
ALTERNATIVE BUDGETS
BUDGETING AS IF PEOPLE MATTERED

John Loxley

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CONTENTS

<i>Acknowledgements</i>	7
<i>Introduction</i>	9
1. Budgets: The Technical Side Made Easy	16
Expenditures, Revenues, Deficits, Surpluses and Debt:	
An Introduction	16
Expenditures Taken Further	19
Revenues Taken Further	21
Other Types of Revenue	24
More on Deficits and Debt	25
Notes	28
2. The Public Policy Side of Budgets	30
The Role of the State Budget	30
The Dynamics of Government Spending	32
Principles of Taxation	36
Budgets, Constitutional and Intergovernmental Relations	46
Notes	48
3. Why Alternative Budgets?	50
The Neo-Conservative Attack on the Public Sector	51
Opposing Neo-Conservatism	54
Notes	56
4. Making Alternative Budgets:	
Some General Considerations	57
Objectives and Principles	57
Balancing Politics and Technical Concerns	60
Putting the Numbers Together	62
Access to Information	65
Getting the Word Out	66
Working with the Media	68
Popular Education	70
Follow-up	71
Notes	73

5. The Alternative Federal Budget in Canada	74
Context	74
The Structure of the Federal Budget and the Fiscal Situation Since 1994–95	76
The Objectives, Principles and Organizational Structure of the AFB	79
There Is, in Fact, an Alternative:	
The Macroeconomic Framework of the AFB	81
The Expenditure Side of the AFB	84
Financing the AFB: Tax Fairness	88
Fiscal Forecasting	90
The AFB and Poverty	91
The AFB and Gender Concerns	92
Gender-Sensitive Budgets Elsewhere:	
Alternative Approaches to the AFB	93
The AFB and the Environment	95
The AFB as Participatory Budgeting	96
Critiques and Weaknesses of the AFB	97
Accomplishments of the AFB Exercise	103
Notes	105
6. Alternative Provincial Budgets	107
Context	107
The Manitoba Case	109
The Budgets of Choice, 1991–2000	114
Alternative Budget Exercises in Other Provinces:	
A Synopsis	121
Notes	126
Appendix to Chapter Six: Balanced Budget Legislation or Bad Budget Legislation?	128

7. Alternative Civic Budgets	133
Context	133
The Winnipeg Case	134
The Alternative Budget for the Ottawa Region, 1997	152
Participatory Democracy in Porto Alegre Brazil	153
Notes	156
8. Accomplishments and Potentials	157
The Impact of the AFB on Government Policy	159
Assessing the Manitoba Budgets of Choice	162
Notes	168
<i>Bibliography</i>	<i>169</i>
<i>About the Author</i>	<i>176</i>

Dedication

In memory of
Reuben H. Mogan
1929–2001

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INTRODUCTION

In his February 1995 budget speech, federal Finance Minister Paul Martin spoke of the “fundamental challenges” facing Canada and the need for government to make “fundamental choices” (Minister of Finance 1995: 3). He promised his budget would chart a new course for the country, and it did. His cuts to program spending totalled \$25.3 billion over three years, slashed \$7 billion off social transfers to provinces and cut 40,000 federal jobs, that is 14 percent of the federal labour force (Department of Finance 1995a). Martin accurately described these cuts as “unprecedented in modern Canadian history” (Minister of Finance 1995: 25). He has since boasted that “between 1992 and 1999, Canada implemented the largest reduction in program spending relative to GDP [gross domestic product] of any G-7 country: program spending as a percentage of GDP dropped about 8.5 percentage points, compared to an average of about 1.5 points for the G-7 countries” (Department of Finance 2000, Annex 4, p.2). A government elected on a mandate to protect and enhance the public sector had savaged public spending with a zeal surpassing that of the Conservative government it had replaced.

Martin outlined a new, reduced role for government, bringing its “size and structure in line with what we can afford” (Minister of Finance 1995: 9). In a budget speech laced with hyperbole and rhetoric, he justified this sea change as the only way of dealing with a debt and deficit that had spiralled out of control: “Our resolve, our values, our very way of life as Canadians are being tested. The choice is clear. We can take the path—too well trodden—of minimal change, of least resistance, or leadership lost. Or we can set out on a new road of fundamental reform, of renewal—of hope restored” (Minister of Finance 1995: 1).

