

The facts, ma'am. Just the facts.

Assessing the Liberals' allocation of the fiscal dividend.

By Jim Stanford

Mark Twain famously defined three kinds of untruths: lies, damned lies, and statistics. He might have added a fourth category: budget forecasts. I've been re-reading Twain recently, in the aftermath of Paul Martin's pre-election mini-budget.

I recently reviewed the Liberal government's fiscal performance during its second term. Did the Liberals spend 50% of their underlying surpluses on social programs, as promised during the 1997 election? Indeed, the Liberals have promised to continue with this "balanced" 50-50 approach if re-elected, and hence their second term record provides a key yardstick for evaluating their trustworthiness.

First I took the government's 1997 program spending (\$108.8 billion), and assumed the cost of existing programs would increase with Canada's population and inflation. This is a standard approach, used by bank economists and other forecasters. I also assumed that the government's 1997 revenues (\$153.2 billion) would grow automatically with national income, also a standard assumption. If the economy grows, revenue from existing taxes also grows.

Any program spending above the 1997 baseline (adjusting for inflation and population growth) was defined as a social reinvestment. Any shortfall of taxes below the 1997 level (relative to GDP) was defined as a tax cut. And any remaining fiscal

Table 1
The Allocation of the Fiscal Dividend
Liberals' 2nd Term in Office, 1997-2001, \$billions

Fiscal Years	1997	1998	1999	2000*	2001*	5-yr. Total
New Program Spending						
Spending at 1997 real per capita level	108.8	110.8	113.6	117.8	121.2	
Actual spending	<u>108.8</u>	<u>111.4</u>	<u>111.8</u>	<u>117.0</u>	<u>125.0</u>	
Additional investment	0	0.6	-1.8	-0.8	3.8	1.8
Tax Cuts						
Taxes at 1997 ratio of GDP	153.2	157.2	169.2	181.1	191.1	
Actual taxes	<u>153.2</u>	<u>155.7</u>	<u>165.7</u>	<u>173.1</u>	<u>178.2</u>	
Tax savings	0	1.5	3.5	8.0	12.8	25.8
Debt Repayment	3.5	2.9	12.3	15.5	13.8	47.9
TOTAL FISCAL DIVIDEND	3.5	5.0	14.0	22.7	30.4	75.6
Shares Going To (%):						
New Program Spending	0	13	-13	-3	12	2
Tax Cuts	0	29	25	35	42	35
Debt Repayment	100	58	88	68	45	63

* Estimated on the basis of the following assumptions, which reflect the current consensus opinions of private forecasters: real GDP growth of 4.5% in fiscal 2000, 3.5% in 2001; GDP inflation of 2.5% in fiscal 2000, 2% in 2001; CPI inflation of 2.75% in fiscal 2000, 2% in 2001; average effective federal interest rate of 7.3% (unchanged from 1999 actual); program spending as projected in 2000 budget plan, with addition of \$1.0 billion in 2000 and \$3.5 billion in 2001 to reflect the September federal-provincial transfers agreement; average tax ratio falls in 2000 and 2001 by 0.4 points of GDP each year.

dividend would show up, by default, as debt reduction.

It seemed straightforward enough to me (the full study is at www.policyalternatives.ca), but the results were shocking (see Table 1). Adjusted for inflation and population growth, federal program spending in 2000 is actually lower than in 1997. By this view, there was no social reinvestment during the Liberals' second term. If I generously extended the whole analysis forward to 2001 (to catch the first big payments announced under September's federal-provincial health accord), spending rebounds to just above the 1997 baseline.

Over the whole period (1997 through 2001), only 2% of the underlying surplus was allocated to genuine enhancements in program spending. The other 98% went to debt reduction (63%) and tax cuts (35%).

Both the Liberals and their right-wing critics, it seems, have a common interest in pumping up the ruling party's reputation as big social spenders—the Liberals because they pose as guardians of the "just society," the Alliance because they hate government waste. So my claim that the Liberals had deviated so wildly from their 50-50 promise evoked some serious cognitive dissonance on the part of journalists, government officials, and even some of my friends.

