

# Restoring integrity to the budget process



*By Scott Clark and Peter DeVries*

The Minister of Finance will soon be completing his pre-2013 Budget consultations. Over the coming weeks, the media and pundits will begin speculating about what the Minister of Finance will do in his 2013 budget.

Will the government be able to eliminate the deficit in 2015-16, without more spending cuts? How will the government respond to the uncertainty created by the short- and long-term fiscal crisis in the U.S.; the on-going uncertainty over the recession in the EU; and the continuing uncertainty over the future of the EURO area? What impacts will the recession in the U.K. and Japan have, and what about the slowing growth in the major emerging markets such as India and China?

How will the government respond to slowing economic growth and stubbornly high unemployment in Canada? Should the government introduce new initiatives to strengthen economic growth and job creation? Will the government begin a process aimed at simplifying and reforming the tax system? Should the government address the growing

fiscal divide between the federal and provincial governments? Should the federal government continue to abdicate leadership in key policy issues of health care, pension reform, Aboriginal issues, education and research, and modernizing Canada's infrastructure?

Mr. Flaherty does not appear to be that interested in any of these questions. He has said that he is quite comfortable with economic growth of around 2 percent or less for 2013, even though this would not reduce the unemployment rate, currently stuck at 7 percent. He has said that the 2013 budget will be a "bare bones" budget.

Mr. Flaherty has also implied that the only objective, on which he apparently wants to be judged, is the elimination of the deficit by 2015-16. Once this has been achieved, Mr. Flaherty can then move on to something else. Given that the next election is likely to be in the fall of 2015, the 2015 Budget will likely show a surplus for 2015-16, since the final outcome for the deficit will not be known until the fall of 2016.

It is now recognized by most observers of the federal budget process, that the integrity and credibility of the process has been seriously erod-

ed in recent years. Less information is now provided to the public in budgets than under previous Liberal and Conservative governments; the authority of Parliament over government spending has been weakened; the understanding of Canadians as to what the government is actually planning to do in the budget has been eroded. Canadians should be concerned not just with the erosion of Parliament's authority, but also ultimately with their own ability to hold the government to account for its actions.

We believe there are a number of actions that need to be taken to restore integrity and credibility to the budget process. They may seem simple and even mundane, but their importance to Parliamentary authority and to Canadians is huge.

What follows are our suggestions.

### **Fix the Timing of the Budget**

Why is the date of the budget so important? It is important because it is critical in determining whether Parliament can adequately exercise its authority over government spending. The issue here is the relationship between the Budget and the Main Estimates.

Under what are referred to as "supply" rules in Parliament, Main Estimates, which detail the Government's spending intentions for the upcoming fiscal year, must be referred to the appropriate Parliamentary Standing Committees for review before March 1st. For the Main Estimates to be relevant, they should be based on the economic and fiscal assumptions in the Budget for that year. This implies that the Budget should be tabled in late January or in early- to mid-February, in order to give the Treasury Board Secretariat time to make the Main Estimates of spending consistent with the economic assumptions and spending decisions underlying the Budget.

Budget 2012, for example, was tabled on March 29, 2012. This meant that Main Estimates of government spending, which were tabled on February 28, 2012, were based on economic assumptions presented in the previous Fall 2011 Update and not those in the 2012 budget. It also meant that the departmental expenditure cuts contained in the 2012 budget were not included in departmental/agency spending estimates submitted to Parliamentary Committees for review.

As a consequence, Parliament was asked in June to approve departmental/agency spending plans for 2012-13 without knowing what they were actually planning to spend. This was not the first time for this to happen. Five of the seven budgets of the government have been tabled after the Main Estimates, thereby making the budget estimates of spending inconsistent with the Main Estimates of government spending. Parliament, as a result, was unable to do its job.

This confusion could be avoided if the government simply committed to tabling its budget before the middle of February. We recognize that the fourth quarter GDP numbers might not be available at the time of the budget. However considerable economic and financial data would be available, and remaining uncertainty could be allowed for in the "risk adjustment" factor included in the budget.

### **Eliminate Confusion over Government Spending Plans**

Fixing the date of the budget is necessary, but far from sufficient to give Parliament the capacity to review government spending and hold the government to account. The fact is, no one in Parliament, or in the government, can tell Canadians what the government is planning to spend.

If the Minister of Finance, who is responsible for setting the overall expenditure framework, and the President of the Treasury Board, who is responsible for overseeing departmental/agency spending, were both asked what the Government intends to spend in the current fiscal year, two different answers would be given. Neither of these Ministers can tell you what the government is planning to spend.

There are a number of simple explanations for these differences.

