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Canadians have much for which to be grateful. We live in a country that allows us to live our lives as we determine, and even our national anthem salutes our “true north strong and free.” How often, though, do we consider what this freedom really means? There are innumerable aspects to our understanding of what freedoms we value, and to which we feel entitled—our *Charter of Rights and Freedoms*, for instance, outlines freedom of religion, freedom of mobility, freedom of expression, and so on, yet there is one particular, but incredibly important, freedom that we too often overlook and take for granted here in Canada: our economic freedom.

As Fred McMahon explains, “economic freedom...liberates people from dependence on government, and that in turn allows for other freedoms and democracy” (“Celebrating Economic Freedom,” pg. 5). Economic freedom, then, is critically important for any nation, and its advancement is of general interest to us here at the Fraser Institute, and is the focus of this issue of *Fraser Forum* in particular.

According to the *Economic Freedom of the World: 2010 Annual Report*, Canada's 7.95 score ranks us as the 7th most free country in the world. Canada's performance is particularly strong in legal structure and security of property rights; access to sound money; and freedom to trade internationally. We live in a nation with relatively straightforward regulations that allow and facilitate entrepreneurial activity in a thorough and transparent manner. Our generally open market and variety of economic choices give us greater choice and freedom. And it is this high level of economic freedom, alongside our free and open markets, that is responsible for guiding Canada through the recent economic downturn with minimal damage while other economies reached near-collapse.

However, Canada is certainly not economically perfect. Our economic freedom lags behind the world average in one crucial area: government spending. In addition to our extensive social welfare programs, government expenditures have increased as a result of recent government stimulus packages. As Charles Lammam and Niels Veldhuis note in this issue of *Forum*, the Harper government has increased spending nearly 15% in the last 3 years and its stimulus spending does not appear to be slowing any time soon. They write: “If our MPs wanted to provide real stimulus to economic growth, they would support a plan to rein in spending, reduce the deficit, and bring down the debt” (“No End in Sight,” pg. 30). Will Canadians encourage them to do so?

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*Canada has  
a high level  
of economic  
freedom*

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# Celebrating economic freedom

FRED McMAHON

**I**ndividuals have economic freedom when property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others. An index of economic freedom should measure the extent to which rightly acquired property is protected and individuals are engaged in voluntary transactions. —Gwartney, Lawson, and Block, 1996



Above is the classic definition of economic freedom, which is not only the focus of this issue of *Fraser Forum*, but it is also a top priority at the Fraser Institute, and we work continuously to promote and deepen economic freedom throughout the world. Below are some examples of the Fraser Institute's efforts:

In August 2010, the Institute released *The Economic Freedom of North America: 2010 Annual Report*. Nathan Ashby of the University of Texas at El Paso was the lead author on this project with Amela Karabegović, and myself as his co-authors. This important study measures the economic freedom of the Canadian provinces and the American states. Nathan has also made terrific progress in measuring the freedom of the Mexican states, though the consistency and availability of data continue to be challenges.

Subsequently, *The Economic Freedom of the World: 2010 Annual Report*, prepared by James Gwartney of Florida State University; Robert Lawson of Auburn University; and Joshua Hall of Beloit College, was released in September. This project was started 25 years ago, initiated and led by Michael Walker, then the executive director of the Fraser Institute, and the late Nobel Laureate Milton Friedman and his wife Rose. The research phase involved 60 of the world's top scholars, including 3 other Nobel Laureates. *The Economic Freedom of the World Annual Report* has become one of the most important intellectual products in the world, as more than 400 academic and policy articles and books have used or tested it.

In October, the Fraser Institute held a joint meeting of the World and Asian Economic Freedom Networks in Jakarta, Indonesia, in conjunction

with the Asian office of the Friedrich Naumann Foundation for Liberty (the Foundation), as well as three partners from Indonesia: the Institute for Economic and Social Research Faculty of Economics at the University of Indonesia (LPEM FEUI); the Freedom Institute, and the Indonesian Institute. The world network has members in 80 nations and territories, all of whom are dedicated to advancing economic liberty whatever their background—whether in the Gaza Strip or Israel, Russia, Georgia, Colombia, or Venezuela.

Early this month, the Arab Economic Freedom network met in Cairo for the release of the *Economic Freedom of the Arab World: 2010 Annual Report* written by Salem Al Ismaily of the International Research Foundation (IRF) of Oman and member of the Fraser Institute's

board of trustees, alongside Amela Karabegović, Miguel Cervantes, and myself. The Foundation's Cairo office is printing and distributing the report, and is sponsoring the meeting in Cairo in cooperation with the IRF and the Fraser Institute. These meetings enable organizations dedicated to advancing liberty to review the most

recent research, develop new research ideas, compare situations across nations, and discuss strategies for improving policy while also getting acquainted.

Finally, at the end of November, the Atlas Economic Research Foundation is sponsoring an economic freedom audit in Morocco. The team will be led by Nouh El Harmouzi, Atlas

Institute, and Atlas Vice President of International Programs Tom Palmer. A booklet has been prepared to highlight Morocco's score in each of the 42 variables that the report uses to measure economic freedom. (See Table 1 for a list of these variables.) These data provide both a comprehensive description of an economy, and a prescription for improvement. The booklet will compare Morocco with the world average, the Arab average, and the world top 10 nations in each area. That allows participants to understand Morocco's policy situation relative to others, and provides "best practices" examples.

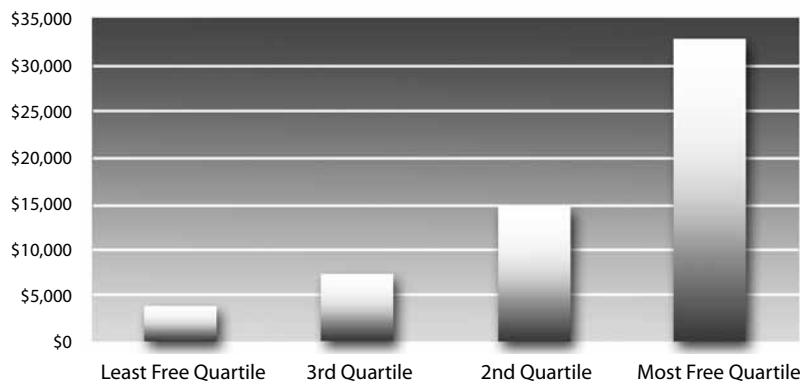
Such audits, including ones also in Jordan and Oman, draw top government officials—cabinet ministers, business leaders, academics—and generate considerable media attention, which helps inform the public alongside the members of the elite in attendance.

So why do we put all this effort into promoting economic freedom? We do so for several reasons: first, economic freedom propels growth and prosperity. Any transaction freely entered into must benefit both parties. This has consequences throughout the economy: producers must either constantly improve the price and quality of existing productions, or innovate new ones. Without this, customers will not freely enter into transactions with the producer. Many billions of mutually beneficial transactions occur every day, powering the dynamic that spurs increased productivity and wealth throughout the economy.

Economic freedom also liberates people from dependence on government, and that in turn allows for other freedoms and democracy. To see this, we need only look around the world. With the partial exceptions of Hong Kong and Singapore, places with high levels of economic freedom also have high levels of other freedoms and democracy. Similarly, other than the partial exception of Venezuela, no nation with weak levels of economic freedom also has high levels of other freedoms and a vibrant democracy.

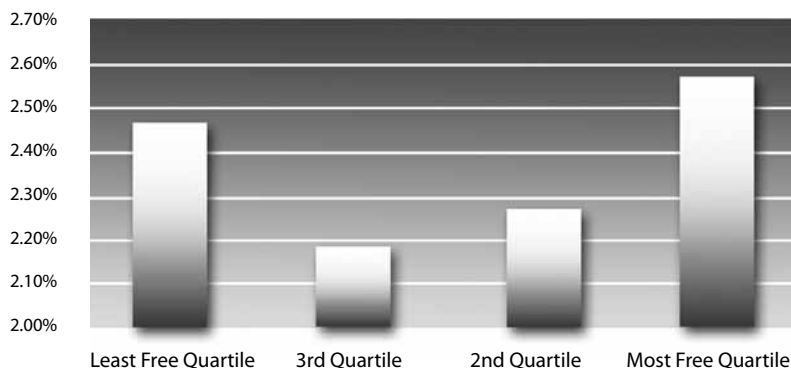
Figure 1 shows the prosperity effect of economic freedom. Figures

**Figure 1: GDP Per Capita (Purchasing Power Parity)**



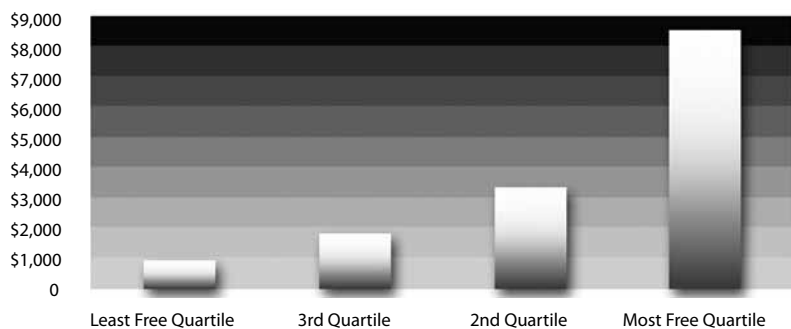
Sources: Gwartney, Lawson, and Hall, 2010: The World Bank, World Development Indicators, 2010.

**Figure 2a: Income Share Held by Lowest 10%, 1990-2008**



Sources: Fraser Institute, *Economic Freedom of the World: 2010 Annual Report*; World Bank, World Development Indicators.

**Figure 2b: Average Income Earned by Lowest 10%, 2008**



Sources: Gwartney, Lawson, and Hall, 2010: The World Bank, World Development Indicators, 2010. Purchasing power parity, 2007 dollars.

2a and 2b disprove the claim made by some that economic freedom increases inequality, while illustrating how it does decrease poverty. The columns represent economic freedom quartiles, from least free to most free. Figure 3 shows the relation, discussed above, between economic freedom and other freedoms, while Figure 4 illustrates the reduction in corruption economic freedom brings—when you are free to make economic decisions, you need not bribe anyone to open a business, or navigate crushing regulation.

Similarly, Figure 5 depicts the relationship between economic freedom and life satisfaction. When you and your family are free to make your own decisions, you can take control of your life and do what brings you the most happiness. Finally, Figure 6 shows the prosperity effect of economic freedom among Canadian provinces and the American states.

These are the reasons why the Fraser Institute focuses so much effort on economic freedom—it promotes prosperity and other positive outcomes. Canadians should care not only about their own economic freedom, but that of others as well. Canadians will benefit as the world as a whole becomes more prosperous and democratic. Richer trading partners mean richer trading opportunities and greater global stability (Gartzke, 2005). Ultimately, all of this is good not just for the world, but also for Canada.

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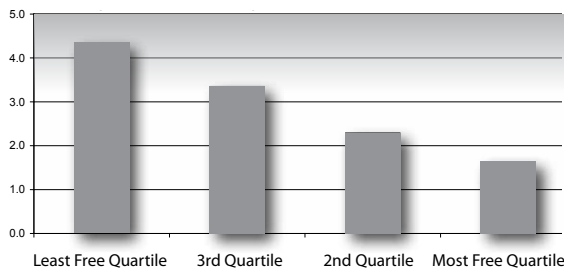
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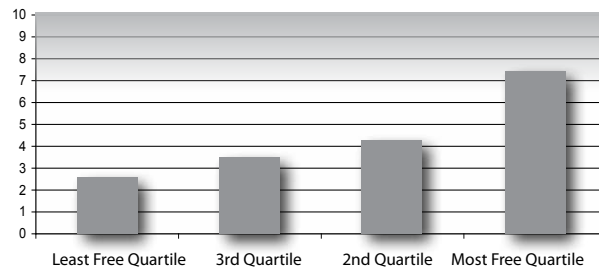
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**Figure 3: Political Rights/Civil Liberties Index, 2008**



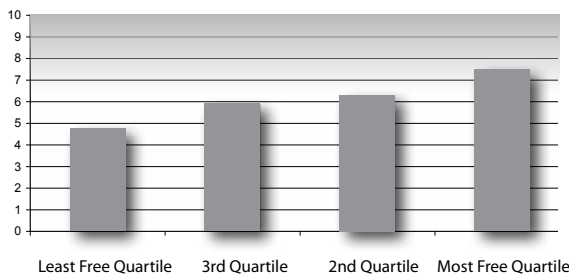
Sources: Gwartney, Lawson, and Hall, 2010; Freedom House, *Freedom in the World Country Ratings*, 2008, available at <http://www.freedomhouse.org/>. Scale of 7, with low scores indicating greater levels of freedom.

