



ALTERNATIVE FEDERAL BUDGET 2005: BRIEFING PAPER MAY 10, 2005

CAN WE AFFORD IT?

THE CASE FOR THE NEW 2005 FEDERAL BUDGET

JUDGE THE BUDGET ON ITS MERITS: THE QUESTION OF THE AFFORDABILITY OF THE NEW FEDERAL BUDGET

It is possible that the 2005 federal budget may be defeated in the House of Commons amidst the tumultuous current situation in federal politics. The defeat of the budget would not only provoke an election—it would also mean that a number of provisions included in the 2005 budget would face an uncertain future in the hands of a newly elected government.

Defeating a government on any budget is a serious matter. The federal budget is a very important document for the governing of our country, and the vagaries of partisan political advantage should not overwhelm a sober consideration of the budget's merits.

In evaluating the merits of the federal budget, it is critical to know whether the measures contained in the budget are affordable under present fiscal circumstances. Since the revisions to the federal budget (see below) include increases in spending, the affordability of the revised budget is an even more pressing question. Thus the Alternative Federal Budget (AFB) has prepared this report to analyze the affordability of the revised federal budget in hopes of contributing to constructive public debate.

HOW HAS THE FEDERAL BUDGET BEEN REVISED?

This is an unusual budget in that it contains both the measures outlined in the Finance Minister's original budget document and the additional measures outlined in the May 3 "Budget Bill Agreement" between the New Democratic Party (NDP) and the Liberal government (see <http://www.fin.gc.ca/news05/05-033e.html>). The term "revised budget" will be used to refer to the original 2005 budget together with the amendments contained in the government's agreement with the NDP.¹

The agreement between the NDP and the Liberal government produced the following revisions to the Finance Minister's original 2005 budget: 1) the original 2005 budget promised corporate tax cuts scheduled to take effect in 2008 and beyond. The agreement between the NDP and the government removes much of these corporate tax cuts from the revised budget (although small businesses will continue to enjoy some of the tax relief promised in the original 2005 budget);² 2) in the two upcoming fiscal years, \$4.5 billion will be spent in education and training, affordable housing, foreign aid, and the environment; 3) \$100 million will be earmarked to protect the earnings of workers in the event of their employers' bankruptcy. We assume

that this \$4.6 billion in additional spending is spread evenly over the two fiscal years.

It is important to note that the additional \$4.6 billion in spending contained in the NDP/Liberal agreement has not been funded via the removal of the bulk of corporate tax cuts that were promised in the government's original 2005 budget. The \$4.6 billion in new spending in the revised budget takes place in the next two fiscal years – while the corporate tax cuts were scheduled take place in 2008 and beyond.

The removal of the corporate tax cuts that the Finance Minister had originally included in the federal budget makes the budget *more* affordable, not less affordable, in the later years of budget's 5-year horizon. However, the question remains as to whether the additional spending promised in the first two years of the budget is affordable, for those are the years in which the NDP/Liberal agreement has increased spending with no corresponding increase in tax revenue.

THE ASSESSMENT OF AVAILABLE FEDERAL SPENDING ROOM

Since the largest challenge concerning the affordability of the new expenses outlined in the NDP/Liberal agreement takes place in the upcoming two fiscal years, the AFB analysis of the affordability of the revised budget will focus on fiscal years 2005/06 and 2006/07.

We now have the benefit of a fiscal forecasting exercise undertaken by the House of Commons Finance Committee to assist us in assessing the federal finances. The Finance Committee has engaged four independent forecasters—the Conference Board of Canada, Global Insight, Professor François Vaillancourt, and Jim Stanford of the Cana-

dian Centre for Policy Alternatives—to review the federal budget. In March 2005 these forecasters presented reports evaluating the federal fiscal outlook after the original federal budget was made public.³

These independent reports provided estimates of the fiscal situation of the government of Canada in fiscal years 2005/06 and 2006/07. Their analyses incorporated the additional spending and taxation measures that were included in the original federal budget, but their reports were prepared prior to the announcement of the new measures contained in the Liberal/NDP agreement. Since the fiscal years analyzed by the independent forecasters are precisely the same years in which the \$4.6 billion in additional expenses will be incurred, the AFB is taking advantage of this source of independent forecasting information. Thus we scrutinized these forecasts to discern whether there is \$2.3 billion in additional spending room in both 2005/06 and 2006/07 over and above the costs of the spending contained in the original budget.

Table 1 presents the four forecasters' original estimates of the "underlying budget surplus."⁴ Table 2 shows those original surplus estimates adjusted for the additional \$2.3 billion in spending continued in the revisions to the budget. Each forecast indicates that the additional spending contained in the NDP/Liberal agreement could be absorbed without incurring a deficit.

The average projected underlying budget surpluses of the four forecasters was \$8 billion in 2005/06 and \$8 billion in 2006/07. A surplus of \$8 billion would be sufficient to absorb an additional \$2.3 billion in spending—without incurring a deficit. In fact, \$8 billion is sufficient to both absorb the additional spending contained in the NDP/Lib-

TABLE 1**ORIGINAL FORECASTS SUBMITTED TO THE HOUSE OF COMMONS FINANCE COMMITTEE**

Underlying Surplus* (billions)	2005-06	2006-07
Conference Board of Canada	8	7.2
Global Insight	4.2	5.7
Vaillancourt	8.5	6.8
Stanford / CCPA	11.2	12.4
Average	8.0	8.0

*includes no Contingency Reserve and Economic Prudence

TABLE 2**FORECASTS ADJUSTED FOR ADDITIONAL SPENDING IN REVISED FEDERAL BUDGET**

Underlying Surplus* (billions)	2005-06	2006-07
Conference Board of Canada	5.7	4.9
Global Insight	1.9	3.4
Vaillancourt	6.2	4.5
Stanford / CCPA	8.9	10.1
Average	5.7	5.7

*includes no Contingency Reserve and Economic Prudence

eral agreement without affecting the reserves that the government typically sets aside for contingency and economic prudence – and there would even be funds left over to increase spending further.

