



# Saskatchewan



# Notes

Volume 2 Issue 13 — December 2003

## Provincial Government Financial Transparency and Balanced Budget Legislation

— *by Gary Tompkins*

In recent times, we have seen a number of provincial governments in Canada identify recurring annual balanced budgets as appropriate financial targets for their operations. Some provinces have gone so far as enacting balanced budget legislation that requires either annual balanced budgets (Ontario) or a budget balance over a defined period of time (Saskatchewan).<sup>1</sup> Even without legislation in place, other governments face considerable pressure from taxpayers and voters to balance their budgets on an annual basis, or at least to not run deficits. External groups such as provincial auditors, the Canadian Taxpayers Federation, and others also attempt to impose their sense of fiscal discipline on governments.

The results of this pressure have not been pretty. We have seen recent provincial budgets hide significant deficits (the British Columbia “fudge-it” budget and the recent

Eves budget in Ontario) through the use of excessively optimistic forecasts. The Saskatchewan government employs a fiscal stabilization fund (FSF), transferring non-existent revenues from that fund to the general revenue fund, thus balancing the budget by moving the deficit to the FSF. At this point, it may be appropriate to rethink what we demand of governments with respect to fiscal discipline. What do we want budgets to tell us? Is a balanced budget an ideal fiscal target?

**What do we want  
budgets to tell us?  
Is a balanced  
budget an ideal  
fiscal target?**

To illustrate this issue, consider the effect of Crown Corporation profits (dividends) on the Saskatchewan government. These revenues represent a significant part of the fiscal capacity of the province to support spending programs. However, while the Crowns yield a predictable source of revenue over the long term, the annual profits can vary significantly. Given this volatility, how can the government support programs requiring a

relatively stable stream of spending with a volatile revenue source while trying to balance its budget on an annual basis? The government has five options.

(1) *Make the program expenditures volatile as well*

This is the worst choice of all but one that is apparently endorsed by the Canadian Taxpayers Federation. If the Crown Corporations have a poor year, simply reduce program expenditures accordingly. This could be accomplished by temporarily shutting down public institutions such as hospitals, schools and universities, reducing road maintenance, slashing public sector wages, and so forth. In a good year, you then re-open the institutions, fill in the potholes, and reinstate salaries. Unfortunately, this would not assist those whose lives were disrupted by the spending cuts, fix the cars damaged by potholes, or attract and retain qualified civil servants.

(2) *Annualize the Crown's contribution to general revenues*

This has been the option used by successive Saskatchewan governments. In this case, the Crown dividends flow into an off-budget fund that contributes a steady stream of revenues to the general revenue fund. When the Crown has a good year, the government withdraws an amount less than the actual profits, leaving the fund in a surplus position. In bad years, the government takes more than actual profits earned, using up

previous surpluses. Over time, this allows the government's budget to be balanced, transferring any surplus or deficit to the off-budget fund.

The problem with this approach is the possibility that the government will abuse the discretionary power it has to determine the dividend it receives. In previous times, the government has hidden massive deficits by requiring an unsupportable large dividend from the Crowns. Governments could also build up a "slush fund" by hiding surpluses in off-budget accounts to enable themselves to fund future election promises. This approach requires an external audit of the operations of off-budget funds to

ensure the government is treating the account in a sustainable fashion. The advantage of this approach is that it allows the government to sustain programs with volatile revenue sources while balancing its budget.

**...how can the government support programs requiring a relatively stable stream of spending with a volatile revenue source while trying to balance its budget on an annual basis?**

(3) *Privatization*

Another way to better match the time patterns of revenues and program expenditures is to privatize the Crowns. By selling off the Crowns and paying off the provincial debt with the proceeds, the government would turn a volatile revenue stream (Crown profits) into a much more steady revenue stream (interest cost savings). Unfortunately, the volatile stream averages about a 10 percent return to equity while interest savings would be in the range of 6 percent, a steep price to pay to reduce

volatility. Further, there are other implications that come with privatization, such as the loss of policy instruments, payment of federal corporate profits taxes, loss of public control over operations, and so forth. People have differing opinions as to whether it would be beneficial to privatize a portion of Crown Corporation activity. Hopefully, no one would agree that reducing revenue volatility should be a motivation for such a move.