**Figure 4: Corruption Perceptions Index Score, 2008/2009**



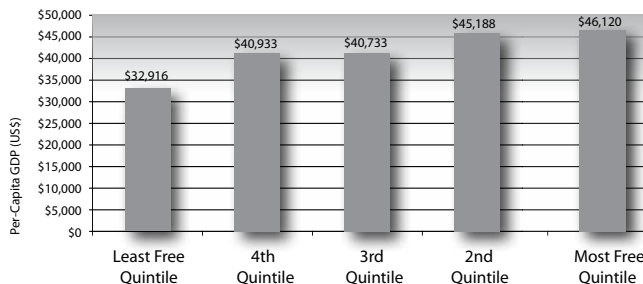
Sources: Gwartney, Lawson, and Hall, 2010; Transparency International, *Corruption Perceptions Index, 2008/2009*, available at <http://www.transparency.org>. 0-10 scale with 10 indicating no corruption and 0 indicating high corruption.

**Figure 5: Life Satisfaction Index, 2008**



Sources: Gwartney, Lawson, and Hall, 2010; Freedom House, *The (un)Happy Planet Index 2.0. Why good lives don't have to cost the Earth*. 2009. 0-10 scale, with 10 indicating high satisfaction and 0 indicating low satisfaction.

**Figure 6: GDP Per Capita, US Dollars**



Sources: Ashby, Karabegović, McMahon, and Cervantes; Statistics Canada, *Provincial Economic Accounts*, 2007; US Department of Commerce, Bureau of Economic Analysis, <<http://www.bea.gov>>.

# Economic freedom is essential for US economic recovery

NATHAN J. ASHBY

The Fraser Institute recently released its update of *Economic Freedom of North America*. This project, first published in 2003 by Amela Karabegović and Fred McMahon, ranks the economic freedom of fifty American states and ten Canadian provinces between 1981 and 2007. The latest publication uses the same methodology as previous editions to introduce two additional years of data (2006 and 2007). It demonstrates that economic freedom has been essential to economic prosperity in the US over a historical period, including three recessions. Further, preliminary visual evidence that I provide in this article suggests that states with the most economic freedom prior to the recession are the states that are recovering most quickly.

## Economic Freedom and the US Recovery

The Economic Freedom Index is constructed by scoring states and then taking the averages in three areas: 1) size of government, 2) takings and discriminatory taxation, and 3) labour market freedom. In 2007, the US leaders in economic freedom were Delaware, Texas, and Colorado (Ashby, Karabegović, McMahon, and Bueno, 2010: 7-8). The least free states were West Virginia, Mississippi, and Maine. Alberta, Newfoundland, and British Columbia led in Canada while Prince Edward Island, Quebec, and Nova Scotia were the least free. The report analyzes the connection between economic freedom and Gross Domestic Product (GDP)

per capita. Using data from 1981 to 2006, the report finds a robust relationship between economic freedom and prosperity: a one-point increase in a state's economic freedom index score corresponds to an increase of \$5,334 in per person income (Ashby, Karabegović, McMahon, and Bueno, 2010: 20-21).

Even without data after 2007, one can analyze the relationship between economic freedom prior to the recession and the economic recovery. Many pundits, including billionaire George Soros, have faulted excessive capitalism and lack of government intervention as the causes of the "Great Recession" and suggest that more government spending and regulation of credit and labour markets are necessary to assure prosperity into the future (El-Gabry, 2009; Evans-Pritchard, 2009). My analysis suggests that this is a mistake. In fact, if only the policies at the state and local level are considered, the states with the highest economic freedom before the recession have generally done better than the least free states in recovering from the recent recession.

We construct two different economic freedom scores. One is the "all government" score, which includes the impact of federal government policy in addition to state and local governments. Secondly, the subnational score only considers the spending, taxation, and labour market policies enacted by state and local governments.

When comparing economic freedom in 2007 to the unemployment rate in August 2010, as found in Figure 1, it appears that states that scored in the lowest one-fifth in eco-





economic freedom in 2007 currently have the highest unemployment rate. The average unemployment rate was about 9.5%, which was by far the worst outcome of all the quintiles. States with high levels of economic freedom had an average unemployment rate of 8.4% (Bureau of Labor Statistics, 2010).

The freest states added an average of 12,000 jobs between July 2009 and July 2010, while the least free states decreased employment by an average of 18,000 jobs. Admittedly, the relationship is much more complex than the evidence displayed in Figure 1. Further analysis is definitely warranted, but these results suggest that Texas—with a current unemployment rate of 8.3%—is a much better model to follow than California, where 12.4% of the workforce is currently unable to find employment (Bureau of Labor Statistics, 2010). States that have lower spending and that have imposed lower tax burdens on their residents were in much better shape to recover from the crisis than those that were not as prudent. States with lower minimum wages and unionization rates, and with employment more concentrated in the private sector have demonstrated much greater flexibility when it comes to hiring workers (Ashby, Karabegovic, McMahon, and Bueno, 2010: 8-9).

### Implications for the future

Unfortunately, the policies of the federal government in recent years have only increased expectations that the government deficit will continue into the future. Health care policies that will be forced upon employers will increase the costs of employment. Policies that favour unions over business owners, such as the proposed *Employee Free Choice Act*, will increase uncertainty among entrepreneurs considering whether or not to invest in the US government. Spending and taxation policies are also increasingly centralized to the federal government, which will tie the hands of state and local governments when it comes to managing economic recoveries in

the future. As economists Noel Campbell, Alex Fayman, and Tammy Rogers (2010) suggest, if these policies go forward, we can expect a significant decrease in economic freedom and therefore prosperity in the United States in the coming years. Their analysis is actually more optimistic than the more likely outcome, as they do not consider the increase in marginal tax rates due to the *Healthcare and Education Reconciliation Act* of 2010, and the expiration of former President George W. Bush's tax cuts. A more reasonable estimate would suggest that the plight of Americans will be even worse.

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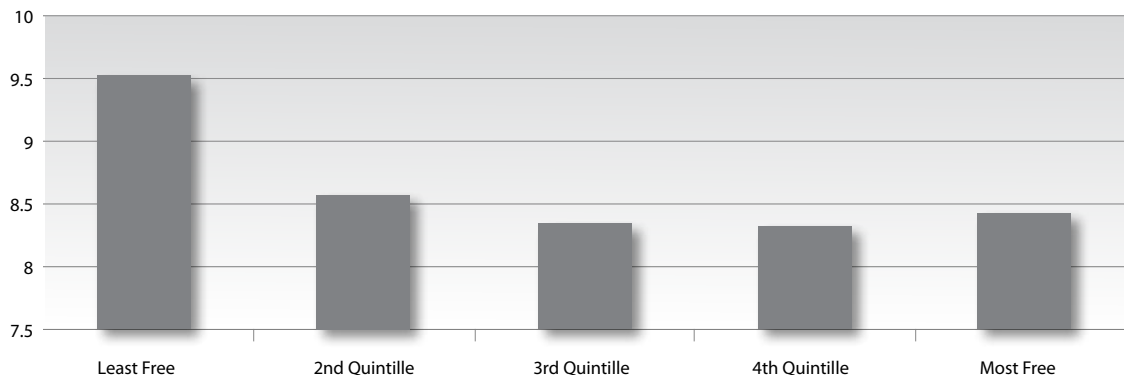
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**Figure 1: State Unemployment Rate in August 2007 and Subnational Economic Freedom in US in 2007**



# Is Cuba finally embracing economic freedom?

MARK MILKE

In a recent *Atlantic* article, columnist Jeffrey Goldberg interviewed the retired Cuban dictator Fidel Castro, and in response to the question, “Is the Cuban economic model still worth exporting?” Castro replied: “The Cuban model doesn’t even work for us anymore” (Goldberg, 2010a). Several days later, Castro backpedaled, claiming he actually meant the opposite. “My idea,” said Fidel, “is that the capitalist system no longer works for the United States or the world. How could such a system work for a socialist country like Cuba?” (Goldberg, 2010b).

Goldberg did not accept the post-interview spin, and neither should the rest of the world. Castro only admitted what is obvious to any tourist, and what the economic data has shown for years: Cuba’s detour into economic tyranny produced a half-century of suffering for Cubans. It is precisely why many of them risked their lives by fleeing on rickety rafts to get to Florida. Castro’s recent frankness was of particular interest to me because in February 2008, I was in a hotel bar in Varadero, Cuba, when Castro announced his resignation. A friend and I toasted his departure. The tourist resort was not the real Cuba, so I also spent five days in Havana. With rare exception, crumbling buildings were obvious, and whereas the Varadero resort had full trays of scrambled eggs for tourists, food rationing was the norm for the average Cuban in Havana.

Since Fidel’s brother Raúl took over power in Cuba in 2008, his reforms have mostly been minor. For instance, all Cubans were finally allowed to own cell phones, buy computers, and enter tourist hotels. All of the more serious restrictions, however, remained (Frank, 2008). Current reforms



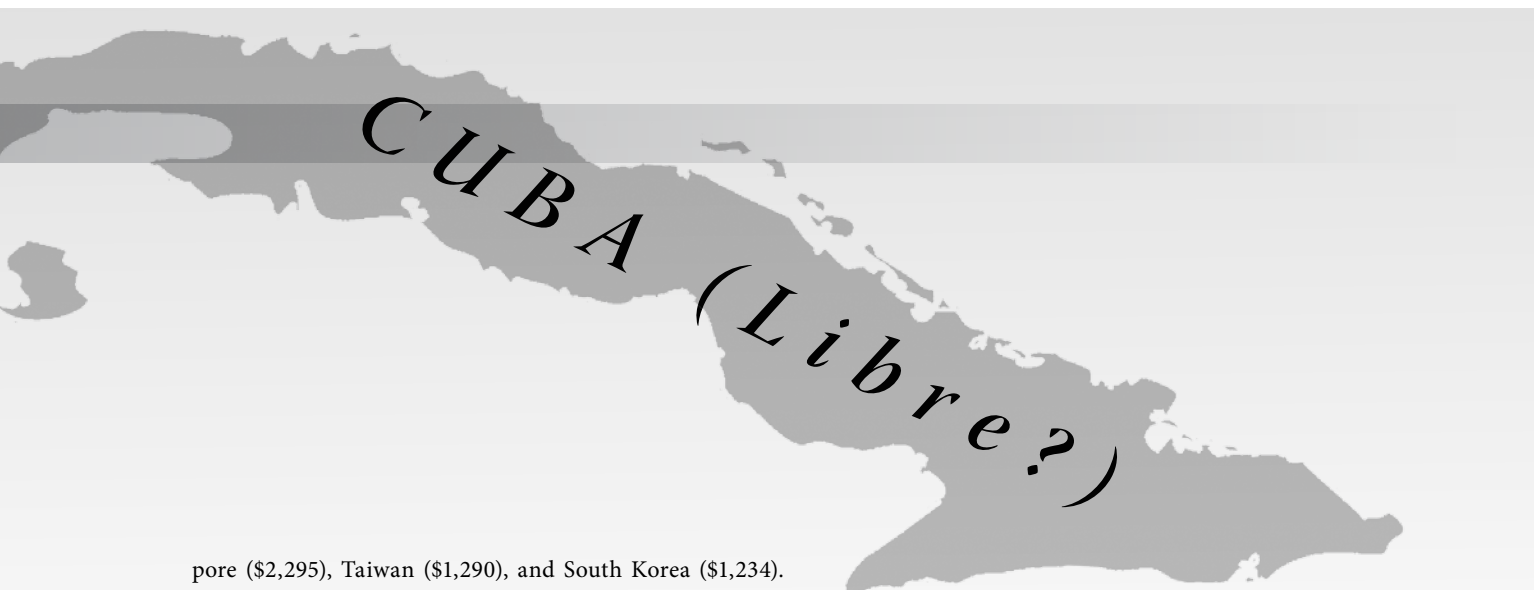
might now be more consequential. In conjunction with Fidel’s published interview in September, Cuba’s government announced in the same month that it will soon lay off one-tenth of the island gulag’s workforce—500,000 people—from inefficient state enterprises (*Associated Press*, 2010).

Revolutionary as the realization of state inefficiency is, even more surprising is that the Cuban Workers’ Confederation supported the cuts to state enterprises. As Cuba’s only legally allowed union, they stated: “Our state cannot and should not continue supporting businesses, production entities and services with inflated payrolls, and losses that hurt our economy [and] are ultimately counterproductive, creating bad habits and distorting worker conduct” (*Associated Press*, 2010).

