

Budget Making Made Easy to Understand: 2006

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In its first Budget, the Harper Government provided a series of tax cuts and credits mostly focused on working and middle class Canadians and particularly those with families. There also are some cuts for both big and small business and targeted benefits for selective industrial sectors. The criticism from the Opposition Parties and the pundit chorus has followed two general themes:

- The money should have been spent on programmes (e.g. Child care, environment, etc) instead of tax breaks for individuals and families.
- This budget is popular but not substantive and the government has focused on the wrong set of issues.

Conservatives are not supposed to be statist so criticizing them for favoring individuals over programme spending would seem to be redundant. And, whether they have the right set of issues, most measures in the budget are the ones that the Party ran and got elected on so it would have been surprising if they had not been in the budget.

Meanwhile, the early reviews suggest this budget has gone down well with the Canadian public. According to a recent Ipsos Poll, twice as many Canadians think it is a 'good' budget as those who think it is 'bad'. Business has given the budget good reviews. The Government's popularity has surged.

But, with a new Government in place, this is a good time to:

- Do a post-mortem on 13 years of Liberal fiscal management; and
- Examine the fiscal situation the Conservatives have to work with going forward.

The table below tells most of the story. It starts with 1993-94. The Liberals first budget was in early 1994 but the 93-94 fiscal year was essentially the financial numbers inherited from the Mulroney Government. 2005-2006 are the numbers the Conservatives inherited from the Martin Government. And 2006-07 and 2007-08 are the Harper Government's own estimates and the first real statements of their fiscal intentions.

Canadian Federal Budget Overview From 1993-94 to 2007-08
(\$ millions of dollars)

Year	Budgetary Revenues	Programme Expenses	Public Debt Payments	Budget Surplus or Deficit (-)	Total Public Debt
1993-94	\$116,040	114,471	40,099	-38,530	\$487,524
1994-95	122,486	114,933	44,185	-36,632	524,156
1995-96	131,397	111,966	49,407	-30,006	554,162
1996-97	140,853	102,260	47,281	-8,688	562,850
1997-98	152,116	106,864	43,120	2,132	560,718
1998-99	156,146	109,995	43,303	2,847	557,871
1999-00	166,112	109,583	43,384	13,145	544,726
2000-01	182,748	118,694	43,892	20,162	524,564
2001-02	171,688	125,018	39,651	7,019	517,545
2002-03	177,832	133,593	37,270	6,970	510,576
2003-04	186,207	141,355	35,769	9,083	501,493
2004-05	211,900	176,300	34,118	1,500	494,400
2005-06	220,900	179,200	33,700	8,000	486,400
2006-07 (est.)	227,100	188,800	34,800	3,600	483,400
2007-08 (est.)	\$235,800	196,500	34,800	4,140	\$480,400

When the Liberals were elected in 1993, the Government's fiscal situation was dire. Debt payments consumed a third of every revenue dollar collected and the public debt was ballooning out of control.

The Liberals did have one factor working in their favor. Several budgets earlier, the Mulroney Government had partially de-indexed income tax brackets. Each year the federal government obtained a nice little hidden tax increase due to 'bracket creep' as inflation gradually pushed taxpayers into higher brackets and more Canadians on the tax rolls. The Liberals had criticized this measure in Opposition but it came to their rescue in Government.

The Chrétien Government also helped its cause by taking two actions:

First, it pushed down programme spending by as much as 10% and then kept a lid on it for a number of years. Since the overwhelming majority of pressures are on politicians to spend; this took considerable discipline. It was not uncontroversial since it involved off-loading costs on the provinces – adding to their fiscal problems - and cuts to a host of federal programmes.

Second, each year the Finance Department deliberately generated extremely conservative estimates for revenue generation. This meant it collected more revenue each year than actually budgeted for. Since government money lapses if not spent, the left-over monies were automatically applied to debt reduction. This stratagem was widely criticized both inside and outside government as dishonest book-keeping but it worked to generate surpluses and accelerated debt reduction. It also recognized a practically political reality. If a lot of money is dumped on the cabinet

table, Ministers will want to carve it up for their own programmes. Hiding the money eliminates that temptation. Think of it as fibbing in a good cause.

With this approach in place, the Chrétien Government hunkered down until a growing economy and rising revenues lifted them out of deficit. In 1997-98, the Liberal Government ran the first of eight successive surpluses. The accumulated debt peaked in that year and has declined every year since.

Sometime after the millennium, the focus of the Liberal Government shifted from restraint to spending and this accelerated in the last several years. Depending on your point of view, you could argue that fiscal discipline started to slip or there was legitimate pent-up demand for public investment after a period of retrenchment. Certainly, the fiscal situation allowed the Government to splurge a bit.

Budgetary Revenues (\$ millions of dollars)

Year	Personal Income Tax + %	Corporate Income Tax + %	Other Income Tax + %	Employment Insurance Premiums + %	Other Revenues	Excise Taxes & Duties (inc. GST) + %	Total Revenue
1993/94	\$51,427 (44%)	9,444 (8%)	1,593 (1%)	18,233 (16%)	8,652 (7%)	26,635 (23%)	\$115,984 (100%)
2006/07	\$109,275 (48%)	34,345 (15%)	4,370 (2%)	16,125 (7%)	18,615 (8%)	43,420 (19%)	\$227,150 (100%)

But even with the recent surges in spending, the Conservatives have inherited a fiscal situation that is extremely healthy.

