Budgets and Deficits: The Federal and Ontario Budgets Compared

Don Mazankowski and Floyd Laughren are pursuing strategies that are remarkably similar

by Fred Lazar

On April 26, Finance Minister Don Mazankowski tabled the federal government's budget in the House of Commons. This budget must be examined together with the economic and fiscal statement delivered to the House by the finance minister on December 2, 1992. Many have suggested that Mazankowski confused these two documents, because the December statement was indeed more of a budget, and the April budget was more of an economic statement.

On May 19, Ontario Treasurer Floyd Laughren presented his government's budget in the Legislative Assembly. A review of the federal and provincial budgets reveals many more similarities than differences. It appears that the fear of rising deficits and the threats of credit-rating agencies have produced a remarkable convergence in the fiscal policies of parties nominally perceived to occupy opposing ends of the political spectrum. As well, these two budgets and those introduced by Quebec, Saskatchewan, and Newfoundland set the stage for a finance ministers' conference to develop a comprehensive and cooperative approach for dealing with government deficits and debts and, more important, with the allocation of fiscal responsibilities between the federal and provincial governments.

The issue of jurisdictional responsibilities that was to be resolved by the Charlottetown accord on the constitution is likely to be eventually resolved through federal-provincial meetings on government fiscal arrangements and deficits. Constitutional reform is not dead. The actors have just moved offstage and out of the public limelight.

Two Budgets Compared

Back to the two budgets and a look first at some of their differences. The federal government, after almost nine years of trying, has again failed to pierce the "mystical" $30 billion deficit target. Indeed, the deficit is expected to top out at $35.5 billion in fiscal year 1992-93 and decline modestly to $32.6 billion in 1993-94. In contrast, the Ontario government appears determined to get its deficit below its self-imposed upper-limit target of $10 billion. Although Ontario will fail in 1992-93, when the deficit will approach $12 billion, apparently it may succeed in 1993-94 when the deficit is anticipated to fall to $9.2 billion.

However, despite the apparent "success" of Ontario and the apparent failure of Ottawa, the picture is much different when we focus on the operating budgetary balances; that is, the budgetary balances excluding interest payments on the outstanding debt. The federal government continues to generate operating surpluses. Ontario, in contrast, will have operating deficits for the 1992-93 and 1993-94 fiscal years.

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The Federal Budget of April 26

Maz's tough budget fails to provide enough economic stimulus to get the economy back to its potential

by John Grant

Despite financial commentators' disdain, I think this budget laid down a sensible track for the next government to follow — with one important exception. Certainly, it was tough enough. Since we are in the midst of a major shift to fiscal restraint at the provincial level, since the federal fiscal stance was already very contractionary, and since this government only has a month to get its measures through Parliament, realism suggests that we shouldn't have expected more.

And we should take note of the budget's projection that program expenditures would have fallen to just 13.9 percent of GDP by 1997-98, versus 17.3 percent in the year just ended and a high of 19.2 percent in 1983-84 (see chart on page 114). If the next government actually manages to do this, the economic impact of the federal government will fall to the lowest point in over 30 years, down 28 percent from its high. So this budget points the way to a hugely diminished federal role in our lives. Those who wanted more "slash and burn" have a credibility problem of their own.

For me, the budget fell short in quite a different respect. What I wanted to see was a commitment to at the earliest possible moment consistent with maintaining price stability. If, in that context, we can get the debt-to-GDP ratio down sharply too (which I certainly believe we can), all the better. And for that matter, why couldn't we do all these things more quickly?

The government's fiscal plan has been hijacked by two big problems this year: a revenue shortfall on the one hand, and persistently high real interest rates on the other. Although there are some avoidance issues to be addressed, revenues will basically respond well to a stronger economy as we get back to potential. The problem of interest rates is a tougher nut, however, because it depends largely on factors beyond our control. The government has evidently decided that its best chance here is to cut the debt-to-GDP ratio and to encourage the provinces to cut theirs as well. The thinking goes that a balanced public sector budget would sharply reduce or even eliminate Canada's need to borrow abroad, and that should give us our best shot at getting interest rates down. I do agree that this is a reasonable hope, and certainly it could enter us on a virtuous cycle if it works. Saving 1 percent a year on federal debt service would cut the deficit by $5 billion or so all by itself when it has worked through.

So I accept that we should set a severe fiscal course, but I also argue that the government and the Bank of Canada should make a clear commitment to getting the economy back to potential within the five-year projection period of this budget or sooner. Of course, this means that monetary policy would have to be sufficiently stimulative to compensate for the fiscal drag. But this doesn't and shouldn't mean that we need to give up on price stability. In my opinion, Canadians are unnecessarily and unrealistically pessimistic about their prospects at this time, and it wouldn't be crass electioneering if someone were to lift their spirits.

John Grant is Senior Economic Advisor at Wood Gundy Inc. The views expressed in this article are his own and should not be attributed to Wood Gundy.

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An overall balanced budget at the federal level will require a massive operating surplus, somewhere in the range of 30 to 35 percent of budgetary revenues. This will necessitate massive spending cuts, sharp tax increases, and record high sustained growth rates for the economy. It appears that part of Ontario's fixation with its deficit stems from the fiscal morass that the federal government has fallen into as a result of its rising debt interest payments.