Granted, the Cuban union is a mouthpiece for the Communist government. That is precisely the point. Their statement, along with Fidel’s comments in the *Atlantic*, underline how serious the regime may be about opening the door just a little to economic freedom.

This has been a long time coming. In 1958, the year before Fidel Castro came to power, Cuba was no paradise; poverty, a corrupt dictator, and the American mafia troubled the country. However, it was still better off than most developing nations at the time. In 1958, Cuba’s per capita Gross Domestic Product (GDP) was \$2,363. (In comparison, Canada’s was \$8,534.) Cuba outranked all other Caribbean countries on this measure, except for Costa Rica, Jamaica, Puerto Rico, and Trinidad and Tobago; it was also not far off the Latin American average of \$3,047 (Maddison, 2008).

Additionally, in 1958, Cuba’s per capita GDP was even higher than some East Asian jurisdictions such as Singa-



pore (\$2,295), Taiwan (\$1,290), and South Korea (\$1,234). Pre-Castro Cuba was also not far behind Japan (\$3,289), and Hong Kong (\$2,924). In the late 1950s, on a per-capita basis, Cuba was two-thirds as rich as Japan, equal to Singapore, and twice as prosperous as South Korea (Maddison, 2008).

Fidel Castro's 1953 rebuke to the then Cuban government, in the form of a four-hour speech during his 1953 trial, "History Will Absolve Me," promised that if he were to revolutionize Cuba, the restoration of Cuba's 1940 constitution would occur, and that he would take immediate steps to solve "the problem of housing, the problem of unemployment, the problem of education, and the problem of the people's health... along with restoration of civil liberties and political democracy." Cubans have seen none of these promises fulfilled.

By 2008, five decades after the revolution, Cuba's per capita GDP was just \$3,764, due mostly to growth in the past decade, and, presumably, from growth sectors such as tourism. As recently as 2000, Cuba's per capita GDP at \$2,422 was nearly the same as it was in 1958 (Maddison, 2008).

In comparison, the economy of Chile, another Latin American country also temporarily run by a dictator, grew from \$4,392 per capita GDP in 1958 to \$13,185 in 2008. That transformation occurred because its rulers, including the dictator Augusto Pinochet, embraced the market economy.

Meanwhile, the East Asian jurisdictions, who half a century ago were either below or barely above Cuba's economic status, have long eclipsed Castro's island. In 2008, per capita income was \$19,614 in South Korea, \$20,926 in Taiwan, \$28,107 in Singapore, and \$31,704 in Hong Kong. In real terms over five decades, Hong Kong's per capita economy grew by a factor of 11, Singapore's by 12, and South Korea and Taiwan by a factor of 16—this while Cuba's equivalent did not even double from its pre-revolutionary state (Maddison, 2008).

Apologists for the Cuban regime often point to the American economic embargo as a prime reason for Cuba's poverty (Carroll, 2009). They are partly right, but the embargo and Communism were both responsible. Oddly, though, the defenders never understood their own argument: free-flowing trade between countries can lift a country's economic prospects and let it flourish, just as will free-flowing trade internally.

I don't hold out much hope that the Canadian apologists will get it, but Fidel Castro apparently now understands the obvious: his attack on markets was a failure.

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\*The data is in 1990 Geary-Khamis PPP dollars. ■

# Will recent bad policy reverse the global advances in economic freedom?



**MICHAEL WALKER**

The recent financial crisis has elicited a very strong reaction from governments around the world, some of which is an attempt to protect the banking system from a liquidity crisis, and from the implosion of the money supply. Those interventions are a natural requirement of a fractional reserve banking system, and although they are of unprecedented proportion, they do not represent a perverse evolution of public policy.

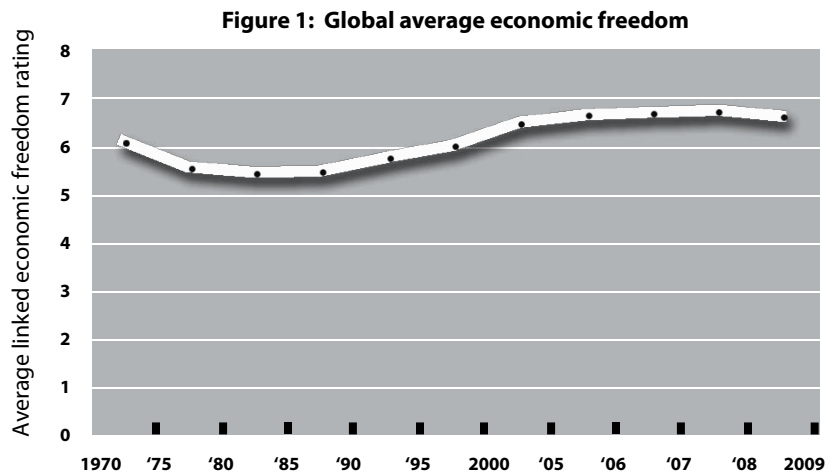
Other actions, including the so-called stimulus packages, have represented a throw-back to the failed policies of the past, and have been the subject of many critical analyses, including some published by the Fraser Institute (Veldhuis and Lammam, 2010a and 2010b). One of the concerns of the critics of the stimulus packages, and other direct economic management and regulatory policies, is that the programs represent a retrenchment from the worldwide movement toward more liberal policy. This movement toward

market-friendly policies during the past 35 years has provided a much-needed boost to the growth and development in less-developed nations, and has integrated the economies of the world to the benefit of the whole world.

The question is whether the crisis-response policies are going to instigate a cascade of poor policy choices that will negate the gains of the past quarter century. The Fraser Institute's *Economic Freedom of the*

*World: 2010 Annual Report*, which examines 44 policy choices and covers 95% of the world's population, is an excellent tool with which to examine the nature of past changes in policy and a prism through which to view potential future changes. In the report, governments and countries get high scores for avoiding policies that reduce economic freedom (Gwartney, Lawson, and Hall, 2010).

Figure 1 tracks the evolution of the global economic freedom





rating from 1970 to 2008. 2008 is the last year for which we have hard data, and it includes the beginnings of the Economic Crisis Response Program. Up to 2008, there was scant indication of a downturn in economic freedom. The global average freedom score had declined from 6.72 in 2007 to 6.66 in 2008—a retrenchment back to the level achieved in 2005, as seen in the chart.

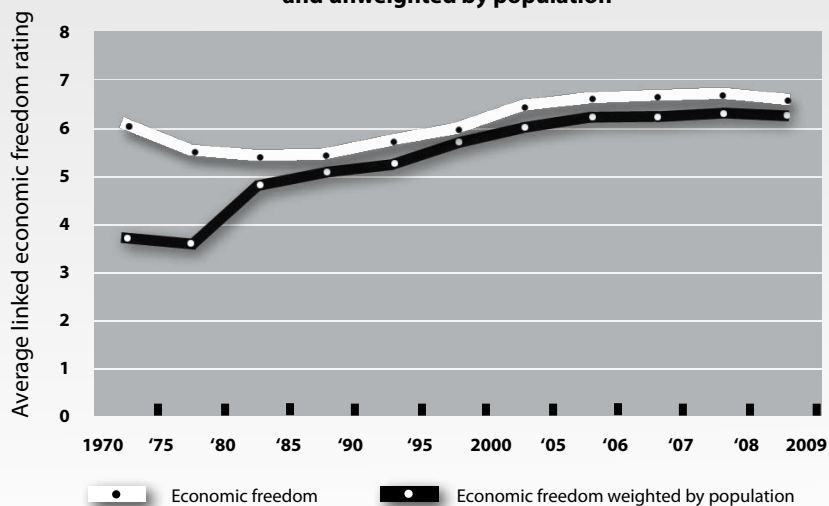
To put this “retrenchment” in context, we note in Figure 1 that the 2007 level was the highest global average economic freedom score ever recorded. We can also note the small size of the current pause in the growth of economic freedom compared to the radical reduction that occurred under the auspices of socialist governments in the 1970s. From 1970 to the 1980-start of the global recovery in freedom initiated by former Prime Minister Thatcher and President Reagan, the global level of economic freedom had fallen from 6.16 to 5.53 (Gwartney, Lawson, and Hall, 2010).

Although it is too early as yet to assess the full impact of government actions on economic freedom because we don’t have hard data for 2009, when much of the activity occurred, there are other important reasons for believing that even if more significant reductions in economic freedom have occurred in developed nations that will not be decisive in the global context.

Figure 1 shows that the level of global economic freedom has barely changed over the entire period charted. One reason is that the Economic Freedom Index measures the level of economic freedom country by country and treats small countries the same as large ones. The evident problem with this approach is that if China has a low level of freedom it affects a significant fraction of the world’s population, while if Iceland had the same freedom level, it would affect only 300,000 people.

One way to deal with this is to construct a measure of freedom in

**Figure 2: Global average economic freedom weighted and unweighted by population**



which we weight the freedom score for a country by its population. In such an index, we get a measure of the extent to which the whole population of the world is experiencing increases or decreases in freedom. The resulting weighted index, shown along with the unweighted index, in Figure 2, indicates that the level of freedom experienced by the world’s population has changed dramatically over the period.

It is no surprise to see this result when we consider that from 1975 to 2000 there were large changes in the level of economic freedom in China, India, and the former Soviet Union, which together represent nearly half the world’s population. By weighting the freedom ratings of those countries by their populations, we highlight the great expansion in the access to freedom that has occurred as a result of the reduction in repression in these regimes. This increase in the prevalence of freedom in the world represents a fundamental change in the way in which the world is organized, and will likely not be more than marginally affected by the policies that were adopted in response to the financial crisis.

In a curious and ironic turn of events, the shift toward freedom in the populous repressive regimes, in com-

bination with the much greater degree of integration of the world’s economies, could cast the newly freed nations as a kind of freedom flywheel preventing backsliding in the more advanced nations. At the very least, comparative backsliding—particularly if the focus continues on financial regulation—will impose costs on errant governments as capital flees to the sunnier climes provided by the newly freed countries.

So the indications are that global economic freedom will be robust in spite of the policy mistakes in many Western countries, but, of course, a full accounting of the impact of the financial crisis on economic freedom is going to have to await the collection of the relevant data in several years’ time.

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# Promoting economic freedom in the Arab world

الاقتصادية  
العربية

RONALD MEINARDUS

*Editor's note: The Friedrich Naumann Foundation for Liberty is a valued partner of the Fraser Institute around the world in promoting economic freedom. We are pleased to present an introduction to its work in the Arab world.*

From the very beginning, the Arab world has played an important role in the international programs of the Friedrich Naumann Foundation for Liberty (the Foundation). The first project office outside Germany was established in Tunisia in 1963 and, remarkably, more than 45 years later, the Foundation is still represented in that North African country. This may say something about the perseverance of the Foundation's efforts. It also underlines the importance that the region on the southern rim of the Mediterranean has for the Foundation.

As a liberal institute, the promotion of liberalism—naturally—is the core objective of the Foundation. Promoting individual freedom is the centre of all the Foundation's aspirations. The Foundation, originally known as the Friedrich Naumann Foundation, later added the well-sounding “für die Freiheit” (German for: “for Liberty”) to her official denomination to make this point clear.

Promoting personal freedom is a challenge in most parts of the world—particularly in the Arab world. We sponsor projects aimed at promoting freedom in the political, social, and economic fields in close cooperation with local and regional partners through our offices in Rabat, Algiers, Tunis, Amman, Jerusalem, and Cairo. Additionally, we are planning to open an office in Beirut before the end of the year; we also have a successful project in Turkey run by our office in Istanbul.

Unnoticed by many in the West, important changes have occurred in parts of the Arab world. The maturing of an Arab civil society, and the emergence of independent media have

changed the political and social landscape for good. In the economic field as well, Arab governments have implemented far-reaching economic reforms. These changes in the Arab world are important because the Arabs are geographical neighbours for Europeans. As this is the world's area of conflict number one, what happens here often has direct impact on developments in Europe—in the political, social, security, and economic spheres.

The Foundation recognizes this, and over the years has cooperated with Arab entrepreneurs to stimulate change. We have chosen these particular individuals and their organizations as partners, as experience tells us that businessmen and women tend to be the most dynamic forces of change and progress in underdeveloped or economically illiberal societies. Over time, we have established close relationships particularly with young entrepreneurs in countries like Morocco, Algeria, Tunisia, Egypt, Palestine, Jordan, and Syria. This network of friends and partners has become an important constituent of the annual Economic Freedom of the Arab World Conference, which the Foundation has co-sponsored with the Fraser Institute and the International Research Foundation of Oman since 2005.

