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ALTERNATIVE FEDERAL BUDGET 2011

Budget 2011 Redux

What's New in Version 2

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On June 6, the newly elected Harper majority government will re-introduce its March 22 budget, the same budget that triggered a federal election that delivered historic results.

Only 12 weeks have passed since this budget was last tabled. We are told little will be different, though much has changed between then and now.

The stay-the-course rhetoric belies a profound change that is in store for Canadians. The March 22 budget laid the foundation for an aggressive assault on federal service delivery, totaling \$20 billion in spending cuts over the next five years. The campaign promise to accelerate the target of deficit elimination by one year means more cuts, sooner.

It's as if the elimination of the deficit is the only role the federal government could or should play. Gone are the concerns about post-recession economic fragility, record household debt, stubbornly sluggish private sector job creation, concerning pressures on publicly funded health care, or crumbling infrastructure across the land.

Canadians can expect this budget will incorporate the Conservatives' campaign commitments to high priced political promises such as an HST deal with Quebec and extend the growth in federal transfers to the provinces and territories for health care. It will carry on with major prison builds, and continue the most extravagant growth in investment on military hardware in Canadian post-war history. It will also follow-through with cuts to corporate income taxes, an issue that unleashed prolonged and vigorous debate about how best to spur job-creation and maintain badly needed public revenues.

Meanwhile, Budget 2011 (version two) promises to pack a few new punches.

For starters, the federal deficit Finance Minister Jim Flaherty predicted just weeks ago in the March 22 budget will suddenly look like a much smaller beast. The combined effect of rising oil and commodity prices will likely result in a boon to federal revenues, helping the government reduce its deficit faster than expected, even before any cuts begin. And yet the government is adding urgency to its plans to steamroll forward with deep

TABLE 1 Federal Deficit, Projected and Actual (\$ Billions)

	2008-09	2009-10	2010-11	2011-12
Budget 2009 Projections (p.29)	\$1.1	\$33.7	\$29.8	\$13.0
Budget 2010 Projections (p.173)		\$53.8	\$49.2	\$27.6
Public Accounts (Actual Deficit)	\$5.8	\$55.6		
October Fiscal Update Projections (p.32)		\$55.6	\$45.4	\$29.8
Budget 2011, March 22, Projections (p.180)		\$55.6	\$40.5	\$29.6
Fiscal Monitor Projections (April 2010 till March 2011)		\$47.0	\$34.4	
(April to March comparisons as % of budgeted amount)		85%	85%	

program cuts, largely by pledging during the election to speed up the schedule to eliminate the deficit by a year.

The scale of these cuts is staggering. The public sector job cuts already flagged in Budget 2011 will result in the elimination of 80,000 public sector jobs — about one-third of the public sector. This will unavoidably result in drastic cuts to public services Canadians currently rely on. The last time we saw such deep cuts was as a result of the 1995 federal budget, which unleashed an unprecedented round of spending cuts, split between direct federal spending and transfers to the provinces, all in the name of avoiding the deficit wall.

But Canada, in 2011, faces no such deficit wall. In fact, a good deal of the deficit would automatically be reduced by revenue growth that comes along with the type of economic growth we've been seeing, in oil, minerals, potash and the financial sector. Except we're cutting corporate taxes, as fast as we can.

The Harper government's plan for Canadians' Number One policy priority — the protection of universal public health care — remains a multi-billion dollar question. So far the Conservatives have cloaked themselves with a fuzzy promise, saying they will simply extend the six percent annual increase in transfers to the provinces when the 10-year-old Health Care Accord signed under the Chretien government expires in 2013-14. We expose here how the devil will be in the details.

Budget 2011 (version two) will lay the foundation for a hard shift to the right, putting in place the machinery that leads to a smaller role for the federal government in Canadians' lives. It will be pitched as the same old, same old. Nothing could be further from the truth. Now that he has secured his majority, Stephen Harper's government will be able to enact Stephen Harper's dream — make government smaller, and take Ottawa out of the picture.

Deficit Reduction

Table 1 shows that the Harper government misjudged how big the federal deficit would get in 2010-11, and may be still miscalculating how rapidly it will fall now.

In late 2008, the Harper government didn't project how bad things would get during the global economic crisis, which almost led to the government's downfall in the winter. Budget 2009 wildly underestimated the financial crisis' affect on future years. Budget 2010 largely maintained the previous projection. However, the most recent Fiscal Monitor tells us revenues are significantly higher than anticipated, and program spending below budget. The deficit is now \$6 billion under even the March 22 projections for 2010-11. Given the strong first quarter performance of the economy, it may come in even lower still.

