LEGISLATING FRUGALITY: THE RISE OF BALANCED-BUDGET LAWS IN CANADA

BY LISA PHILIPPS

Fiscal restraint has become a virtual mantra for all Canadian governments, regardless of geographic or political affiliation. The quest for deficit and debt reduction is clearly a defining feature of the current political moment. Recently, several provinces have moved to entrench these conservative fiscal policies in the form of balanced-budget legislation. Since 1993 the North West Territories, Alberta, Saskatchewan, Manitoba, Quebec and New Brunswick have all passed laws that purport to limit government's freedom to borrow, and Ontario may be next. The merits of a federal balanced-budget law seem likely to be debated in the coming months (the Reform Party has thrown down the gauntlet in its "Fresh Start" pre-election document), and the idea of constitutionalizing a balanced-budget requirement has even been raised in some quarters. These developments are no doubt inspired in part by the experience of the United States, where fiscal limitation laws have a long history. In 1995 a balanced-budget amendment to the American Constitution was defeated by a single Senate vote, and many expect it to resurface before long.

The merits of a federal balanced-budget law seem likely to be debated in the coming months (the Reform Party has thrown down the gauntlet in its "Fresh Start" pre-election document), and the idea of constitutionalizing a balanced-budget requirement has even been raised in some quarters.

A GOOD IDEA?

Proponents argue that fiscal limitation laws counteract the inherent tendency of elected governments to spend public funds on goods that are highly valued by narrow electoral constituencies (or "special interests"). According to public choice theories, it is seldom cost-efficient for the general body of taxpayers to mount organized opposition to such spending, particularly when costs are deferred through deficit financing. While superficially logical, such arguments often distort the real causes of deficits, and misleadingly paint all deficit spending as harmful to the public interest.

In a time when the need for fiscal restraint tends to go unquestioned, the risk is that balanced-budget laws will be accepted uncritically in Canada without adequate consideration of their potential harms. The degree of constraint these laws can impose on our spending and taxing choices is not yet widely appreciated.

WHAT THE NEW CANADIAN LAWS SAY

The catch phrase "balanced-budget laws" doesn't begin to convey the scope of these statutes, or the striking diversity of approaches across the country. There is a stark contrast between jurisdictions like Alberta and Manitoba that prohibit deficits entirely and hence require annual balance, and the Saskatchewan or New Brunswick versions that measure fiscal balance over a longer cycle of three or four years. Aside from Alberta's, all the statutes define some exceptional circumstances where borrowing is permitted, such as wars, expensive natural disasters, or a major drop in federal transfers or other revenues. In terms of enforcement, Manitoba provides (remarkably) for a 20 percent cut to cabinet ministers' pay if the government runs an illegal deficit, rising to 40 percent after two consecutive deficits. Members of the N.W.T. executive run the risk of dismissal if they incur a deficit. At the other extreme, New Brunswick's law carries no punishment and merely declares cyclical balance to be an "objective" of government.

In terms of enforcement, Manitoba provides (remarkably) for a 20-percent cut to cabinet ministers' pay if the government runs an illegal deficit, rising to 40 percent after two consecutive deficits.

Significantly, Manitoba and Alberta have adopted tax limitation laws alongside their anti-deficit rules. Alberta must hold a referendum before introducing a general sales tax. Manitoba has erected an even higher barrier to raising new revenue: the government must obtain *majority approval* in a referendum before increasing *any* of its four major taxes. These same two provinces have enacted detailed schedules for repaying accumulated debt out of future surpluses.

A feature common to all jurisdictions is their emphasis on financial transparency and disclosure. It is popular to require finance ministers to report periodically on the government's compliance, and to impose guidelines for fiscal accounting and economic forecasting. This appearance of greater openness and accountability is beguiling, however, because it commits the folly of equating balanced budgets with good government. The potential drawbacks of this type of legislation can be grouped into three broad categories: economic instability, social inequality, and false democracy.