Budget expenses, for example, are on an accrual basis of accounting while the Main Estimates are on a cash basis. The Auditor General of Canada has raised this accounting difference on numerous occasions. The Standing Committees of the Public Accounts and on Government Operations and Estimates have also recommended that the "Office of the Comptroller General complete its study of accrual-based budgeting and appropriations and report back by March 31, 2013 its recommendations on whether the Government of Canada should pursue accrual-based budgeting in departments and accrual-based appropriations in its financial reporting system."

Pending resolution of the accrual accounting issue, there is no reason why the Main Estimates cannot be made more compatible to the Budget by eliminating other differences.

There are a number of simple changes which if implemented would help Parliamentarians. The Budget forecast of expenses is presented on a gross basis. This means that all revenues received from parties outside the government are included as part of budgetary revenues. This is not, however, the case of the Main Estimates, where some revenues are netted against related spending. For example, the Royal Canadian Mounted Police (RCMP) provides policing services to a number of provinces. Charges for these services are netted against spending by the RCMP in the Main Estimates, but these same charges are classified as part of "other revenues" in the Budget.

The Main Estimates also excludes a number of items that are included as expenses in the Budget. According to the Public Sector Accounting Board, refundable tax credits should be included as part of spending. The tax system is used to determine eligibility and the amount of the benefit. However, the amount received does not affect the taxpayer's tax liability. In other words, the tax system is being used to deliver a spending program. For example, the Canada Child Tax Benefit is classified as part of Children's Benefits and included as spending in the Budget but not in the Main Estimates.

The above two accounting differences explain about \$30 billion of the difference between the Budget estimates of spending and those in the Main Estimates.

There is absolutely no reason why the Main Estimates of government spending cannot be put on the same basis as the Budget estimates of spending.

### **Provide More Details on the Economic Forecasts**

The Government has continued the practice, first adopted by the Liberals in 1996, of using the average of the private sector economic forecasts for budget and fall update planning purposes. This arose out of a recommendation made by Ernst & Young that the House of Commons Standing Committee on Finance engage an independent panel to assess the government's economic and fiscal forecasts. Instead, the government chose to survey private sector economists on a quarterly basis and to use the average of their forecasts.

There are a number of issues with this process. First, this was not the recommendation of the Ernst & Young study. They noted that the Department of Finance, with its staff of professional economists, had one of the best forecasting records. Their recommendation centered more around public perception and how to enhance the credibility of the Department's forecasts.

Second, only major economic aggregates are surveyed. The list includes: real gross domestic product (GDP); GDP inflation; nominal GDP; 3-month treasury bill rate; 10-year government bond rate; exchange rate (US cents/C\$); unemployment rate; consumer price index; and U.S. real GDP growth. The Department uses the average of these forecasts. Little information is provided on the range of these forecasts, and the reasons for their differences. No information on the components of GDP either on the expenditure side or the income side is provided. This makes any independent assessment of the forecast virtually impossible.

Third, the Department surveys about 15 private sector forecasters. However, very few of these forecasters provide forecasts beyond two years. This introduces an element of bias between the short- and medium-term forecasts. In addition, most private sector forecasters do not possess the models required to undertake comprehensive economic forecasts.

Fourth, in using the private sector average, the Minister of Finance is able to deflect blame for missed forecasts to the private sector. According to the Ernst & Young study, "the Minister and Department clearly must remain responsible for the achievement of the fiscal plan."

Fifth, the Department of Finance disaggregates the real and nominal GDP survey results into its components. How these are allocated can have major implications for the fiscal forecasts, given the different tax rates associated with the various income components. This information is not published, making it extremely difficult to assess the fiscal forecast. Attempts to secure the data through access to information requests have been denied on the basis that the data constitutes a "Cabinet Confidence".

Sixth, the Department will often adjust the average private sector forecasts to introduce "prudence" in order to enhance the possibility

of the fiscal targets being met. Originally, the Liberals adjusted the private sector average forecasts (lower real and nominal GDP and increased interest rates). This was criticized by financial analysts as they wanted to see what impact these adjustments had on the fiscal forecasts. Recently, Minister Flaherty has been including a "risk adjustment factor" in his fiscal forecasts. Although the aggregate amount is known, its distribution among the revenue components is not.

To improve transparency and accountability, it is time that the Department of Finance's economic forecasts were used for the Government's fiscal forecasts. These should be compared to the private sector average economic forecasts, with justifications provided for notable differences. Details on the economic forecasts should be provided in the budgets and updates. Any explicit "risk adjustment factor" should be shown separately and not allocated to the various revenue components.

### **Provide Greater Transparency and Accountability in Budget Planning; Save the Parliamentary Budget Office**

During the 2006 election, the Conservative Party promised greater transparency and accountability in budget planning. Unfortunately, this has not turned out to be the case.

