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Out of Control: Reining in Soaring Federal Spending is a Critical Task for the Next Parliament

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The release of multi-billion dollar party platforms in the federal election campaign is occurring against an ominous backdrop — Ottawa's program spending, which began burgeoning around 2000 and has exploded in the past couple of years. Canadians have not seen real per-person increases like these since the early 1970s — the heyday of interventionism that sowed the seeds of unsustainable deficits and high taxes in the following two decades. Worse, the patterns of growth — huge increases in transfers to other levels of government, miscellaneous handouts and mounting spending on government operations — recall some of the worst excesses of those years.

An urgent task for the members elected to Canada's next parliament will be remembering that governing means choosing, not spending on anything and everything. The annual budgets for the past five fiscal years only prefigured about half of the $56 billion in new program spending that actually occurred. If Canadians are to enjoy budget surpluses, reforms of federal-provincial relations, and pro-growth tax relief in the future, the next parliament must put in place a fiscal framework where projections of revenue and spending are meaningful.

Rich Increases

Since the mid-1990s, federal budgets have systematically under-projected revenue growth and over-projected interest costs. The resulting inflated surplus estimates are well known. Less well known, but increasingly alarming, is that most of those surpluses never occurred. The reason: Budgets also systematically under-projected spending, and subsequent spending overruns absorbed most of the extra money

Looking only at the past five years, the spending increases projected in each budget for the upcoming year totaled some $28 billion over the period. The actual increases in spending recorded in the public accounts for those years totaled more than $56 billion.[1] The most recent complete fiscal year, 2004/05, was the worst yet. The spring 2004 Budget projected a spending increase of $4.5 billion, or 3.1 percent. The actual increase was $22.2 billion, or 14.5 percent.[2]

The books will not close on the 2005/06 budgetary year, which runs until the end of March, until the fall. Developments to date, however, suggest more of the same. The February 2005 Budget projected a program-spending increase of only $3.2 billion, or 2.0 percent. But the November Economic and Fiscal Update (the "mini-budget") showed figures for 2005/06 that were $7.3 billion, or 4.6 percent, higher than what the Budget had shown for the prior year. And the most recent Fiscal Monitor showed program spending for April through October up 10 percent from the year-earlier period. If that pace persists — and the soaring price tag of campaign promises suggests no slackening — the actual increase will be upward of $17 billion.

Whatever the exact figure, another prodigious overrun is in store. The restraint of the mid-1990s is dead and buried. Real program spending per Canadian is mounting into record territory (see Figure 1).

Poor Priorities

The election promises underline the fact that any expenditure will have at least some supporters. But ramping spending up on the fly appears to be leading not only to 1970s-style ballooning of aggregate amounts, but also to increases in specific areas that recall the traps of the 1970s.

Table 1 provides an overview of recent spending by broad category. (Figure 2 uses these figures to highlight the spending growth rates for two recent five-year periods.) The biggest, major transfers to persons, contains "statutory" programs driven by formula, such as seniors' benefits, the child benefit, and employment insurance (EI).[3] The recovery of the economy, as well as reforms that reduced the subsidy EI provides to industries that produce more lay-offs, reduced spending in this category slightly between 1995 and 2000. Although some of those reforms are now undone, a strong job market has forestalled any marked effect on spending, and the 5.0 percent average annual increase in this area since 2000 is smaller than growth in any other category.

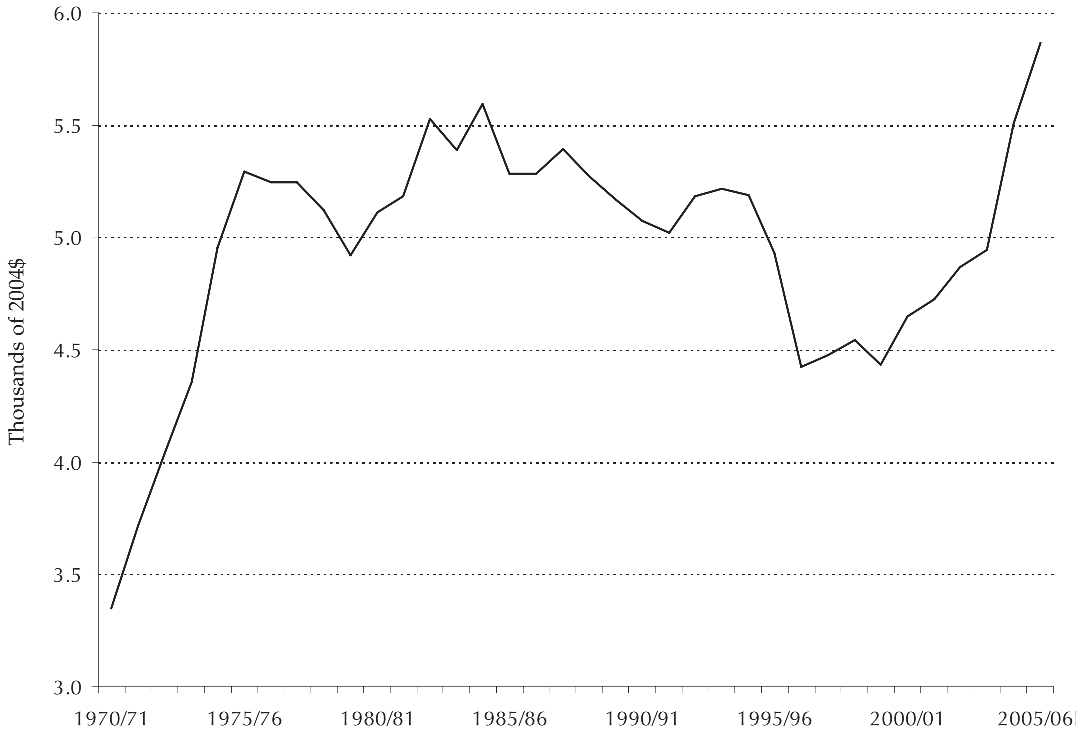
Transfers to other governments are a different story. Restraint notoriously shrank transfers to provinces after 1995. Since 2000, they have ballooned — up 12.5 percent annually on average, or $19 billion in total. Ottawa is moving

