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# What to do with the balanced budget dividend

*Stanley Hartt reviews the options and pressures facing the federal government as it considers how to manage anticipated surpluses over the coming years. Hartt suggests that the governing Conservatives would be wise to keep in mind that the electorate is more likely to cast a vote for a party based on promises of what's to come than on past accomplishments.*

***Stanley Hartt***

Six years after acknowledging in the 2009 federal budget that Canada would be forced into deficit by circumstances resulting from the Global Financial Crisis, the Department of Finance is making no secret of the fact that we may expect Budget 2015 to produce a modest budgetary surplus. It is natural to react like lottery winners, or the heirs of a long-lost but nevertheless beloved rich relative, by rubbing our hands in glee as we contemplate what to do with these unaccustomed and welcome riches.

But hold on a minute! If we learned nothing else from the recent experience of being driven offside by exogenous events not of

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our doing, some prudent contemplation of the alternatives would be in order. The initial prize will be small enough that the range of options will be limited, but projections, barring unforeseen calamities or our own imprudence, are that our fiscal dividend will grow over the medium term, giving our government real and substantial choices.

On the menu might be tax cuts, debt reduction, augmented or new program expenditures, or combinations of the above. Let's consider the possibilities in order.

### 1. None of the Above

Governments, and the people who elect them, always begin an analysis of this kind by assuming that politicians are sent to Ottawa to spend and thus improve the lot of the governed, or, if redistribution is your bag, the lot of some of them. But if the maxim "good policy is good politics" holds true, there should be occasions when the voting public says "Wait a minute; there are a number of priorities already known to be in need of a solid rethink and a likely injection of substantial additional funds in the foreseeable future, and we ought to carefully consider our priorities over the next decade, beyond the electoral cycle and the term of the fiscal plan".

Think of the inadequacy of retirement savings as the baby boomers shuffle out of the formal workforce into retirement or "consultancies". The current hodge-podge retirement savings system consisting of RRSPs, TFSAs, Defined Benefit Pension Plans, Defined Contribution Pension Plans, CPP, OAS and GIS, supplemented by personal, non-tax-assisted, savings (often in the form of a principal residence) adds up to a sub-optimal aggregate savings rate and therefore a level of income in retirement that cannot sustain the accustomed prior lifestyle. Before throwing money at this problem (let alone "balkanizing" it with separate provincial retirement plans), wouldn't it be wise to embark on an in-depth study looking for potential restructuring solutions? Not all problems facing governments are best addressed by immediate spending alone.

The health care system continues to groan along as it grows as a proportion of provincial budgets. Wait-times in elective procedures are used as rationing tools. Technological and pharmaceutical advances bloat the expenditure profile over time, to where our universal, single-payer system itself becomes imperilled. Why not consider addressing this long-term challenge with some thoughtful revamping, which may involve some myth-busting about what our system can and cannot be expected to deliver over the long-term?

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There exists at all times what the Department of Finance refers to as a "pressures" list representing spending ideas from line departments, always vastly in excess of available resources, yet many, if not most, of them very good initiatives. But it is rare that any combination of these "programs-in-waiting" have the capacity for massive benefit to the common good that the two issues mentioned above, retirement savings and medical care, hold for Canadians if they can be rendered sustainable. Why not take a breath and some time to identify our priorities for the fiscal dividend and not race into some short-term expedient that satisfies the syllogism "we must do something; this is something; let's do this".

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### 2. Tax Reductions

Economists will tell you that an across-the-board reduction in marginal tax rates will be a better way of delivering tax relief than targeted tax expenditures (either deductions or credits) designed to encourage a particular kind of activity. It is also more stimulative to the economy, as resources get allocated to where the after-tax return rewards the most efficient use of capital. The current government has opted to create a Christmas tree of tax relief baubles (labelled as "tax reductions", adding up, at last count, to 138 specific measures).

Of course, the cost of this pales beside the current elephant in the room, the long-anticipated "income splitting" for couples with children under the age of 18. Deferred until the deficit is eliminated (which is exactly what we are discussing here), the government's proposal would allow one partner to shift the tax burden on up to $50,000 per year in taxable income to the other. While very expensive in relation to the expected surplus in the next budget, it falls miles short of the cost of the joint return, enshrined in US tax law as the policy reaction to a 1926 US Supreme Court decision which found that, under California's community of property regime, each spouse had an existing, present and real ownership interest in the other spouse's earnings, which brought about the ultimate income splitting for tax purposes.