Martin cynically talked about fairness and hope while slashing spending on health care, education and social assistance. His message was clear. There was no alternative to the introduced cuts; today’s painful medicine now was vital to avoid immediate bankruptcy and to secure our country’s future prosperity.

But Martin was wrong. There were alternatives. Only a few days

before this abrupt change of policy direction, a group of social activists had presented Canadians with a different vision. The Alternative Federal Budget (AFB), the work of the Winnipeg-based social justice coalition Choices and the Ottawa-based Canadian Centre for Policy Alternatives presented a financial plan that would create employment, strengthen social programs and reduce the deficit. Unlike the federal budget, which had been prepared in secrecy by bureaucrats actively hostile to the policy platform on which the Liberal government had been elected, the AFB had been developed openly through consultations and discussions across the country. In this way, Canadians affected by budget decisions could influence the budget-making process. The values and priorities of the economic advisers to the AFB differed from those of their federal counterparts. The latter were seen to be implementing the agenda of the business and finance community: reduce the size of the public sector, reduce taxation and allow the wealthy to get richer, whatever the impact on the poor. AFB advisers emphasized the importance of public services to the well-being of Canadians and the need to strengthen those services. They stressed the overwhelming importance of putting Canadians back to work, as both a benefit in and of itself and because the growth generated by increased employment would finance public services and reduce the deficit. They also advocated increased taxes on the wealthy and reduced taxation of the poor.

The AFB was a remarkable innovation in Canadian political debate. It laid bare the differences in viewpoint between those who held power and those whose lives were affected by the decisions of the powerful. It gave a voice to the hitherto powerless in a detailed programmatic way, with the fiscal implications being carefully measured.

The preparation of such a fiscal framework is a demanding task. It is much easier to respond negatively to policy proposals and budgets put forward by others than it is to develop policy and budget alternatives. The preparation of budgets requires clarity of position on broad fiscal parameters, such as levels of spending, growth of taxation and the size of deficits. It also calls for clarity on the composition of spending. This can be arrived at only after detailed consideration of policy in different areas of government and the assignment of relative priorities between areas. A similar exercise is called for on the details of the composition of taxation. These are politically demanding tasks that take time to complete and that ultimately necessitate hard political choices and, sometimes, a careful phasing in of policy initiatives over several budget periods. In this way detailed policies are subjected to the discipline of fiscal parameters, and

this, of course, puts clear limits on the size and range of the political promises that can be made and honoured. It is precisely for this reason that opposition parties are often loathe to get involved in alternative budgeting. They prefer to leave open the extent to which they can actually meet campaign promises until well after they have been elected to office.

Comprehensive alternative budgeting is premised on the belief that the electorate is increasingly sceptical about the fiscal sustainability of left-wing policy prescriptions. Therefore, demonstrating the fiscal feasibility of socially progressive policies is first and foremost, a tool of political mobilization designed to overcome political scepticism. An essential component of that mobilization, however, is the participatory nature of budget preparation itself. Government budgets essentially are elitist documents prepared by technicians under varying degrees of political direction. Alternative budgets are premised on a belief that the broadest possible participation and the most open discussion by ordinary citizens are desirable and, indeed, necessary to the preparation of a product designed to secure their political support. Technical parameters of budgets must be consistent and budget constraints must be respected, but these are of quite secondary importance to both the tax and expenditure contents of budgets and the assignment of relative priorities between budget items, which require no technical ability.

Opening up the budget preparation process to popular input is, therefore, an essential feature of alternative budgeting. The philosophy underlying participatory budgeting is that anyone with sufficient time and interest can be part of the process and can make a positive contribution to drawing up the budget. Securing broad-based participation in the exercise is at least as important as the end product, and hence considerable attention must be paid to budget process. Contributing to the development of a budget increases awareness of policy options, of how policy converts to programs and of how programs translate into financial demands on the budget. This type of awareness also empowers ordinary people to participate with confidence in a political process that requires them to do more than exercise their vote every few years. It helps people to understand possible approaches to a given area of social need, the competing program demands for limited resources, the various ways of increasing tax resources and the likely political, economic, social and environmental ramifications of such increases. It helps to develop an appreciation of the need for priorities and for phasing in innovative or expanded programs. It helps ordinary people to evaluate budget pro-

nouncements by government and to see through the arguments about the inevitability of particular fiscal stances.

