3 percent) in 2000/01.

The ratio of provincial government spending to GDP in Manitoba increased from 21.5 percent in 1981/82 to 24.0 percent in 2000, an increase of 2.5 percentage points (11.6 percent). Similar to Saskatchewan, the gap between spending as a percent of GDP in Manitoba and the national average increased as most other provinces showed greater restraint in their spending. The gap for Manitoba increased from 1.4 percentage points (7.0 percent) in 1981/82 to 4.9 percentage points (25.7 percent) in 2000/01.

For most of the years considered, the size of government in Alberta was smaller than the national average. The gap between Alberta and the national average increased from -3.4 percentage points (-16.9 percent) in 1981/82 to -4.6 percentage points (-24.1 percent) in 2000/01.

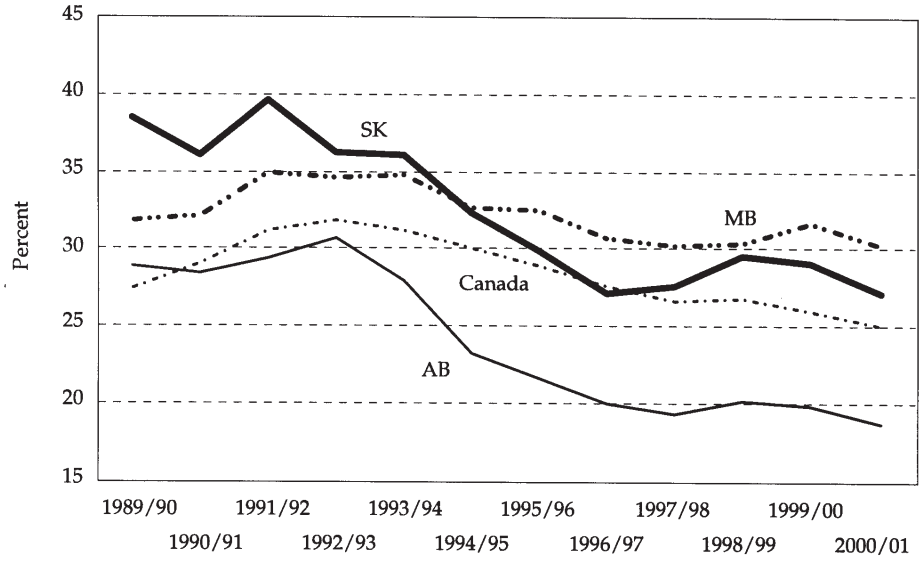
In 2000/01, in terms of government spending compared with the size of economy, Saskatchewan maintained the third smallest provincial government behind Alberta and Ontario. Although Saskatchewan's restraint program was not as strict or as deep as Alberta's, it did constrain the size of government relative to the economy, and decreased the amount the government spent per capita. Over the last decade, Saskatchewan has exercised some measure of fiscal restraint, although more will be needed if the province is to take the next step in its pursuit of long-term prosperity.

Consolidated FMS Data: A Comprehensive View

Note: Due to a limited time series, we were not able to provide an analysis prior to 1989/90.

In addition to the provincial-only data, Statistics Canada also publishes information on provincial spending that is consolidated to include local (municipal) government activities, and so provides a more comprehensive view of government spending differences among provinces. This consolidated information is an important addition to the provincial-only data since it adjusts for differences in municipal spending responsibility

Spending Figure 6: Consolidated Provincial-Local Expenditures as a Percentage of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

among provinces. It eliminates any apparent advantage or disadvantage a province may have that is solely due to the differing spending authority at the local level.

Per Capita Analysis

Spending Figure 5 shows real per capita spending on a consolidated basis for the Prairie provinces and for Canada in the 1990s. In 1990/91, the three Prairie provinces had real per capita consolidated spending that was higher than the national average. Alberta spent the most at $10,330 per person, followed by Saskatchewan ($9,453), and finally by Manitoba ($8,893). The national average was $8,708 per capita. In 1990/91, Alberta's real consolidated spending per person exceeded the national average by $1,622 (18.6 percent), Saskatchewan's spending exceeded the average by $745 (8.6 percent), and Manitoba's exceeded the average by $185 (2.1 percent).

The 1990s witnessed a large decline in real consolidated per capita spending in Alberta, a significant decline in the same spending in Saskatchewan, a small increase in Manitoba, and a small decline in the national average. In 2000/01 in Saskatchewan, real consolidated per capita spending fell by $565 to $8,888 from its 1990/91 rate of $9,453, a decline of 6.0 percent. In Alberta, real consolidated per capita spending fell by $1,491 from $10,330 in 1990/91 to $8,839 in 2000/01, a decline of 14.4 percent. Spending in Manitoba rose by $40 from $8,893 in 1990/91 to $8,933 in 2000/01, an increase of 0.5 percent.

Percent of GDP Analysis

Consolidated expenditures by government can also be compared to the size of the economy. Spending Figure 6 illustrates real consolidated provincial-local expenditures as a percent of provincial GDP between 1989/90 and 2000/01.

Saskatchewan begins the 1990s with the largest government, compared with the size of the economy, of any of the Prairie provinces. Specifically, 36.1 percent of GDP was consumed by consolidated government expenditures in Saskatchewan in 1990/91. In that year, Saskatchewan spent 24.2 percent (7.0 percentage points) more than the national average. Meanwhile, in 1990/91 Manitoba spent 10.9 percent (3.2 percentage points) more than the national average and Alberta had the smallest government relative to the size of the economy of the three Prairie provinces at 2.2 percent (0.6 percentage points) less than the national average.

Between 1990/91 and 2000/01, consolidated provincial-local spending as a percent of GDP shrank in the Prairie provinces and the country as a whole. The smallest reduction in the size of government relative to the economy took place in Manitoba, which between 1990/91 and 2000/01, reduced its size of government by 6.1 percent, from 32.3 percent in 1990/91 to 30.3 percent in 2000/01. The 2000/01 rate is still well above the national average of 25.9 percent.

Saskatchewan reduced the size of government from 36.1 percent in 1990/91 to 27.1 percent in 2000/01, a reduction of 25.0 percent, although its size of government remains above the national average (25.9 percent). Between 1990/91 and 2000/01, Alberta achieved the largest reduction in the size of government in the country. Alberta reduced its consolidated spending by 34.0 percent, from 28.4 percent of GDP in 1990/91 to 18.6 percent of GDP in 2000/01.

Budget & Fiscal Performance Index: Jurisdictional Comparisons

The Fraser Institute produces two studies that compare performance in fiscal policy: the Fiscal Performance Index (2001) and the Budget Performance Index (2001). The Fiscal Performance Index compares tax and spending performance among Canadian provinces and US states, while the Budget Performance Index compares spending, tax revenues, and debts and deficits among Canadian governments only.

In the 2001 Fiscal Performance Index, Saskatchewan ranked 45th out of 54 US states and Canadian provinces in spending control with a score of 50.4 out of a possible 100. Among provinces, Saskatchewan ranked above only British Columbia in the index, and well behind Alberta, which placed 9th with a score of 66.1 (Emes, 2001b).

In the Budget Performance Index (2001), Saskatchewan ranked 9th out of 10 for spending with a score of 26.8 out of a possible 100 (Emes, 2001a). Saskatchewan's performance in both of these indices suggests that the province is still spending too much relative to both other Canadian governments and US states.

The data discussed earlier seem to contradict the results in the two indices. However, it is important to note three things. First, the indices have a shorter time horizon than the analysis above. Second, even though Saskatchewan spends less than it used to, its spending remains above national levels. Third, the studies place considerable importance on spending relative to personal income, and Saskatchewan has performed relatively poor on this measure.

Conclusion

In many ways, Saskatchewan has achieved more than any other "have-not" province. It has one of the smaller direct government sectors in Canada, and has constrained expenditures to a greater extent than many of the other provinces. This has enabled it to move to the head of the so-called "have-not" provinces, but as yet, it has not taken the next step to increase its prosperity and economic performance. Although the province's spending and size of government are relatively competitive with the poorer provinces, it is not yet so with Alberta or Ontario.

Section III. Government Tax Policy

People often view tax policy in isolation from related polices such as government spending and the reliance on debt and deficits. Given that government spending ultimately drives taxation, and that deficits and the accordant accumulation of debt are simply deferred taxes, it is critical to evaluate such policies comprehensively. Section II of this study evaluated government spending in Saskatchewan. Section III, Government Tax Policy, assesses Saskatchewan's public policies regarding government revenues (taxes) and the use of debt and deficits.

The first part of this section assesses debts and deficits in Saskatchewan. The next section presents a general discussion of the level of government revenues collected in Saskatchewan and the other Prairie provinces. A detailed analysis of particular taxes in Saskatchewan follows, along with inter-provincial comparisons. The section then concludes with some general economics of tax policy including information on the cost of different types of taxes.

Debt & Deficits: Balancing the Books

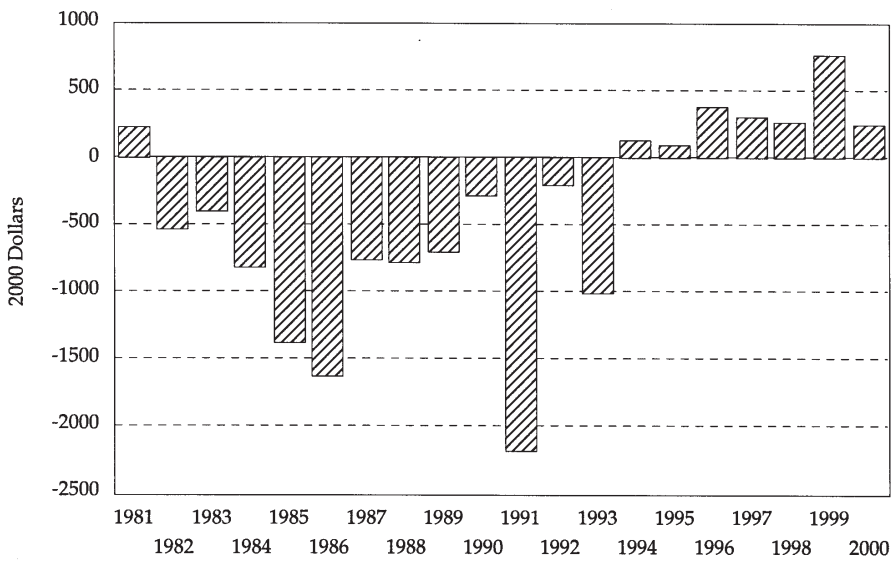
Over time, everyone—individuals, firms, or governments—must balance their budgets. The present value of expenditures must equal the present value of revenues in due course (Blanchard and Fischer, 1993; Romer, 1996; Good, 1995; Law and Clemens, 1998). For governments, this principle means that a current deficit will translate into a future tax. If a government runs a deficit today, it must run a surplus tomorrow to generate the financial resources required to pay the principal and interest accumulated on today's deficit.

Tax Smoothing: Optimal Public Finance

Given the general principle that governments, like all other economic participants, must balance their books, the pertinent question becomes: what is the most efficient (i.e., best) way for the government to finance spending over time? According to economist Robert Barro, governments should choose the mix of deficits and surpluses that minimize the "excess burden" of taxation (Barro, 1979). The foundation of this argument is that government spending is ultimately financed by taxation, and taxation causes economic distortions by altering relative prices and economic incentives (Aaron and Pechman, 1981).

