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For immediate distribution
Wednesday, February 15, 2006

NEWS RELEASE

Fiscal Imbalances and Budget Accountability: Two Issues That Await the New Finance Minister

Managing the surplus has proven more challenging than taming the deficit, says Thomas J. Courchene

Montreal – As Jim Flaherty assumes responsibility for the influential finance portfolio, the Institute for Research on Public Policy (IRPP.org), is today releasing a study that urges the new government to bring more accountability to the budget process and address fiscal tensions between Ottawa and the provinces.

Author Thomas J. Courchene (IRPP Senior Scholar and Queen's University professor) observes that, partly due to the policies of Paul Martin during his tenure as Finance Minister, Canada has become the envy of the G7 nations with regard to public finance, boasting the longest string of federal budget surpluses and the lowest debt-to-GDP ratio. But for Paul Martin, the politics and economics of managing surpluses as Prime Minister have arguably turned out to be more challenging than taming the deficit as finance minister, writes Courchene.

A side effect of deficit-proofing the budget process via contingency reserves and conservative economic assumptions is the “problem” of large surpluses that disappear via end-of-fiscal-year ad hoc measures to increase spending, cut taxes or pay down the debt. These choices “ought to come about as a result of policy decisions debated and acted upon by Parliament, not determined by the accuracy (or, rather, the inaccuracy) of budget estimates,” affirms Courchene.

Before its fall, the Martin government attempted to address this issue by proposing the now-defunct *Unanticipated Surpluses Act*, which stipulated that any surpluses in excess of the \$3 billion contingency reserve would be allocated equally among spending priorities approved by Parliament, a one-time personal income tax credit, and debt reduction.

But Courchene is concerned that such an approach would remove any incentive to improve the quality of budget forecasts. “This is akin to a ‘pay-as-you-go’ system of budgeting...which is not really a ‘budgeting process’ in the true sense of the term,” he writes. The tendency to precommit surpluses before they actually materialize leads him to wonder “whether Paul Martin as prime minister may have put in jeopardy the fiscal legacy of Paul Martin as finance minister.”

The other problem the new finance minister will inherit from the Martin era is the issue of fiscal imbalances. Courchene notes that the 1990s fiscal turnaround in Ottawa was accomplished in part by downloading its deficit to the provinces. Since 1997, however, Ottawa's spending priorities have largely or wholly been in areas of provincial jurisdiction, such that "the federal government is in effect donning the mantle of an overarching 11th province." Furthermore, high energy prices have magnified interprovincial fiscal imbalances to the point where poorer provinces will find it difficult to provide reasonably comparable levels of public services at reasonably comparable levels of taxation as enshrined in the Constitution.

"Accountability and Federalism in the Era of Federal Surpluses: The Paul Martin Legacy, Part II" is the latest *Working Paper* to be released as part of the IRPP's Economic Growth and Social Progress research program, and is based on a more detailed conference paper, entitled "Balanced Budgets: A Canadian Fiscal Value," that examines Paul Martin's fiscal legacy as finance minister and prime minister. Both publications are available online in Adobe (.pdf) format on the Institute's Web site (www.irpp.org).

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