Slashing budget expenditures, cutting taxes and reducing the size of the public sector, both services and jobs, constitute a key platform in the right-wing political agenda. The budget has become a prime area of political struggle and the left has come to understand that fighting back requires more than a purely defensive posture. It demands no less than a rebuttal of right-wing fiscal arguments and the generation, with broad popular input, of progressive economic and social policies within a coherent and responsible fiscal framework. Therefore, alternative budgets are as much tools of political empowerment as they are blueprints for a more progressive political outlook, and these two elements should not be separated.

Until quite recently, the budgets of governments at all levels, from the federal government down to school boards, generally were considered too technical for the average person to understand in any detail and certainly too complex for the ordinary citizen to help design. Budget Day, as an event, was and still is often reduced to simple headlines about whether or not taxes have gone up. The media portray tax increases as little more than disastrous while tax reductions are welcomed, and many of the deep cutbacks experienced in the early 2000s have been driven by hasty and ill-considered cuts in taxation. Whatever their origins, almost all cutbacks are justified in the media as necessary to responsible budgeting. The ordinary taxpayer is not usually encouraged to go beyond this simplistic frame of reference, to get to the meat of budgets to see, for example, why taxes need to go up or down or to understand how the government is raising and spending money. Nor are ordinary people expected to enter what governments like to portray as a very technical area. The result is that most budgets are presented as if no alternative is possible.

Budgets do indeed have technical dimensions and sometimes these can be difficult to understand, even for people who have worked in the area for years.¹ The basic technical concepts and relationships are not beyond the reach of the person in the street, however, and, as the recent proliferation of alternative budgets suggests, Canadians who are not experts can critically examine budgets and pose well-constructed and plausible alternatives. In the process, they have demonstrated that technical issues pose no real barrier to popular participation in budgeting.

Chapter 1 outlines the most important, basic, technical aspects of budgets, common to all levels of government. It will explain the

relationship between government spending, government revenue and debts and deficits, and illustrate how to determine the appropriate amount for each, relative to the community's ability to manage them. It will show the importance of the cost of borrowing money—the rate of interest on debt—in the growth of government debt and in the ability of governments to fund important social programs. It will also show how the various levels of government are linked together through budgets. The oddities of budgets of different levels of government are not difficult to comprehend and can be understood relatively quickly. None of this is so complicated that only experts can understand it. Why, then, do governments and bureaucrats insist that budgets are beyond the grasp of ordinary Canadians?

The answer to this question lies in the essentially political nature of budgets and budgeting. Budgets are political statements put to numbers or to dollars and cents. They reflect the policy priorities of the level of government in question, and their contents can affect various groups of citizens quite differently. Sometimes this is fairly obvious. For instance, in the 1990s the Filmon government in Manitoba cut back funding for public schools and allocated it to private schools for the relatively wealthy. Equally obvious is the example of a government choosing to raise tax revenue in a way that hits the poor or average taxpayer harder than the rich, for instance by raising the sales tax rather than a high-income surtax or a capital gains tax. At other times, the impact of budget measures is less obvious, but no less real. Government spending and taxation have class, gender, regional and intergenerational impacts (as well as environmental and natural resource implications) that can be fully appreciated only by a careful analysis of the detailed content of budgets. Sorting out these impacts may call for a degree of technical expertise, but which impacts to examine is also a political question, well within the capabilities of ordinary Canadians. These and related public policy issues involved in budgeting are dealt with more extensively in Chapter 2.

The full impact of recent budget cutbacks on different income/wealth groups, in terms of job losses, cuts in wages and salaries, reduced access to public services, increased insecurity in the future and such like, usually has not been assessed up front and put on the table as part of the political debate. Neither has the real cost of cutting taxes, in terms of the implications for levels of service and for growth in “hidden” taxes such as user fees. Failure to make public the basic impact analysis of budgets and the justification of cutbacks in a broader context of alternative ways of dealing with perceived fiscal problems are logical outcomes of an

approach to budgeting whose underlying assumption is the purely ideological notion that there is no alternative and that budgets are properly the preserve of the expert or the elite.