A rule requiring the government to balance its budget every year would not be optimal. Tax collection and government spending fluctuate according to the business cycle, and such a rule would require tax rates to fluctuate in unison with cyclical patterns, implying higher tax rates in periods of slow economic growth or recession, and vice versa. The economic costs of tax collection would increase because tax rates and spending would have to increase and decrease according to the cyclical behaviour of the economy. A far better strategy is to accumulate surpluses during good economic times and exhaust these surpluses later, when economic conditions deteriorate. Such a strategy would enable government to smooth tax rates over time and minimize the inefficiencies caused by distortionary taxes (Aiyagari, 1989). In other words, government budgets should be balanced over the business cycle.

Tax Figure 1: Real Per Capita Annual Budget Balance in Saskatchewan (1981/82 through 2000/01)



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

Saskatchewan's Debt Record: Recent Success

There are a number of ways to assess a jurisdiction's use of deficit financing and the burden of accumulated debt. This study looks at debt and deficits from three perspectives: per capita, relative to the size of the economy, and the cost of servicing debt. Each method has its own strengths and weaknesses. In aggregate, the three measures should provide a comprehensive and realistic evaluation of debt and deficits.

Before examining the three measures, it is important to note the aggregate trend in debt and deficits. Prior to 1993/94, Saskatchewan consistently operated in deficit, and thus accumulated debt. The real net debt of the province peaked in 1993/94 at $12.4 billion. Through fiscal restraint coupled with lower interest rates and higher than expected revenues, as of 1999/00, Saskatchewan was able to reduce its net debt to $10.3 billion, a reduction of 17.1 percent.

Per Capita

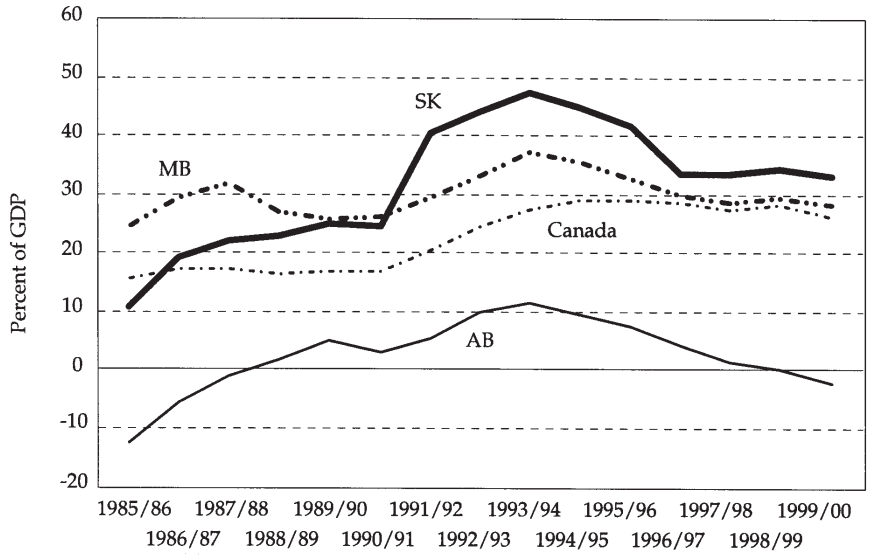
Tax Figure 1 illustrates the real per capita surpluses (deficits) that Saskatchewan posted between 1981/82 and 2000/01.[11] Although it is not unusual for a government to operate in deficit during recessions, Tax Figure 1 indicates that Saskatchewan failed to generate surpluses during the expansions of the 1980s and 1990s, indicating a structural or more permanent deficit.

Saskatchewan posted a real per capita surplus of $228 in 1981/82 (Tax Figure 1). Unfortunately, this was the last year that a surplus existed in the province until 1994/95. Between 1982/83 and 1993/94, Saskatchewan consistently posted deficits; the highest per capita deficit was recorded in 1991/92 at $2,171. The continuing deficits increased the province's accumulated debt.

Beginning in 1994/95 and continuing on to 2000/01, Saskatchewan has regularly posted surpluses that average $308 per capita over the period. The turnaround in the province's finances

11 This data comes from the Financial Management System (FMS) published by Statistics Canada rather than the budgets used by government. The FMS is a more consistent and broader measure of fiscal performance than that provided by budget information.

Tax Figure 2: Provincial Government Net Debt as a Percent of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

Tax Figure 2 shows two trends for the other Prairie provinces. First, Alberta begins the period with a net surplus, and ends the period with a net surplus, all the while keeping its debt-to-GDP ratio substantially below both the national average and the other Prairie provinces. Second, Manitoba begins the period with a debt-to-GDP ratio somewhat above Saskatchewan's but ends the period with a ratio below Saskatchewan's and close to the national average.

was accomplished largely by fiscal restraint, although increasing tax revenues and decreasing interest costs have buoyed Saskatchewan's fiscal performance.

Debt as a Percent of GDP

The amount of accumulated debt can also be compared with the size of the economy. Saskatchewan's net debt as a percent of GDP, that is, its debt relative to the size of the economy after taking into consideration the province's financial assets, went from being below the national average in 1985/86, to consistently above the national average (see Tax Figure 2). Saskatchewan's debt-to-GDP ratio continued to grow throughout the late 1980s and early 1990s, reaching a peak of 47.5 percent in 1993/94.[12] Debt as a percentage of GDP dropped starkly between 1994/95 and 1996/97, decreasing 29.8 percent from its peak.

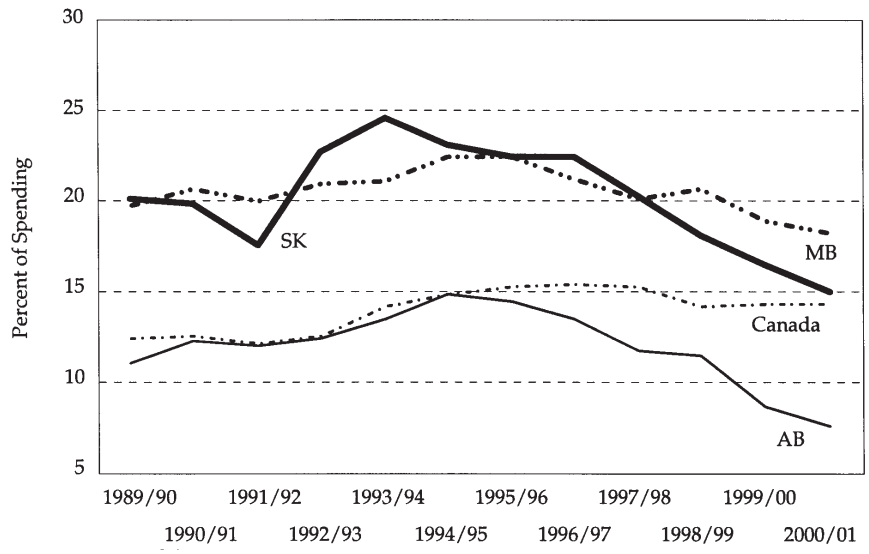
Saskatchewan currently has the fifth highest ratio of debt-to-GDP among the provinces. Although the province has been able to avoid deficits and the accordant accumulation of debt in recent years, its ratio of debt-to-GDP is still quite high, particularly with respect to the other Prairie provinces.

Debt-Servicing Costs

The final method this study uses to assess the state of Saskatchewan's debt and deficits is the cost it bears for debt-servicing. Real debt-servicing costs in the province have declined from a peak of $1.9 billion in 1993/94 to $1.0 billion in 2000/01, a 45.7 percent reduction. Part of the reduction was achieved through the general decline in interest rates. However, part of the reduction was a result of reduced overall debt, that is, the paying down of accumulated debt.

12 Unfortunately, the data for Tax Figures 2 and 3 are not as complete as the data in Tax Figure 1. All consistent data are shown.

Tax Figure 3: Provincial Government Debt Service Costs as a Percent of Total Spending



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

A simple examination of aggregate debt-servicing costs does not capture the budgetary burden of servicing accumulated debt. Tax Figure 3 presents provincial debt-servicing costs as a percent of total government spending. With this method one can observe the wedge between total spending and spending on actual programs.

The peak in debt-servicing costs for Saskatchewan occurred in 1993/94 at 24.6 percent of total spending. In 1993/94, the portion of total spending in Saskatchewan allocated for debt-servicing was 10.4 percentage points (72.9 percent) higher than the provincial average. It has since been reduced to the point where it is only marginally above the national average (Tax Figure 3).

Fiscal Stabilization Fund—Achieving Long-Term Balance

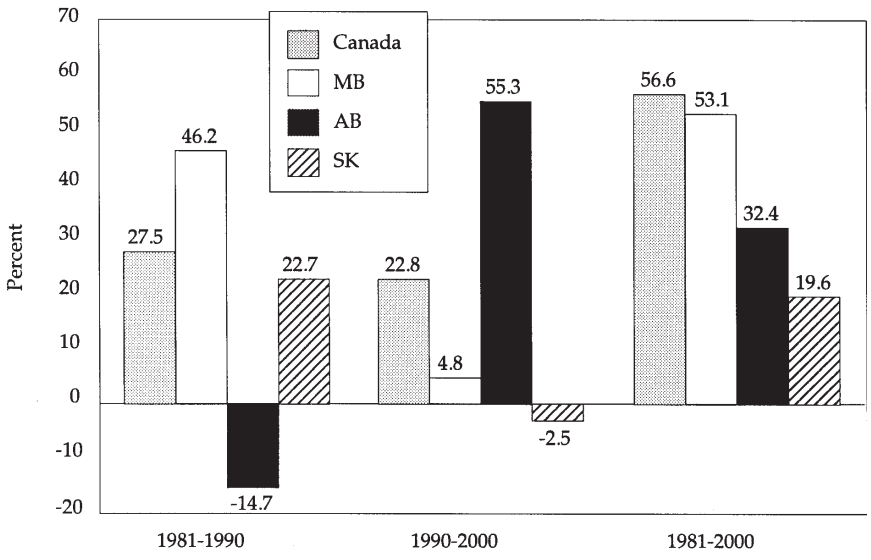
Saskatchewan recently implemented a policy to help it maintain fiscal balance over the longer term. Specifically, in 2000 the province created the *Fiscal Stabilization Fund*. The fund was established specifically to "assist in the achievement of the Government of Saskatchewan's long-term objectives by stabilizing the fiscal position of the Government of Saskatchewan from year to year" (Saskatchewan Ministry of Finance, 2000a). In other words, the fund was established to save surpluses during periods of economic expansion in order to offset deficits during periods of economic decline.

The fund was originally established with a balance of $775 million, financed by the general surplus of the government in 2000/01, which included a one-time transfer of $700 million from the Saskatchewan Liquor and Gaming Authority.[13] The minister responsible for the fund must submit a four-year plan annually that achieves a balance in the fund in the third year of not less than 5 percent of the expected revenues. In other words, each annual plan must forecast a balance in the fund three years out, equal to 5 percent of revenue.

Last year's budget (2001/02) projected a required transfer from the Fiscal Stabilization Fund of

13 The $700 million consisted of the retained earnings of the Saskatchewan Liquor and Gaming Authority that had accumulated up to the time of the transfer.

Tax Figure 4: Growth in Real Government Revenue



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

$263.7 million in order to balance the province's books. It is now estimated that $410.7 million, an increase of 55.8 percent, will have to be transferred from the Fiscal Stabilization Fund in 2001/02 in order to achieve a balanced budget. The larger than expected transfer in 2001/02 means that the Fund will maintain a balance of roughly $364.3 million at the beginning of 2002/03. However, the recent *Budget* (2002/03) indicates that the entire Fiscal Stabilization Fund will be used over the next two years to balance the province's budget. In other words, the provincial budget would be in deficit for the next two years without transfers from the Fiscal Stabilization Fund. Also, this means that there will be no resources available for further assistance (i.e., transfers) from the fund after 2003/04.