We can expect an even sunnier picture on June 6, given what has happened to oil and other commodity prices. With stimulus-related spending virtually ended, a record deficit may well be close to cut in half in two years, without lifting a finger.

The rhetoric will be that public service cuts are a critical next step, but the reality is that economic growth is the fastest path to smaller deficits. Growth through prices or volumes both increase government revenues without having to raise a single tax rate.

While we can't count on surprise surpluses at the federal level, Canada's rate of economic growth beat expectations for 2010, growing 3.3% over the course of the year after a 2.6% decline in 2009.¹ The machine shows no signs of slowing, for all the talk of fragile growth. First quarter 2011 results show an annualized growth rate of 3.9%. The U.S. equivalent is 1.8%.² Canada is widely expected to be at the head of the G7 pack for the next decade when it comes to economic growth. The federal deficit could shrink more quickly than anticipated, raising doubts about the need for any deep cuts at all.

TABLE 2 Canada's Sales Tax Regime: HST or Not

Province/Territory	HST* introduced	PST Rate	GST/HST Rate	GST Included In PST Tax Base?	Combined Rate
British Columbia	July 1 2010	N/A	12%	N/A	12%
Alberta		Nil	5%	N/A	5%
Saskatchewan		5%	5%	No	10%
Manitoba		7%	5%	No	12%
Ontario	July 1 2010	N/A	13%	N/A	13%
Quebec	January 1 1991* QST plus GST (administered by Quebec Government not Federal government)	8.5%	5%	QST calculated on top of purchase price plus GST	13.5%
New Brunswick	April 1 1997	N/A	13%	N/A	13%
Newfoundland	April 1 1997	N/A	13%	N/A	13%
Nova Scotia	April 1 1997	N/A	15%	N/A	15%
Prince Edward Island		5%	5%	Yes	10%
Northwest Territories		Nil	5%	N/A	5%
Yukon		Nil	5%	N/A	5%

HST and Quebec

The issue of the HST will rear its head in Budget 2011 (version two), bringing an end to at least one tension between the Harper government and Quebec. On July 1, 2010, B.C. and Ontario implemented the HST (Harmonized Sales Tax). Together they received \$5.9 billion³ from Ottawa to help smooth the transition, which aligns the base on which goods and services are taxed and streamlines tax-collecting administration costs. In the late-1990s, most of the Atlantic provinces introduced the HST. They, too, received financial assistance from the federal government. Table 2 shows who is now in the HST universe.⁴

Quebec harmonized its sales tax base (the QST, Quebec Sales Tax) with Ottawa in 1991, the first jurisdiction to do so after the introduction of the GST. However, it retains control over the administration of both the GST and the QST in Quebec, for which it gets \$150 million a year from CRA, the federal revenue-collecting agency.⁵

Given the balance of power in the House of Commons in March 2011, including the \$2.2 billion in the March 22 budget could have helped Harper cut a deal with the Bloc and avoid a federal election. The money was not in that budget. Instead, Quebec's demands were met on April 1⁶, just 10 days after the budget was tabled and within the first five days of the federal election campaign. If re-elected, Stephen Harper pledged to give Quebec \$2.2 billion, essentially for making the QST jive

with the GST in 1991. Expect him to make good on this promise in Budget 2011 (version two).

Spending Cuts

The Harper minority government had already highlighted \$11 billion in cuts to come from Strategic Reviews over the next five years, as Table A1.2 in Budget 2011 showed. The March 22, 2011 budget shows spending cuts worth more than \$17 billion over the next five years, ramping up from \$434 million this year to more than \$5 billion a year by 2014–15. Of this, \$11 billion represented new cuts not promised in previous budgets.

That \$17 billion in cuts ramped up over five years is apparently not enough anymore. Tony Clement, the new Minister of the Treasury Board, now says he will be seeking \$4 billion a year in reductions.⁷ That means more cuts, earlier.

Since the Harper government has come to power, it has announced \$20 billion in spending cuts, \$4 billion in new taxes (by closing tax loopholes) and \$220 billion in tax cuts. In fairness, it has also raised expenditures by \$565 billion -- but \$453 billion of that is since the global economic crisis began. A new world now begins, and it's all about cutting.