This conference has been held in such diverse places as Beirut, Muscat, Doha, Marrakech, and even along the shores of the Dead Sea. The venue of the 2010 Economic Freedom of the Arab World Conference was Cairo. The main objective of these events was to popularize in the Arab world the Economic Freedom Index and the empirically based concept that increasing economic freedom leads to economic

# الحرية في العالم



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development. Also in this part of the world, the popularization of economic freedom is of strategic importance in the political (and ideological) arguments with the opponents of economic freedom.

One important key to the continued success of the Economic Freedom of the Arab World Conference has been the close cooperation of the three co-organizers, each of whom has a unique comparative advantage. While the Fraser Institute provides the methodological expertise and international prestige, the International Research Foundation of Oman contributes expert knowledge on economic data and developments in the Arab world. Lastly, the Foundation shares our wide network of young entrepreneurs and economic free-thinkers interested in learning more about the linkage between freedom and progress.

Over the years, the annual Conference has become an important part of our regional activities. Apart from the presentation of the newest statistical survey data, the conference participants debate important issues related to economic reform such as deregulation, social policies, and free trade. By sponsoring these meetings, we also intend to strengthen the bonds between like minded Arab entrepreneurs and advocates of economic freedom to thereby impact the related debates in the public sphere. For inspiration, we may look to Asia or Latin America where the Foundation has successfully supported the establishment of regional economic freedom networks in cooperation with the Fraser Institute.

The publication of the annual regional report in Arabic—in cooperation with Mahrousa Publishers in Cairo—has enhanced the visibility of the reports' findings. Importantly, the Foundation's country projects use this publication for training seminars on economic matters in the Arab world.

In spite of these success stories, the promotion of freedom in general—and economic freedom in particular—remains an uphill battle. One of the main challenges in this part of the world is what I would call the discrepancy between official rhetoric and political practice. Often, governments profess to implement liberal policies; however, what happens in reality does not have a liberalizing effect: critics deplore that much of what passes for economic reform is mainly window dressing for the sake of international consumption. In some countries, policies portrayed to the public as economic liberalization programs have lost credibility with local constituencies as they have yet to produce the results announced in the beginning, and the supposed beneficiaries are still waiting for the trickle-down effect. One example of this is employment, a major challenge in parts of the Arab world. According to a study by the United Nations Development Program (UNDP), many of the reform initiatives did not lead to a reduction of unemployment rates. This has tarnished the popularity of governments and economic planners and, unfortunately from a liberal perspective, also damaged the image of liberalism as a proven and successful strategy for economic development. At this juncture, the data of the Economic Freedom Index attain their crucial importance as they document in an empirical manner that more economic freedom creates more wealth.

How this wealth is distributed (or redistributed) in society is a different question all together. This is not for economists, but politicians to address. One major problem in the Arab world is that most governments lack democratic legitimacy, as they are not elected in a democratic manner. This, again and again, overshadows any talk about economic freedom in this part of the world. ■

# Economic Mauritius's

JEAN-FRANÇOIS MINARDI AND ERIC NG PING CHEUN

**Y**ear after year, the worst economic performers in the *Economic Freedom of the World Annual Report* are developing nations and the top performers are developed countries. This year's report, however, provides a glimmer of hope as there are now two developing countries in the top ten nations: Chile and Mauritius.<sup>1</sup>

For the very first time, a Sub-Saharan African country is now the ninth freest economy in the world. Mauritius is a remarkable example of economic development created by an increasing level of economic freedom over the last three decades. The country's economic freedom rating was 5.16 in 1980, and it is now 7.61 (Gwartney, Hall, and Lawson, 2010: 106). When we consider the five components<sup>2</sup> of the Economic Freedom Index since the 1970s, it is clear that Mauritius has improved its economic freedom essentially by reducing the size of its government (from a rating of 6.8 in 1970 to 8.4 in 2008), and by increasing its freedom to trade internationally (from a rating of 4.0 in 1970 to 7.4 in 2008) (Gwartney, Hall, and Lawson, 2010). This has allowed the small Indian Ocean Island to grow much faster than other developing nations. According to the World Bank's 2009 Country Classification, Mauritius is now considered an upper-middle-income economy—the last step before entering the exclusive, developed countries' club.

## Why is economic freedom good for development?

The low level of economic freedom<sup>3</sup> in developing countries is a problem because numerous studies have shown that coun-

tries with more economic freedom grow more rapidly, and achieve higher levels of per capita income than those that are less free (Norton and Gwartney, 2008: 27). Economic freedom not only drives economic growth and prosperity, but also contributes to the emergence of civil liberties and political freedom, both of which are essential to human rights and liberal democracy<sup>4</sup> (Gwartney and Lawson, 2009: 22; Al Ismaily et al., 2008: 13).

Dr. William Easterly, Co-Director of the Development Research Institute, an independent and non-partisan organization doing research on the economic development and growth of poor countries, notes that economic freedom seems well established as a path to prosperity. Yet, people like Dr. Jeffrey Sachs, the author of *The End of Poverty* and who played a key role in the UN Millennium Project,<sup>5</sup> still argue for a significant increase in foreign aid<sup>6</sup> to help poor countries escape the "poverty trap" that he believes prevents poor nations from experiencing economic growth (Easterly, 2006: 33).

However, as Easterly states, Africa has received \$568 billion in aid over the past four decades, and the results have been far from impressive in terms of poverty reduction and economic development (2006: 34). As China has demonstrated over the past two decades—during which time 300 million Chinese people rose out of extreme poverty—raising economic growth by increasing economic freedom is a more efficient and successful way to reduce poverty in developing countries (Norton and Gwartney, 2008: 33).

This is why a higher level of economic freedom in developing countries that liberates people from dependence on government and allows them to make their own economic and political choices is so important.



# freedom, launching pad



## A brief history of the Mauritian economy

Since its independence in 1968, Mauritius has developed from a low-income, agrarian economy dependent on sugar cane, to an upper-middle-income country that has carved out niches in the textile industry, in tourism, and in financial services (Ng Ping Cheun, 2007: 1). This success can be attributed mainly to the strategies undertaken by successive governments over the past four decades to bring about economic diversification.<sup>7</sup>

The development in the 1970s of an outward-looking, export-oriented strategy spearheaded by textiles and clothing manufacturing, has been a driving force in the take-off of the Mauritian economy (Dabee and Greenaway, 2001). Foreign investors were attracted by the provision of generous incentives such as tax holidays and duty-free imports of raw materials and equipment; free repatriation of capital;<sup>8</sup> the availability of a cheap and docile workforce; a relatively stable political and social climate; and by the preferential trade access to European Union markets.<sup>9</sup> In parallel to the development of the industrial Export Processing Zone (EPZ),<sup>10</sup> the national airline Air Mauritius expanded into new non-stop destinations in Europe, which contributed to boosting the tourism industry in the 1980s (Mauritius, 2010a).<sup>11</sup>

In fact, much of the Mauritian economic growth has been driven by export performance. Exports, which totaled only Rs1.8 billion in 1976, increased tenfold to Rs18.1 billion in 1990. Annual real Gross Domestic Product (GDP) growth averaged 5.4% between 1976 and 1990,

the main contributor being the EPZ sector, which grew at an average annual rate of 16% between 1976 and 1990, with a peak of 35% in 1986 (Mauritius, 2010b).<sup>12</sup>

The diversification strategy was expanded in the 1990s with the consolidation of the financial services sector into commercial banking, insurance and global business, and also in the 2000s with the information and communication technology becoming a new economic sector. From 1991 to 2010, the economy enjoyed an average annual real growth of 4.9%.<sup>13</sup>

## What explains the Mauritian success?

Because it lacks natural resources, Mauritius's prosperity is dependent on its people. James Meade, winner of the 1977 Nobel Prize in Economics, lamented the island's ethnic diversity as a curse in 1961. However, it turns out that this very diversity creates useful linkages of international trade as well as important networks of foreign direct investment with the former colonial powers, and with the countries of origin (Subramanian, 2009).

Mauritius has been a liberal democracy with a sophisticated and impartial legal system since its independence. Both the rule of law and respect for private property play a positive role in making the island an attractive investment location. Instead of nationalizing the sugar sector, guaranteeing the rights of the sugar owners who make up the economic elite has well served the Mauritian economy and contributed to its rapid expansion and diversification. Equally, a free and

vibrant press, and participatory politics ensure confrontation of ideas, warning of emerging problems and feedback on official decisions, thus bringing out the best in all stakeholders. All these institutions, along with preferential trade agreements, have shaped Mauritius's economic performance (Subramanian and Roy, 2001).


There are, however, some limits to the Mauritius model. We note the great social inequalities within the population, and also the government's interventionism in the economy. The policy of protecting domestic markets while providing incentives for export enterprises strains public finances.<sup>14</sup> Furthermore, there exist non-tariff barriers in the form of a large bureaucracy and import licences on numerous products from circuit breakers to weighing scales. The government is also heavily involved in private companies through majority shareholding. It has a stake in banking, insurance, telecommunication, commercial aviation, housing, real estate, restaurants, and entertainment activities. It also wields a monopoly on public utilities and casinos, and has a long reach through its State Investment Corporation, which holds investments in about 90 companies out of a total of more than 5,000 across all economic sectors (State Investment Corporation Ltd., 2010).

## Conclusion

Since their independence, many developing countries have suffered from poor economic and political governance. However, Mauritius has shown that there is an alternative path towards relative economic prosperity, poverty reduction, and liberal democracy. Other developing countries should try to replicate this experience in order to create an institutional and policy environment that is conducive to the smooth operation of markets, the realization of gains from trade and entrepreneurial activities, and that will enable economic and political freedom to flourish for the benefit of their citizens (Gwartney and Lawson, 2004: 28).

## Notes

<sup>1</sup>In this year's index, the top ten nations are Hong Kong,



Economic  
freedom  
liberates people  
from dependence  
on government

Singapore, New Zealand, Switzerland, Chile, the United States, Canada, Australia, Mauritius, and the United Kingdom. The bottom ten nations are Zimbabwe, Myanmar, Angola, Venezuela, the Republic of Congo, the Democratic Republic of Congo, the Central African Republic, Guinea-Bissau, Burundi, and Algeria. Chile appeared for the first time in the top ten in the 2008 index, and ranked fifth this year (Gwartney, Hall, and Lawson, 2010: v).

<sup>2</sup>In the *Economic Freedom of the World: 2010 Annual Report*, economic freedom is measured in five areas: (1) size of government; (2) legal structure and security of property rights; (3) access to sound money; (4) freedom to trade internationally; and (5) regulation of credit, labour, and business.

Economic freedom is measured on a scale of 0 to 10 where a higher value indicates a higher level of economic freedom.

<sup>3</sup>According to James Gwartney, and Robert Lawson (2009: 3), authors of the *Economic Freedom of the World: 2010 Annual Report*, the key ingredients of economic freedom are personal choice, voluntary exchange coordinated by markets, freedom to enter and compete in markets, and protection of persons and their property from aggression by others.

<sup>4</sup>For Freedom House (2008): "Political rights enable people to participate freely in the political process, including the right to vote freely for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, and elect representatives who have a decisive impact on public policies and are accountable to the electorate. Civil liberties allow for the freedoms of expression and belief, associational and organizational rights, rule of law, and personal autonomy without interference from the state." Academic research has also shown that economic freedom is a necessary, though not sufficient, condition for liberal democracy (Berger, 1992: 11).

<sup>5</sup>The UN Millennium Project was commissioned by the UN Secretary-General in 2002 to develop a concrete action plan to end poverty hunger and disease in the world.

<sup>6</sup>A system in which wealthy nations subsidize poor ones.

<sup>7</sup>The first attempt at economic diversification started in the 1960s with the implementation of an import-substitution strategy, an inward-looking strategy espousing the orthodoxy



that prevailed at that time in African developing economies.

<sup>8</sup>Investors could freely repatriate their capital without being taxed on their gains or subject to capital control.

<sup>9</sup>Mauritius was allowed to sell an agreed quota of its sugar production to the EU at guaranteed prices under the *Sugar Protocol*, a trade instrument forming part of the Lomé Convention, and it benefited duty-free and quota-free access for its textile products to the EU and to the US markets under the *Multi-Fibre Agreement*.

<sup>10</sup>EPZ was a tax regime particular to a qualified group of exporting activities such as textiles, clothing, and jewelry. The qualified firms did not necessarily group themselves into a geographic zone, but were scattered all over the island. They benefited from various fiscal and tax incentives contrary to domestic-oriented manufacturers. Since 2006, there has been a single, uniform tax regime for the whole sector.