Budget Performance Index: Jurisdictional Comparisons

The Budget Performance Index provides some additional inter-jurisdictional performance information about debts and deficits. Saskatchewan ranked second out of the 11[14] provinces on the debt and deficit sub-index with a score of 81.8 out of a possible 100. Saskatchewan fell behind only Alberta, which earned a perfect score of 100.0 by eliminating its net debt (Emes, 2001a). Saskatchewan was one of only five jurisdictions that maintained an average annual surplus over the period of analysis[15] and it had the second largest decrease in net debt per capita, and as a percent of GDP.

Debt and Deficits Conclusion

Saskatchewan has made progress in achieving fiscal balance, in particular its consistent balanced budget record since 1993/94. However, it still maintains a relatively high ratio of debt-to-GDP and is still spending roughly 15 percent of its resources on debt-servicing. Clearly more needs to be done in terms of debt reduction.

14 The Budget Performance Index, unlike the Fiscal Performance Index, covers only the provincial governments and the federal government.

15 The period of analysis for the Budget Performance Index is the most recent five fiscal years available.

Taxation in Saskatchewan

Ultimately, government spending drives taxes. As the previous analysis of government spending concludes, Saskatchewan has improved its size of government as measured by government spending. It is still, however, above the national average in spending and must further reduce government if it is to join the ranks of the "have" provinces. Reducing real government expenditures further will enable the province to reduce taxes more than has been announced in recent budgets.

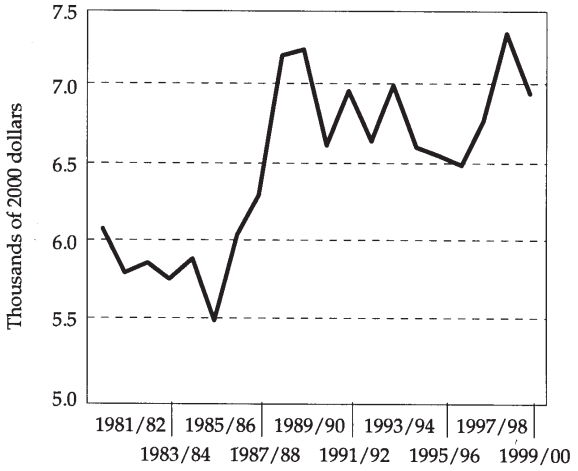
The following section assesses tax policy in Saskatchewan. First, the study assesses the general trends in revenue for the province using a number of measures, including per capita government revenues, and government revenues as a percent of the economy. Next, it makes a series of comparisons between Saskatchewan and the other Prairie provinces, as well as the national average. In particular, it examines personal income taxes, corporate income taxes, sales taxes, and corporate capital taxes with a focus on determining Saskatchewan's competitiveness. An analysis of Saskatchewan's tax mix follows, with a proposal for a more optimal mix of taxes.

Government Revenues in Saskatchewan

This study will employ three primary sources as well as supplementary supporting documents to assess government revenue: Statistics Canada's Financial Management System, Statistics Canada's Provincial Economic Accounts, and the Province of Saskatchewan's 2002/03 *Budget*.

Statistics Canada's Financial Management System is the best source for inter-governmental comparisons because is it standardized across jurisdictions. The Financial Management System (FMS) coupled with the Provincial Economic Accounts will be the basis for all historical analysis.

Tax Figure 5: Real Per Capita Provincial Government Revenues for Saskatchewan



Sources: Statistics Canada, *Provincial Economic Accounts*, Public Institutions Division, Financial Management System; calculations by the authors.

The study will use budget information to provide some insight into the government's future plans.

Real (inflation-adjusted) government revenues in Saskatchewan increased from roughly $6.0 billion in 1981/82 to $7.1 billion in 2000/01, or 19.6 percent (see Tax Figure 4). This compares with a national average increase of 56.6 percent, and increases in Manitoba and Alberta of 53.1 percent and 32.4 percent, respectively.

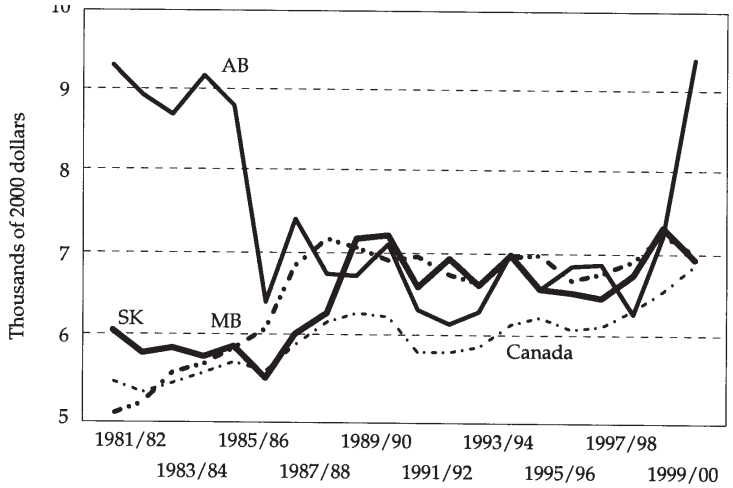
Government Revenues in Context

Aggregate increases in government revenues alone can be too simplistic a measure since it ignores important factors such as population growth. A jurisdiction could, for instance, experience shrinking government in both per capita terms and as a share of the economy while total aggregate revenues increased. To be effective, government revenue should be measured on a per capita basis, and/or compared with the size of the economy.

Real Per Capita Government Revenue

Tax Figure 5 illustrates the growth in real per capita government revenues in Saskatchewan between 1981/82 and 2000/01. The figure clearly shows the sharp increase in revenue collection in the mid- to late-1980s. Although real per capita revenues have fluctuated, the overall trend since 1990/91 is relatively constant.

Tax Figure 6: Real Per Capita Provincial Government Revenues (Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

In 1981/82, Saskatchewan extracted $6,112 in real per capita revenue, 11.3 percent more than the national average of $5,489. Revenues peaked in 1990/91 at $7,270 per capita, or 15.9 percent more than the national average. By 2000/01, real per capita provincial revenues were $6,983, marginally above the national average of $6,934. The gap between Saskatchewan and the national average on this measure has been largely eliminated.

Tax Figure 6 presents the real per capita provincial government revenue for the Prairie provinces and Canada as a whole. In 1981/82, Manitoba collected $5,095 per citizen, $394 less than the national average. Alberta exceeded the national average by 70.0 percent with real per capita revenues amounting to $9,332 (a figure that includes natural resource revenue imputed to individuals).

By 1990/91, real per capita government revenue from all three Prairie provinces well exceeded the national average. In 1990/91, Saskatchewan had the highest real per capita government revenue at $7,270, $999 (15.9 percent) more than the national average of $6,272. Alberta's real per capita revenue exceeded the national average by $891 to rank second in terms of real per capita revenue that year, and Manitoba had the third highest real per capita government revenue at $6,975.

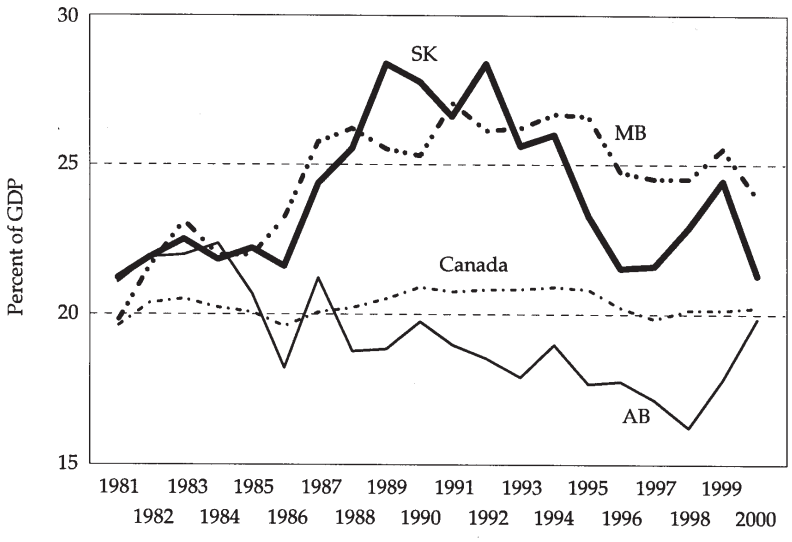
For much of the 1990s, real per capita government revenues were flat in Manitoba and Saskatchewan. Alberta's revenues, due to its natural resources, fluctuated more than the other Prairie provinces. The national average, meanwhile, was increasing marginally. Thus, both Sask- atchewan and Manitoba now generally extract real per capita revenues approximate to the national average.

Government Revenue as a Percent of GDP

A difficulty with per capita analysis is that it ignores income growth, or the per capita revenue related to its citizens' income levels. Thus, two jurisdictions with varying income levels but approximate per capita revenue levels bear different burdens. As was the case with government spending, the best barometer of the burden of government revenues is the comparison of those revenues to the size of the economy.

Tax Figure 7 illustrates government revenue as a percent of GDP (the economy) for all three Prairie

Tax Figure 7: Real Government Revenue as a Percentage of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

provinces and for Canada as a whole between 1981/82 and 2000/01.[16] Saskatchewan and Alberta begin the period with equivalent provincial revenue levels relative to the size of the economy—21.2 and 21.1 percent, respectively. Both rates are higher than the national average of 19.6 percent and the level of revenues collected in Manitoba compared with the economy (19.7 percent).

Saskatchewan's revenue-to-GDP ratio was stable until roughly 1986/87 when it escalated from 21.6 percent of GDP to 28.4 percent of GDP in 1989/90. The rate remained relatively high until 1995/96, and has generally been volatile since then. There are two important factors to note from Tax Figure 7: one, that government revenues as a percent of GDP in Saskatchewan have been above the national average for the entire period of analysis and two, that the share of GDP taken as government revenue is much smaller in Alberta than in Saskatchewan.

At the end of 2000/01, Saskatchewan's government revenues take 21.3 percent of the economy. Thus, at the beginning and end of the period, the province's government revenues represent about the same percent of the economy. In terms of overall rankings for 2000/01, Saskatchewan collects the third least amount of revenues compared to the size of the economy. Only Alberta and Ontario collect less.[17]

Consolidated FMS Data: A Comprehensive View

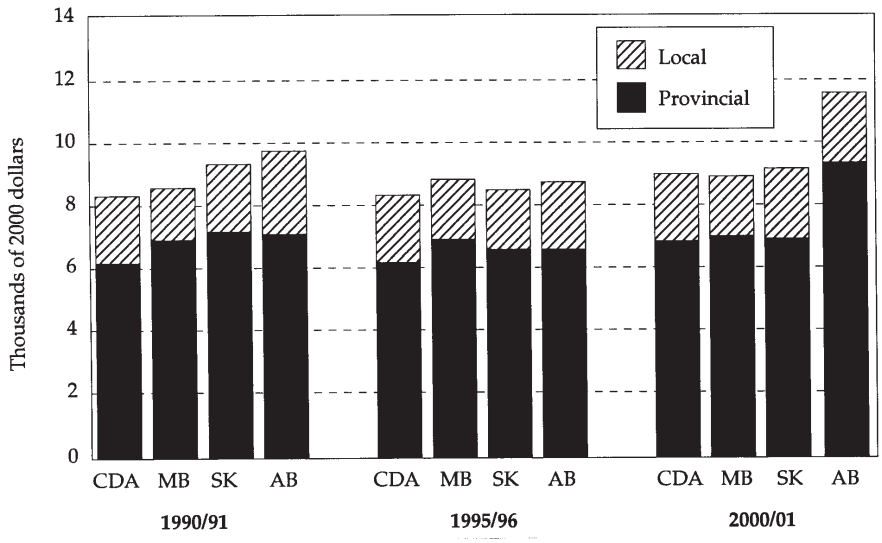
Note: Due to a limited time series, we were not able to provide an analysis prior to 1989/90.