Global Insight is the most pessimistic of the forecasts, indicating that in their view no deficit would be incurred, but the federal government would need to dip into its prudence/contingency reserves to accommodate the additional spending. CCPA's analysis is the most optimistic, as it foresees over \$11 billion in the current fiscal year, and over \$12 billion in 2006/07. This is more than enough to accommodate the additional spending in

the Liberal/NDP agreement, and even increase spending further, without having to use these reserves.

This more optimistic stance of the Stanford/CCPA forecast is in keeping with AFB's track record in estimating federal budget surpluses. For years now the AFB has pointed out that the government has foreseeable surpluses that are far higher than are portrayed by either the Finance Minister or by many private sector forecasters. And the AFB's track record on this matter has been excellent: the AFB has proven much more accurate than has the government in projecting federal budget surpluses.

TABLE 3:
FORECAST AND ACTUAL FEDERAL BUDGET BALANCES 1999/2000 THROUGH 2003/04¹
(\$billion)

	Official Budget Target ²	AFB Estimate ³	Actual
1999-00	3.0	16.0	12.7
2000-01	3.0	15.5	18.1
2001-02	1.5	8.5	8.9
2002-03	3.0	6.7	7.0
2003-04	1.9	8.3	9.1
Total	12.4	55.0	55.8

1. Prior to fiscal year 2002-03, estimates were not made in terms that reflected full accrual accounting measures. As of October 2003, the government has provided fiscal reference tables that restate previous numbers in full accrual terms. However, Table 1 presents the pre-accrual numbers for years prior to 2002-03 in order to compare the government's estimates with AFB estimates for those years. For years 2002/03 and beyond, all numbers are expressed in full accrual terms.
2. Equal to balance of "budget for planning purposes", excluding contingency reserve fund, from each annual federal budget.
3. Estimates of status-quo federal surplus reported in *Vital Measures: Alternative Federal Budget 1999* (February 1999); *Reality Check: An Alternative Economic Update* (October 2000); *Alternative Federal Budget Economic and Fiscal Statement* (December 2001); *The Cure for the Common Budget*, (February 2003); and *Rebuilding the Foundations* (March 2004) respectively.

ANOTHER LOOK AT THE REVISED BUDGET

In a context in which many forms of social spending have been neglected for so many years, the revised budget addresses a number of glaring priorities. Its provisions for affordable housing construction and support to provinces to reduce the costs of post-secondary tuition help to fill significant holes in the February budget. Additional funds for international development, energy retrofits and public transit are also welcome supplements to the original budget. These funding commitments not only provide important social investments, but also address some of the election commitments made by the Liberals in the 2004 election campaign. And since the Liberal Party did not include corporate tax

relief in their election platform, we are pleased see the removal of these costly tax cuts.

The agreement negotiated with the NDP builds on some of the other positive developments in the original February budget bill. For example, the commitment of \$5 billion over five years is an important step toward establishing a pan-Canadian child care program. The transfer of gas taxes to municipalities will help to renew Canada's deteriorating municipal infrastructure and to create jobs.

However, even with the latest revisions, the new 2005 budget is still far from the proposals put forward by the AFB. The revised budget provides funding commitments for only two years, rather than the sustained ongoing support required to address these public policy priorities. In addition, there are many pressing needs that are given scant at-

tention in the revised budget. For example, the spending commitments on issues of particular interest to Aboriginal peoples are both vague and fall far short of the needed funds. And measures to reduce poverty are still grossly inadequate. The costly personal income tax measures contained in the February budget were presented as a support for low- and middle-income Canadians, but in fact they make Canada's tax system less progressive and do not give meaningful support to those whom they are ostensibly designed to help.

While the revised budget falls short of the prescriptions advanced in the Alternative Federal Budget, we conclude that it is both affordable and a substantial improvement over the original 2005 federal budget. We expect that the government will have sufficient budget surpluses to pay for all of the new spending outlined in the government's original budget, plus the \$4.6 billion in new measures negotiated with the NDP. In addition, we believe that there is evidence of sufficient fiscal capacity to enact additional spending in several areas neglected in this budget. Thus, while the budget is far from perfect, the AFB concludes that it should be passed.

ENDNOTES

- ¹ Our understanding is that subsequent announcements with spending implications are a separate matter from the revised federal budget.
- ² The precise magnitude of the corporate tax cuts that were reversed is difficult to ascertain without further information about how the agreement between the NDP and the government will be interpreted by the framers of corporate tax policy
- ³ Their reports are "Canadian Economic and Federal Fiscal Outlook, March 2005" by the Conference Board of Canada, "Economic Forecast and Fiscal Plan March 2005 Update" by Global Insight, "Federal Budget Forecasting: March 2005 Update" by Professor François Vaillancourt, and "Federal Fiscal Forecasting Round 2: Post-Budget Update. March 31 2005" by Jim Stanford, Research Associate of the Canadian Centre for Policy Alternatives.
- ⁴ The so-called "underlying surplus" means that no contingency reserves or economic produce allowances have been subtracted.



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