<sup>11</sup>Tourist arrivals grew from 115,080 in 1980 to 291,500 in 1990, representing an average annual growth of 10%. Gross tourism earnings, which amounted to only Rs0.36 billion in 1980, multiplied tenfold to Rs3.5 billion in 1990.

<sup>12</sup>Mauritius Employers' Federation (1998)

<sup>13</sup>See: <<http://www.gov.mu/portal/goc/cso/ei861/natacc.pdf>>

<sup>14</sup>The State Trading Corporation Ltd., the state-owned commodity importer, controls imports of rice, flour, petroleum products and cement; and it even now purchases foreign exchange directly from the central bank rather than from commercial banks. For its part, the Agricultural Marketing Board controls imports of potatoes, onions, corn and some spices that compete with locally grown produce.

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ALEXANDER MOENS

The best outcome for American public policy, and Canadian interests in the 2010 congressional elections would be a decisive amount of new congressmen and congresswomen committed to reducing public spending in both significant and immediate ways.

The large federal budget deficit, alongside an array of new regulations in health care, banking, and energy initiated by the Obama administration, is fueling economic uncertainty and causing anemic growth. According to the Congressional Budget Office (CBO)—the US agency that reviews congressional budgets and other legislative initiatives with budgetary implications—the current level of publicly held federal debt is the equivalent of 60% of US Gross Domestic Product (GDP). Government spending as measured per household cost has gone up by \$5,000 in just two years to \$30,543 per household in 2010 (Riedl, 2010). Under current legislation, which includes the extension of the Bush-era tax cuts, the federal debt is expected to reach \$20.3 trillion by 2020, or 90% of GDP (CBO, 2010a, 2010c, 2010d).

The public debt accumulating by the US is not merely of peripheral interest to Canada. It poses two direct challenges: while the Canadian fiscal condition is much stronger, our economy remains attached at the hip to the American economy. Canada experienced an economic contraction in 2009, and after strong early growth in 2010, the pace has declined consid-

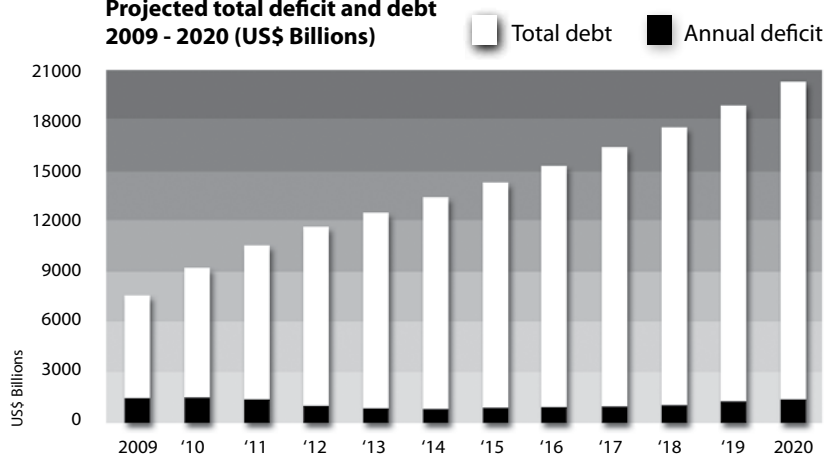
erably. Economic growth in Canada has slowed in part as a result of tepid US growth. Merchandise exports to the US have not yet recovered their pre-2008 levels (Thomson, 2010; Veira, 2010). The high unemployment rate and slow economic growth south of the border also generate protectionist sentiment in Congress with dire consequences for Canada. New regulations surrounding “Buying American,” green energy, and country of origin labelling (COOL) act as de facto trade barriers.

The results of the 2009 \$787 billion stimulus program appear to be minimal, and certainly do not seem to justify the large costs to American taxpayers. The high unemployment rate at 9.6% (as of September 22) underscores the lack of impact of the stimulus program (US Bureau of Labor Statistics, 2010). President Obama and the Democratic Congress have followed a brazen

“spend and borrow” pattern of public policy. Since the beginning of 2009, the Obama administration has signed over 235 pieces of legislation into law (White House, 2010). While most of the legislation has minor implications for projected budget deficits, some of the new laws call for significant amounts of additional spending. The total projected net effect on the annual deficits of new legislation signed by the Obama administration for the period 2010–2020 is \$ 864.2 billion<sup>1</sup> (author’s calculation; CBO, 2010c). This includes both new expenditures as well as projected offsets, including the *Patient Protection and Affordable Care Act* (ObamaCare) passed in 2010.

The medical insurance reform implemented by the Obama administration in the *Medicare Physician Payment Reform Act* of 2009 came with a price tag of approximately \$210

**Projected total deficit and debt 2009 - 2020 (US\$ Billions)**



billion (CBO, 2009a). The *Jobs for Main Street Act* cost nearly \$7 billion (CBO, 2009a), *Helping Families Save Their Homes Act* cost \$11.3 billion (CBO, 2009c), the *Restoring American Financial Stability Act* of 2010 cost \$19.7 billion (CBO, 2010a), and the *Serve America Act* cost \$8.2 billion (CBO, 2009b). Federal aid to states and municipalities proposed in August 2010 is estimated to be an additional \$26 billion (Montgomery and Anderson, 2010).

The spread between federal revenues and expenditures in 2010 has become alarmingly large. Economic growth alone cannot close the gap in projected revenues, and spending in the next ten years, which will still be near \$1 trillion in 2020 (CBO, 2010a, 2010c, 2010d). The Obama administration apparently does not see the writing on the wall. Its public policy is stuck in spending and borrowing. Recently, the president proposed a \$50 billion stimulus funding plan for a six-year period for infrastructure, including high-speed rail (*Economist*, 2010).

Many Americans were already concerned about the large increases in public spending since 2001 for the War on Terror and the failure of Republicans to cut domestic spending during the presidency of George W. Bush. The Obama campaign in 2008 emphasized the notion that the president and his economic team would govern from the centre rather than from the left (Obama, 2006, Plouffe, 2009). Given that the Clinton Administration kept spending controlled after the 1994 mid-term elections, it was possible that Obama would follow a similar path. The 2008-2010 record, however, indicates that the administration has been audacious in its capacity to ignore America's biggest public policy challenge: an annual deficit of 10.3% of GDP, and an ocean of growing debt given the additional difficulties of future shortfalls in Social Security, and Medicare and Medicaid (CBO, 2010a).

When the spending policies of the Obama administration and the current Congress are considered alongside the proposed tax plans, we see the unfolding of a familiar design. On January 1, 2011, the Bush tax cuts of 2001 expire. The Obama plan is to

allow the top two marginal tax rates respectively at 33% and 35% to increase respectively to 36% and 39.5% (Williams, 2009; Tax Policy Center, 2009; BarackObama.com, 2008). This significant tax hike is estimated to take over \$900 billion of personal income out of the US economy. The small businesses that are in these brackets are the ones that earn the majority (72%) of small business income (Dubay, 2010). Additionally, the administration is asking Congress to let capital gains and dividend taxes rise from 15% to 20% (Williams, 2009; Tax Policy Center, 2009; BarackObama.com, 2008).

This November's midterm election is of pivotal importance, as another two years of large-scale spending will make the badly needed fiscal correction nearly impossible.

## Electoral Hurdles

Despite the concern of American voters about the growing debt and the current unpopularity of President Obama and the Democrats, American politics, as usual, is not straightforward. As of writing, the Republican Party needs a net victory of 39 seats to take over the 435-seat House and 10 senate wins out of 37 to form a majority in the 100-seat Senate. This scenario is, however, far from guaranteed. Even though decisive numbers in the opinion polls demonstrate disapproval of Congress, Democrats, and President Obama, those aggregate numbers do not necessarily decide individual House of Representatives' races. The average loss in the first mid-term election for the majority party is 16 seats (Cook, 2010). House representatives are up for election every two years and they keep very close watch on what their constituents want. They also ensure that a lot of federal cash is flowing to their ridings and keep considerable war chests in place to ward off opponents during the campaign. As a result, incumbency rates in the US Congress are very high.

There is also another complication. The Republican Party is going through an internal revolution of sorts. Republican congressmen and congresswomen between 2000 and 2006—unlike the Gingrich Republicans of the

mid 1990s—increased federal spending considerably. For example, the 2003 drug benefit expansion (Medicare Part D) enacted by the Republican-led Congress and advocated by the Bush administration has an estimated net cost of \$394.8 billion over the 2004–2013 period (CBO, 2003). Party members are appalled at the lack of fiscal prudence among Republican incumbents and their lackluster opposition to Obama's spending. The newly created Tea Party contains a mixture of fiscal and social conservatives. The Tea Party has been able to upset several primary campaigns of so-called "establishment" Senate Republicans such as Mike Castle's bid in Delaware, and the seats of Lisa Murkowski in Alaska and Bob Bennett in Utah. The good news is that there are now more committed budgetcutters on the ballot. The problem, though, is that it remains unclear how well these new Tea Party candidates will stand up in the general election. Some states such as Delaware are traditionally liberal and voters may have no stomach to cast their ballots for "mavericks." Then again, voters may be energized enough this time around to do exactly that.

A third factor at play is the rise of the so-called "Blue Dog Democrats" who have increasingly flexed some muscle in opposition to the leadership of the White House and House Speaker Nancy Pelosi. These Blue Dog Democrats tend to be more fiscally conservative than other Democrats. Some 30 Blue Dog Democrats in the House are on record opposing Obama's plan to raise income taxes for the top two brackets in January 2011 (Weisman, McKinnon and Meckler, 2010). In effect, voters may put more pressure on some conservative Democrats to vote for fiscal discipline, rather than replacing them with Republicans. In other words, it is possible that Republicans may not gain a majority, but that fiscal discipline will still improve by means of more committed Blue Dog Democrats. If Republicans fall short of gaining 39 seats in the House, and if neither party is able to command 60 seats in the Senate, bipartisan compromise will be a necessity in which fiscal conservatives from both parties will be in a position to play a stronger role.



A leading role by fiscal conservatives in Congress is the only hope to force the Obama administration to follow a different course and to begin restoring confidence in the American economy.

## Note

<sup>1</sup>The US\$864.2 billion was calculated by aggregating all of the cost estimates produced by the US Congressional Budget Office for each piece of legislation that will impact budget deficits signed into law since Obama entered the White House in 2009.

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# The hard facts about BC's minimum wage

BC would be wise to ignore calls to increase the minimum wage

**NIELS VELDHIJS AND AMELA KARABEGOVIĆ**

In late September, BC Labour Minister Murray Coell announced that his government would consider increasing BC's minimum wage (Lee, 2010 and CBC News, 2010). Union bosses, including BC Federation of Labour head Jim Sinclair cheered the move and BC New Democratic Party (NDP) leader Carole James, highlighting her pedestrian knowledge of economics, declared that an increase in the minimum wage is "actually an economic stimulus" (*Vancouver Sun*, 2010).

Both Sinclair and James argue that BC's minimum wage is the lowest in the country, that increases are needed in order to reduce poverty for the working poor, and that increases can be imposed without negatively affecting employment. The hard facts, however, tell a remarkably different story.

Let's begin with the claim that BC's minimum wage is the lowest in Canada, a view based on the statutory minimum wage rate—the hourly rate established by government. This measure, however, does not account for the ability of businesses to pay the minimum wage. A more appropriate way to measure minimum wages is to examine the income generated by earning the minimum wage relative to the average worker's productivity (output per worker) in the province. For example, Alberta's statutory minimum wage rate (\$8.80) is higher than BC's (\$8.00), but productivity is also higher in Alberta, which means that businesses are able to pay a higher minimum wage (HRSDC, 2010). Alberta's minimum wage is 13% of the average worker's productivity compared to 19% in BC (Statistics Canada, 2010a and 2010b; HRSDC, 2010; and TD Bank Financial Group, 2010). Adjusting for productivity then, BC's minimum wage is actually higher than that of Alberta, Saskatchewan, and Newfoundland.

Next, consider the argument that minimum wage increases are necessary to raise the income of society's low-income workers. While this claim certainly appeals to one's emotions, the typical minimum wage earner is not the person depicted by advocates of minimum wage hikes. Data from Statistics Canada reveals the majority (59%) of Canadian minimum wage workers are young—between the ages of 15 and 24—and the majority of those (nearly 90%) live at home with family (Statistics Canada, 2010c). Many of the remaining individuals earning minimum wages are adults supplementing their family income with part-time work during child-rearing years, or after retirement.