Increasingly, however, popular movements are rejecting the take-it-or-leave-it approach to budgeting and are stepping into the fiscal arena to challenge governments politically. They are developing alternative budgets, and they are putting pressure on governments through essentially non-parliamentary means. The rationale for choosing this venue for political struggle and the goals such a strategy hopes to achieve are addressed in Chapter 3. Major considerations in choosing an approach to alternative, more participatory, forms of budgeting—including how best to mobilize people to prepare budgets and how to disseminate the final product—are dealt with in Chapter 4. Inevitably, choosing to organize politically around budget issues has meant confronting governments on the technical assumptions of their budgets since it is these that have been used to justify the lack of alternative political approaches to budgeting. The balance between the technical and the political aspects of preparing alternative budgets is a difficult one to deal with in the abstract. The appropriate mix will be determined by specific political and economic circumstances, but some general considerations are raised in this chapter too.

Chapter 5 analyzes what has perhaps been the most sophisticated broad-based participatory budget exercise in Canada in recent years: the Alternative Federal Budget (AFB). Coordinated by Choices and the Canadian Centre for Policy Alternatives, the AFB has evolved into a detailed, credible alternative to federal public policy and has gained widespread popular support. This chapter will explain the origins of the AFB exercise, its organization, its principal recommendations and its dissemination.

Comprehensive, participatory alternative budgeting began in Canada in the early 1990s at the provincial level in Manitoba and has spread to most other provinces. Chapter 6 examines the background to recent fiscal developments at the provincial level. It discusses and evaluates the Manitoba alternative provincial budget exercise in some detail and then looks at the very impressive and more recent ones in New Brunswick, Saskatchewan, Ontario and Prince Edward Island. In passing, it assesses the rationale for and wisdom of balanced budget legislation which a number of provinces have introduced principally, it is argued, as a means of imposing a fiscal straightjacket on current and future governments at that level.

Fiscal options available to lower levels of government, such as municipalities and school boards, are often more limited than those available to the federal and provincial governments because of the limited mandates of these levels of government and the restrictions imposed on their legal ability to raise revenue. At the same time, their budgets are often much more amenable to influence from ordinary members of the public because they are so much more accessible and their decision-making processes a little more transparent. The impact of their budgets also often has an immediacy not shared by other levels of government, as for instance when the snow is not cleared or when libraries or classrooms are closed down. This immediacy comes partly from the types of service delivered and partly from the relatively small geographic area usually encompassed at this level of government. Chapter 7 examines some experiences at the civic level in Canada and also looks at an exciting experiment in participatory budgeting at the civic level in Brazil that could have some important lessons for Canada.

Chapter 8 considers what alternative budgets have accomplished and might hope to accomplish in future, recognizing that they are but one possible arena for political action against neo-conservative public policies and that they might have several different, and not necessarily mutually compatible, objectives. It concludes that the efforts to date have been worthwhile, principally because they have demonstrated the budgetary credibility of progressive economic and social policies, establishing that there are indeed alternatives and, equally importantly, that ordinary people can play a role in developing these. They have provided a much-needed focus around which to build coalition politics on the left. There is, however, much room for improvements both in the technical content of participatory budgets and in the political process through which they are constructed and disseminated. More thought needs to be put into how such exercises might best be fitted into broader political movements, involving their integration with non-budget reform programs and with parliamentary political processes.

Note

1. For example, the government of Manitoba transferred surpluses from its Lotteries Fund into the budget and from there to a Fiscal Stabilization Fund. In 1996, however, the remaining surplus in the Lotteries Fund was transferred to an Accumulated Deficit Fund and, in effect, disappeared with no impact on the budget or the Fiscal Stabilization Fund. There seemed to be no logic in this and, in a telephone conversation, the Provincial Auditor's Department did not agree that the transfers reflected the true picture of the government's fiscal state.

1. BUDGETS

THE TECHNICAL SIDE MADE EASY

Expenditures, Revenues, Deficits, Surpluses and Debt: An Introduction

At the simplest level, budgets are statements about how much money a government or agency plans to spend, what it plans to spend that money on and how it plans to raise it. On the one side of the budget, therefore, are expenditures, and on the other side revenues. If the two sides of the budget are exactly equal, so that the amount of money being spent is the same as that being raised, then the budget is said to be *balanced*. If, however, money being spent exceeds that being raised, then the budget is said to be in *deficit*; if revenues exceed expenditures, then the budget is said to be in *surplus*. All budgets, regardless of how complicated they may look, can be reduced to three lines—spending, revenue and the bottom line. The bottom line will be zero if the budget is balanced, negative if it is running a deficit and positive if it is running a surplus.¹