As noted above, budget documents now contain less economic and fiscal data than in any budget over the previous twenty-five years. It is simply impossible to adequately assess the economic and fiscal forecast based on the data provided. Requests for information are denied on the basis that the data constitutes "Cabinet Confidence".

Only recently did the Department of Finance release a study on the long-term sustainability of federal government finances — a study that had been promised in 2007. And it did so only after the Auditor General of Canada brought this issue to light. The Department has not released any other analytical studies in the last six years. (This is a major departure from the practice followed previously by both Liberal and Conservative governments.)

However, the information released by the Department of Finance only related to the federal government, even though it promised in 2007 to present analyses on the total government sector. The Auditor General also recommended that the federal government provide long-term sustainability analyses for the total government sector. The International Monetary Fund in its November 2012 report to the Minister also recommended that the Department of Finance publish the sustainability analysis for the total government sector.

To date, the Minister of Finance has refused to do so, even though the analysis exists in the Department of Finance. For some reason the Minister seems more intent on not providing the public with information, rather than engaging Canadians in discussion on critical policy issues.

Given this lack of transparency, the Parliamentary Budget Office (PBO) has proven to be a credible resource to Parliament and Canadians. The term of the current Parliamentary Budget Officer expires

March 25, 2013. The next Officer will need to be someone who understands the budgetary and estimates processes and is willing to stand up to his/her major critics — the Government.

In the 2006 election campaign, the Conservative Party promised an independent office, reporting to Parliament with virtually full access to all relevant information. Once elected, the legislation creating the PBO fell far short of that commitment. The Government has consistently refused requests from the PBO for data it believes it needs to properly fulfill its mandate. It is time that the 2006 election commitment is honoured and that the PBO become an officer of Parliament.

We have never understood the Government's desire to fight with the PBO from its very beginning. In fact, in all of these disagreements with the PBO, the Government's attacks have become personal rather than professional disagreements. The fact is that the PBO has turned out to be right in every disagreement with the government.

These illogical fights with the PBO inevitably end up making the Government look like it has something to hide, has not done the analysis, and cannot be trusted. Both the credibility of the Minister of Finance and the credibility of the Government have suffered as a result.

### Stop Throwing Parliament under the Budget "Omnibus"

The two budget Bills associated with the 2012 budget were, to put it mildly, a disgrace and an insult to Parliament and to Canadians. The use of Budget Omnibus Bills has grown to the point that they seriously undermine the integrity and credibility of the budget process and the authority of Parliament. Little information is now provided in the Budget, so it has become impossible in reading the budget documents to fully understand what the government is actually proposing to do. There is a clear lack of transparency and accountability.

There is an urgent need to restore the role of Parliament and its committees in assessing, reviewing, and approving proposed legislation. Without sufficient information and the clear intention of the proposed initiatives, Parliament and its Committees cannot properly assess the budget. Parliamentary debate is stifled, public involvement ignored and the implementation of good public policy prevented.

The budget needs to be much more explicit on the proposed policy initiatives, providing sufficient details and background information on the proposed initiatives for Parliamentary assessment and for a better understanding by the public at large. Budget Omnibus Bills should be restricted to proposed tax changes only and all proposed spending initiatives should be presented either through the Main Estimates or through separate legislation, submitted to the applicable Parliamentary Committee for review.

### Provide Leadership for Canada Inc.

According to the Parliamentary Budget Office, the fiscal structure of the provincial-territorial government sector is not sustainable, while that of the federal government is (Fiscal Sustainability Report 2012).

What is emerging is a widening "fiscal divide" between a federal government with its diminished size and sound finances, and provincial governments with growing fiscal imbalances resulting from growing spending pressures (e.g., for health, education, infrastructure) and slowing economic growth and revenue growth. This growing federal-provincial "fiscal divide" is not sustainable. Unfortunately, at the present time Canada Inc. is without economic and financial leadership. Historically, this has been the role of the federal minister of finance.

### Conclusion

There are three budgets remaining before the next election. If the Government's forecasts are to be believed and the deficit is on track to be eliminated by 2015-16, then it will be faced, before the election, with the issue of what to do with emerging surpluses in the second half of the decade. These will be important policy and political decisions.

We believe, however, that the above "process" issues are equally important. Implementing these recommendations would help restore integrity and credibility to the budget process and, in doing so, to the government itself. This is something the government needs badly.

*C. Scott Clark held senior roles in the Department of Finance, including associate deputy minister (1994-1997) and deputy minister (1997-2000). Peter DeVries was director of fiscal policy at the Department of Finance (1990-2005).*

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