In addition to the provincial-only data presented above, Statistics Canada also publishes information on provincial government revenue that is consolidated to include local or municipal activities, which provides a more comprehensive view of the differences in government revenue among the provinces. This information is an important addition to the province-only data since it adjusts for differences in local revenue collection among the provinces by eliminating any advantage or

16 Tax revenues as a percent of GDP is not the best indicator of the size of government because of the presence of surpluses (over-taxation) or deficits (over-spending). A more appropriate measure of the size of government is government expenditures as a percent of GDP.

17 There is one caveat about Saskatchewan's rank: government revenues as a percent of GDP in Ontario and Alberta are considerably lower than they are in Saskatchewan.

Tax Figure 8: Consolidated Provincial-Local Real per Capita Revenue for Select Years (Five Year Averages)



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

disadvantage a province may have when more or less revenue is collected at the local level.

Per Capita Analysis

Tax Figure 8 presents the consolidated provincial and municipal revenues for the three Prairie provinces and Canada as a whole. The three Prairie provinces began the 1990s with similar per capita consolidated revenue positions. In 1990/91, Saskatchewan raised $9,307 in real per capita consolidated revenues, which was $991 or 11.9 percent more than the national average, and second only to Alberta at $9,721. That year, all three Prairie provinces extracted real per capita consolidated revenues in excess of the national average.

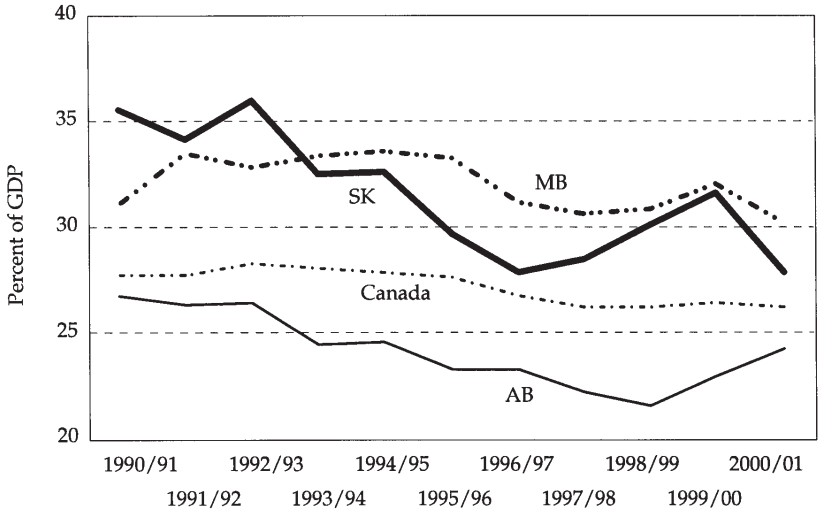
Over the 1990s, Alberta's real per capita consolidated revenues grew the most—by 19.0 percent from $9,721 in 1990/91, to $11,571 in 2000/01, although most of this occurred in the last two years. Much of the increase is due to the rapid increase in Alberta's resource revenues. Manitoba's real per capita consolidated revenue was 4.1 percent higher in 2000/01 than in 1990/91. Saskatchewan is the only province of the three whose real per capita consolidated revenue declined; it fell by 1.6 percent from $9,307 in 1990/91 to $9,157 in 2000/01. All three provinces extracted more real per capita consolidated revenue than the national average in 2000/01, although the gap had narrowed since 1990/91.[18]

Percent of GDP Analysis

As discussed previously in the provincial-only data section, one difficulty with using a per capita analysis is that it ignores income growth. By its nature, per capita analysis does not focus on the overall income in different jurisdictions, but looks solely at the difference in per capita revenues or expenditures. Two jurisdictions with different income levels but approximate levels of per capita revenue would not feel the same burden, even though the per capita analysis would suggest they did. As was the case with government spending, the best barometer of the burden of government revenues is the comparison of that revenue to the size of the economy.

18 The three Prairie provinces collect more revenues, on a real per capita basis, at the provincial level than the national average. The inverse also holds true: all three provinces collect less revenue at the municipal level.

Tax Figure 9: Consolidated Provincial-Local Government Revenues as a Percentage of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

Tax Figure 9 presents the consolidated revenues collected by the provincial and municipal governments in the three Prairie provinces, as well as the national average between 1990/91 and 2000/01.

Both Saskatchewan and Manitoba begin and end the period with consolidated government revenues in excess of the national average. In fact, the percentage of the economy collected as government revenue in both provinces exceeded the national average throughout the period examined in Tax Figure 9. Specifically, Saskatchewan begins the period with consolidated government revenues at 35.6 percent of GDP, 7.8 percentage points above the national average of 27.8 percent. Manitoba begins the period with consolidated government revenues at 31.1 percent of GDP, 3.3 percentage points above the national average.

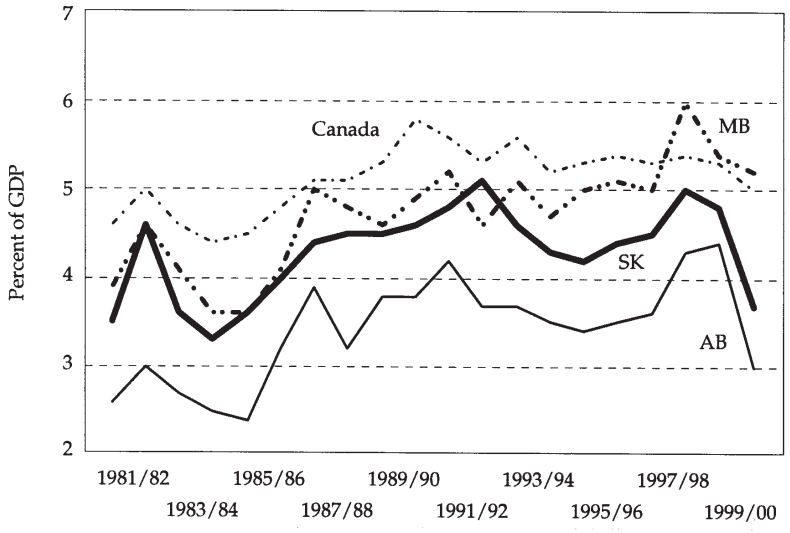
Saskatchewan has the largest percentage drop in these revenues, falling from 35.6 percent of GDP in 1990/91, to 27.9 percent in 2000/01, a decrease of 7.7 percentage points, representing a 21.6 percent decline. Manitoba's consolidated revenue take, compared with the size of the economy, remained relatively stable. That province started the 1990s with consolidated government revenues representing 31.1 percent of GDP and ended the period with government revenues consuming 30.3 percent of GDP. Beginning in 1993/94, Saskatchewan's take, namely revenue as a percent of GDP, was smaller than Manitoba's.

Alberta's consolidated revenues as a percentage of the economy ended the period roughly where they began, although the last two years have seen a large increase in natural resource fees. Alberta began the period with consolidated revenues representing 26.8 percent of GDP and ended the period with revenues at 24.3 percent of GDP, a decline of 2.5 percentage points, representing 9.3 percent.

Even though the percentage of GDP extracted in consolidated revenues in Saskatchewan declined rather markedly, it still ranks above the national average. The trend is generally improving, but clearly more needs to achieved, particularly with respect to meeting the national average.

Saskatchewan ranked fourth among the provinces in the percent of the economy consumed by consolidated revenues in 2000/01, behind the three traditional "have" provinces: British Columbia, Alberta, and Ontario. Saskatchewan has made some progress in terms of restricting the size of government and the burden of taxation. However, it has not taken the required next step; if Saskatchewan is to become more prosperous and wealthier, it must do more.

Tax Figure 10: Provincial Government Personal Income Tax Revenues as a Percentage of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

Budget Performance Index: Jurisdictional Comparisons

The Fraser Institute's Budget Performance Index compares spending, revenues, and debts and deficits among Canadian governments. In 2001, Saskatchewan fared well on the index, ranking third out of 11 jurisdictions in tax rates and revenue with a score of 62.0 out of a possible 100 (Emes, 2001a). It also performed relatively well on the change in top personal income tax rate, the change in the sales tax rate, top personal income tax rate, sales tax rate, and federal transfers as a percent of total provincial revenue. On the other hand, it performed relatively poorly on changes in the general business income tax rate, annual average change in tax revenue as a percent of GDP, top corporate income tax rate, and tax revenue as a percent of GDP.

Optimal Tax Policy

Tax policy should focus on raising adequate revenue to cover government expenditures in the least economic distortionary manner possible. Too often, tax systems are set up to achieve objectives other than raising revenue, which results in unnecessary distortions and other detrimental consequences.

Four Key Taxes in Saskatchewan

The next part of the study analyses and compares four key taxes: personal income tax, corporate income tax, corporate capital taxes, and sales taxes, in Saskatchewan, the remaining Prairie provinces, and the nation as a whole.[19] In some cases, data for the rest of the provinces are also presented. The intention of this section is to give a critical evaluation of the current state of these taxes in Saskatchewan.

Personal Income Tax (PIT)

Personal income tax receipts are by far the largest source of direct (own-source) revenue for Saskatchewan. In 2000/01, they contributed 17.6 percent, more than a sixth, of all revenue. Personal income tax and sales taxes are by far the most recognized and visible taxes in Canada. Therefore, it is critical that Saskatchewan have a competitive personal income tax regime.

Tax Figure 10 shows provincial personal income tax revenues as a percent of GDP for the Prairie provinces and for Canada as a whole from 1981/82 through 2000/01. Personal income tax

19 Only the provincial portion of these taxes is considered here.

Tax Table 1: Personal Income Tax Rates, Thresholds, and Exemptions (2002)

Brackets/ Exemptions	Canada		Manitoba		Alberta		Saskatchewan	
	Income Range	Tax Rate	Income Range	Tax Rate	Income Range	Tax Rate	Income Range	Tax Rate
1st Bracket	$7,634-31,677	16.0%	$7,412-30,544	10.9%	$13,339 & over	10.0%	$8,400-30,000	11.25%
2nd Bracket	$31,678-63,354	22.0%	$30,545-65,000	15.4%			$30,000-60,000	13.25%
3rd Bracket	$63,355-103,000	26.0%	$65,001 & over	17.4%			$60,000 & over	15.5%
4th Bracket	$103,001 & over	29.0%						
Basic Exemption	$7,412		$7,412		$13,339		$8,000	
Spousal Exemption	$6,923		$6,293		$13,339		$8,000	

Source: Canada Customs and Revenue Agency (2002); SK Ministry of Finance (2000b, 2001b, and 2002a).

revenue as a percent of GDP was higher in 2000/01 than in 1981/82 in all the provinces.[20] Saskatchewan's personal income tax take, relative to the economy, is below that of Manitoba and the Canadian average, but above Alberta's.

Personal Income Tax Reform

In November 1999, the Saskatchewan Personal Tax Review Committee published a report recommending a number of tax reforms that could enhance Saskatchewan's personal income tax system competitiveness. Eight of the Committee's specific policy recommendations were:

1) That Saskatchewan's PIT system move to a "tax on income" from the then "tax on tax" system.