1 These totals downplay the true record of under-projection in spring budgets. The government only presented the 2001 Budget in December, and presented no formal budget in 2002 at all, merely a fall Economic and Fiscal Update. So both documents effectively acknowledged money already spent. The three budgets presented before their fiscal years started, in 2000, 2003 and 2004, prefigured a total of $9 billion in new spending. The actual increases for those years totaled $39 billion.

2 I compare annual projected and recorded increases rather than levels to reduce the impact of accounting changes, and because the budget and public-accounts presentations net different revenue items against spending, a distortion that affects annual changes less than levels.

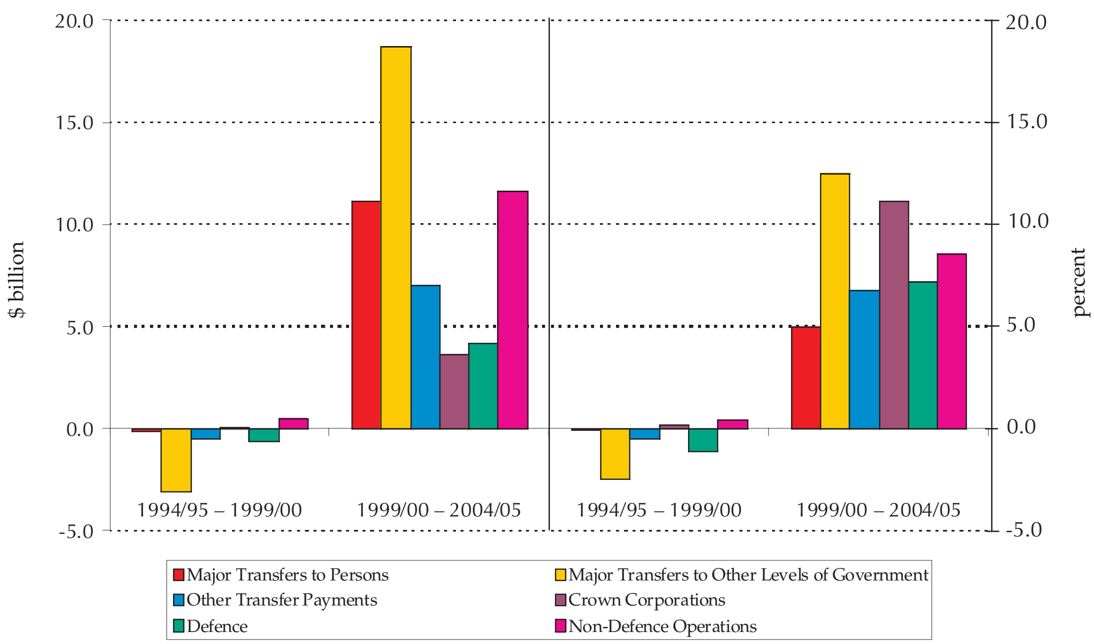
3 For the sake of presenting figures that are compatible with the Public Accounts, Table 1 follows the practice of netting the Goods and Services Tax Credit and the amount of Old Age Security payments clawed back through the personal income tax out of the transfer figures. Including these amounts would increase the totals by $3.3 billion and $0.7 billion in 2004/05, but would not appreciably affect the trends.

Figure 1 *Real Federal Program Spending per Person, 1970/71 to 2005/06*



Source: Receiver General of Canada, Public Accounts for Canada, various issues; author's calculations.

Figure 2 *Program Spending Growth by Category, 1994/95—1999/00 and 1999/00—2004/05*



Source: Receiver General of Canada, Public Accounts for Canada, various issues; author's calculations.