The Harper team has been crystal clear about which taxes would be cut, but has not specified which programs and services would make up this new \$11 billion in cuts, or how priorities would be set for the cutting machine. The Parliamentary Bud-

TABLE 3 Budget 2011 Savings Measures (\$ Millions)

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	Total
2010 Strategic Reviews*		194	271	569	525	534	2,094
Tax Fairness—Closing Tax Loopholes		240	730	1,095	1,040	990	4,095
Total Savings Recorded in Budget 20110		434	1,001	1,664	1,565	1,524	6,189
Targeted Strategic and Operating Review Savings			1,000	2,000	4,000	4,000	11,000
Total Savings	0	434	2,001	3,664	5,565	5,524	17,189

NOTE Totals may not add due to rounding

* National Defence savings were booked as part of Budget 2010

SOURCE Federal Budget 2011, Table 5.1

get Officer has been critical of this government's big spending cut promises without spelling out the inevitable service reductions that will result from those cuts.

Over and above the strategic review processes already in play in many departments, all government departments will now be asked to prepare two budgets, one cutting five percent of its spending, another cutting 10 percent. That comes with a caveat: Minister Clement thinks it may be better to cut entire programs than simply cut equally across the board. The advice on what to cut and what to save will come through a special cabinet committee, chaired by the Minister. It will be advised by "outside experts" that have not been named. It would be difficult to devise a more politicized or non-transparent process.

Recent indications suggest the \$11 billion in cuts will be taken mostly, if not entirely, out of staff positions, with the elimination of 80,000 out of 178,000 federal government jobs. Currently, just fewer than 6,000 public service workers retire every year. This will undoubtedly go up in the coming years, however even the most optimistic projections, including buyouts, predict a total of 40,000 staff losses by 2014-15. The other 40,000 would have to come in the form of massive layoffs.

While contracting was technically part of the solution to the government's first round of cuts, that area of government spending didn't decrease for this reason: As the government forces managers to cut back on staff, managers turn around and outsource the job -- because the work still needs to be done. This is particularly the case with IT, management consulting and temporary help. The result is higher costs for the government, lower benefits for the workers and more staff turnover.

One thing is clear: Cutting 80,000 positions will reduce many departments to skeleton crews performing only the most basic function. If Canadians have a problem with their tax forms or need to get a passport renewed, the new man-

tra of the federal government will be "get in line." Canadians experienced these kind of cutbacks in the mid-1990s and it wasn't pretty.

Medicare and the 6% Escalator

No elected politician in Canada wants to be seen to be on the bad side of Medicare — but Budget 2011 (version two) will not end up re-assuring many people about what lies ahead.

When the 10-year Health Care Accord ends in 2013-14, the funding deal between the federal government, provinces and territories is officially over. The March 22, 2011 budget had a planning horizon that extended to 2015-16, two years beyond the end of the accord. But there was not a word in the budget about federal funding for health care, beyond the oft-repeated line that the federal books would not be balanced by reducing transfers to the provinces.

Halfway through the election campaign, Stephen Harper explicitly stated that his party, if re-elected, would maintain the current 6% escalator.⁸ But there is no reference to that in the Conservative party platform.

In fact, there is no indication of what federal health care funding would look like under a majority Conservative government. More questions are raised than answered. Here are some:

- Will federal funding continue to flow without conditions or be tied to certain objectives, as was the case in the side-car deals with the previous Health Accord (for example, diagnostic equipment and wait times)?
- Will federal cash transfers increase by 6% a year, or will the increase be made up of some mix of cash and increased transfer of tax points (a long-standing request of Quebec)

- Will the new deal go for more than two years beyond the expiry of the old deal?
- Will there be one deal, including all partners in the federation, or is the new normal a series of bi-lateral deals between the federal government and individual provinces/territories?
- How will the principles of the Canada Health Act be upheld?

It is doubtful we will see the answer to any of these questions in this budget, or even before next spring. Canada's health ministers will meet this summer, as they do every year. But there will be a whole new crop of Premiers at the meeting next year. The following seven provincial and territorial jurisdictions hold elections this fall: Newfoundland and Labrador, Prince Edward Island, Ontario, Manitoba, Saskatchewan, Northwest Territories, and the Yukon.⁹

Consequently there will be little negotiation of substance in the next six months, and next to nothing said in this next budget about federal financing of health care. But, without question, big change is coming for Medicare in the coming years.

Defence

There is no shortage of controversy over the Harper government's decision to purchase of 65 F-35 fighter jets. With the purchase, Canada would embark on the most expensive procurement program in Canadian history, one that involves no competition.