2) That the current system, which included a basic tax, a flat tax, a high-income surtax, and a deficit reduction tax be replaced by a three-tiered system of income tax with three rates: 11 percent on income up to $35,000, 13 percent on income between $35,000 and $100,000, and 15 percent on income in excess of $100,000.

3) That Saskatchewan increase the basic non-refundable credit to $8,000 for both an individual and a spouse. In addition, the child credit would be $3,000 and the supplemental senior credit would be $1,500.

4) That eligible taxable capital gains in excess of the lifetime exemption be subject to provincial income tax at the lowest rate (11%), regardless of income.

20 Although the 2000/01 data show a drop in the ratio of personal-income-taxes-to-GDP in the prairies and in Canada as a whole, provincial governments have been conservative in their revenue estimates in recent years. As such, the drop is unlikely to be as sharp when the data are revised.

5) That Saskatchewan implement full indexation of both the non-refundable tax credits and tax brackets.

6) That the base of Saskatchewan's provincial sales tax be expanded and that the rate be reduced to 5 percent.

7) That the government of Saskatchewan undertake further investigations of additional possible changes which may add to the competitiveness and effectiveness of the province's tax system.

8) That the changes recommended be implemented immediately, before the transition to a tax on income system.

Source: Government of Saskatchewan, *Final Report of the Personal Income Tax Review Committee* (PITRC), released to the public on November 19, 1999.

In its 2000 budget, the provincial government committed itself to most of the recommendations contained in the *Saskatchewan Personal Tax Review Committee*'s report.[21] The last of the tax reforms will be implemented on January 1, 2003, and will consist of: basic and spousal exemptions of $8,000, tax rates of 11, 13, and 15 percent on incomes between $8,000 and $35,000, $35,000 and $100,000, and in excess of $100,000, respectively.[22]

These changes are a distinct improvement. Unfortunately, they are insufficient to make Saskatchewan's personal income tax system competitive with Alberta's. Tax Table 1 contains the personal income tax rates for the Prairie provinces and the federal government for the current year (2002).

In two areas, the deficiencies of Saskatchewan's reformed system are most visible: high- and low-income personal income tax. The top marginal personal income tax rate in Alberta is 10.0 percent, 5.5 percentage points lower than in Saskatchewan. Even when Saskatchewan's reforms are fully implemented, Alberta's rate will still be 5 percentage points less than, or two-thirds of the comparable rate in Saskatchewan.

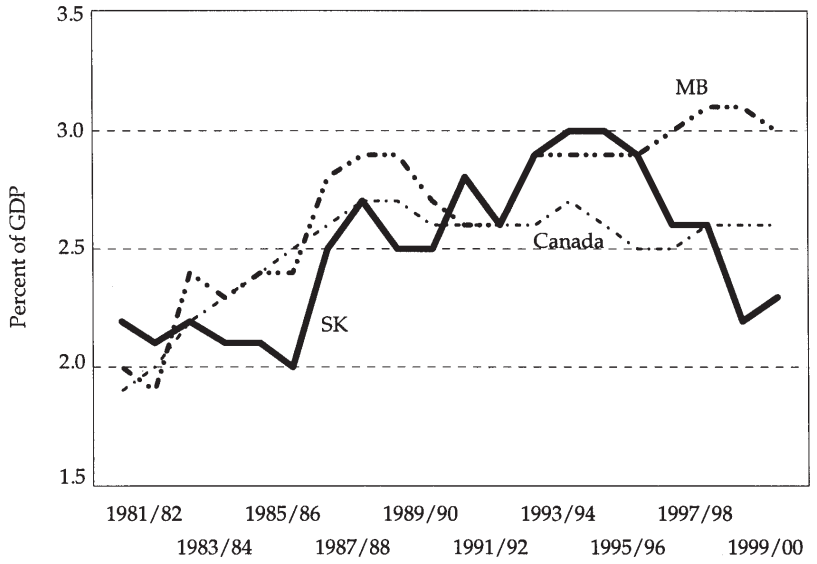
Similarly, low-income earners are also penalized. When assessing the effective tax rate for those on low incomes, it is critical to combine the exemption value with the applicable tax rate. The value of the exemption, or the amount individuals can earn tax-free, has a much greater affect on low-income earners than the applicable tax rate. Low-income earners are generally better off with a higher exemption and higher rate than with a lower exemption and lower rate. The fact that Saskatchewan's exemption is only 63.0 percent of Alberta's, and that the applicable rate is 1.0 percentage point higher in the former province, means that low-income earners in Saskatchewan will inevitably pay higher personal income taxes than comparable individuals in Alberta.

Although Saskatchewan's personal income tax reforms are positive, the system in that province is still not competitive with Alberta's. However, the changes do establish a solid foundation from which to launch additional reforms. Clearly, Saskatchewan will have to further reduce its top marginal rate if it is to compete with Alberta and neighbouring US states. It is, therefore, critical that Saskatchewan develop and implement a

21 The most significant recommendation implemented relates to the provincial sales tax. The Commission had recommended extending the base significantly and lowering the rate to 5.0 percent. In fact, the province maintained the PST rate at 6.0 percent and marginally expanded the base.

22 The taxable capital gains of farmers and small business owners were taxed at the lowest provincial income tax rate beginning in 2001.

Tax Figure 11: Provincial Government Sales Tax Revenues as a Percentage of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

Saskatchewan's sales tax has been volatile over the last 20 years, partially due to changing bases and fluctuating rates. Tax Figure 11 shows provincial government sales tax revenues for the Prairie provinces and for Canada as a whole relative to the size of the economy.

Saskatchewan has generally used the sales tax, as measured by sales tax revenues compared with the size of the economy, to a lesser extent than Manitoba and Canada as a whole. (Of course, Alberta does not have a sales tax at all.[24]) The mid-1990s is an exception to this. At that time, Saskatchewan's use of the sales tax was well above the national average.

multi-year schedule to reduce or even eliminate the top marginal personal income tax bracket with a view towards collapsing the current three rates into one, similar to Alberta's single rate tax.[23]

Provincial Sales Taxes

Sales or consumption taxes are another major source of revenue for the provincial government. In 2000/01, consumption taxes in general represented 22.9 percent of total revenue. Saskatchewan's provincial sales tax, referred to as the Education & Health Tax (E&H), contributed 10.7 percent of total revenue, with the remainder provided by alcohol and tobacco taxes, amusement taxes, gasoline and motor fuel taxes, and gaming taxes.

Along with the personal income tax reforms came changes to Saskatchewan's sales tax, the E&H. The Personal Tax Review Committee had recommended expanding the base of the sales tax while lowering its rate. In its 2000/01 *Budget*, the Saskatchewan government expanded the sales tax base (although not to the extent suggested by the Committee), but did not reduce the rate. The sales tax base was expanded to include many goods and services covered by other jurisdictions' sales tax regimes.[25] The province also introduced a sales tax credit to offset the effect of the sales tax changes on lower income earners.[26]

The expansion of the sales tax base, even with the creation of a tax credit program, yielded increased revenues, which partially offset the per-

23 An expanded discussion of flat tax reform is available in Emes and Clemens (2001), available on the Internet at *www.fraserinstitute.ca*.

24 A number of researchers have argued that its health premium is similar to a consumption or sales tax.

sonal income tax reductions. The Department of Finance in Saskatchewan estimates that a one percentage-point increase in the provincial sales tax would yield an additional $126.8 million in revenue (McGregor, 2002). As Tax Table 2 indicates, Saskatchewan has the lowest provincial sales tax rate in the country excluding Alberta, which does not have a provincial sales tax.

As will be discussed later in this section, Saskatchewan's relatively low use of a consumption tax may allow for efficiency gains if it re-configures its tax mix. The province could reduce certain high-cost taxes, and increase other low-cost taxes, in order to achieve greater economic efficiency without losing any revenue.

The taxation of business inputs is a second issue associated with the provincial sales tax in Saskatchewan. Consumption, or sales taxes as they are more commonly referred to, are supposed to be designed to tax consumption, not investment. For instance, the goods and services tax (GST), the federal sales tax, exempts inputs into the business process in order to ensure that only final consumption is taxed, and investment in the production of goods and services is exempted. Unfortunately, the Saskatchewan sales tax does not exempt business inputs from taxation.[27] Businesses are charged sales tax on inputs which are used to produce goods which are again subject to the sales tax when sold. Such taxation is an impediment to business investment and development since it discourages investment in some of the tools that make a society more productive, namely, plants, machinery, and other equipment. Saskatchewan must deal with this major problem immediately, even if it means increasing the applicable sales tax rate.

Tax Table 2: Provincial Sales Taxes

Province	General Rate
BC*	7.5
AB	Nil
SK	6
MB	7
ON	8
QC	7.5
NB	8
NS	8
PEI	10
NF	8

Note: Many provinces assess a separate sales tax (different rate) on accommodations and meals.
*The rate was increased from 7.0 to 7.5 percent in the 2002 provincial *Budget*.
Source: Treff and Perry, 2001.

Business Taxation: A Core Problem in Saskatchewan

Business Income Taxes

Although business or corporate income taxes (CIT) represent a small portion of provincial revenue (only 4.4 percent in 2000/01), they are nonetheless an important driver of, or deterrent to, economic activity. It is, therefore, essential that Saskatchewan maintain a competitive business tax regime.

Who ultimately pays the taxes levied on business? There is a general perception that business

25 For example, professional services, specialized services, non-medical prescriptions, and dry cleaning were among the goods and services added to the provincial sales tax base.

26 See the Saskatchewan Department of Finance, *A Plan for Growth and Opportunity: Personal Tax Reform in Saskatchewan*, March 2000.

27 Saskatchewan does offer a sales tax exemption for farm machinery and repair parts as well as an investment tax credit for manufacturing and processing.

Tax Table 3: Summary of Provincial Business Income Tax Rates (2001)

Type of Business	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NF
Small Business Rate (%)	4.5	5.0[ab]	6.0	5.0	6.0[c]	9.04	4.0	5.0	7.5	5.0
Small Business Threshold ($)	200,000	350,000[c]	300,000	300,000	400,000	200,000	200,000	200,000	200,000	200,000
General Corporate Rate (%)	13.5	13.0[be]	17.0	16.5[f]	12.5[g]	9.04/ 16.46[h]	16.0	16.0	16.0	14.0
Manufacturers and Processors Corporate Rate (%)	13.5	13.0[be]	10.0/ 17.0	16.5[f]	11.0[g]	9.04	17.0	16.0	7.5	5.0

[a]Alberta's Small Business Income Tax Rate will ultimately be reduced to 3.0%.
[b]Alberta's rates are effective April 1. The rates prior to April 1, 2002 are 13.5 percent for corporations and 5.0 percent for small businesses.
[c]Ontario's Small Business Income Tax Rate will be reduced to 4.0% by 2006.
[d]Alberta's small business exemption will ultimately be raised to $400,000.
[e]Both of Alberta's corporate income tax rates are ultimately scheduled to be reduced to 8.0 percent.
[f]Manitoba's corporate income tax rates are scheduled to fall to 15 percent in 2005.
[g]Both of Ontario's corporate income tax rates are scheduled to be reduced to 8.0 percent.
[h]The higher rate applies to passive (investment) income of a corporation.
Sources: *Alberta Business Tax Review: Report and Recommendations* (2000); Ontario Ministry of Finance; Canadian Tax Foundation (2000); Alberta Ministry of Finance, *Fiscal Plan 2002*; *Finances of the Nation*; Ontario *Budget*, 2000; Bird and McKenzie, 2001; specific inquiries to provincial Ministries of Finance.

