Alternative Federal Budget 2004

Fiscal and Economic Update

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The Alternative Federal Budget is prepared each year by a coalition of community, labour, environmental and social advocacy organizations, coordinated by the Canadian Centre for Policy Alternatives. The 2004 Alternative Federal Budget will be released by the project in February 2004, about the same time as the next federal budget. This statement represents the current thinking of AFB participants regarding the current fiscal situation faced by the federal government, and outlines the broad policy options which will shape the coming budget-making process. For further information on the Alternative Federal Budget, please visit www.policyalternatives.ca.

Rumours of Tight Federal Finances are Greatly Overstated (That Makes Six Times In A Row)

Worried about Ottawa's finances? Don't be. Based on Alternative Federal Budget (AFB) calculations, we predict an underlying federal budget surplus of $6.6 billion in fiscal year 2003/04 (barring future spending or tax policy announcements), as shown in Table 2. The government can post this budget surplus and still spend $10 billion more than it did in fiscal year 2002/03. Thus the federal government has the ability to address the suffering inflicted by natural and economic disasters (SARS, forest fires, hurricanes, BSE, West Nile) without jeopardizing federal budget surpluses.

Yet, listening to the ominous depictions of the federal finance minister, one would never guess that the fiscal picture could be so upbeat. Manley warns us that the current fiscal situation is so tight that budget deficits may again materialize. Paul Martin, the prime minister in waiting, cautions that the current fiscal context obliges Canadians to restrain their expectations for federal government spending.

This fiscal fear mongering is becoming an annual ritual. The government's Annual Financial Report, released October 22, 2003, confirmed a $7 billion budget surplus last fiscal year – the only surplus in the G7 countries. Previously the federal government had projected a $3 billion surplus, so it beat its own projection by $4 billion. We at the AFB weren't surprised: last year the AFB had predicted a $6.7 billion surplus.

This disjoint between the relatively optimistic fiscal reality and the federal government's pessimism is not new. Every year since the elimination of the federal budget deficit in 1997, Paul Martin and now John Manley have low-balled their estimates of the federal surplus. By the time their excessively cautious assumptions and their padded reserves are factored in, they claim that government finances are too tight to accommodate significant reinvestment in programs and services for Canadians. Yet every year the federal government has posted a surplus far in excess of its projections. Table 1 compares the federal government's forecasting record relative to the predictions of the AFB, illustrating the federal government's consistent pattern of underestimating the funds at its disposal.

We could forgive any finance minister the occasional mistake. But making the same mistake—and a mistake of this magnitude—six times in a row? Any private sector forecaster with such a bad track record would be invited to consider a career change.

Six years of this repeated low-balling suggests a systematic policy of misrepresenting the true state of the federal government's finances. For years now, the AFB has been pointing out that these duplicitous forecasting practices serve to conceal the federal government's neglect of program spending. Low-balling its forecasted surplus helps the government claim that it doesn't have the fiscal room to increase spending on programs and services for Canadians. Then—presto—when the fiscal year ends, the finance minister announces that he really had more fiscal room to work with than he had previously admitted. By citing accounting rules that prohibit spending money after fiscal year-end, the federal government avoids using these resources to address program spending needs.

By portraying fiscal resources as modest, while sitting on undisclosed surpluses, the federal government evades its responsibility for funding the social programs and other services Canadians deserve. This enables the federal government to escape accountability for its budget choices, and deprives Canadians of transparent and accurate information about the true state of the country's finances.

Table 1
Forecast and Actual Federal Budget Balances 1999/2000 through 2002/03[1]
(billions of dollars)

	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
Total	10.5	46.7	46.7

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); *and The Cure for the Common Budget* (February 2003), respectively.

Surpluses at the Expense of Programs for Canadians

This year's $7 billion budget surplus is particularly disappointing for the labour, social environmental and other civil society organizations which participate in the AFB. In the last federal budget, the government announced that it would ramp up program spending to address the emerging crises in the quality of health care, education, public infrastructure, and other public services that were the result of the painful fiscal restraint that Canadians endured in the 1990s.