Since the failed March 22 budget, additional details have emerged about the ballooning costs of the fighter jets. It turns out that the fighter jets will be sold to Canada without engines.¹⁰ The low price of \$75 million per fighter repeatedly quoted by the Department of National Defence will not be enough to get a plane that actually flies. Instead, the engines will have to be bought separately from Pratt and Whitney.

Not only will the fighters come without engines, they may well arrive several years late. The beleaguered program is facing mounting technical problems in its U.S. testing that may delay the plane past its planned 2016 delivery date.¹¹

American legislators have been much more dogged than their Canadian counterparts at trying to get the full cost of operating their F-35s, over and above the cost of buying them in the first place. The pentagon reported in late May that the American F-35 program will cost \$1 trillion over its lifetime, a first for a U.S. weapons program.¹² Ashton Carter, the U.S. un-

dersecretary of defence for acquisition called the maintenance costs "unaffordable."¹³

The Canadian government's initial estimate of maintenance costs was a mere \$9 billion. The Parliamentary Budget Office has estimated that maintenance costs may reach \$19.5 billion. If the U.S. estimate of \$1 trillion is adjusted for the number that the Harper government wants to acquire, it would reach \$27 billion for maintenance alone. All these figures are above and beyond the cost of buying the fighters in the first place, which is currently estimated at approximately \$9 billion.

Despite clear gaps in transparency about what Canada is actually buying and U.S. legislators finding shockingly high maintenance costs, the Harper government steadfastly refuses to re-examine the project. The alternative is to refocus the Canadian military on what Canadians think it does best: peacekeeping, a stealth fighter of unknown cost is essentially useless when it comes to humanitarian missions.

Corporate Tax Cuts

The large public service cuts that are all but inevitable under a Conservative majority have brought corporate tax cuts full circle. By the time the service cuts are fully implemented in 2014-15, they will be worth approximately half of the lost yearly revenues from the corporate income tax cuts initiated in 2006.

Cutting 80,000 public sector jobs, which amounts to an increase of about 0.5% in unemployment, is not a smart job creation strategy. Corporate tax cuts, for their part, are completely untied to any tangible outcome. Companies need not create jobs nor invest in better production to get a corporate tax break. On average, big companies in Canada have managed to underperform in terms of job creation while recording bigger profits.

While this is certainly low tax strategy, it is also one that leads to slower job creation while leaving Canadians with less access to government services.

Party Politics

Lastly, lest anyone doubt the political nature of government budgets, the issue of political party subsidies will find its home in Budget 2011 (version two).

Prime Minister Harper has made no secret about his longstanding desire to cut public supports to political parties. He raised eyebrows when his government's response to the worst

financial and economic global crisis since the Great Depression included a proposal to cut the \$2 per vote subsidy, among a handful of other aborted budgetary measures in November 2008.

On the fifth day of the spring 2011 federal campaign, Stephen Harper declared he would ban public support for political parties if he won a majority.¹⁴

His Finance Minister, Jim Flaherty later clarified they would phase out the \$2 a vote system over the next three years, reducing the subsidy to \$1.50 this year, \$1.00 next year and 50 cents in the final year.

In 2010 \$10.4 million went to the Conservatives, \$7.3 million to the Liberals, \$5 million to the NDP, \$2.8 million to the Bloc Québécois, and \$1.9 million to the Greens.¹⁵ The results of the 2011 federal election will change those figures.

The total cost of the program last year was \$27 million. The federal government spent \$244.8 billion on program expenses in 2009–10 and \$29.4 billion in public debt charges. The program represents less than 0.01% of the budget. Clearly this is not about cost.

The rationale given is that Canadians think parties should raise their own money. Another view holds that diversity of political opinion is what makes democracy tick, and that the infrastructure of politics — communicating with voters, election campaigns, leadership races, and even the process of raising money — all take money, and lots of it.

Prime Minister Jean Chretien exited politics by putting limits on how much individuals, corporations and unions could contribute to political parties, to reduce undue influence of those with ready cash. His cap was \$5,000. Prime Minister Harper reduced that to \$1,100, making public subsidies an even more important source of ready financing.¹⁶

The Harper approach, now Canada's, stands virtually alone in the view that the political process does not need publicly funded support. Developed nations such as the U.S., the UK, France, Germany and Australia all publicly subsidize political parties in order to support and enhance democratic practice through voice and choice.¹⁷

Notes

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