If a deficit is being budgeted, the government or agency in question must cover it, or finance it somehow, from sources other than normal revenue. There are a number of ways of financing a deficit. The government could use up reserves of cash it might have lying in a bank deposit or have invested in interest-bearing assets, such as the bonds (debts) of other governments or agencies. Alternatively, it could sell off other assets, such as Crown corporations (publicly owned companies), land or buildings, and use the proceeds to finance the imbalance in the budget. Normally, however, where permitted, the government will finance the deficit by borrowing money from banks, pension funds, companies, individuals or even other governments. Thus, running a deficit usually means increasing borrowing or incurring debt. There is, therefore, a direct link between budget deficits and the amount of money a government owes. Debt owed by the government can be looked at as the sum of deficits accumulated over time. The amount of debt outstanding will rise every year a deficit is incurred.

Table 1.1. The Relationship Between Budgets and Debt

\$ billion	Case 1	Case 2	Case 3
Revenues	152	135	162
- Expenditures	152	152	152
= Deficit (-)/Surplus (+)	0	-17	+10
Debt Before Budget	593	593	593
Debt After Budget	593	610	583

By the same token, if a government is spending less than its normal revenue in any budget period (normally the financial year, but it could be longer or shorter than this) then it will run a budget surplus. This surplus will enable the government to put money in the bank, lend it out to other governments or agencies, buy real assets (land, buildings or Crown corporations) or, more normally these days, repay debts it owes from running deficits in previous budget years. The only way the government can reduce its debts without selling off the family silver (e.g., public assets such as Crown corporations, land, buildings or cash in the bank) is to run budget surpluses.

There is, therefore, usually a close relationship between running a deficit and increasing outstanding debt and running a surplus and reducing outstanding debt. This is shown in Table 1.1, which is based on the 1997 federal budget, the last year in which a budget deficit was experienced.

The government plans to spend \$152 billion in each of the three cases but revenue estimates range from \$135 billion to \$162 billion. In Case 1, revenues and expenditures are budgeted to be equal. This is a balanced budget; the government has no need to borrow, but neither will it generate any new money to reduce outstanding debt. The debt outstanding after the budget is implemented will be exactly the same as it was before the budget, i.e. \$593 billion. In Case 2, which was the actual budget in 1997, a budget deficit of \$17 billion raises debt from \$593 billion to \$610 billion. If, for some reason, revenue were to rise to \$162 billion (Case 3), a budget surplus of \$10 billion would result. This could be applied to debt reduction, lessening outstanding debt to \$583 billion at the end of the year.

When a government borrows it must pay interest on the debt or, put in other terms, incur *debt-servicing charges*. Thus, a portion of government expenditures goes to debt-servicing costs. It is useful to separate this amount from the total amount available for spending, the balance then being what is called *program spending*. The size of debt-servicing costs

depends upon the amount of outstanding debt and the cost of borrowing money (the interest rate). For any given amount of debt outstanding, an increase in interest rates payable on debt raises the cost of servicing debt. The government then faces a number of choices. It can meet the increased cost of borrowing by raising revenues, usually through increased taxes. It can reduce its other expenditures (i.e., program spending). Or, it can allow its bottom line to adjust to increased debt cost (i.e., allow deficits to rise or surpluses to fall). If revenues are limited, pressures will be felt either on program spending or on the bottom line of the budget, either by increasing deficits or by reducing surpluses, both of which increase outstanding debt. If, alternatively, program spending cannot easily be reduced, taxes must be increased or the deficit allowed to increase (and the surplus to reduce). If, for some reason, a government must stick to a planned deficit (or surplus), then increased borrowing costs must be met either by reducing program spending, by raising taxes or by a combination of the two.

In 1997, as illustrated in Case 2, the federal government was planning to spend \$152 billion in total. Of this, \$46 billion, or 30 percent, was budgeted for public debt-servicing charges. Since the debt outstanding at the beginning of the year was \$593 billion, this suggests that the average cost of borrowing for the federal government was expected to be 7.75 percent ($46/593 \times 100$) in 1997. Most federal debt is short-term, outstanding for only 90 days, which means that changes in interest rates have a fairly immediate impact on debt-servicing charges. If, for instance, rates were to rise or fall by 1 percent, the annual cost of servicing the debt would rise or fall by \$5.93 billion within three months, with important implications for one or more of taxes, program spending or the deficit. Where borrowing is more long-term, as is often the case with provinces and municipalities, the impact of changes in the interest cost of borrowing will be felt more slowly, as only a portion of the debt comes up for renewal each year. The immediate impact will be felt only on monies needed to finance the current year's deficit and on the cost of any debt maturing (falling due) in the current budget year which will be refinanced or renewed. To estimate the extra cost of borrowing when long-term debt is involved, one needs to know the maturity profile of debt: how much was borrowed when, at what interest rate and when it falls due.

