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The Fiscal Stabilization Fund:

Budget Stabilization Mechanism or Smoke and Mirrors?

— by Gary Tompkins

> The NDP government described the FSF as a budget stabilization mechanism, allowing the government to maintain stable funding of programs in the face of significant fluctuations in revenues, particularly resource revenues and federal transfers. Others described the FSF as a 'smoke and mirrors' mechanism to allow the government to present a 'balanced' budget when it actually forecast a significant budget deficit.

Most economists would argue that government budget deficits in tough economic times are a good idea as long as offsetting surpluses are recorded in better times. Poor economic performance results in lower revenues, and demands on public services and support programs rise. The most recent provincial budget forecast an operating surplus (revenues less current program spending) for 2003-04 of $257.4 million. Since interest payments were expected to be $650 million, we should expect a forecast budget deficit of $392.6 million, a not unreasonable result given the recent performance of the agricultural sector. However, the provincial government transferred $392.7 million from the Fiscal Stabilization Fund (FSF) which led to a 'Budget Balance' surplus of $0.1 million.

Following the release of the 2003-04 Saskatchewan provincial budget, there was considerable commentary focused on the role of the FSF in the budget. The NDP government described the FSF as a budget stabilization mechanism, allowing the government to maintain stable funding of programs in the face of significant fluctuations in revenues, particularly resource revenues and federal transfers. Others described the FSF as a 'smoke and mirrors' mechanism to allow the government to present a 'balanced' budget when it actually forecast a significant budget deficit.

The Government of Saskatchewan has a current debt of approximately $11.7 billion, and that is forecast to rise to $12.2 billion by the end of fiscal 2003-04. The Budget Summary indicates "Government debt is estimated to increase by $421.0 million, primarily to replace the funds withdrawn from the Fiscal Stabilization Fund". However, there is no FSF, except on paper. Instead of having a forecast budget deficit and borrowing the additional amount, the government will 'withdraw' $392.7 million from the FSF and then borrow to 'replenish' the FSF. The net result is exactly the same, as the provincial debt will rise by the forecast deficit (more or less)—the deficit and borrowing requirement is simply transferred from the government's budget balance to the FSF. These steps appear to be deceptive.

Another problem with the FSF is that it gives opposition parties a focus for their budget criticism while not requiring them to respond with a viable alternative.

So why bother with this exercise? Provincial governments in Saskatchewan are faced with considerable variability in revenue above that normally arising from varying strength of the economy. Resource prices, growing conditions, and federal transfer payments can yield revenue windfalls or disappointments. Under these conditions, it is unreasonable to ask the government to balance the budget every year. However, there is strong 'public' pressure to do just that. Not only has the government enacted legislation to balance the budget over a four-year cycle, it has taken considerable pride in announcing that the 2003-04 budget was the 10th consecutive balanced budget.

Until recently, provincial governments have had three financial mechanisms that enabled them to 'balance' the budget in the face of revenue volatility—retained earnings in the Crown Investment Corporation and the Saskatchewan Liquor and Gaming Authority (SLGA) as well as other 'paper' funds such as Crop Insurance. For example, in the 1999-00 budget, the government had a forecast deficit that would be covered by a $190 million withdrawal of SLGA retained earnings. As the year progressed, the fiscal year turned out better than anticipated and the government did not take the money. This example demonstrates the government's ability to exercise considerable discretion over the dividend it receives from 'off-budget' financial entities and that there was not necessarily any linkage between the dividend received and expected financial performance of the SLGA.

After years of pressure from the provincial auditor, the government decided to move SLGA's retained earnings into the budget in the 2000-01 fiscal year. However, rather than show a $132.7 million surplus, plus a one time revenue gain of almost $700 million from SLGA, the government allocated $775 million to the FSF and showed a forecast budget surplus of $57.7 million. In fiscal 2001-02 a budget deficit was covered by a $280 million withdrawal from the FSF. No withdrawal was taken in 2002-03 (down from a budget forecast of $225 million) and it is anticipated a further $392.7 million will be transferred for 2003-04. The creation of the FSF and incorporation of SLGA's operating surpluses and deficits into the budget process improved budget transparency. The financial relationship now is not completely transparent but is at least less opaque. The government is now planning to similarly incorporate forecasts of Crown Corporation financial performances into the budget process.