Those concerned about "special interests" affecting budgetary decisions should look first to the corporate sector and its unparalleled influence on fiscal policy.

ECONOMIC INSTABILITY

Removing borrowing from the list of fiscal options open to government seriously hampers its capacity to respond to cyclical downturns in the economy. It means that a drop government seriously hampers its capacity to respond to cyclical downturns in the economy. It means that a drop in revenues will create pressure for spending cuts at exactly the wrong time, potentially worsening a recessionary trend. Despite their near iconic status, strictly balanced budgets do not always promote stable, welfare-maximizing economic conditions. As every firm and household knows, deficit financing is sometimes the most efficient and least costly option. Overly simple public choice arguments fail to recognize that political leaders may rightly determine that counter-cyclical spending is in the public interest.

Balanced-budget laws help to construct government as constrained and limited. They present the abstract goal of a zero deficit as a meaningful and indeed paramount measure of government performance, deflecting questions about whether the state is fulfilling its role of promoting a minimum level of equality and basic human rights in our society.

Destabilization is a particular concern when it comes to a federal balanced-budget law, but badly timed provincial spending cuts can also harm local economies. And American economists have cast doubt on whether reserve funds (like that created by Manitoba) can bear the whole weight of a serious slump. Alarmingly, the new Canadian laws appear to exceed the restrictions on many American states, where capital spending is often exempted and balance is often mandated only for the forecast, as opposed to the actual budget. When we add in penalties for cabinet ministers and requirements for tax referenda, some of our new balanced-budget laws create worrisome incentives for destabilizing spending cuts.

SOCIAL INEQUALITY

Critics of deficit spending often blame social programs for the debt, ignoring the far greater contribution of other factors like high interest rates and tax expenditures. Those concerned about "special interests" affecting budgetary decisions should look first to the corporate sector and its unparalleled influence on fiscal policy. The real worry is that the politics of the budget process tend to ensure that spending cuts are thrust disproportionately upon the least privileged groups in society.

Besides potentially forcing additional regressive spending cuts, balanced-budget laws reflect and help to legitimate a larger political vision that seeks to reduce the role of government in meeting social needs. This vision calls on citizens to become more self-reliant by deploying their own resources in an allegedly more productive private sector. What this program overlooks is that unequal access to resources and markets often determines who is, and is not, able to secure a decent living with individual initiative. Too often, the promotion of smaller government goes alongside a lesser commitment to reducing inequalities based on class, gender, race, and other social characteristics.

Even more worrisome is the way balanced-budget laws excuse governments from having to justify why deficit elimination should be their overriding priority. Far from increasing our control over economic policy, such laws may simply facilitate politicians in denying responsibility for their choice of public policy goals.

Balanced-budget laws help to construct government as constrained and limited. They present the abstract goal of a zero deficit as a meaningful and indeed paramount measure of government performance, deflecting questions about whether the state is fulfilling its role of promoting a minimum level of equality and basic human rights in our society.

FALSE DEMOCRACY

The new wave of balanced-budget legislation purports to enhance the transparency and accountability of fiscal policy. In reality, these laws are unlikely to achieve any genuine democratization of economic policymaking, something we certainly need. Though they call for more public disclosure of fiscal information, it is information that speaks only to the bottom line. It in no way facilitates discussion of *how* budget targets were met, the rationales for specific cuts, who the government talked to in making them, or their economic and social impacts.

Even more worrisome is the way balanced-budget laws excuse governments from having to justify why deficit elimination should be their overriding priority. Far from increasing our control over economic policy, such laws may simply facilitate politicians in denying responsibility for their choice of public policy goals.

CONCLUSION

Balanced-budget laws offer a seductively simple response to the fiscal challenges facing governments. This article suggests they also entail some dangers that should deter us from uncritically accepting them into Canadian law.

***Lisa Philipps** is an Assistant Professor of Law at Osgoode Hall Law School, York University.*