On the assumption that keeping faith with promises to taxpayers is just as important as the predictability and perceived fairness of the regime as a whole, the government will likely allocate a good chunk of the predicted budgetary surplus to honouring this promise, though it might be hoped that design changes could be identified to make it marginally less costly while largely delivering the anticipated targeted relief.

After that, it might be that the tax system could well use a purging of the bells and whistles that have built up in it since the major tax reform initiative launched in 1988. In that instance, the elimination of most deductions and credits led to a huge reduction in marginal tax rates in both the personal and corporate systems, while remaining revenue neutral even before the commodity tax changes (which eliminated the outdated, leaky Manufacturer's Sales Tax and replaced it with a value added tax).

The government correctly boasts about what internationally-low marginal rates have done to benefit investment in Canada and a thoughtful re-examination of the entirety of our regime would be a timely thing to put in the window displaying a vision for a renewed mandate. Simplification of the tax system would be a natural by-product of such a review.

### 3. Debt Reduction

What the focus on debt reduction must not ignore is that it is usually not undertaken as a goal in itself, merely because a cautious approach to fiscal management abhors owing money. Rather, reducing the debt should be seen as increasing the margin of manoeuvre for other government programs. At a time like the present, where interest rates are low by historical standards, the impact that service charges on the national debt have in crowding out spending on programs is not quite as perceptible as when interest rates are considerably higher, but debt service charges invariably infringe on a government's ability to choose among their other legislative priorities and to fund new initiatives. The benefits of parsimony are not limited to the comfort of knowing that the albatross around our necks is shrinking but include the restoration of the ability to govern. We should always look at the debt reduction option in this way, and never as austerity for austerity's sake.

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### 4. New Program Expenditures

The wish list is always long, and much of it is also good. But most programs don't come with a budgetary requirement that begins and ends in the year the program is launched. Programs have "tails", i.e. the continuing cost to the treasury of maintaining the program through its legislated life, or indefinitely. Remember the controversy over the "real" cost of those magnificent, state-of-the-

art military aircraft known as the CF-35? Expenditures must be profiled over many years lest their approval infringe on the budgetary space available for other, equally-desirable programs. Let us not be so quick to pounce on the announcement-of-the-moment imperative but rather make prudent and eyes-wide-open judgments about where our spending dollars should be allocated.

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A strong case can be made for the use of "other people's money" in the form of Public Private Partnerships to assist in the renewal and improvement of much-needed infrastructure. It may indeed cost more over the life of the asset in question to finance such projects at the borrowing cost of a private sector entity rather than at the lower cost of capital enjoyed by various levels of government, but the benefit of having the infrastructure project up and running years sooner than would otherwise be the case can easily overcome this greater cost through the contribution to growth and investment derived from improved social overhead capital. Canada has sufficient well-established precedents for such recognized forms of financing that it would hardly be breaking new ground if private capital were mobilized for spending on key priority projects rather than using tax or borrowed dollars.

New sources of revenue should also be considered to fund expenditures deemed immediate in priority and importance to the economy as a whole. Privatization of Crown corporations and assets should be considered where significant proceeds can be realized on the sale (or conversion to concessions) of assets the government does not need to own in order to provide public services. This journal has already published a strong piece (see Nicholas Hann, April 2014) demonstrating how the various airport authorities could be converted to commercial concessions with a huge one-time gain to governments without cannibalizing the public revenue stream currently derived from this source.

## Conclusion

The correct answer is, of course, a combination of all of the above, recognizing the impact that a decision in any of the categories listed will have on the others. A tax expenditure here and an announcement of a public works project there means less money to fix the social issues engendered by an aging population. But curbed enthusiasm and moderated restraint in embracing any of the potential uses for our new-found freedom of action should be the watchword.

In case it has escaped the reader's notice (which would be entirely the author's fault for being less than crystal clear) there is a theme running through all the above recommendations, namely, that governments are not elected for what they have done but rather for what they propose to do in the future. One need look no further than the revered Sir Winston Churchill, who, having done a small thing called winning the Second World War for the British people, was turfed unceremoniously from office in favour of the Socialist Clement Atlee on the basis of "what have you done for me lately". Governments which seek election for multiple, repeated terms must offer a vision of the society they propose to build which corresponds to the concerns and interests of the electorate as they ponder the future. That is why most of the suggestions herein advocate careful examination of large, long-term issues facing the country and not a quick "let's spend the inheritance" party.

The debate will doubtless continue as we get closer to the actual day on which we are delivered from the shroud of deficits into the sunshine of surpluses and choices.

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