Additionally, workers earning the minimum wage today are not the same individuals who earned the minimum wage a year or two ago (Godin and Veldhuis, 2009). That is, minimum wage work is largely a temporary experience. The vast majority of minimum wage earners experience upward income mobility rather quickly. In fact, research shows that after one year, more than 60% of minimum wage workers earn more than the minimum wage, with a typical wage gain of about 20% (Smith and Vavrichek, 1992). After two years, more than 80% of minimum wage workers earn more than the minimum wage (Long, 1999).

Herein lies the main problem with minimum wage increases: employers respond by reducing the number of workers they employ and/or the number of hours their employees work. Consequently, minimum wage increases take away opportunities for low-skilled workers and young people to enter the workforce, gain experience, and move up the income ladder.

This unpleasant reality is well documented in the research. A review of academic studies from Canada and around the world demonstrates convincingly that high minimum



wages lead to lower employment levels. For example, 14 academic studies specifically examined the impact of minimum wage increases in Canadian provinces, including British Columbia (Godin and Veldhuis, 2009). The Canadian research indicates that a 10% increase in the minimum wage is likely to decrease employment by 3–6% for young workers aged 15 to 24. For those young workers most directly affected—workers earning between the current \$8 hourly wage and the proposed \$10 hourly wage—the impact is more acute, with employment losses of up to 20%. Given the negative employment impact of minimum wages, it should come as no surprise that while the overall unemployment rate in British Columbia is 7.3%, the unemployment rate for those aged 15 to 24 is 14.7%—more than double (Statistics Canada, 2010d).

A recent Fraser Institute minimum wage study estimated that if the BC government succumbs to calls from unions and other activists to increase the minimum wage rate to \$10 per hour from the current rate of \$8 per hour, the province would shed upwards of 52,000 jobs (Godin and Veldhuis, 2009).

If Jim Sinclair and Carole James are successful, their efforts will rob young and unskilled workers of the opportunity to participate in the labour market and gain the skills and experience they need to increase their incomes. For the benefit of the province's young workers, BC would be wise to ignore calls to increase the minimum wage.

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# Trying times with Moscow

ALAN W. DOWD

In the summer of 2010, Russian Tu-95 long-range bombers encroached on Canadian airspace at least twice. In August, a pair of Tu-95s was only 30 miles outside the Northwest Territories when Canadian F-18s escorted them away. This followed a July incident in which Canadian F-18s intercepted two Tu-95s east of Goose Bay. Russia's provocative military activity has not been confined to Canadian airspace; Tu-95 encroachments on Alaskan airspace have been commonplace since 2007. Moreover, in February of 2008, a flight of four Russian Tu-95s threatened the aircraft carrier *USS Nimitz* in the open waters of the North Pacific Ocean and one of the Russian bombers made two passes over the deck of the US ship. While en route, another violated Japanese airspace (Starr, 2008).

In September of 2010, just weeks after the Tu-95s made their unwelcome visit near the Northwest Territories, a Russian anti-submarine aircraft flew within 100 feet of the *USS Taylor*, a US frigate operating in international waters in the Barents Sea. The incident was so serious that US Chief of Naval Operations Adm. Gary Roughead raised the issue with his Russian counterpart (Osborn, 2010).

This unfortunate return to Cold War-style brinkmanship on the part of the Russian military may be an under-the-radar phenomenon for most Canadians and Americans, but it is becoming an all-too-frequent occurrence. American and/or Canadian warplanes have intercepted between 12 and 18 Russian bombers each year since 2007 (Deslongchamps, 2010).

What does this trend mean, and how should Canada and the United States respond?

## A Zone of Peace?

Russia's apparent probing of North American defenses is a function of two related factors. First, it is generally accepted among observers of international security policy that Russia is eyeing the resources of the Arctic, and is signaling its seriousness about claiming those resources. The US Geological Survey estimates that the Arctic may hold 1,670 trillion cubic feet of natural gas and 90 billion barrels of oil, equaling 30% of the world's undiscovered gas and 13% of undiscovered oil (USGS, 2008). These Arctic energy resources will be increasingly recoverable and transportable because the fabled Northwest Passage, once frozen throughout most of the year and navigable only by heavy-duty icebreakers, is thawing (Ek, et. al., 2009).

Although Russia's Prime Minister Vladimir Putin recently expressed his desire "to keep the Arctic as a zone of peace and cooperation," actions speak louder than

words (de Carbonnel, 2010). In 2009, Moscow announced plans to build a string of military bases along Russia's northern tier (UPI, 2009). In 2008, a Russian General revealed plans to train "troops that could be engaged in Arctic combat missions," ominously adding, "wars these days are won and lost well before they are launched" (AFP, 2008).

During a 2007 expedition, Russia planted its flag under the ice—far beyond the internationally recognized 200-mile territorial limit. The lead explorer provocatively declared, "The Arctic is ours" (Clover, 2008). In fact, as early as 2001, Russia brazenly claimed almost half of the Arctic Circle, and all of the North Pole as its own (Idov, 2008).

As my colleague Alexander Moens and I have noted, "Russia's outsized Arctic claims rest on a dubious interpretation of an underwater ridge linking to the Russian landmass, and Russia argues that this ridge is an extension of its own continental shelf" (Moens and Dowd, 2009). Not surprisingly, Russia's Arctic neighbours do not share this view. In 2010, as the US and Canada began a joint expedition to collect data on the extended continental shelf, the US government emphasized that "the United States has an inherent national interest in knowing, and declaring to others with specificity, the extent of our sovereign rights with regard to the US extended continental shelf. Certainty and international recognition are important in establishing the necessary stability for development, conservation and protection of these areas, likely rich in resources" (US Extended Continental Shelf Project, 2010).

Yet both Canada and the United States face challenges in asserting their rights and fending off Russian encroachment. Budgetary restraints have eroded plans by various Canadian governments to invest heavily in Arctic military and security capabilities (Moens and Dowd, 2009). The United States has only three polar icebreakers, and two of these \$800-million ships have exceeded their projected 30-year lifespan. In fact, engine failure prevented the icebreaker *USCGC Polar Sea* from deploying to Antarctica in June 2010. Meanwhile, the icebreaker *USCGC Polar Star* is being refurbished and will not be deployable until 2013 (*Defense News*, 2010).



The Canadian Coast Guard Ship Louis S. St-Laurent ties up to the Coast Guard Cutter Healy. The ships are taking part in a survey that will help define the Arctic continental shelf.

Russia, by comparison, can deploy 20 icebreakers (O'Rourke, 2008). This imbalance could allow Russia to solidify its Arctic claims, while hindering American and Canadian efforts to make and defend their own.

## Zone of Conflict?

A second reason for Russia's muscle flexing is more worrisome than where and how the Arctic pie is divided. Russia's political, military, and diplomatic apparatus is pushing back against Western power, even against the settled outcomes of the Cold War. As Robert Kagan of the Brookings Institution concludes, "It is the entire post-Cold War settlement of the 1990s that Russia resents and wants to revise" (Kagan, 2007).

The examples supporting this claim abound:

- Russia appears unwilling to accept that some of its neighbours are sovereign. What else could explain its invasion of Georgia, crippling cyber-attacks on Estonia, interference in the internal politics of Ukraine and Lithuania, or garrisoning of troops in Moldova (over Moldova's objection)?
- When Moscow is unhappy with the governments in Minsk, Kiev, or Warsaw, it shuts off gas supplies bound for Europe in the dead of winter.
- Moscow resents NATO enlargement, and bristles at plans for a NATO-wide missile defense, so it has conducted war games focused on a Polish "aggressor," complete with simulated nuclear strikes aimed at Poland (Day, 2009).
- Moscow opposes America's presence in Central Asia, so it has bullied regional leaders to disrupt US logistics arteries into Afghanistan (Scheineson, 2009).

Add to this list Russia's aerial brinkmanship, and Moscow's actions provide plenty of justification for a hedging strategy on the part of the US, Canada, and their Arctic allies. We see the outlines of this return to realism vis-à-vis Moscow in Canada's purchase of 65 F-35 Joint Strike Fighters, and in the increased activity and interest among allied nations in Arctic security.

In August, Canadian military forces, along with assets from the US 2nd Fleet, the US Coast Guard, and the Danish Navy, conducted military maneuvers in the Arctic (Comte, 2010). Last year, Norway led an Arctic exercise enfolded 13 nations. Sweden followed with large-scale war games oriented on the Arctic. Denmark is also standing up its own Arctic military command (Weber, 2009).

NATO is even contemplating Arctic intervention. As then NATO Secretary General Jaap de Hoop Scheffer said of NATO involvement in the Arctic in 2009, "I would be the last one to expect military conflict...but there will be a military presence" (*Associated Press*, 2009). US Navy Adm. James Stavridis, who serves as NATO's military commander, is less sanguine, conceding that the Arctic could become "a zone of conflict" (UPI).

Some, especially in the Canadian press and opposition, dismiss all this as saber rattling (Gillies, 2010; Riley, 2010). But if it is, Moscow picked up the saber first. Either way, Churchill's 1946 observation about his Russian counterparts still applies: "There is nothing they admire so much as strength, and there is nothing for which they have less respect than for weakness, especially military weakness" (Churchill, 1946).

## A Complex Relationship

Despite all this, we are not necessarily entering a new cold war. After all, Russia's unwelcome flights near North American airspace are news today because they are fairly infrequent. During the Cold War, they were so commonplace that they were seldom even reported.

Moreover, even as Moscow makes mischief from Asia all the way to the Arctic, it pays to recall that the Russian military and its Western counterparts are cooperating in important areas. The United States and Russia inked a major strategic arms reduction treaty this year, the so-called New START Treaty (White House, 2010).

The US, Canada, and Russia recently collaborated for Operation Vigilant Eagle, the first-ever exercise testing their ability to cooperate in a midair hijacking scenario. The exercise involved assets from NORAD, US F-22s, as well as Russian Su-27s and MiG-31s. The warplanes intercepted the "hijacked" aircraft and then ground assets collaborated as the planes moved from one country's airspace to another's.

Elsewhere, Russia has allowed some NATO members to transport non-lethal equipment into Afghanistan via Russian territory. In fact, Russia is NATO's main fuel supplier in Afghanistan (Shanker and Opiel, 2008).

In a signal that it shares Western concerns over Iran's nuclear program, in September the Kremlin promised to block the sale of highly sophisticated S-300 air defense systems to Iran.

Also in September, Russia and Norway resolved a long-running boundary dispute, paving the way for energy exploration and development in some 67,000 square-miles of the Arctic Ocean, holding an estimated 39 billion barrels of oil (Kramer, 2010).

Finally, it is ironic that the harassment of the *USS Taylor* occurred just days after it made a historic visit to the Russian port of Murmansk to celebrate the end of World War II. It was the first time a US warship had visited Murmansk since the war.

In short, Russia's relationship with the West is less dangerous, but more complex, than it was during the Cold War. As Canadian Forces Col. Todd Balfe observed after Vigilant Eagle: "we are trying to transition our relationships militarily from a period of confrontation...to a period of cooperation" (Humphreys, 2010). The operative word here is "trying"; Russia and the West remain somewhere between confrontation and cooperation.

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# No end in sight

NIELS VELDHUIS AND CHARLES LAMMAM



**W**ith members of parliament back to work in Ottawa, and economic growth having unfortunately slowed, Canada's opposition parties are increasing the pressure for more stimulus spending.

If New Democratic Party (NDP) leader Jack Layton had his way, he would accelerate spending to keep pace with President Obama, who is quickly digging the United States into a fiscal hole that will take decades to reverse (Vieira, 2010). Taking a slightly more moderate position, Michael Ignatieff and the Liberals want the stimulus to keep flowing after the set March 31, 2011 "end date" (Vieira, 2010).

Given these options, fiscally conservative Canadians should rightly support the governing Conservatives who have thus far indicated that they are sticking to their plan to provide no further stimulus. This fall, Finance Minister Jim Flaherty stated that his party wants to "stay with our exit strategies to get us out of this temporary, extraordinary stimulus" (Vieira, 2010).

That, of course, assumes that the federal government is actually planning to end the "temporary" stimulus spending on March 31, 2011, as previously claimed. Unfortunately, it seems to be planning no such thing. One only has to look at the government spending plans to see that there really is no end in sight. Rather than end the stimulus and decrease spending to pre-recession levels, the Conservative government plans to continue what it has been doing for the past four years: spend, spend, and spend.

Consider the Harper government's record since taking power in 2006.<sup>1</sup> Before the recession, it significantly increased spending from \$209 billion in 2005/06 (the Liberals' last year in office) to \$239 billion in 2008/09, an increase of nearly 15% over three years.

