

Cut now, not later

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When the federal government announced in its November economic and fiscal update that it would miss its target for balancing the budget,¹ it confirmed something that should be obvious to all students of recent Canadian economic history: Crossed-finger revenue forecasts and unrealistic spending growth projections are no basis for sound economic policy.

Ottawa's delay in balancing its budget will result in additional government debt and a much larger bill for the next generation to pay back. So why are virtually all provincial governments poised to follow this same failed strategy?

All provinces save Saskatchewan expect to run deficits over the next several years. British Columbia and Manitoba currently have the smallest deficits among the provinces (0.4% and 0.6% of GDP). At the other end of the spectrum, Ontario has a \$16.3 billion deficit (2.6% of provincial GDP). Ontario's deficit is so large that it makes up more than 64% of the total deficits recorded by all the provinces in 2011-12, even though the province represents 38% of total Canadian GDP (Statistics Canada, 2011).

In addition to the size of their deficits, what's also important is when each province plans to eliminate them. Even for the most aggressive deficit slayers of the bunch—BC, Alberta, Quebec, and Nova Scotia—it will take another three years of red ink (see table 1).²

But here's the rub: Nearly all provinces are using optimistic revenue projections with annual growth rates ranging from 3.2% in Manitoba to 7.3% in Alberta. Ontario, where the deficit problem is most severe, is assuming very rosy revenue projections of 4.3% per year for the next seven years.

On the other side of the ledger, the provinces plan to significantly restrain their expenditures by holding the growth of program spending (total spending minus

interest costs) to between 1.4% in Ontario and 1.9% in Quebec.

Given the recent spending history of many provincial governments³ (even before the 2008 downturn) and the fiscal pressures put on various programs from an aging population, it is unlikely that the provinces will be able to keep spending to these rates over the medium term.

Consider that in the five years before the recession (2003-04 to 2008-09) Quebec increased program spending at an average rate of 4.9%, the lowest average among all provinces. The biggest spender, Alberta, increased program spending at an annual rate of 11.2%. The balanced budget plans of all provinces are currently built on promises to restrain program spending growth to under 2.0% (Canada, Department of Finance, 2011a; Provincial Budgets, 2011). That hardly seems likely.

Combine optimistic revenue projections and unrealistically low rates of program spending growth, and you get balanced budget plans that contain substantial risks—especially in light of the following scenarios.

First, revenues may not materialize as expected due to slower economic growth. Lower than fore-

Table 1: Growth rates in revenues and spending for deficit provinces (percent)

Provinces	Revenues	Program Spending	Number of Years to Balance
British Columbia	3.4	1.5	3
Alberta	7.3	1.5	3
Manitoba	3.2	1.8	4
Ontario	4.3	1.4	7
Quebec	4.9	1.9	3
New Brunswick*	n/a	n/a	4
Nova Scotia	0.5	1.8	3
Prince Edward Island*	n/a	n/a	4
Newfoundland & Labrador	0.4	1.8	4

*Note: The averages presented were calculated over the period required in each province to achieve a balanced budget. NB and PEI did not provide sufficient information in their 2011-12 budgets to allow for the required calculations for inclusion.

Source: Provincial budgets, 2011; calculations by authors.



casted commodity prices would especially hurt provinces that depend on natural resource royalties. For instance, Alberta is expecting average revenue growth of 7.3% over the next three years (Alberta, Department of Finance and Enterprise, 2011). That might be attainable if commodity prices remain strong, but a minor dip in revenue expectations would delay the balanced budget plan.

Second, program spending may increase faster than anticipated for a number of reasons such as natural disasters, political pressure, and higher entitlement spending.

Finally, interest costs may also turn out to be higher than expected, putting upward pressure on government spending.

By relying on strong future revenue growth, most provincial governments are dealing with their fiscal problems using a passive approach. If the economic outlook worsens, and the provinces like the federal government miss their balanced budget targets, Canada will be left with larger deficits for a much longer period and significantly more government debt—both of which are drags on the economy.

Total provincial debt is already expected to reach \$487 billion this year (Gulati and Burleton, 2011). Add this to the federal debt that's currently at \$586 billion and Canadians are leaving over a trillion dollars (\$111,000 per Canadian family) in debt for the next generation to pay (Canada, Department of Finance, 2011; calculations by authors). With the federal government and nearly all provinces expecting deficits into the foreseeable future, the total level of debt will increase significantly.

Politicians from all political parties need to realize the seriousness of the inherent risks in their fiscal plans. Rather than rely on the failed policies of the past, of trying to slow spending growth while hoping revenues rebound sufficiently, provincial governments should be proactive and enact immediate program spending reductions and reforms.

Notes

1 Canada, Department of Finance, 2011b.

2 The number of years to balance the budget runs from 2011/12 to the year of balance. Saskatchewan was in a surplus position in 2011/12 and is excluded from the analysis. New Brunswick and Prince Edward Island were excluded from the analysis as their 2011 budgets lacked the information required for the calculations.

3 See Veldhuis et al. (2011) for an overview of this history.

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