While the average cost of borrowing by the federal government was about 7.75 percent in 1997, the cost of borrowing new money had fallen to about 3.8 percent for short-term borrowing and to about 5.9 percent for twenty-five-year borrowing.

One other complication on debt-servicing charges is that sometimes the debt is denominated in foreign currencies, which means it must be repaid in that currency. This is often the case for the provinces but less so for the federal government. In these cases, the amount of debt outstanding, and the Canadian dollar costs of servicing the debt, will depend to some degree on the exchange rate between the Canadian dollar and the currency in question. Thus, if a province were to borrow U.S.\$100 million at 8 percent a year at an exchange rate of U.S.\$0.75 to the Canadian dollar, or Cdn\$1.33 to the U.S. dollar, then the Canadian dollar costs of the debt would be \$133 million and annual debt servicing costs would be \$10.67 million ($8/100 \times 133$). If the U.S. dollar were to appreciate or grow stronger relative to the Canadian dollar—by, say, 10 percent—then the Canadian dollar value of the outstanding debt would rise immediately by 10 percent to \$146 million ($\$133\text{m} \times 1.1$) and the cost of servicing the debt would rise from \$10.67 million a year to \$11.7 million ($8/100 \times 146$ a year), with absolutely no change in the interest rate. If the exchange rate changes were to be reversed, with the Canadian dollar growing stronger relative to the U.S. dollar, then debt and debt-servicing costs in Canadian dollars would decline. Foreign currency debt can, therefore, introduce some unpredictable fluctuations both in the dollar value of outstanding debt and in the cost of debt servicing. This was particularly evident in 2001 and 2002 when the Canadian dollar fell in value from U.S.\$0.68 to about U.S.\$0.62, increasing the Canadian dollar value of U.S.-denominated debt by almost 10 percent.

Expenditures Taken Further

As mentioned above, expenditures in budgets are usually broken down into program spending and debt-servicing charges. Program spending can then be broken down into more detail in a number of different ways, depending on what one wants to see in the budget. Frequently, program spending is broken down according to the amount allotted to each government department or ministry—health, education, family services and so on. This type of categorization is useful for showing trends in broadly defined administrative or policy areas; for further information, one needs access to the detailed budget of each department or ministry. Provincial budgets and much of the federal budget is set up in this way.

Other ways of presenting expenditures—by type of expenditure or by economic function—serves other purposes, e.g., to illustrate the extent to which government spending finances wages and salaries,

supplies, travel or consultancy fees. This type of detail is almost always published after the event in governments' financial statements, but it is often not readily available in budgets themselves, civic budgets often being the exception. Should one want a breakdown of transfer payments by governments to individuals, that information is readily accessible at the federal level for such items as unemployment insurance and seniors' benefits, but it is often more difficult to derive from provincial budgets for items such as social assistance, educational grants and so on, even though governments have it. Transfers to individuals may take the form of *tax expenditures*, spending by government that appears not on the expenditure side of the budget but as a reduction in tax collected on the revenue side of the budget. Credits for young children and support of the elderly and sick to offset the cost of sales taxation to low-income families are all examples of tax expenditures that might interest us. Usually they cannot be found in budgets; their totals become known only after income tax statistics are published, which means at least a three-year delay. Likewise, we might be interested in transfers to companies. If these take the form of cash subsidies, they ought to be included as expenditures and show up in the budget as such, though often they are not easily isolated. If, however, they take the form of tax expenditures, as for instance when companies are allowed to write off certain capital investments or expenditure on sports or entertainment, again delays in reconciling income taxes mean that the amounts involved will not be known for four or five years and will affect the revenue, not the expenditure, side of the budget.