During the recession itself, the government bought into the false notion that fiscal stimulus spending is an effective way to boost economic activity. From 2008/09 to 2010/11, federal spending increased by nearly \$42 billion as a result of the government's stimulus package, and is expected to reach \$281 billion by the end of this fiscal-year (2010/11).

What is the Conservative Party's plan after stimulus spending "ends" on March 31, 2011? As Figure 1 depicts, stimulus spending is actually not ending at all. If it were, we would see a significant decrease in spending levels in 2011/12, similar in fashion (though in the opposite direction) to the dramatic increases over the past two years, but we don't.

In 2011/12, planned federal spending will decrease by only 1.4% (\$3.8 billion) before it increases again over the final 3 years of the government's fiscal plan. By 2014/15, spending will be \$30.6 billion, 11.4% higher than it was in 2009/10.

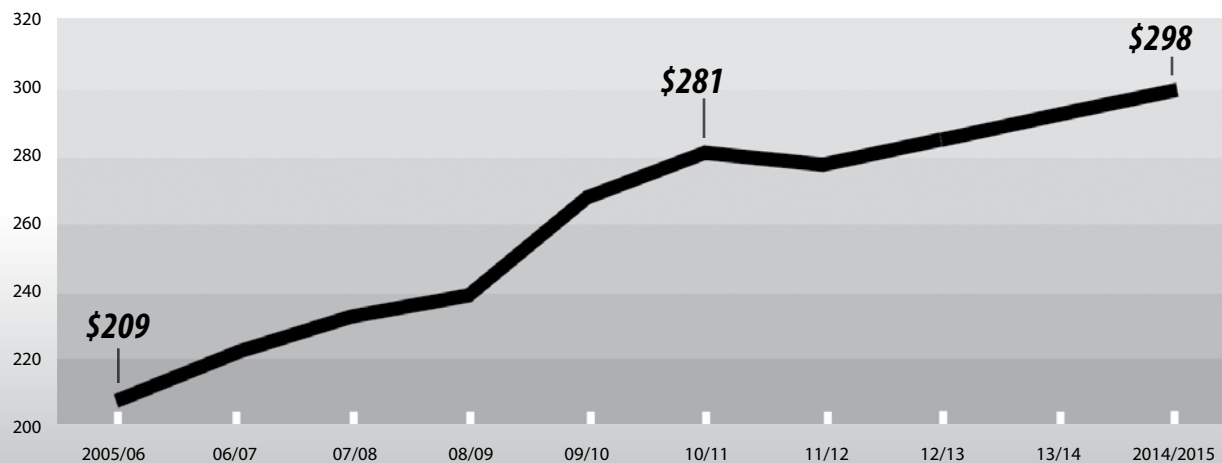
While the Liberal, NDP, and Conservative parties debate the end of stimulus spending, the reality is that most of the "temporary" spending is set to become the baseline for future budgets. The result will be a permanent increase in government spending going forward.

Because of the government's failure to reduce spending to pre-recession levels, Canadians can expect \$105 billion in deficits over the next 5 years, in addition to the \$54 billion deficit in 2009/10. As a result, the federal debt will swell to \$622 billion in 2014/15 from \$464 billion in 2008/09, undoing a decade of debt repayment.

If our federal politicians wanted to get behind a genuine effort to stimulate the economy, they would rally behind a plan to restore balance to our nation's finances. While plenty of empirical evidence exists showing the negative relationship between debt levels and economic growth, a paper entitled *Public Debt and Growth*, published in July by the International Monetary Fund (Kumar and Woo, 2010) warrants a close look. The IMF study examined the relationship between public debt and economic growth for a group of 38 advanced and emerging countries over almost 4 decades. It found that a 10 percentage point increase in a country's debt-to-GDP ratio leads to a decrease in per-person economic growth by 0.2 percentage points, "mainly due to reduced investment and slower growth of the capital stock per worker" (Kumar and Woo, 2010:21).

Another important recent study *Growth in a Time of Debt*, by University of Maryland professor Dr. Carmen Reinhart and Harvard University professor Dr. Kenneth Rogoff found much

**Figure 1: Federal Government Spending (in Billions)**



of the same: persistent deficits propel public debt to levels that impede economic growth (Reinhart and Rogoff, 2010).

By the end of the 2010/11 fiscal year, the federal debt to GDP ratio will increase by 6.4 percentage points from its 2008/09 level—just the federal debt alone. Factor in the provinces (in particular Ontario where the provincial debt to GDP ratio is expected increase to over 29% in 2013/14 from 18.0% in 2007/08), and the picture becomes truly alarming (Ontario, Department of Finance, 2010).

Federal politicians, especially Mr. Ignatieff, ought to re-examine how the former Liberal government (facing significant pressure from the then Reform Party) set forth a plan to balance the budget. The reforms by former Prime Minister Jean Chrétien and Finance Minister Paul Martin eliminated a deficit much larger than the current one (4.8% of GDP compared to 3.1%), within three years (Department of Finance, 2009, 2010; authors' calculations).

Their accomplishment represented a remarkable fiscal transformation that, in part, made Canada the envy of the developed world. Spending reductions, balanced budgets, and debt repayment contributed to Canada's outstanding economic performance from 1997 to 2007 (Crowley et al., 2010).

Both the Liberal and NDP parties want to see more stimulus spending; the Conservatives talk about ending it, but without developing any plans to do so. If our MPs wanted to provide real stimulus to economic growth, they would support a plan to rein in spending, reduce the deficit, and bring down the debt. It worked before and it will work again.

## Note

<sup>1</sup>The spending figures in this article include both actual and estimated data. Figures up to 2008/09 are actual data sourced from Canada, Department of Finance, 2009, while figures from 2009/10 and beyond are estimates from the federal government's 2010 budget (see Canada, Department of Finance, 2010). These spending figures were based on the latest available data at the time of writing, but more recent data has since

been released in October 2010 with publication of the federal government's *Update of Economic and Fiscal Projections*.

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# Subsidizing professional sports is the worst form of corporate welfare

MARK MILKE AND NIELS VELDHIJS

Given the federal government's past, present, and projected future budgetary red ink, Canadians could be forgiven for thinking it might be better for Ottawa to pinch pennies rather than dole out hundreds of millions more dollars in business subsidies—or corporate welfare—this time to pro-sport franchises who are arguably the most undeserving recipients of all, as most of them are owned by billionaires.

However, there is always the possibility that politics may trump economic sense. While Prime Minister Stephen Harper said in September that his government will never directly fund professional sports teams (Kennedy and Mayeda, 2010), the possibility still remains that taxpayers might be forced to pay for the facilities in which such teams play. At first blush, Harper's comments might appear to have ruled out corporate welfare for professional sports teams, but his subsequent comment, "if there is a role for the federal government, it must be equitable across the country and also affordable" (Séguin 2010), did nothing to dispel the possibility of taxpayer-funded support for professional sports facilities.

Instead, Harper's comments increased the potential bill that Canadian

citizens will need to pay. The estimated amount for a Quebec City arena is \$175-million from the Quebec government and a similar amount from Ottawa (Kennedy and Mayeda, 2010). Once we add to that "equitable" amounts for other sports venues in Calgary, Edmonton, elsewhere on the Prairies, and perhaps even in Hamilton, Ontario for a dreamed-of—but not yet real—NHL team there, taxpayers could soon be spending real money. To fund such arenas is no different from funding factories for automotive or aerospace companies. The claim is that taxpayers do not "directly" fund General Motors, Chrysler, Pratt & Whitney, or Bombardier, but it is a distinction without a difference.

There are numerous reasons not to fund for-profit sports teams. Let us start with the supposed benefits to local economies that promoters of government subsidies trumpet: increased economic activity, more jobs, increased tax revenues, higher incomes, and a more attractive environment for future business prospects. The myth at play is that sports teams have a magical "multiplier effect" upon the local economy. Build-it-and-they-will-come economics, or—in the case of a sports team's threats to leave a city—the fear that massive

amounts of economic activity and tax revenues will be lost are unsupported claims.

Money spent on professional sports tickets comes at the expense of spending on other activities such as movies, concerts, or dining out. Thus, if the Calgary Flames or Toronto Maple Leafs left their respective cities, some sports fans who previously spent \$1,000 on tickets and beer every season are not going to throw such money into the fireplace in the team's absence. Instead, they will likely spend it somewhere else: on minor hockey, more beer, or on some other event. Economic activity and tax revenues will still result.

The economic logic is the same if an NHL team were located in Quebec City. People who might have spent money on skiing, or on the Quebec Winter Carnival previously would now spend some of their disposable income on NHL hockey tickets. Therefore, the question is whether taxpayer subsidies for sports teams have a beneficial net economic effect. Not according to University of Maryland-Baltimore County professor Dr. Dennis Coates and University of Alberta professor Dr. Brad Humphreys, who recently reviewed the academic literature on the economic impacts of profes-



sional sports franchises and stadiums. They concluded that no matter what cities or geographical areas are examined, no matter what estimators are used, no matter what model specifications are used, and no matter what variables are used, articles published in peer-reviewed economics journals contain almost no evidence that professional sports franchises and facilities have a measureable economic impact on the economy (Dennis and Humphreys, 2008, 302).

Ironically, rather than increase local economic activity and income, a diversion of consumer spending to professional sports teams (or their facilities) can often have the opposite effect. Given that salaries make up most of a team's expenditures, and given that the players of professional sports teams most often do not live in the city in which they play, the result is that much of the money consumers put into tickets is spent in other cities, and often in other countries. Even worse, a subsidy for an arena will only accomplish putting taxpayers further into debt for decades.

The *New York Times* reported that the now-demolished Giants stadium in New Jersey has US\$110-million in debt that taxpayers must still pay off. Similarly, in Seattle, the King County Multipurpose Domed Stadium (King dome) was demolished a decade ago,

but it is also still receiving citizen tax dollars to pay its outstanding debt of US\$80-million (Belson, 2010).

The economics of subsidies to professional sports teams have always been abysmal and have not changed, which is why proponents usually resort to emotional arguments to defend their positions. Perhaps that is why, in the initial lobbying for the corporate welfare for a hypothetical hockey team in Quebec City, jersey-wearing Minister of Veterans Affairs and Minister of State Jean-Pierre Blackburn said it was important to remove the "scars" Quebecers suffered in 1995 when their hockey team, the Quebec Nordiques moved to Colorado (LeBlanc, 2010).

These made-up psychological "wounds" pale in comparison to the real fiscal damage that will be done if provincial and federal balance sheets engage in more corporate welfare by providing funding professional sports teams—even through their facilities.

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# Reform EI to avoid future tax hikes

CHARLES LAMMAM AND NIELS VELDHIJS



## **Reduce the burden on workers and employees**

**L**ate last year, Prime Minister Stephen Harper pledged that his government “[wouldn’t] be raising taxes” (Clark, 2009). Despite this promise, however, Canadian workers and employers recently learned they will be facing higher employment insurance (EI) premiums (payroll taxes) on January 1, 2011, with further increases still to come (Canada, Department of Finance, 2010).

The EI premium increase was recommended by the Canada Employment Insurance Financing Board, which is mandated with setting EI premiums to ensure the program breaks even over time.<sup>1</sup> After being frozen since 2009, EI premiums will need to rise over the next several years to help cover the significant increase in EI benefit payouts that resulted from the recession and a host of temporary changes that made EI more generous.

While the Conservative government has limited the EI premium hike to a third of the annual maximum allowed by the Financing Board, an increase is still an increase. To fulfill their “no tax increase” promise, the government should reduce taxes elsewhere and seize the opportunity to reform our employment insurance system.

To offset the EI premium increase, the Conservatives should consider personal income tax reductions in the coming 2011 budget. This would ensure that the total tax bill does not increase, and would produce a change in the tax mix that would strengthen economic growth.

There is overwhelming evidence that different taxes have different economic effects, and personal income taxes are more economically damaging than payroll taxes.<sup>2</sup> The federal Department of Finance’s own research concludes that raising an extra dollar in taxes through personal income taxes costs the Canadian economy an additional \$0.56 in lost output, whereas it costs only \$0.27 for payroll taxes (OECD, 1997).

More fundamentally, the Conservatives should take the opportunity to reform the EI program to reduce the burden on workers and employers in the future. While several options are available, at minimum, the government should ensure that the EI program truly provides an insurance function for labour-market participants.

One option for reform is to use experience rating. Under such an employment insurance scheme, premiums and benefits vary depending on specific occupations and regions. For instance, individuals in occupations with a high risk of job loss are more likely to draw benefits from the system and thus would pay higher premiums (or receive lower benefits), while those in low-risk occupations would pay lower premiums. With experience rating, businesses that regularly take advantage of the system by temporarily laying off workers and re-hiring them later would pay more. Indeed, the EI reforms enacted in the 1990s (and unfortunately removed in 2001) illustrate that experience rating helped reduce program expenditures (Nakamura and Diewert, 2004).

