

## ECONOMIC REPORT

### PROSPECTS FOR FEDERAL FINANCES UNDER A LIBERAL GOVERNMENT

by Fred Lazar

#### THE MULRONEY LEGACY

When Brian Mulroney and his Conservative party came to power in the autumn of 1984, the federal government's budgetary deficit was on track for a record high of \$38.5 billion for the 1984-85 fiscal year. The combination of modest spending restraint and higher taxes reduced the deficit to \$28.2 billion by 1987-88. But despite additional tax hikes, the abandonment of continued spending restraint and the high interest rate and recession legacy of John Crow's attack on inflation put the deficit back on a rising path.

Although the April 1993 budget forecast a deficit for the 1993-94 year of \$32.6 billion, it appears at this time that the deficit is more likely to be in the \$38.5 billion range. Nine years of Conservative government will leave the federal deficit at about the same level as when Mulroney first took over the reins of power. Despite the efforts of Michael Wilson and Don Mazankowski, John Crow proved to be more influential in affecting the size of the deficit. Indeed, Crow derailed the Conservatives' attack on the deficit and contributed through his tight monetary policies about \$50 billion to the total debt accumulated by the federal government during the past six years.

The Mulroney government did have some success in reducing the

federal deficit as a proportion of GDP. While it totalled 8.7 percent of GDP in 1984-85, it will average closer to 5.5 percent in 1993-94.

During the election campaign, Jean Chrétien and his Liberals promised to create jobs and maintain social programs while at the same time reducing the deficit to 3 percent of GDP. Will the new Liberal government be able to achieve these goals within one term, especially when they are starting with a deficit-to-GDP ratio of about 5.5 percent and an economy that is sputtering along?

#### IS THE 3 PERCENT TARGET ACHIEVABLE?

The Liberal government will not be able to resort to higher taxes to tackle the deficit. During the Mulroney era, total federal taxes increased as a proportion of GDP from 14.5 percent in 1984-85 to about 16 percent in 1993-94, an increase of close to 11 percent in the total federal tax burden on Canadians. Consequently, the Liberals will have to rely on spending restraint and hope for a sustained economic recovery and low interest rates. How much spending restraint will be necessary and will this be compatible with the economic and social goals?

To answer this question, I examined the following two scenarios. In the first case, I assumed that the economy would grow at an average rate of 3.5 percent per year in real terms during the next five years, inflation would average 2 percent per year, and tax revenues would hold steady growing in line with the overall economy (that is, growing at about 5.6 percent in nominal terms per year). In the second case, I assumed that the real GDP would increase more slowly at an average rate of 2.5 percent per year and that federal government revenues would increase less rapidly than the overall economy.

As can be seen in the accompanying table, in the absence of spending restraint (program spending growing at the same rate as nominal GDP so that the government expenditure to GDP ratio remains constant), the deficit in the first case could increase from \$38.2 billion in 1993-94 to over \$55 billion in 1998-99. As a proportion of GDP, the deficit could approach 6 percent by the end of one term of a Liberal government.

However, the 3 percent target might be attained by 1998-99 with a program of modest spending restraint. That is, if total program spending is not allowed to increase more rapidly than the rate of inflation (zero real growth in spending), by 1998-99 the deficit might fall to \$24.4 billion or 2.6 percent of the estimated GDP.

If, however, the economy continues to recover very slowly and the Liberals are unable to stimulate the economy to grow at even a 3.5 percent annual rate and tax revenues continue to collapse as the underground economy continues to expand (the second case scenario), zero real spending growth would not be sufficient to achieve the 3 percent target. According to my estimates (see table), the deficit could get locked into the \$40 to \$41 billion range throughout the first term and by 1998-99 it could average 4.5 percent of GDP.

A five-year program spending freeze (zero nominal growth) would be necessary to get the deficit down to the \$24 billion level. Consider that with the exception of the 1985-86 fiscal year, program spending continued to grow every year during the Conservatives' regime. Moreover, a spending freeze would be incompatible with the economic and social goals set out by the Liberals during the campaign.