In the following table, the provincial government's fiscal results from 2000-01 through 2003-04 are presented with the transfers from the SLGA and the FSF separated out. This allows the comparison of the actual fiscal surplus or deficit with the 'budget balance' reported by the government. Over this period, the government reported a cumulative 'budget balance' surplus of $61.0 million. However, after internal transfers are removed, the actual cumulative figure is a deficit of $536.5 million.

Provincial Finances – Fiscal Years 2000-01 to 2003-04 ($ millions)

	2000-01 Actual	2001-02 Actual	2002-03 Fore-cast	2003-04 Budget
Revenues (ex. Transfers)	6,053.8	6,059.1	6,404.5	6,228.0
Operating Spending	5,256.8	5,721.2	5,784.4	5,970.6
Interest Payments	664.1	616.8	618.0	650.0
Surplus (Deficit)	132.9	(278.9)	2.1	(329.6)
Transfer from SLGA	699.8			
Transfers from (to) FSF	(775.0)	280.0	0.0	392.7
"Budget Balance"	57.7	1.1	2.1	0.1

The previous year offers an instructive example of how variable the government's fiscal position can be. At the release of the 2002-03 budget, the government anticipated that a $225 million shortfall would need to be covered by the FSF. By the time the provincial government's Mid-Year Report was released, this figure had ballooned to $324.3 million. Its Third Quarter Report reduced the anticipated shortfall to $253.4 million. In the fourth quarter, led by a boom in resource revenues (52% higher than forecast in the budget), the situation improved to such an extent that no transfers were necessary. However, rather than forecasting a budget deficit that (happily) turned into a balanced budget, the government maintained the appearance of a balanced budget with the deficit and recovery occurring in the FSF. It probably was appropriate to anticipate a budget deficit for 2002-03 that was eliminated as a result of unanticipated increases in resource prices—particularly oil. So why go through the FSF exercise to achieve a 'balanced budget' when it appears to fool no one and simply renames the deficit? Why this obsession with balancing the budget when the revenue and expenditure variability make it a practical impossibility? On the other hand, if it fools no one, is there a problem?

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In my view, the reason we have a FSF is that some in the public want a balanced budget and the FSF allows the government to deliver. To put things in a positive light, there are many ways to eliminate an anticipated budget deficit. Cuts to program spending, higher taxes, optimistic economic assumptions, taking an excessive dividend from Crown Corporations, and transferring the deficit to the FSF are among the ways a balanced budget can be reached. The FSF approach is a relatively benign way to achieve the target compared with bad public policy or saddling the Crowns with excessive debt.

The problem is that the 'balanced budget' may give government a rationale for fiscally irresponsible behavior. The past two decades have not been good for publicly funded programs and institutions. Funding increases have tended to be modest (at or below inflation) and, as a result, the government faces many demands for higher funding. At the same time, the government has instituted significant cuts in personal and corporate income taxes. The myth of the balanced budget may allow the government to persuade us that both goals have been and can be accomplished. Would a government facing a $225 million deficit have continued with the personal income tax reductions given the demands for higher funding?

Another problem with the FSF is that it gives opposition parties a focus for their budget criticism while not requiring them to respond with a viable alternative.

On another note, it should be emphasized that the Government of Saskatchewan is not alone in budgetary manipulation. While the federal government has the opposite problem in that it wishes to hide surpluses, it also appears to desire recurring balanced budgets. To achieve its goal, spending figures are manipulated so that program spending that is scheduled to occur in the future is counted in the current fiscal year.

In conclusion, we would probably be better off if there was no FSF. Voters, taxpayers, and public program stakeholders would have an easier time evaluating the performance of the government and the viability of the alternatives put forward by the opposition parties if deficits were presented as they exist. Currently, we have inadequately funded public services, falling tax rates, and a budget deficit. Absent significant economic growth, this is not a sustainable situation and it is important that the government and opposition parties present a clear policy on how they will deal with this situation. What we have received instead is an accounting contrivance that allows everyone to avoid the central issue and focus on the validity of the FSF. The FSF is simply a response to strong demand by some for an impossible goal—yearly balanced budgets. We would be better off demanding that parties articulate their views of the relative importance of program funding, tax reductions, and growing levels of public debt and not have governments use the goal of budget balance as an excuse to engage in bad public policy or to manipulate budget figures. ❖

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