3.7 Impact Of No Fiscal Compensation

As is detailed in Section 2.6, we have assumed in all cases reported that the federal government compensates itself for lost customs revenues by imposing a surcharge on personal income taxes. This case reports the impact if the federal government does not compensate itself.

As is detailed in the following tabulation, exclusion of the tax surcharge would yield a yet larger impact on the economy. If measured in terms of GNP, the impact is positive until the end of the 1990s, when payments of interest and dividends to foreigners for earlier current account deficits finally overwhelms the positive effects on consumers. In general, there is a negative effect on investment, reflecting higher interest rates, and on government spending, reflecting the reduced revenues available to the federal goernment. Net exports represent another negative effect on GNP, reflecting the fact that the exclusion of the tax surcharge stimulates domestic demand generally.

Total output and employment is positively affected throughout the 18 years of the impact. There are generalized positive effects for most sectors until the mid-1990s, when increasing Canadian costs and reduced investment begin to adversely affect most industries producing traded goods.

Our results suggest increased nominal and real interest rates, slightly more inflation, and a depreciated Canadian currency. The principal unfavourable effect is on the federal treasury, reflecting the revenues they forego in this case.