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### CHALLENGES AND THREATS

The biggest threats and the greatest challenges facing the Liberals as they take office are to accelerate the momentum of economic growth and

three goals simultaneously. It will continually be walking a tightrope between fiscal responsibility and social and economic responsibility. There is little that the government can do about external factors, other than to argue more forcefully for cooperation among the G-7 to stimu-

Federal Budget Deficit Projection, 1993-94 to 1998-99

Fiscal Years	\$ billions					
	'93-'94	'94-'95	'95-'96	'96-'97	'97-'98	'98-'99
<i>Scenario 1</i>						
Program Spending: Grows Annually in Line with Nominal GDP (5.6%)						
Deficit	38.2	41.2	44.3	47.8	51.4	55.4
(% of GDP)	(5.3)	(5.5)	(5.6)	(5.7)	(5.8)	(5.9)
Program Spending: Zero Real Growth (2% per year)						
Deficit	38.2	36.8	34.6	31.9	28.5	24.4
(% of GDP)	(5.3)	(4.9)	(4.4)	(3.8)	(3.2)	(2.6)
<i>Scenario 2</i>						
Program Spending: Zero Real Growth						
Deficit	38.2	40.2	42.0	41.6	41.0	40.1
(% of GDP)	(5.3)	(5.4)	(5.4)	(5.1)	(4.8)	(4.5)
Program Spending: Spending Freeze (0% per year)						
Deficit	38.2	37.6	36.4	32.9	28.8	24.1
(% of GDP)	(5.3)	(5.0)	(4.7)	(4.0)	(3.4)	(2.7)

to restore the confidence of taxpayers in the fairness and integrity of the tax system. The combination of slow economic growth and tax avoidance will force the Liberals to jettison either their deficit goal or their economic and social goals and will most likely result in a massive defeat for the party in the next federal election.

Furthermore, the Liberals have to avoid any escalation in interest rates. A renewed attack on inflation by the Bank of Canada would push the economy back into a recession and push up nominal and real interest rates to tragically high levels—tragic for the economy and Canadian citizens. As well, for every 1 percentage point that interest rates exceed the current levels, the federal government deficit would increase by between \$6 and \$8 billion.

The Liberal government will not have much latitude in pursuing the

late the world economy and resolve needless trade disputes.

However, the Liberal government cannot afford to allow the Bank of Canada to follow its own whims and in the process sabotage the efforts of the government to remain on the tightrope. This means that John Crow cannot be reappointed when his contract expires at the end of January and that his replacement should be an individual with excellent credentials in the domestic and international financial communities, so as to prevent any short-lived attack on the Canadian dollar, and one who will show more sympathy for the unemployed and be more sensitive to the high costs of a vigorous deflationary policy.

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## LEGAL REPORT

### JUDICIAL AMENDMENT OF STATUTES TO CONFORM TO THE CHARTER OF RIGHTS

by Peter W. Hogg

It is trite to observe that the *Charter of Rights and Freedoms* has expanded the role of the courts in Canada. Not only has the Charter added new grounds of judicial review of legislation that were not available before 1982, it has also led to new judicial remedies in cases where statutes have been found to be in conflict with the Charter.

It had always been assumed that courts lacked the power to add new words to a statute. The direct amendment of a statute could be accomplished only by Parliament or the legislature itself. In *Schachter v. Canada* (1992), however, the Supreme Court of Canada said that the court could add words to a statute if that were the best way to cure a constitutional defect. The court described this technique as "reading in," and said that it was a "legitimate remedy."

Reading in was not actually ordered in *Schachter*, but the remedy has now been ordered by the Ontario Court of Appeal in *Haig v. Canada* (1992). Haig had been discharged from the armed forces by reason of his homosexuality. He could not obtain a remedy under the *Canadian Human Rights Act* because the Act, although affording protection against many grounds of