Unnamed Finance officials told CBC my methodology was akin to "alchemy"—without describing exactly where it erred. Stay tuned for the mini-budget, they said, which will show how the surplus was really allocated.

And indeed, right there in Annex 1 on page 127 of the mini-budget, was the official breakdown of the Liberals' surplus allocation since 1997. Needless to say, page 127 didn't make many headlines on budget night. It claimed that 46.5% of the surplus has been spent on social reinvestments—not exactly half, but golly, pretty close.

How did the Liberals do it? How did they invest half of a huge fiscal dividend in social programs, while essentially freezing the total program budget in real per capita terms? They considered new spending and tax cuts up to 2002-03, but didn't count any debt repayment beyond 2000. They redefined \$14 billion worth of targeted tax cuts as actually constituting program spending (turning tax cuts into spending as neatly as an alchemist turns lead into gold). This includes the capital gains tax breaks which are "targeted" at rich investors and their brokers; only a Liberal could call this a social program and still keep a straight face.

They counted every dollar of increased program spending since 1997 as a reinvestment—inflation or

	2000-01	2001-02	2002-03	2003-04	2004-05	5 Yr. Total
New Tax Cuts	2.8	6.7	8.7	9.4	6.7	34.3
New Debt Reduction¹	7.0	(7.0)	(7.0)	(7.0)	(7.0)	35.0
New Spending						
Environment	-	.1	.1	.1	.1	
Fndn. for Innovation	0.5	-	-	-	-	
SSHRC	-	0.02	0.02	0.02	0.02	
TOTAL²	0.5	0.12	0.12	0.12	0.12	1.1³
Notes:						
1. Martin announced at least \$10 billion in debt reduction for 2000-01, \$7 billion higher than his prior commitment. For subsequent years, debt reduction will be announced on a year-by-year basis, but Martin indicated in the mini-budget that booked surpluses will average in excess of \$10 billion per year in the absence of an economic slowdown.						
2. Tables 1.1 and 1.3 of the mini-budget include the value of the one-time enhancement to the GST credit announced for 2000-01, as a spending program (even though it is a tax cut, and even though it is also listed among their tax cuts summarized in Tables 5.1 and 5.2).						
3. If the additional spending announced in the mini-budget for 2005-06 on the environment and SSHRC is included, this brings the total as announced new spending to \$1.1 billion; without that additional year, the total is less than \$1 billion over five years.						

no inflation, population growth or no population growth. And they've even included an additional \$12 billion saved from spending reductions in other program categories. Apparently taking money out of one pocket and putting it into another is now a "reinvestment."

While Annex 1 was relegated to well-deserved obscurity, the big news on budget night was \$35 billion in new tax cuts over five years, and about \$35 billion in additional debt reduction over the same period (with Martin more-or-less committing to pay off about \$10 billion per year, far above his official \$3 billion target). Martin allocated exactly \$1.1 billion in actual new government spending over six years, for research and the environment (see Table 2). Purely by coincidence, I'm sure, this implies that over 98% of new monies announced in the mini-budget go to tax cuts and debt reduction, with just under 2% for new spending.

CBC Radio's Mary Lou Finlay literally didn't believe me when I said on air that the mini-budget contained only \$1.1 billion in newly announced spending. She turned to a bank economist to confirm that

I was wrong—without actually offering what he thought was the true figure.

No one, it seems, can believe that Liberal fiscal policy has become virtually as conservative as Stockwell Day's. Come to think of it, that is hard to believe. And why should we let the facts confuse us? After all, politics is about power, not about the internal logic of one's arguments.

Still, like an obsessed maniac trying to prove a bizarre conspiracy theory, I pound out the forecasts on my spreadsheet. "It's true, it's true," I keep insisting. "They've hardly allocated anything to new spending!" Turn it off and come to bed, my spouse gently says. Try to forget about it. You'll feel better when the election is over.

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