- Revenue growth has outstripped programme spending over the last thirteen years. While programme spending has increased by 65%, revenues have increased by 96%.
- Debt repayment has dropped from a third of every revenue dollar generated to 15%.
- While the absolute debt has not dropped significantly, the government's ability to manage it has increased. In 1993-94 the federal government's annual revenue (think income) was just 24% of its total debt. It is now 46%.

Even by international standards, our fiscal performance has been exceptional. Canada was the only G7 country to record a surplus in 2003, 2004, and 2005 and we are predicted to be the only G7 country to record a surplus in 2006 and 2007. The Canadian debt-to-GDP ratio fell below the US two years ago and that gap is widening in Canada's favor.

Additionally not only is the Federal Government doing well but the provincial fiscal situation has dramatically improved (see table below). Most provinces are running surpluses and Ontario is likely to declare one before the next provincial election.

Substantial Improvement in Budgetary Balances in Recent Years

	(millions of dollars)					
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Federal	6,742	7,073	8,891	1,456	8,000	3,600
N.L.	-468	-644	-914	-489	77	6
P.E.I.	-17	-55	-125	-34	-18	-12
N.S.	113	28	38	165	78	93
N.B.	79	1	-173	242	117	22
Que.	22	-728	-358	-664	0	0
Ont.	375	117	-5,483	-1,555	-1,369	-2,350
Man.	63	4	13	405	3	3
Sask.	1	1	1	383	298	102
Alta.	1,081	2,133	4,136	5,175	7,375	4,096
B.C.	-1,184	-2,737	-1,275	2,575	1,475	600
Y.T.	-21	-5	12	5	38	9
N.W.T.	120	-34	-65	-17	18	31
Nun.	-47	12	7	-8	6	-8
Total provincial-territorial	117	-1,907	-4,187	6,184	8,098	2,592

Sources: Federal and provincial-territorial Public Accounts and budgets.

Political posturing on the 'fiscal imbalance' issue will not be deterred, nor will the provinces stop 'crying poor', but both levels of Government have dramatically improved their financial performance and prospects.

Critics typically portray Conservatives as ideologues and political grinchers who will slash and burn public programmes. This is not in evidence in the Conservatives' own projections. Programme spending will go up 5.4% in 2006-07 and 4.1% in 2007-08.

They have promised to find \$1 billion in programme cuts in each of the next two years. 51% of all programme spending is tied to transfers to the provinces, elderly & child benefits, and employment insurance benefits. Since these programmes are contractually bound or hard to touch, these cuts have to be made within direct programme expenses. But, these cuts only represent a little over 1% of these programme monies. The Conservative are keeping their 'hair shirts' in the closet.

In the nineties the Liberals attacked the debt but tended to nibble at it in recent years; the Conservatives also plan to nibble for the next two years.

Critics argue the Conservatives have failed to cost their promises to solve the 'fiscal imbalance', aboriginal agreements and a 'made-in-Canada' energy strategy and when they do, these commitments will put pressure on the fiscal framework. From a negotiating point of view, it would be naive to put their numbers on the table at this stage. When there are agreements, those monies will be disbursed over a number of years. There is no automatic reason to believe they cannot be managed. At the

same time, the Conservatives have reduced a numbers of taxes so revenues will not grow as fast as previously. So the margin of risk has closed in a bit.

Bottom-line: These budget projections are clearly framed by the reality of a minority government and the desire to win a majority government in the next year or two. There are not many tough messages about restraint. But this budget is not high-risk financial management; it looks feasible.

Canadians have bought the message that deficits are bad and Governments should run surpluses. There is a high political penalty for any governing party that falls into the red. The Conservatives are acutely aware of this and have to ensure there is sufficient margin in their fiscal plans to avoid running too close to the edge. By their own efforts, they have raised the standards against which they will now be judged.

Over the medium-term, the Conservatives are unlikely to be able to offer new significant tax cuts without putting a tighter reign on spending.

Over the longer term, the baby boom vanguard is hitting 65 in 2011 with the promise of higher health and social care costs to follow and a misalignment between workers and retirees. The Asian and Indian Sub-Continents are economically ascendant driving significant competitiveness, training and education challenges for Canada. All this suggests the next decade may be more challenging than the one we are in.

This requires the federal government to come to some conclusions about the right level and mix of personal and corporate taxes. Canada's response to the issues of health care and competitiveness fall under the jurisdictions of, and are far more dependent on, the actions of the provinces and the municipalities. Debates about the appropriate share of revenue and responsibilities between the three levels of government will be with us for some time. There is likely to on-going pressure on the federal government to transfer more monies or vacate tax room. This would suggest there is a need to continue to manage federal finances prudently and to keep the pressure on debt reduction to allow even more fiscal flexibility in the near future.