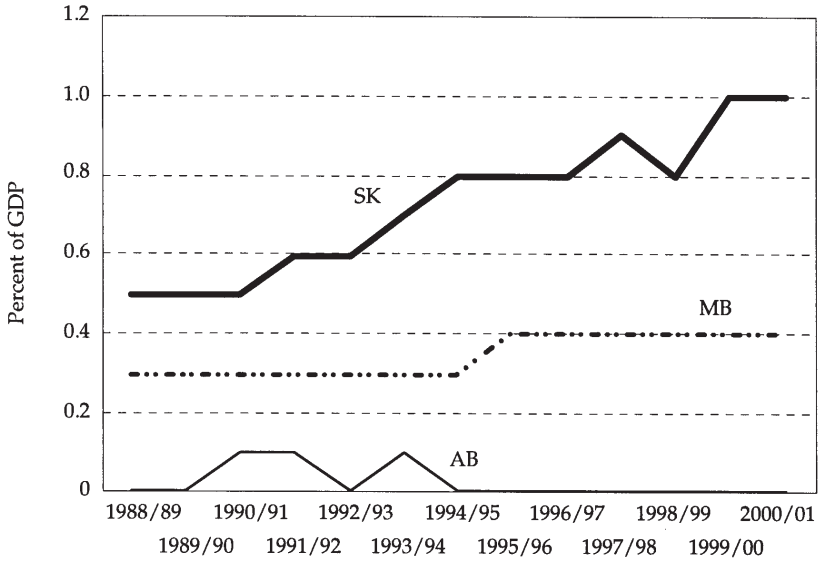
taxes are borne by businesses themselves, or by the wealthy. The reality is quite different. The burden of business taxes ultimately falls on individuals. The Carter Commission,[28] one of Canada's most important inquiries into taxation, concluded that businesses ultimately do not bear the burden of taxation. Rather, they simply pass the taxes on to customers in the form of higher prices, to shareholders and owners in the form of lower returns, and/or to employees in the form of lower wages. Ultimately, then, business taxes are borne by individuals, albeit indirectly.

Tax Table 3 contains business income tax rates for all of the provinces. Saskatchewan currently has the highest statutory corporate income tax rates in the country both for general corporations and for manufacturers and processors (M&P). Saskatchewan's statutory tax rate for small business is generally in the middle of the range of rates for the provinces. That said, it has one of the higher thresholds for small business taxation.

The corporate income tax rate gap is most noticeable with Saskatchewan's neighbour, Alberta. Alberta currently has general and M&P rates of 13.0 percent. However, Alberta, like Ontario, has announced a multi-year plan to reduce both rates to 8.0 percent. This means that Saskatchewan's current 17.0 percent rate will be more than double the rates of Alberta and Ontario once the reductions in those provinces are fully implemented. The problem of high relative corporate income tax rates is likely to worsen for Saskatchewan as other provinces begin to reduce their rates. British Columbia, for instance, recently reduced its corporate income tax rate to 13.5 percent from 16.5 percent. Obviously, it is a high and immediate

28 Formally referred to as the Royal Commission on Taxation (1966).

Tax Figure 12: Provincial Government Corporate Capital Tax Revenues as a Percentage of GDP



Sources: Statistics Canada, Provincial Economic Accounts, Public Institutions Division, Financial Management System; calculations by the authors.

priority for Saskatchewan to reduce its corporate income tax rates.

The Capital Tax: Particularly Damaging

Capital taxes are an important revenue source for Saskatchewan. In 2000/01, this type of tax provided 4.6 percent of total revenue,[29] which is more than corporate income taxes reap. Tax Figure 12 shows provincial corporate capital tax revenues as a percent of GDP for the Prairie provinces and for Canada as a whole from 1988/89 through 2000/01.[30] Saskatchewan clearly collects more corporate capital taxes relative to the size of the economy than Manitoba or Alberta. The province should be concerned both about its increasing reliance on this form of tax, and the increasing gap with the national average.

Corporate taxes pose a serious problem for Saskatchewan. Businesses face capital taxes whether they generate a profit or not. Increasingly in recent years, governments have relied on profit-insensitive taxes, such as capital and property taxes, to avoid, or at least mitigate, the part of their revenue that is affected by the cyclical nature of business. The close relationship between business income tax collections and business profits yields an unpredictable, uneven revenue stream that rises and falls with the business cycle.

The capital tax has been referred to as one of the most damaging taxes in the Canadian system. It fails every test of tax effectiveness and may be the very worst way to raise revenue. It is a highly distortionary tax and on that count alone fails the test of efficiency. It punishes a number of sectors that are by their very nature capital-intensive, further reducing the efficiency and fairness of the tax. The design of the tax in Canada means that it unduly punishes financial institutions, again failing the test of fairness. The corporate capital tax is both expensive for government to administer, and for business to comply with. The corporate capital tax is not only distortionary and inefficient, but is overly complex and a significant impediment to economic growth and prosperity.

Unfortunately for citizens of Saskatchewan, the province is the greatest user of capital taxes in the country, according to a recent study by The Fraser Institute (Clemens *et. al.*, 2002) that evaluated

29 Total revenue is distinct from own-source revenue as it includes transfers, particularly those from the federal government.

30 This analysis and data is taken from Clemens, Emes, and Scott (2002).

Tax Table 4: Federal and Provincial Capital Tax Rates (July 2001)

	Non-Financial Rate (%)	Financial Rate (%)
Fed	0.225[a]	1.0/1.25/1.40[b]
BC	0.30[c]	1.0/3.0[d]
AB	Nil	Nil[e]
SK	0.6[f]	0.7/3.25[g]
MB	0.3/0.5[h]	3
ON	0.3	0.6//0.9[i]
QC	0.64	1.28
NB	0.3[j]	3
NS	0.25/0.5[k]	3
PEI	Nil	3[l]
NF	Nil	4[m]

Notes:
[a]A $10 million taxable capital deduction is allowed.
[b]The lower rate is applied to firms with taxable capital of between $200 and $300 million; the middle rate is imposed on corporations with taxable capital of over $300 million. The rate of 1.40 percent is the result of a 12 percent surcharge, which is applied to corporations with taxable capital of over $400 million.
[c]This rate will be eliminated by September 1st, 2002.
[d]The lower rate applies to financial institutions with taxable capital of less than $400 million, and the higher for those with over $400 million.
[e]This tax was eliminated on April 1st, 2001.
[f]The first $15 million in taxable capital is deductible as per Budget 2002/03. This represents a 50 percent increase in the value of the deduction.
[g] The lower rate applies to financial institutions with taxable capital of less than $400 million, and the higher to those with taxable capital over $400 million. In addition, resource companies are subject to a 3.6 percent surcharge on the difference between total sales and the capital tax liability.
[h]The lower rate applies to those corporations with total taxable capital between $5 and $10 million. The higher rate includes a surcharge of 0.2 percent on corporations with taxable capital of over $10 million.
[i]The rates apply to various amounts of taxable capital. Due to the complicated nature of the rate schedules, it is best to refer to the Ontario Capital Tax Act for the exact application of the rates and bases.
[j]A $5 million taxable capital deduction is allowed.
[k]If a corporation has taxable capital of $5 million to $10 million they are entitled to a $5 million dollar deduction, but are taxed at the higher rate. Those with over $10 million in taxable capital are not entitled to the deduction but are taxed at the lower rate. Those with taxable capital of less than $5 million are exempt from taxation.
[l]A $2 million deduction is allowed.
[m]A $5 million taxable capital deduction is allowed for those firms with total taxable capital of less than $10 million.
Sources: Clemens *et. al.*, 2002.

the corporate capital tax in Canada and measured its use across all Canadian jurisdictions. Specifically, the province ranked first for capital tax usage relative to: (1) own-source revenues, (2) GDP, and (3) corporate income tax. It ranked second, behind only Quebec, for corporate capital taxes as a percent of business profits.

By two measures of capital tax usage, Saskatchewan essentially stands alone in the extent of its use: capital tax as a percent of own-source revenue, and capital tax as a percent of corporate income tax. Saskatchewan collects more capital taxes relative to own-source revenues than any other jurisdiction in Canada. In 2000/01, capital tax revenue constituted 5.4 percent of own-source revenues[31] collected in Saskatchewan. Saskatchewan's heavy reliance on capital taxes as a source of government finance is not a recent phenomenon. The province has ranked first on this mea-

Tax Table 5: Marginal Effective Tax Rates On Capital* (2000)

Sector	BC[a]	AB[b]	SK	MB	ON[c]	QC	NB	NS	PEI	NF
Manufacturing	27.9	21.6	26.8	30.0	25.6	24.2	26.0	24.9	19.9	15.5
Services	35.9	30.6	38.3	37.7	33.8	31.1	34.1	32.9	33.4	29.4

*Combined federal/provincial Marginal Effective Tax Rates
[a]BC's METR for both manufacturing and service companies should decline since it has reduced corporate income rates, eliminated its general capital tax, and exempted business inputs from the provincial sales tax.
[b]Alberta's METRs are expected to drop to 17.3 percent for manufacturers and 19.8 percent for service firms by 2006, based on announcements.
[c]Ontario's METRs are expected to drop to 23.1 percent for manufacturers and 25.8 percent for service firms by 2006, based on announcements.
Source: Bird and McKenzie, 2001.

sure since 1993/94, and was ranked second prior to that.

The other indicator by which Saskatchewan's use of capital taxes is unique is the ratio of capital taxes collected to corporate income taxes. Saskatchewan is the only jurisdiction to consistently collect more capital tax revenue than corporate income tax revenue. In 2000/01, Saskatchewan collected $1.05 in capital taxes for every $1.00 collected from corporate income tax. Quebec ranked second, but trailed Saskatchewan significantly; it raised $0.63 in capital tax revenues for every $1.00 of corporate income tax revenues that year.

Further evidence of Saskatchewan's relatively high use of capital taxes is that it assesses some of the highest rates in the country (see Tax Table 4). Furthermore, capital tax revenue has grown by over 165 percent in real terms since 1989/90, surpassed only by British Columbia, Nova Scotia, and New Brunswick (which implemented new taxes over this period).

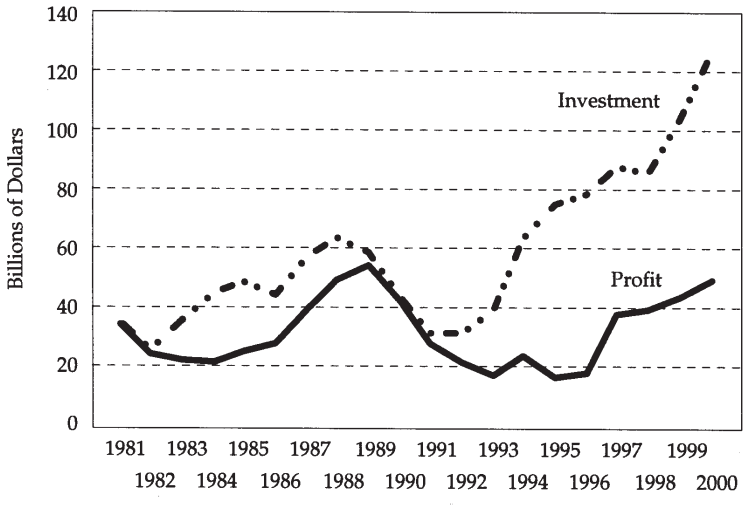
In its 2002 *Budget*, Saskatchewan increased the threshold or exemption value for corporations from $10 million to $15 million. The Ministry of Finance estimated that over 100 companies would now be exempt from the tax (Saskatchewan Ministry of Finance, 2002). However, given the enormous economic costs associated with using capital taxes at all, particularly their deleterious effect on economic growth and investment, the elimination of the capital tax in Saskatchewan must be an immediate and high priority, even if it results in an intermediate loss in revenues. The long-term benefits of eliminating the tax, such as increased economic growth, increased investment, and ultimately higher wages, will far outweigh any revenue losses that may occur.