It is sometimes useful to know how much government spending is for current purposes and how much takes the form of investment spending, which will have longer-term beneficial implications. This involves dividing the budget into current and capital expenditures. Usually, the definition of *capital spending* stipulates that the item has to have a life greater than one year and be above a certain minimal cost. There are problems with this somewhat arbitrary definition, however. Roads, bridges, schools, hospitals and large machines are classified as capital expenditures while lap top computers, because they cost too little, may not be, yet both add to our capacity to produce goods and services. In addition, and more importantly, it can be argued that non-building, non-machinery spending on education and health really represent a long-term investment because they build up the capital of society and its ability to develop in the future. Nevertheless, all governments in Canada treat these expenditures as consumption items or as current

spending, suggesting that their impact is felt all within a single budget year.

The federal government and some provincial governments do not distinguish between current and capital spending in their main budget summaries, but why is it useful to do so? Some would argue that, apart from its importance in economic analysis, the distinction is useful in accurately measuring government deficits and surpluses. Some believe that it is quite legitimate for governments to borrow for capital investment purposes because such expenditures have a life that goes well beyond the current budget. When this distinction is made, the deficit is calculated only on the current account of the budget, the deficit disappears altogether and what initially appeared as overspending is shown to be prudent budgeting. For example, in 1994/95, the province of Manitoba showed a deficit of \$196 million but, when capital expenditures of \$309 million were allowed for, an operating surplus of \$113 million appeared.

Further discussion of the expenditure contents of budgets will be reserved for future chapters. Suffice it to say here that most provincial, municipal and school board budgets across Canada would contain basic similarities regarding what they spend their money on but differences arise, depending upon how the division of fiscal and administrative responsibilities has evolved historically in various jurisdictions. For example, in some provinces all expenditures on social assistance show up in the provincial budget while in others some municipalities assume a portion of welfare costs.

Revenues Taken Further

The revenue side of government budgets consists mainly of taxation, with different levels of government having jurisdiction over different forms of taxation. The federal government relies mainly upon income tax on both individuals and corporations, the sales tax, customs duties on imported goods and excise taxes levied on specific home-produced goods or services (often luxuries, such as automobile air conditioners). The provinces rely mainly on income tax, which is administered jointly with the federal government; provincial sales tax, which may or may not be integrated with the federal sales tax; and a variety of other taxes and fees. Municipalities tend to rely heavily on property taxation and a whole slew of local fees and taxes, while school boards often share property taxes collected by municipalities. All governments below the federal level rely very heavily on transfer payments from higher levels of

government. Thus, the budgets of provinces are financed to a significant degree by various transfer schemes operated by the federal government, such as those contributing to health, post-secondary education, social assistance and, for poorer provinces, equalization payments. The activities of municipalities, in turn, are funded to a degree by transfers from provinces and sometimes, as in the infrastructure program, by transfers from the federal government. In the year 2000, for instance, the province of Manitoba raised \$6.7 billion in revenue, \$2.1 billion of which, or 31 percent, came in the form of federal transfers (see Table 6.3). In the same year, the city of Winnipeg derived \$92.5 million or 13.8 percent of its revenues (ignoring sales of services by the utilities it owns) from transfers (see Table 7.1). School boards rely heavily, almost entirely in some parts of the country, on transfers from provinces.

This means that the budgets of different levels of government are inextricably intertwined, and the dynamics affecting them often come from higher (and sometimes lower) levels of government. Thus, if one level of government cuts back its expenditures by reducing transfers to lower levels of government, the lower level of government must meet this reduction in its revenue either by cutting its own services or by offsetting it and maintaining services by taking other measures, e.g., by increasing taxes. This shifting of fiscal problems is called *offloading* and, as we shall see in later chapters, it has been a serious problem in recent years. Transfers often bring with them a kind of *conditionality*, meaning that the money can be spent only for purposes approved by the higher level of government. This conditionality can be expressed in broad policy terms, as it is for federal transfers to provinces for health purposes (provinces have to adhere to the *Canada Health Act*), or it can be narrow and project-related, as when transfers are tied to a particular capital project such as a road or bridge. In general terms, higher levels of government desire greater conditionality and accountability for their transfers, maximizing the political impact of transfers to their advantage; recipient governments are interested in gaining maximum flexibility in the use of transfers so that they can direct them towards their own political priorities.