This legacy of program spending neglect is apparent. In the 1970s and 1980s, program spending averaged 17.3% of GDP. Since balancing the budget, program spending on average has constituted 11.5% of GDP. Last year the government promised an increase in program spending—setting a goal of 12.2% of GDP. This was modest progress by historical standards, but it was moving in the right direction.

However, despite hopes that the federal government might be improving its program spending record, it has continued to under perform. Program spending in the fiscal year ending March 31, 2003 fell more than $5 billion short of estimates contained in the federal budget brought down only weeks before the fiscal year end. Actual program spending in 2002/03 equaled only 11.5 % of GDP, hardly any higher than the previous year—despite all the new federal "spending announcements".

How could the government fall so short of its promises? Well, the devil is in the details, but, simply put, it promised to spend money and then didn't. An examination of Table 8 of the government's Annual Financial Report indicates that the government failed to live up to its spending commitments. The government under-spent in two major areas : "fiscal arrangements" (a subcategory of major transfers to other levels of government consisting basically of equalization payments) and "all other expenses" (this consists of spending in all government departments including, national defence, as well as subsidies and other transfers to crown corporations). The government's under-spending in these two areas was a substantial $4.9 billion. This $4.9 billion, plus some smaller under-spending elsewhere in programs, created a "savings" of $5.2 billion that the government used to beef up its surplus.

The AFB's Projections for Federal Finances

Every year the AFB offers its own estimates of the fiscal situation faced by the federal government. We do this by means of a "status-quo" fiscal outlook, in which the federal fiscal situation is projected in the absence of any significant changes in tax or program spending policy. To describe federal finances in this status–quo manner, we scrutinize the last year for which we have data in the fiscal reference tables, 2002/03, and take this year as a benchmark. In the absence of any compelling reason to expect the government to change its behavior, we extrapolate from the 2002/03 data to estimate the condition of federal finances in the future.[1]

In terms of tax revenue, we assume that the ratio of tax revenue to GDP stays constant at the 2002/03 level of 15.4%. Holding the revenue to GDP ratio constant at 15.4% is broadly in line with recent experience, since the previous year's ratio came in only slightly higher at 15.5%.

Because of the many shocks to the Canadian economy posed by the recent natural and economic disasters, we believe that there are a number of one-time expenditures that the government must make to address these crises. The AFB accommodates this need for increased program spending in its fiscal outlook. Thus in 2003/04, we assume the government will spend the full amount promised in the February 2003 budget - $143.0 billion—in hopes that they will not fall short of their program spending goals as they did in 2002/03.

This assumption would leave the government room to increase program spending by a full $10 billion in 2003/04 relative to 2002/03 levels. Consequently, program spending in 2003/04 would constitute 11.8% of GDP, a proportion not seen since the late 1990s. After these one-time program expenditures are completed, we assume that the government will revert to its previous spending behaviour. Thus for 2004/05 and beyond, we assume that the federal government will continue to hold program spending to 11.5% of GDP.

Having granted the federal government spending room to address these one-time natural and economic disasters, there is of course the possibility that they will fail to spend the full $10 billion for increased program spending that is available based on AFB calculations. If they spend less than $10 billion, the budget surplus for 2003/04 will increase accordingly. For example, if the federal government were to conform to their 2002/03 record and spend the equivalent of 11.5% of GDP (that is, $139.3 billion), the federal budget surplus for 2003/04 would rise to $10.2 billion.

The status-quo federal fiscal outlook makes several additional assumptions about future economic conditions:

1 We adopt the Bank of Canada's projections for annual average real GDP growth of 2.0%

1 This status-quo assumption also implies that any previous federal government decisions that might have a delayed impact on either program spending or tax revenues are also assumed to have no net effect on these two important ratios.

in 2003, 3.25% in 2004. (Monetary Policy Report of October 2003). For years 2005 and beyond, we adopt the Bank of Canada's assumption for long-run potential real GDP growth (3.0%).