Marginal Effective Tax Rates for Business

After examining provincial corporate income and corporate capital tax rates, it is useful to look at what are called Marginal Effective Tax Rates (METR) on capital. METRs take into account differing tax bases, the presence of tax credits, and other characteristics of provincial tax systems that are not readily apparent in a simple comparison of tax rates (Chen, 2000). The METR enables us to measure, in a comprehensive manner, the true marginal taxes facing businesses in a particu-

31 Excludes transfers from other levels of government.

Tax Figure 13: Business Net Fixed Capital Formation (Investment) and Corporate Profits Before Taxes



Sources: Statistics Canada, Provincial Economic Accounts; calculations by the authors.

Business Investment and Taxation

This study's first section, "Economic Performance," has already identified one of Saskatchewan's principle problems as a lack of business investment. Tax Figure 13 shows net business investment and corporate profits for Canada between 1981/82 and 2000/01. There is a clear relationship between business profitability and investment, even before adjusting for any lag effects. Clearly, a main driver for business investment is after-tax profitability. Saskatchewan's onerous, punishing taxation of business is a major impediment to investment. An overarching objective for the government of Saskatchewan must be a large and permanent reduction in business taxes.

lar jurisdiction. This is particularly important in Saskatchewan's case since the province augments its already high corporate income tax rates with high corporate capital tax rates. Also, it taxes business inputs through the sales tax.

The METR calculation is onerous and complex. Thankfully, the task has already been completed by Richard M. Bird and Kenneth J. McKenzie. Their Marginal Effective Tax Rates on Capital are depicted in Tax Table 5.

The METR analysis identifies a major problem facing Saskatchewan: high business taxes. Saskatchewan maintains the highest METR for service companies, and the third highest METR for manufacturing firms. Given British Columbia's business tax reductions in 2001 (including corporate income tax reductions, elimination of the general corporate capital tax, and the exemption of machinery and equipment from the provincial sales tax), Saskatchewan is likely to have the second highest METR for manufacturers in 2002.

The Cost of Taxes

Taxes distort the economy by altering incentives and changing the relative prices of certain activities, goods, and services (Aaron and Pechman, 1981). Ideally, the tax system achieves efficiency, that is, it raises revenues in the least distortionary manner possible, and thus maximizes economic growth. A large and growing body of research documents the negative effects associated with tax structures that attempt to modify behaviour at the cost of efficiency. Some of the higher-profile studies have determined that:

- High marginal tax rates on labour reduce labour supply. By lowering the cost of leisure, high marginal income tax rates encourage people to substitute leisure for work (Heckman, 1993; Triest, 1990).
- Payroll taxes increase the cost of labour, both absolutely and, more importantly, relative to capital. An increase in payroll taxes will cause firms to change the mix of labour and capital, moving away from labour towards

capital so as to minimize their costs. Payroll taxes can, therefore, be seen as a tax on employment. Empirical evidence supports the assertion that payroll taxes have a negative impact on employment (OECD, 1994; De Matteo and Shannon, 1995). For instance, De Matteo and Shannon (1995) found that a 1 percent increase in average payroll taxes increases the employers' real wage costs by 0.56 percent, reduces workers real wages by 0.55 percent, and reduces employment by 0.32 percent.

- Taxes on capital gains and dividends reduce both savings and total investment. Taxes on capital gains and investment income reduce the rate of return and, thus, result in lower overall levels of investment since what investors care about is the rate of return net of taxes, as opposed to gross, pre-tax returns (Summers, 1984; Ture and Sanden, 1977). Since productivity improvements are often embodied in new capital investment, the impact of such taxes in the long run is to slow the rate of capital accumulation and the rate of economic growth (Marsden, 1983).

- Punitive taxation levels encourage the growth of the underground economy. When faced with high tax rates, individuals will tend to engage in untaxed activities and avoid taxed activities (Feige, 1989; Lippert and Walker, 1997). For instance, in some cases, provincial sales taxes have been shown to promote tax evasion and the growth of a black market "underground" economy (Starobin, 1994). Empirical estimates suggest that the size of the underground economy in Canada could be anywhere from 4.5 percent to 20 percent of GDP (Mirus, Smith, and Karoleff, 1994; Drummond, Ethier, Fourgere, Girard, and Rudin, 1994).

- The deadweight costs of taxation are particularly high in Canada. It has been estimated that each additional dollar of taxes collected through the Canadian federal personal income tax system reduces output by $1.38; a dollar increase in taxes collected through the provincial income tax reduces output by $1.66 (Dahlby, 1994).

Different types of taxes create different economic distortions and so will affect economic growth differently. One critical issue in tax policy is the mix of taxes particular jurisdictions use to raise the revenue they require. The list of taxes that government has at its disposal seems almost endless: income (both personal and business), payroll, property, sales, licenses, fees, capital, etc. The appropriate mix is necessary to ensure that taxes are efficient, simple, and equitable.

As discussed, different taxes introduce different types of distortions with varying costs. A number of studies have attempted to document these costs. These studies focus on answering the question: what is the additional cost to the economy of raising an additional dollar of revenue from a particu-

Tax Table 6: MEC Estimates for Select Canadian Taxes

Tax	MEC
Corporate Income Tax	$1.55
Personal Income Tax	$0.56
Payroll Tax	$0.27
Sales Tax	$0.17

Source: Organization for Economic Cooperation and Development, *OECD Economic Surveys*, 1996-1997.

Tax Table 7: Marginal Efficiency Cost Estimates for Various Taxes

Tax	MEC
Capital Income Taxes (Individual & Corporate)	$0.924
Corporate Income Tax	$0.838
Individual Income Tax	$0.598
Labour Income Tax	$0.482
Sales Tax	$0.256
Property Taxes	$0.174

Source: Jorgenson and Yun (1989).

Tax Table 8: Composition of Government Revenue in Saskatchewan (Select Years)

	1991/92	1995/96	2000/01
Own Source Revenue	70.1%	83.2%	85.4%
Income Taxes	19.5%	22.7%	23.9%
Personal Income Tax (PIT)	18.1%	18.0%	17.6%
Corporate Income Tax (CIT)	1.3%	3.8%	4.4%
Mining and Logging	0.1%	0.9%	1.9%
Taxes on Payments to Non-Residents	0.0%	0.0%	0.0%
Other Income Taxes	0.0%	0.0%	0.0%
Consumption Taxes	18.9%	25.5%	22.9%
General Sales Tax	10.4%	12.7%	10.7%
Alcoholic Beverages and Tobacco Taxes	1.9%	1.9%	1.8%
Amusement Tax	0.0%	0.0%	0.0%
Gasoline and Motive Fuel Taxes	4.0%	5.5%	5.1%
Liquor Profits	2.0%	2.8%	2.0%
Remitted Gaming Profits	0.7%	2.5%	3.4%
Other Consumption Taxes	0.0%	0.0%	0.0%
Property and Related Taxes	2.1%	3.6%	4.6%
General Property Taxes	0.0%	0.0%	0.0%
Capital Taxes	2.1%	3.6%	4.6%
Other Property and Related Taxes	0.0%	0.0%	0.0%
Other Taxes	8.0%	5.4%	6.0%
Payroll Taxes	0.0%	0.0%	0.0%
Motor Vehicle Licences	1.4%	1.5%	1.6%
Natural Resource Taxes and Licences	0.9%	1.5%	2.2%
Miscellaneous Taxes	5.7%	2.5%	2.2%
Health Insurance Premiums	0.0%	0.0%	0.0%
Contributions to Social Insurance Plans	1.9%	2.3%	2.3%
Sales of Goods and Services	2.4%	3.9%	4.0%
Investment Income	17.1%	19.4%	21.4%
Other Revenue from Own Sources	0.3%	0.3%	0.3%
General Purpose Transfers from Other Government	11.6%	4.2%	11.1%
Specific Purpose Transfers from Other Government	18.2%	12.6%	3.5%
TOTAL REVENUE	100.0%	100.0%	100.0%

Source: Statistics Canada, Public Institutions Division, Financial Management System; calculations by the authors.

lar tax? To do this, the studies have often looked at the marginal efficiency cost (MEC) of taxes.

The MEC analysis has often led to a common finding: business taxes are much less efficient than those with a labour income or consumption base. Two core studies discuss MECs. The first, as shown in Tax Table 6, presents the MECs calculated for the OECD by the Federal Ministry of Finance (1997) for select Canadian taxes. The second set of estimates, shown in Tax Table 7, is drawn from a study by Jorgensen and Yun (1991). These values are among the most widely-cited measures of the marginal efficiency costs of taxation.

The US study by Dale Jorgensen and Kun-Young Yun calculated the marginal efficiency cost of certain taxes as: consumption taxes ($0.26), labour taxes ($0.38), capital income taxes at the business level ($0.45), and capital income taxes at the individual level ($1.02). Put more plainly, it costs the economy $0.26 to raise an additional dollar of revenue using consumption taxes. At the other end of the spectrum, it costs the economy $1.02 to raise an additional dollar of tax revenue

Tax Table 9: Provincial Tax Mix (2000/01)

	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NF
Income Taxes	40.3%	53.2%	40.1%	44.2%	46.1%	48.3%	40.8%	44.1%	35.7%	38.2%
Personal Income Tax	33.8%	36.0%	29.5%	36.9%	33.4%	42.2%	34.0%	38.8%	28.2%	33.6%
Corporation Income Tax	5.9%	17.2%	7.4%	7.1%	12.5%	6.0%	6.7%	5.3%	7.5%	4.0%
Consumption Taxes	34.1%	20.4%	38.4%	36.7%	34.7%	26.5%	40.4%	45.0%	47.0%	46.5%
General Sales Tax	19.9%	0.0%	17.9%	21.3%	23.8%	15.3%	24.4%	25.9%	30.4%	26.5%
Property and Related Taxes	11.9%	9.9%	7.8%	7.4%	4.1%	4.6%	11.0%	1.8%	9.0%	0.4%
Capital Taxes	2.4%	0.3%	7.7%	2.9%	2.5%	3.8%	1.5%	1.8%	0.3%	0.4%

Source: Statistics Canada, Public Institutions Division, Financial Management System; calculations by the authors.

using capital taxes assessed on the individual. In order to achieve efficiency (one of the three tenets of tax policy), taxes that minimize distortions in the economy (i.e., consumption taxes) should be employed to the greatest extent possible.

Both sets of MEC estimates show that simply reconfiguring the tax mix so that it moves from income and capital bases towards consumption bases yields considerable efficiency. The efficiency gain associated with the movement toward lower MEC tax mixes has encouraging implications for fiscal policy in Saskatchewan—and for all Canadian jurisdictions. A revenue-neutral shift toward more efficient taxes will allow government to maintain its spending levels while spurring additional growth in the economy.

The Structure of Government Revenues in Saskatchewan

The MEC analysis is useful to a point; where there is an opportunity to restructure the mix of taxes, the analysis may encourage a particular government to do so, such that the average MEC is lowered. In Saskatchewan's case, it raises the question: is there an opportunity to reconfigure the tax mix such that an efficiency gain can be achieved without a tax cut?

Tax Table 8 depicts Saskatchewan's tax mix in 1991/92, 1995/96, and 2000/01.