The debt interest payment projections in the two budgets provide an interesting footnote to this comparison of deficits. Despite an approximate 8 percent increase in the federal government debt in 1992-93, Mazankowski's budget assumes that public debt charges will remain constant at $49.5 billion in the 1993-94 fiscal year. In Ontario, a 21 percent increase in its outstanding debt in 1992-93 is projected by Laughren to result in a 33 percent increase in debt charges in 1993-94. One suspects that both governments deliberately erred in making their interest rate assumptions. Ottawa had an interest in underestimating public debt charges in order to show some improvement in its overall deficit position in 1993-94. Ontario had an incentive to overestimate its interest payments in order to convince the broader public service of the need to accept the $2 billion expenditure reductions in the negotiation of a "social contract."

Taxing Times in Ontario

Finance Minister Mazankowski introduced his budget by claiming that it contained "no new taxes" and "no tax increases." Floyd Laughren, in order to attain his deficit target for the next fiscal year and to persuade the people of Ontario that the necessary sacrifices would be borne fairly, resorted to a number of tax and user-fee increases. In 1993-94, the discretionary tax changes introduced in the budget would increase the tax burden in Ontario by about $1.6 billion. In addition, new user fees would generate another $239 million in revenues for the government. Moreover, excerpting a page from the Michael Wilson budget reduction strategy of off-loading to a junior level of government, the Ontario government's proposed reductions in grants to municipalities, schools, and universities undoubtedly will result in higher property taxes and tuition fees and other user-fee increases. It is not surprising, therefore, that Mazankowski and the business community in general criticized the Ontario budget for its tax increases.

Differing Economic Projections

Finally, the federal and provincial governments seem to be looking at the future through different glasses. In its economic outlook, Ottawa expects the economy to grow in real terms by 4.6 percent in 1994 and at an average annual rate of 4.3 percent in both 1995 and 1996. Ontario anticipates more moderate rates of growth — 3.4 percent in 1994, 3.9 percent in 1995, and 4.2 percent in 1996.

If the Ontario projections are closer to the mark, then the rosy employment growth projections in the federal budget will not materialize and the economic record of the Mulroney government will look quite poor during this year's election campaign. Obviously, the federal government would like to convince the electorate that their policies have set the stage for a dramatic and sustained recovery. In addition, if lower growth does occur, then once again the Department of Finance will err dramatically in projecting the elimination of budgetary deficits within four to five years. The Department of Finance now has a 15-year track record of consistently and wrongly projecting balanced budgets, so no one pays any attention to its budget forecasts.

Impact of Fiscal Restraint on Economic Growth

Even the Ontario growth estimates may be overly optimistic. As the federal and all provincial governments simultaneously attack their respective budget deficits this year, it is difficult to envision a strong economic recovery. Aggregate spending cuts and tax increases may range between $10 and $15 billion this year, or roughly 1.5 to 2.0 percent of Canada's GDP. Unless long-term interest rates drop sharply, or consumer and business confidence rise significantly or Canada's competitiveness improves sharply, it is difficult to envision economic developments offsetting the combined fiscal drag on the Canadian economy. One need only look at the California economy to see the potential effects of fiscal restraint. During the 1980s, California prospered as defence spending increased sharply. California is now in the midst of its worst depression in 60 years as a result of cutbacks in defence spending and the state government's draconian efforts to balance its budget.

To deflect criticism of their apparent single-minded pursuit of lower deficits, the two budgets emphasized their respective job creation initiatives. Here too the similarities stand out. Both targeted investments in people and infrastructure and support for small business and communities. Both ministers also argued for more efficient government and less waste in the provision of government services. The expenditure control plan officially announced in the Ontario budget together with the social contract negotiations and objectives seem to parallel the spending restraint initiatives in the December statement of Mazankowski that were extended in the April budget.

Escaping the Deficit Trap

The two budgets raise but do not adequately address the link between deficits and economic growth. A buoyant economic recovery would go a long way toward solving the deficit problem. But is a strong and sustained recovery possible when all governments in Canada will continue to focus on deficit reduction?

Both ministers talked about the need to improve confidence and lower interest rates by reducing government deficits. Yet, despite an inability to get below and stay below the $30 billion deficit target, Finance Minister Mazankowski pointed out in his December economic statement that "Consumer confidence ... has now reached its highest level since the fourth quarter of 1989 ... [and] Canadian interest rates moved down from a peak of 14 percent in May 1990 to under 5 percent in September as inflation and inflation pressures were reduced."

As for the link between government debt and Canada's international net indebtedness, both may reflect a weak economy and a lack of competitiveness. That is, the Canadian economy, for various reasons including perhaps the wrong mix of government policies, has been unable to maintain its share of world markets. This, in turn, has resulted in lower growth and lower government tax revenues, and merchandise trade surpluses inadequate to offset Canada's increasing deficits in service transactions.

A federal-provincial finance ministers' conference and the followup meetings will have to address, in addition to jurisdictional fiscal responsibilities and the allocation of tax powers, the appropriate conduct for fiscal policy at a time of weak economic growth and high unemployment and the appropriate mix of spending, tax, and regulatory policies to turn around Canada's competitiveness. Although it appears that most Canadians favour deficit reductions, there is little discussion of how to go about achieving this objective in such a way that the more important goals of full employment, sustained increases in the standards of living, a cleaner environment, and price stability are not compromised.

Fred Lazar is an Associate Professor of Economics, Faculty of Administrative Studies and Faculty of Arts, York University.