2 The GDP deflator is conservatively assumed as 3.0% in 2003 and 1.5% in 2004. For 2005 and beyond, GDP inflation is assumed to be equal to expected long-run CPI of 2.0%, the midpoint of the Bank of Canada's target range.

3 The effective interest rate on the federal debt for 2003 is calculated by taking the debt service payments for that year and dividing them by the average level of the debt outstanding. Thereafter, we assume the effective interest rate to be constant at 7.256%.

4 Because the status-quo fiscal outlook freezes changes in tax revenue or program spending (expressed as a percentage of GDP), we assume a continuation of current government practice in that any budget surplus is used to reduce federal government debt.

On the basis of these assumptions, Table 2 presents the status-quo federal fiscal outlook.

Based on these assumptions, the AFB predicts a government surplus of $6.6 billion in fiscal year 2003/04, rising to a surplus of $20.1 billion in fiscal year 2006/07. This consititutes a cumulative surplus of $55.9 billion between fiscal years 2003/04 and 2006/07. Of course, if tax revenue or program spending change relative to our assumptions, results will change accordingly.

Table 2
AFB Status Quo Fiscal Outlook[1]

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Budgetary Indicators in fiscal Years	actuals	actuals				
Revenue	171.7	177.6	186.6	195.4	205.2	215.5
Program Spending	125	133.3	143.0	146.0	153.2	160.9
Debt Service	39.7	37.3	37.0	36.6	35.6	34.5
BUDGET BALANCE	**7.0**	**7.0**	**6.6**	**12.9**	**16.3**	**20.1**
Closing Debt	517.5	510.6	504.0	491.1	474.8	454.7
Effective Interest Rate on debt	7.619%	7.256%	7.256%	7.256%	7.256%	7.256%
Macroeconomic Indicators in calendar years						
	2001	**2002**	**2003**	**2004**	**2005**	**2005**
GDP nominal	1107.7	1153.9	1211.6	1269.1	1332.6	1399.2
GDP real ('97 chain)	1040.4	1074.5	1096.0	1131.6	1165.6	1200.5
Real GDP Growth	1.92%	3.28%	2.00%	3.25%	3.00%	3.00%
GDP Inflation	1.0%	0.89%	3.0%	1.5%	2.0%	2.0%
Budgetary indicators as percentage of GDP						
Rev/GDP	15.5%	15.4%	15.4%	15.4%	15.4%	15.4%
Program Spending/GDP	11.3%	11.5%	11.8%	11.5%	11.5%	11.5%
Debt Service/GDP	3.6%	3.2%	3.1%	2.9%	2.7%	2.5%
Debt/GDP ratio	46.7%	44.2%	41.6%	38.7%	35.6%	32.5%

[1]Accrual method of accounts used, all dollar amounts in billions.

The underlying data indicate strongly that the risk to the federal budget balance has been grossly overstated by a government that is deliberately misleading Canadians, yet again, about the true strength of its fiscal position. After six years in a row of posting surpluses much larger than it "expected," the federal government's credibility in claiming that the cookie jar is once again empty has been stretched to the breaking point. The federal government has ample fiscal room with which to meet the pressing demands of Canadians for urgent repairs to the public programs and assets that make such a contribution to the quality and security of our lives: health care, education, and infrastructure. In this year, of all years, as Canadians have endured a worrisome string of natural and economic disasters (SARS, forest fires, hurricanes, BSE, West Nile), the Canadian government cannot turn its back on Canadians. For the federal government to claim that it can't afford to respond to these demands when in fact its coffers are full, is not an act of fiscal prudence—it is an act of democratic irresponsibility

Canadian Centre for Policy Alternatives
410-75 Albert Street, Ottawa, ON K1P 5E7
tel: 613-563-1341 fax: 613-233-1458
http://www.policyalternatives.ca