Taxes and other *own-source revenues*, such as fees, interest earnings and dividends from Crown corporations, are the major source of revenue for most levels of government. For the federal government, taxation accounted for 82 percent of total revenues in 1997/98.² The share of taxation varies greatly from province to province. Those that are heavily dependent on federal transfers and that have a relatively small economic base have relatively low tax and other own-source revenue

shares (e.g., New Brunswick, 64 percent; and Manitoba, 70 percent). Those that are less dependent on transfers and that have a large economic base have higher levels of taxation in total revenue (e.g., Ontario, 97 percent; Alberta, 93 percent) (Treff and Perry 2001: Chapter 2). The share of taxation in the total revenue of municipalities depends upon the range of services offered at that level, the extent to which provinces finance those services and the power of the local authority to vary its revenue base. The City of Winnipeg draws about 66 percent of its total non-utility revenue from taxation, Montreal 80 percent, and Calgary 61 percent (Treff and Perry 2001: Appendix C). Taxation clearly remains the most important source of fiscal revenue in Canada.

It is important to distinguish between the *tax base* and the *tax rate*. The base is what the tax is collected upon. This could be some definition of earnings (personal or corporate income tax), a range of purchases (e.g., sales, customs, excise or gas tax), the value of property (municipal or school board tax), the value of output (mineral or oil tax) or some other variable. In practice, the tax base is often quite complicated for most taxes. Taxable income, for instance, is different from income actually earned, and many companies and individuals need the services of an accountant to derive one from the other. Taxpayers can deduct from taxable income a number of expenses related to employment, education, disabilities and child care. They may also receive *tax credits*, which directly reduce the amount of tax payable for such things as increases in the cost of living, payment of property taxes, tuition fees, contributions to pension schemes and donations to charities. Some tax credits (such as the dividend tax credit paid to those earning income from stocks and the Goods and Services Tax (GST) credit for low-income earners) are refundable so that they are paid even if taxable income is zero or negative, but the bulk of such credits (such as personal, spousal and family credits) are non-refundable. Likewise, the GST has quite a complicated base with some goods, such as groceries, pharmaceuticals, purchases by provincial governments and by treaty Indians on reserves, being taxed at a zero rate with full deduction of any GST on intermediate purchases. Other goods and services are exempt from GST but with no deduction of GST on intermediate purchases, such as rents, financial services and many health and dental services.

Revenue from any particular tax is equal to the base of the tax times the rate of tax. In the case of federal income tax the rates are 17, 24 or 29 percent (before tax credits), depending on taxable income, while the GST is 7 percent.

Other Types of Revenue

Apart from taxes and transfers, all levels of government derive revenue from a variety of other sources. All earn interest on any money held in the bank or in the form of bonds of other entities. Provinces and municipalities rely quite heavily on revenue gained from the purchase of licenses for motor vehicles, businesses, dogs, bicycles, etc. Court fines, land titles fees, fishing and park licenses are features of most provincial budgets; parking fees and fines and user fees for parks, pools, libraries and even golf courses are common in civic budgets. The earnings of Crown corporations can be significant items in provincial budgets, especially where liquor commissions operate or where hydro and telephones remain in Crown hands. At the civic level, the net earnings of water, sewer, hydro, asphalt, land or other locally owned operations will find some reflection in revenues after appropriate transfers to reserve funds. Such reserve funds need to be examined carefully as they might be available to support operating budgets in times of acute need.

Two other sources of provincial revenue need to be mentioned. The first source is water rentals, which is a form of taxation on hydro utilities, based on their use of water to generate the electricity. In essence, this is best interpreted as a tax on the monopoly earnings (called “rents” in economics, representing earnings above those that would be enjoyed in a competitive situation) of the utilities. These can be significant and reasonably reliable sources of revenue. The second and much more important and controversial source is gambling. The governments of most provinces regulate the gambling industry and derive revenue from it. Some provincial governments actually own gambling establishments and lease out video lottery terminals (VLTs), the most lucrative and rapidly growing form of gambling. The growth of gambling revenue in Canada has been absolutely staggering, and the federal government has vacated that field in favour of the provinces in return for a guaranteed slice of the profits. In Manitoba, for instance, provincial revenue from gambling rose from \$60 million or 1.2 percent of total revenue in 1990 to a high of \$387 million or 7 percent of total revenue in 1995–96.

Finally, some provinces have established fiscal stabilization funds, a kind of provincial piggybank for storing revenues to be drawn upon when faced with recession, cutbacks in federal transfers, etc., or when extraordinary expenditures take place. While this appears to be a prudent move, provincial auditors and others question the wisdom of putting money into such a fund when governments have large debts or are actually running deficits on their operating budgets. Such funds tend to

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