**The recent budget debacles in B.C. and Ontario show how easy (and meaningless) it can be to balance the forecast budget. All it requires is delusional optimism or cynical opportunism.**

interpret them as the outcome of normal and rational operation of government revenue and expenditure programs—not as building up a slush fund or a sign of out of control spending. The test of sustainability should take into account annual fluctuations in revenues and expenditures and requires a much more complex analysis than simply looking at the result of a single fiscal year.

In conclusion, the pressure on governments to balance every annual budget has led to yet another

**(4) *Deceit***

There are (at least) three budgets that are released to describe government activities. The first and most prominent to the general public is the forecast budget for the next fiscal year. The second is the actual financial outcome at the end of the year, and the third is the financial statements released by the Provincial Auditor. The recent budget debacles in B.C. and Ontario show how easy (and meaningless) it can be to balance the forecast budget. All it requires is delusional optimism or cynical opportunism.

example of the law of unintended consequences. In the example above, I used the volatility of Crown dividends to illustrate the problems created by balanced budget restrictions, whether they are imposed formally through legislation or informally through pressure from some sectors of the public. There is also similar volatility in other revenue sources (resource taxes and royalties), as well as expenditure

**(5) *Budget Surpluses and Deficits***

The final option is the best from the standpoint of financial transparency and stability of government programs. Let the surpluses and deficits appear on the budget statement and

**...a deficit is not necessarily an indication of fiscal management, a surplus is not necessarily an indication of excessive taxation relative to program spending, and a balanced budget is not necessarily a sign of a sustainable balance of taxes and spending.**

programs (crop insurance). In these circumstances, a deficit is not necessarily an indication of fiscal management, a surplus is not necessarily an indication of excessive taxation relative to program spending, and a balanced budget is not necessarily a sign of a sustainable balance of taxes and spending.

*(continued on page 4...)*

Taxes and spending should be balanced over a reasonable period of time. We should expect annual budgets to show surpluses and deficits and our evaluation of government financial performance should take into account whether this was a “good” or a “bad” year. Governments have the capacity to easily deal with revenue and expenditure volatility through the use of debt. When we demand that governments deliver annual balanced budgets, we are forcing them to either transfer the volatility to the beneficiaries of program spending (who are less able to deal with volatility), to privatize and transfer the volatility to private owners (at a steep price), or engage in deceitful forecasting or accounting practices. Demanding balanced budgets does not enhance public transparency nor encourage rational fiscal behaviour. ❖

**Demanding balanced budgets does not enhance public transparency nor encourage rational fiscal behavior.**

---

**ENDNOTE:**

- 1 For a broader discussion of provincial balanced budget legislation see John Loxley, *Alternative Budgets: Budgeting as if People Mattered* (Halifax: Fernwood, 2003), 128-132.
- 

*Gary Tompkins is Associate Professor in the Department of Economics at the University of Regina and a Research Associate for the Saskatchewan Office of the Canadian Centre for Policy Alternatives.*

The Canadian Centre for Policy Alternatives—Saskatchewan (CCPA-SK) is an independent, non-partisan research organization. Studies undertaken by CCPA-SK will arise from a community, collective, and social concern.

**CCPA-SK Saskatchewan Notes** are produced and distributed electronically. They can be reproduced as an OpEd or opinion piece without obtaining further permission, provided they are not edited and credit is given.

If you would like to receive the **Saskatchewan Notes** please contact CCPA-SK to begin your free subscription.

**Canadian Centre for Policy Alternatives – SK**

2717 Wentz Ave., Saskatoon, SK S7K 4B6

Ph: 306-978-5308 — Fax: 306-922-9162

Email: [ccpasask@sasktel.net](mailto:ccpasask@sasktel.net) / Website: [www.policyalternatives.ca/sk](http://www.policyalternatives.ca/sk)