Does Saskatchewan have any opportunities to re-configure the current tax mix to make its system more efficient simply by using better taxes to collect the same amount of revenue? To answer this question, one missing factor is required: what do the other provincial tax mixes look like? Tax Table 9 indicates how much of each of several types of tax the provincial governments rely on to raise revenues within their own provinces.

Given the data presented in Tax Table 9, Saskatchewan has an opportunity to achieve economic efficiency gains without reducing taxes, although clearly a host of business taxes must be reduced. As discussed previously, capital taxes are one of the costliest ways to raise revenue. Far more than any other province, Saskatchewan depends on capital tax revenues. The province with the next highest capital tax as a percent of own-source revenues ratio is Quebec, at 3.8 percent. Conversely, Saskatchewan is the fifth lowest user of general sales taxes, one of the least

costly methods by which to raise revenue. Thus, Saskatchewan should, at the very least, begin to move away from capital taxes towards more general consumption taxes, such as the general sales tax.

Conclusion

The government of Saskatchewan's personal income tax reforms are a step forward and will improve the competitiveness of the province's tax system. However, much more needs to be done, particularly on the business tax side. Specifically, corporate income tax rates need to be reduced, the corporate capital tax must be eliminated, and business inputs must be exempted from sales tax if Saskatchewan's business tax system is to become more competitive. Finally, the province can become more efficient without losing revenue. In fact, the efficiency gains that come from shifting away from capital taxes towards consumption taxes should result in higher revenues.

Section IV: Policy Recommendations

Given Saskatchewan's economic performance over the last 20 years as presented in Section I, along with its current spending, taxing, and borrowing policies, as summarized and analyzed in Sections II and III, the province needs both an immediate and longer-term reform program if it is to become wealthier and more prosperous. While the province must take some steps immediately, some of the reforms will take longer to implement—perhaps several years. This following section outlines both the immediate and longer-term recommendations.

Immediate Reforms

- **Immediately reduce per capita expenditures to the national average.** This reform would require reducing government expenditures by approximately $176 per capita, or roughly $180 million.
- **Initiate a comprehensive review of all government business enterprises (Crown Corporations).** Saskatchewan must privatize many of its state-owned enterprises. The review should identify government business enterprises that can be privatized quickly, and those that may take longer to privatize.
- **Implement legislation requiring that all proceeds from privatization be specifically applied to the province's outstanding debt.**
- **Implement spending reductions concurrently with tax reductions.** Finance tax reform and tax reductions from the spending cuts of roughly $180 million, and the savings garnered from reduced interest costs.
- **Ensure that all of the tax cuts implemented in the immediate reform stage be focused on business taxes.** Specifically, this study recommends the following changes:
  - **Dramatically reduce the general corporate capital tax.** The 2002/03 provincial *Budget* estimated that the province would receive $340.2 million in total corporate capital tax revenues, including both financial and general corporate capital taxes. The Ministry of Finance estimates that a one-percentage point change (plus or minus) in the corporate capital tax general rate results in a static revenue change of $18.9 million. That is, ignoring the dynamic effects of such tax changes, such as supply-side efficiency gains, the amount of revenue lost (or gained) due to a one-per-

centage point change is estimated at roughly $19.0 million.

- **Immediately reduce the corporate income tax rates (general and M&P) to 13.0 percent.** Such a reduction would make Saskatchewan's corporate income tax rates competitive with both Alberta's and British Columbia's and places them substantially below those in Manitoba. The 2002/03 provincial *Budget* estimated that the province would receive $118.5 million in total corporate income tax revenues, including both general and M&P corporate income taxes. The Ministry of Finance estimates that a one-percentage point change (plus or minus) in the general corporate income tax rate results in a static revenue change of $18.0 million. That is, ignoring the dynamic effects of such tax changes, such as supply-side efficiency gains, the amount of revenue lost (or gained) due to a one-percentage point change is estimated to be $18.0 million.

- **Harmonize the provincial sales tax (E&H tax) with the federal goods and services tax (GST).** Harmonizing the two taxes would achieve two critical reforms in Saskatchewan. First, it would stop the sales tax from taxing business inputs. That business inputs are now taxed is a significant impediment to investment and capital development, and is one of Saskatchewan's principal economic problems. In addition, harmonizing the taxes would streamline administrative requirements for businesses; where they now file multiple sales tax reports, after this reform they would have to file only one. This type of reform could be revenue neutral, that is, neither increasing nor decreasing the amount of revenue collected.

- **Rationalize public sector employment.** Saskatchewan's public sector is much larger than the national average. It will inevitably be reduced in size, both in an absolute and a relative sense through privatization. However, the government should re-assess the method of delivery for all remaining departments, ministries, and government business enterprises in order to identify additional possibilities for contracting out, public-private partnerships, etc.

- **Earmark any and all unexpected surpluses to debt reduction.** Any unexpected surpluses arising from lower than expected interests costs, lower than forecasted spending, or higher than anticipated revenues, must be applied specifically to reducing the province's debt.

- **Introduce a strong Tax and Expenditure Limitation law.** Strong Tax and Expenditure Limitation laws, or TELs, have proven successful in stemming the growth of government and ensuring fiscal responsibility in the United States (Krol, 1996 and 1997; Stansel, 1994; Matsusaka, 1995). Both tax and expenditure limitation laws effectively constrain the ability of governments to increase either taxes and/or spending without popular approval. For instance, expenditure limitation laws require any spending increase in excess of inflation and population growth to be specifically approved by referendum. Such a system has caused the US states to focus on the goods and services actually required of them, as opposed to funding projects driven by special interests.

Longer-term Reforms

- **Reduce the percentage of the economy consumed by government expenditures to a level commensurate with the "have" provinces.** Currently consolidated government expenditures (provincial and municipal) in Saskatchewan consume 27.1 percent of the economy (GDP). Governments in Alberta and Ontario, Canada's two "have" provinces,

consumed 18.6 percent and 22.7 percent, respectively, in 2000/01. Saskatchewan must implement a program of fiscal restraint coupled with economic growth in order to reduce the size of government (and its accordant burden) to a comparable size. The real size of government in Saskatchewan compared with the economy must be reduced by roughly 7 percentage points, or roughly one-quarter.

- **Implement the second phase of privatization.** This second phase includes government business enterprises which, for one reason or another, need more time to privatize. For instance, privatizing the various power companies will inevitably require an overhaul of industry regulation legislation, which obviously takes time. Nonetheless, these Crown Corporations should be privatized as expediently as possible. Again, the entirety of the proceeds from such privatizations must be reserved solely for debt reduction.

- **Announce and implement a series of business and personal tax cuts**.

  - **Legislatively implement a plan to completely eliminate corporate capital taxes, both for general corporations and financial institutions.** The 2002 provincial *Budget* estimated that the province would receive $340.2 million in total corporate capital tax revenues, including both financial and general corporate capital taxes. The net revenue loss will be less than expected as supply-side incentives are re-instituted and business development occurs. Tax receipts in other tax areas, such as corporate income tax and personal income tax, should at the very least offset a portion of the expected revenue losses.

  - **Announce a multi-year plan to reduce corporate income tax rates, both the general and the M&P rates, to 8.0 percent.** Such a cut would match the rate reductions already announced by Alberta and Ontario, and the reductions generally expected to be implemented in the future in British Columbia. The 2002 provincial *Budget* estimated that the province would receive $118.5 million in total corporate income tax revenues. The revenue loss will be less, given the probability of strong supply-side responses, including significant increases in business investment and development.

  - **Phase out the top marginal tax rate, scheduled to be 15 percent on incomes over $100,000.** The elimination of the top marginal tax rate would leave Saskatchewan with two statutory personal income tax rates: 11 percent on income up to $35,000, and 13 percent on income in excess of $35,000. By collapsing the personal income tax rates, Saskatchewan would close the gap in the top marginal tax rate with Alberta. In addition, it would increase incentives for diligence, risk-taking, entrepreneurialism, and innovation by increasing the returns to those activities.

- **Consider increasing the provincial sales tax rate, if required, to finance other tax reductions.** Saskatchewan currently has the lowest statutory sales tax rate in the country. Given its relatively high use of capital-based taxes, such as the corporate capital tax and corporate income taxes, coupled with the relative efficiency of consumption taxes, Saskatchewan should shift the burden of taxation away from capital towards consumption. In other words, if revenue is needed once the corporate capital tax is eliminated and the corporate income tax rates are reduced, then the province should consider increasing the provincial sales tax rate. In terms of revenue impact, the Ministry of Finance estimates that a one-percentage point change (plus or minus) in the provincial sales tax rate without any change to the underlying base would result in an incremental change in revenues of $126.8 million.

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About the Authors

Jason Clemens is the Director of Fiscal and Non-Profit Studies at The Fraser Institute. He has an Honours BA in Commerce and an MA in Business Administration from the University of Windsor as well as a post-Baccalaureate Degree in Economics from Simon Fraser University. His publications and co-publications for The Fraser Institute include *Canada's All Government Debt* (1996), *Bank Mergers: The Rational Consolidation of Banking in Canada* (1998), the 1998, 1999, 2000 and 2001 *Non-Profit Performance Report*, *The 20% Foreign Property Rule: Decreasing Returns and Increasing Risk for RRSPs and RPPs* (1999), *Preserving Independence* (1999), *Returning British Columbia to Prosperity* (2001), *Flat Tax: Issues and Principles* (2001), *Surveying US and Canadian Welfare Reform* (2001), and *Corporate Capital Tax: Canada's Most Damaging Tax* (2002). His articles have appeared in the *Wall Street Journal*, the *National Post*, the *Globe and Mail*, the *Vancouver Sun*, the *Calgary Herald*, the *Winnipeg Free Press*, the *Ottawa Citizen*, the *Montreal Gazette*, *La Presse,* and other newspapers. Mr. Clemens has been a guest on numerous radio programs across the country and has appeared on the CBC National News, CBC Business Newsworld, Global TV, BCTV, and Report on Business TV as an expert commentator. He has also appeared before committees of both the House of Commons and the Senate as an expert witness.

Joel Emes is Senior Research Economist at The Fraser Institute. He is a regular contributor to *Fraser Forum*, the Fraser Institute's monthly magazine, and co-author of *Tax Facts 10*, *Tax Facts 11*, *Tax Facts 12*, and *Canada's All Government Debt* (1996, 1998, and 1999 editions). His articles have appeared in the *National Post*, *Globe and Mail*, the *Calgary Herald*, the *Vancouver Sun* and the *London Free Press*. Mr. Emes is also the primary researcher for Tax Freedom Day and the Institute's Provincial and State-Provincial fiscal comparisons, the *Budget Performance Index*, and the *Fiscal Performance Index*. He received his M.A. in Economics from Simon Fraser University.

Nadeem Esmail joined The Fraser Institute as a Health Policy Analyst in September 2001. He completed his B.A. (Honours) in Economics at the University of Calgary and received an M.A. in Economics from the University of British Columbia. Mr. Esmail is the lead researcher for The Fraser Institute's *Waiting Your Turn* annual survey of waiting lists in Canada and has written on a number of health care topics including health technology, insurance, and labour wages.

Barry Cooper is Professor of Political Science at the University of Calgary and Senior Fellow at The Fraser Institute. He has published extensively in the area of political philosophy and Canadian public policy, most recently, *Unholy Terror: The Origin and Significance of Contemporary, Religion-based Terrorism*, the first in The Fraser Institute's Studies in Defence and Foreign Policy series. He has received the Konrad Adenauer Award from the Alexander von Humbolt Stiftung and a Killam Research Fellowship. He is a Fellow of the Royal Society of Canada.