Another option is to consider switching to a system of individual unemployment accounts. Here, workers pay premiums into their own account, which then is portable between jobs. The money in the account can be used only to finance the worker’s needs during periods of unemployment. For those who make little or no use of the account over their work lives, they can use any excesses for retirement. Such a system would strongly reduce the distortions in decisions regarding working, quitting, and searching for a job that exists under the current system.

Countries such as Chile have already experimented successfully with innovative unemployment accounts in their public employment insurance system. A recent study, *Incentive Effects of Unemployment Insurance Savings Accounts: Evidence from Chile*, published by the United Kingdom’s Centre for Economic Policy Research, found that Chile’s system has increased job-finding rates and reduced unemployment duration (Reyes et al., 2010). Not surprisingly, workers who rely on individual unemployment accounts search harder for jobs than those not relying on them.

The Harper government claims the hike in EI premiums is not as much as it could have been, but an increase is

*(Continued on page 34)*



# Ignatieff has it backward on corporate income taxes

CHARLES LAMMAM AND NIELS VELDHIJS

Liberal Party leader Michael Ignatieff recently gave Canadians a sneak preview of what is shaping up to be an economically damaging election platform. With the spending-induced federal deficit already pegged at \$45 billion this year, and with expectations of deficits for at least the next five years (Canada, Department of Finance, 2010), the Ignatieff Liberals seem to think now is the time to spend another \$1 billion a year on a new “Family Care Plan” (Liberal Party of Canada, 2010).

That Ignatieff touted the pledge as “affordable” and “fiscally prudent” is certain to leave many Canadians scratching their heads (CTV.ca, 2010). How exactly is another billion dollars in annual spending fiscally prudent? It was Ignatieff, after all, who properly criticized the \$1 billion cost of the G-20 summit in May. “These numbers are off the scales,” Mr. Ignatieff said, as he reprimanded the Conservatives for a “total lack of proper management of public finances” (Taber, 2010).

Maybe the Liberal leader thinks he is more prudent with his priorities because an Ignatieff-led Liberal government would come up with the money to introduce the Family Care Plan by cancelling the previously scheduled corporate income tax rate reductions (Liberal Party of Canada, 2010). In theory, the Liberal’s math seems simple: if you need money, then increase taxes. While this type of thinking might be expected from students in a first-year introductory economics course, attendees at the Liberals’ summit held in March should have known better. Apparently, no economists participated.

In reality, increased taxes change the incentives people face, and the result is negative economic repercussions. Specifically, higher corporate income tax rates decrease the after-tax rate of return that investors receive. This reduces their incentives to invest and grow, and leaves firms with less money for productivity-enhancing investments in plants, machinery, equipment, and new technologies (such as computers and software). Because productivity is a key driver of wages, reduced productivity means that workers are the ones who ultimately suffer.

The Liberals have it backward. If we want more revenue to spend on programs, then we need businesses to invest, expand, and create more jobs. The solution is reducing, not increasing, corporate income taxes.<sup>1</sup>

The economically damaging effects of corporate taxes are well documented.<sup>2</sup> For example, a 2008 study, *The Effect of Corporate Taxes on Investment and Entrepreneurship*, published by the National Bureau of Economic Research, analyzed

data from 85 countries, and found that higher corporate tax rates reduce both investment and entrepreneurial activity (Djankov et al., 2008). Specifically, a 10-percentage-point-increased corporate tax rate reduces a country’s total investment to Gross Domestic Product (GDP) ratio by about 2 percentage points, reduces the number of businesses by 1.9 firms per 100 people, and discourages the rate of new business registration by 1.4 percentage points.

Another recent study, *Do Tax Structures Affect Aggregate Economic Growth?*, from the Organisation for Economic Co-operation and Development (OECD), explored the direct relationship between various taxes and economic growth for 21 developed countries over the period 1971–2004 (Arnold, 2008). While personal income, consumption, and property taxes all had negative effects on per-person income growth, corporate income taxes had the most damaging effect.<sup>2</sup>

A growing economy characterized by more investment, increased job creation, and higher incomes for workers eventually leads to more government revenue of all types, including personal income tax, GST, and corporate income tax revenues.

This is why governments across Canada of all ideological stripes have done just the opposite of what Mr. Ignatieff is proposing. His Liberal predecessors former Prime Minister Jean Chrétien and then Finance Minister Paul Martin understood the importance of reducing corporate taxes, which is why they dropped the federal rate to 21% from 28%. Many provincial governments have also cut corporate income tax rates in recent years, including NDP governments in Saskatchewan and Manitoba.

Mr. Ignatieff would be wise to look at what Ontario Liberal Premier Dalton McGuinty has done. He increased Ontario’s corporate income tax rate shortly after coming into power, realized the destructive impacts of that move, and did a u-turn last year, announcing a rate cut to 10% from 14% by 2013 (Lammam and Veldhuis, 2009).

Mr. Ignatieff and the Liberals may want to spend more, but imposing a de facto increase to corporate taxes is not the way to get the revenue to do so.

## Notes

<sup>1</sup> The Ignatieff liberals are proposing a de facto corporate income tax increase since the current schedule for reduction in the federal corporate income tax rate, from 18% this year to 16.5% in 2011, and to 15% in 2012, was set in place back in

2007. Firms and individuals have established plans based on this expectation, so canceling the reduction would have essentially the same effect as an increase.

<sup>2</sup> For a comprehensive review of the literature on the economic impacts of taxation, including corporate taxes, see Palacios and Harischandra (2008), and Murphy and Clemens (2010).

<sup>3</sup>For a detailed discussion of why some taxes such as the corporate income tax impose greater economic costs than others such as a consumption tax, see Clemens et al. (2007).

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## Reform employment insurance

(Continued from page 32)

still an increase. Without offsetting tax decreases and true EI reform, Canadian workers and businesses will continue to face higher taxes for years to come.

## Notes

<sup>1</sup>For more information on the Canada Employment Insurance Financing Board, see CEIFB (2009).

<sup>2</sup>For a review of the literature on the economic effects of different taxes, see Clemens et al. (2007).

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# Unethical EHRs?



DR. GORDON ATHERLEY

In mid-September 2010, Canadians learned of the most shocking medical privacy scandal Canada has ever seen (and there has been competition). The *Toronto Sun* reported that this scandal involved Sean Bruyeya, who served in the Canadian Forces from 1982 to 1996, and who had fought for veterans' rights since 2005 (Payton, 2010). After several requests under *Canada's Access to Information Act*, Bruyeya learned that at least 614 different people had accessed his file as many as 4,131 times over a ten-year period. The *Hill Times* then quickly followed with Veterans Ombudsman Pat Stogran's announcement that Veterans Affairs may have improperly shared or accessed Stogran's own personal medical files as many as 400 times during his high-profile fight to improve veterans' benefits (Naumetz, 2010).

Veterans Affairs Canada confirms that all veterans' medical data is kept in Electronic Health Records (EHRs). Hardly two weeks earlier, the Organisation for Economic Co-operation and Development (OECD, 2010a) implicitly chastised Canadians for being overly fastidious about their medical privacy. Arguing that EHRs seem to be an obvious solution to manage risk in health care delivery—among other things—it asserted that progress is often blocked by “perhaps exaggerated concerns for privacy” (OECD, 2010a).

What comprises justifiable concerns for privacy needs debate that should begin with the contradiction between the public's beliefs about privacy, and the governments' purposes for EHRs. To explore Canadian views on privacy, in 2007, the Canadian Medical Association and Ipsos Reid sponsored a representative poll of Canadian adults. Of the poll's respondents, 85% were confident in the “level of confidentiality” of the information they give their physicians, an increase from 74% in 1999. Additionally, 74% agreed that it is either very or somewhat acceptable for their physicians, with patients' consent, to allow electronic access to patient information for diagnosis and treatment by specialists or hospitals (Ipsos Reid et al, 2010).

As more evidence of trust in physicians, the poll recorded that 72% of respondents said that it is either very or somewhat acceptable that a patient's personal health record is stored and managed by his or her physician, and that no information is released without the patient's consent. In sharp contrast, the

poll recorded that only 33% of respondents said that it is either very or somewhat acceptable that local regional health authorities or agencies centrally store and manage some of “patients' core clinical data elements” from their personal health records (Ipsos Reid et al, 2010).

Canada Health Infoway, a federal government foundation, reveals that Canada's governments intend EHRs to exist for all 33 million Canadians, and that Canada Health Infoway plans to achieve this target by 2016 (Canada Health Infoway, 2010). On the front lines of care, Infoway explains, Electronic Medical Records (EMRs)—the private records that physicians compile on their patients and keep in their office computers—provide essential information for capture by EHRs, the key components of the electronic system designed by Canada Health Infoway to fulfill the intentions of governments for EHRs.

In the Infoway-designed EHR system, the personal health information on 33 million individually identifiable Canadians that physicians compile electronically would continuously compose the EHRs. Infoway's Director of Media Relations says that defining policies for privacy of EHRs of individually identifiable Canadians is the responsibility of the provinces and territories (Strasbourg, 2010).

Provincial legislation, and the contradictory abstractions that surround it, often conceal the destinations for personal health information in EHRs. An example is Ontario's Information and Privacy Commission's concept of “privacy by design except as required by law” (Cavoukian, 2007). Despite comforting titles like *Personal Health Information Protection Act*, provincial laws prescribe the purposes that permit government agents to access identifiable individuals' EHRs without requiring the individuals' consent. The purposes for which such disclosure is permitted—and therefore required at the governments' discretion—include planning and management of the health system, as the OECD is advocating.

In support of its advocacy, OECD selectively references “major intergovernmental agencies,” including the Canadian Institute for Health Information, Canada Health Infoway, the Health Council of Canada, and the Canadian Patient Safety Institute, which are all ardent advocates of EHRs (2010b). Did these agencies constitute a special interest group that shaped



OECD's advocacy of EHRs?

Among intergovernmental agencies a contradiction exists between advocating EHRs and protecting Canadians against technological risks. This was revealed late in 2009 in the orchestrated campaign hosted by the Canadian Agency for Drugs and Technologies in Health (CADTH, 2009), a pan-government agency funded by the federal and provincial governments. The campaign challenged Health Canada's decision to bring EHRs under the federal Medical Device Regulations. CADTH complained that this change "comes at a time when federal and provincial governments are actively pursuing policy objectives involving the deployment of EHRs." "Indeed," said CADTH, "Canada Health Infoway... was created to advance electronic health records in Canada [and] jurisdictions are also supporting their own eHealth initiatives...Consequently, there is speculation that federal and provincial plans to accelerate the development and adoption of electronic health records solutions across Canada could be delayed" (CADTH, 2009).

But the Medical Device Regulations, which cover 60,000 licensed medical devices, are also Canadian patients' greatest protection against junk or dangerous technology. Why CADTH opposed the application to EHRs of Canada's most important patient-safety legislation for technology in health care is puzzling given that EHRs depend on information technology, which has a notorious and growing record of privacy breakdowns, security breaches, and various forms of abuse including identity theft and terrorism (Atherley, 2009).

CADTH prevailed, and Health Canada delayed enforcement of the Medical Device Regulations for a year. Health Canada offered the explanation that many non-compliant patient management software products are on the Canadian market. In an oddly worded rationalization it added that the "post-market surveillance profile of patient management software devices," for which it provided no reference, "indicates that patient safety will not be compromised by [Health Canada's] approach to achieving full compliance of all patient management software medical devices" (2010).

Meanwhile, government EHR initiatives continue despite concerns. One such concern arose in January 2010 when the Society of General Practitioners of British Columbia and the BC College of Family Physicians warned physicians that uploading patients' personal information from an EMR to an EHR enables government departments to share the information broadly (Society of General Practitioners of BC et al, 2010). From this and other revelations it is clear that the government owns and mines EHRs, and enables electronic access to them by any persons or organizations of governments' choosing.

The contradictions create crucial ethical questions for debate and discussion. Given that patients' personal health information, complete with identification data, is passed from physicians' EMRs into government-accessible EHRs, we must ask several important questions. First, how much personal health information about individually identifiable Canadians should governments be allowed to consult, compile, collate,

and communicate? Further, how much do Canadians know about, and concur with, the purposes governments intend for personal health information compiled in EHRs? Finally, what relevance is there in the *Charter of Rights and Freedoms* for Canadians' EHR privacy?

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