Table 1 *Federal Spending by Major Category, 1994/95 to 2004/05*

	Annual Amounts											Changes			
												Levels		Annual Rates	
	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	1994/95 to 1999/00	1999/00 to 2004/05	1994/95 to 1999/00	1999/00 to 2004/05
						$ billions						*$ billions*		*percent*	
Major Transfers to Persons	40.3	39.1	38.8	39.0	39.9	40.2	41.9	45.8	48.0	50.0	51.3	-0.1	11.2	-0.1	5.0
Major Transfers to Other Levels of Government	26.3	26.1	22.2	20.5	25.5	23.2	24.7	26.6	30.6	29.4	42.0	-3.1	18.7	-2.5	12.5
Other Transfer Payments	18.5	16.6	16.0	21.1	17.4	18.0	21.1	18.3	20.0	23.0	25.0	-0.5	7.0	-0.5	6.8
Crown Corporations	5.2	9.6	5.2	4.4	5.8	5.2	5.4	6.1	6.6	6.6	8.9	0.1	3.7	0.2	11.2
Defence	10.6	9.8	8.8	9.1	9.3	10.1	9.7	10.4	11.8	12.9	14.3	-0.5	4.2	-0.9	7.2
Non-Defence Operations	22.3	19.7	20.3	21.6	21.6	22.8	27.2	29.7	29.0	31.9	34.4	0.5	11.6	0.4	8.6
Total Program Spending	*123.2*	*120.9*	*111.3*	*115.6*	*119.5*	*119.5*	*130.1*	*137.0*	*146.0*	*153.7*	*175.9*	*-3.7*	*56.4*	*-0.6*	*8.0*

Source: Receiver General of Canada, Public Accounts for Canada, various issues; author’s calculations.

aggressively into areas of provincial — and lately, municipal — competence. Federal money does nothing for provincial healthcare and urban infrastructure that provincial and local money, raised from taxpayers closer to the action, could not do better. Similar increases in the 1970s prefigured political tensions and upheaval in Canada's intergovernmental finances. MPs should demand reform, not further hikes, in this area.

The numbers in the third category, other transfers, tell no more cheerful a tale. In the late 1990s, Ottawa curtailed handouts that distorted Canada's economy and enticed many Canadians into the addictive and wasteful quest for largess. Now, subsidies are again a growth industry — up almost 7 percent on average each year since 2000. Agriculture, industry, public works — old players are back in the game, and new ones have emerged. The 1970s showed the folly of large-scale tax support for activities that Canadians, acting on their own, would reject. A new century does not overturn that conclusion.

Crown corporations comprise another category where Canadians should question rapidly rising spending. As the Gomery Report and recent controversy over Freedom of Information disclosures underline, the operations of crowns are not sufficiently transparent. Higher estimates for decommissioning Atomic Energy of Canada Limited's nuclear facilities inflate the 11-percent-plus average growth rate over the last five years for this category. The year-to-date figures, however, show continued growth in the base. State involvement in Canada's economy through crowns was no recipe for prosperity in the past, and will not be in the future.

Defence spending also shrank in the late 1990s and has shown rapid growth — 7.2 percent annually on average — since 2000. While many Canadians support a larger contribution to world security and better protection of Canadian territory, these outlays still need scrutiny. Are recent additions to the hardware and personnel of the Canadian forces consistent with the country's long-term strategic interests? If not, some of this spending may preempt needed investments elsewhere.

No category needs fiercer scrutiny than the last: non-defence operations. Ottawa's spending on civil servants, supplies, buildings and so on dropped relatively little in the late '90s climate of austerity. Yet it has burgeoned since, growing 8.6 percent annually, for an $11.6 billion increase, over the past five years. The average government department spent 50 percent more on operations in 2004/05 than in 1999/2000. The need for government to operate efficiently in performing legitimate functions did not disappear with the deficit. A budgeting framework that subjected spending to proper oversight would not support this kind of explosion in internal costs.

The Need to Choose

This backdrop of unreliable projections and surging spending has lowered the level of the election debate. Straightforward questions about the consistency of party platforms with balanced budgets are impossible to answer when the baseline is so uncertain.

It also affects the fiscal choices the parliament Canadians elect on January 23rd will face. The budget overruns of the past five years have already robbed Canadians of key opportunities. Debt that we could have paid down is still outstanding. Federal-provincial transfers that we could have streamlined continue to promote friction and unaccountable policy paralysis. Taxes that we could have reformed still discourage work, saving and investment. If the 1970s-style increases in handouts, subsidies and operating costs continue, simply repairing the damage will be a huge task for the next government.

Even if creating a budgeting framework that gives Canadians reliable figures to work with is not a high-profile issue in the election campaign, it is an urgent priority for the next parliament. Budgets are not trivial items to be voted and forgotten. They are cornerstones of accountability for public money. Avoiding deficits, designing a more effective system of intergovernmental transfers, reforming taxes to support growth — to achieve these goals, Canadians need a federal government that can control its spending.

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