



Alternative Federal Budget 2006

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Taking the Spin Out of the Economic and Fiscal Update A Guide to the Numbers

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IS IT PLAUSIBLE OR IS IT SPIN?

In today's environment, the federal budget — or in this case the Economic and Fiscal Update — is driven more by politics than economics. At the Alternative Federal Budget, we sometimes joke that the government's communications professionals provide the fiscal estimates, and then the Finance Department is called in to justify them.

In the upcoming Economic and Fiscal Update, there is enormous pressure for the Martin government to massage the numbers in a manner that is consistent with its pre-election strategy. But how can we distinguish plausible financial information from the ubiquitous spin?

Of course, those talented at spinning with numbers are good at providing a persuasive rationale for their numbers. Even if the rationale for a particular number is suspicious, it may take time to thoroughly assess it (at which point the government may be hoping that media attention has moved on).

We cannot guarantee that the tools offered in this report will uncover all of the spin implicit in the official numbers, or that a suspicious number may not be defensible upon further investigation. Here our "used car" advice prevails: looking at the odometer and checking for rust is no guarantee that you have found a reliable car. But if you fail to do at least a cursory inspection, the used car dealer can sell you quite a lemon.

AN INITIAL POINT OF COMPARISON

When assessing the plausibility of the government's numbers, it is helpful to have other fiscal forecasts at your fingertips to provide you with a point of comparison.

At the Canadian Centre for Policy Alternatives, we use our own fiscal forecast for this purpose. Our latest forecast was released in October, as one of the four independent forecasts provided to the House of Commons Standing Committee on Finance¹. Table 1 provides the summary statement of that forecast. You can consult the full text of our forecast at www.policyalternatives.ca.

TABLE 1 Summary Statement of Transactions, CCPA October 2005 Fiscal Forecast

Budgetary Transactions (\$Billions)	2003-04 (actual)	2004-05 (actual)	2005-06	2006-07	2007-08
Revenue	186.2	198.4	208.0	216.6	224.9
Program Spending (excluding Contingent Spending)	141.4	162.7	160.4	168.2	175.8
Contingent Spending (Bill C-48)			2.3	2.3	
Total Program Spending	141.4	162.7	162.7	170.4	175.8
Debt Service	35.8	34.1	33.9	33.7	33.7
Underlying Budget Surplus	9.1	1.6	11.4	12.5	15.4
Prudence					
Contingency Reserve			3.0	3.0	3.0
Economic Prudence			1.0	2.0	3.0
Total			4.0	5.0	6.0
Budgetary Balance	9.1	1.6	7.4	7.5	9.4
Federal Debt (accumulated deficit)					
Apply Contingency Reserve to Debt	501.5	499.9	496.9	493.9	490.9
Per Cent of GDP					
Revenue	15.3	15.4	15.3	15.2	15.0
Program Spending (excluding Bill C-48)	11.6	12.6	11.8	11.8	11.7
Bill C-48			0.2	0.2	
Total Program Spending	11.6	12.6	12.0	11.9	11.7
Debt Service	2.9	2.6	2.5	2.4	2.3
Underlying Budget Surplus	0.7	0.1	0.8	0.9	1.0
Federal Debt (assuming Contingency Reserves applied to Debt)	41.2	38.7	36.6	34.6	32.8

NOTE Numbers may not add due to rounding

While macroeconomic conditions have evolved somewhat since the publication of our October forecast (which can affect revenues and expenditures), this forecast at least serves as an initial point of comparison.

HOW BIG IS THE CURRENT YEAR BUDGET SURPLUS? — THE TRADITIONAL FOCUS OF FEDERAL FINANCE WATCHERS

The numbers:

In October, the CCPA estimated the underlying budget surplus for 2005/06 at \$11.4 billion. The average of the four fiscal forecasts submitted to the Finance Committee puts the 2005/06 underlying budget surplus at \$10.6 billion.

Definitions are important². The “underlying budget surplus” is defined as total revenues minus total expenditures. Total expenditures consist of both government programs and debt service charges. Thus, the “underlying budget surplus” is the surplus prior to the subtraction of Contingency Reserves or economic prudence allowance³.

To measure the fiscal room available to absorb new spending or tax measures, we disregard these reserves and focus on the underlying budget surplus. This has the added merit of bypassing any political games being played with these prudence reserves.

We currently forecast an underlying budget surplus in the range of \$10 billion to \$13 billion for 2005/06. If the government claims its underlying budget surplus is less than \$10 billion, it has some explaining to do. If the underlying surplus is a lot lower than \$10 billion, this explanation had better be very good indeed.

Cautionary Note: the above figures are for a “status quo” underlying budget surplus estimate, meaning that it does not reflect any newly

announced spending or taxation measures. If the government introduces new spending or tax cut measures in the Economic and Fiscal Update, this would reduce the underlying budget surplus accordingly. (Thus a \$5 billion underlying budget surplus is plausible if the Economic and Fiscal Update also announces between \$5 billion and \$8 billion in new tax cuts or spending increases.)

The Spin:

Typically, the Finance Minister has low-balled his estimate of the current year budget surplus. This has damaged the credibility of the government’s fiscal forecasting, but it has enabled the Finance Minister to “find” money to spend at a later date if political circumstances demand it.

If the government wishes to implement spending and/or tax measures as part of its pre-election strategy, it will likely wish to demonstrate that these measures are affordable. However, the anticipated longevity of this government plays an important role in determining how much surplus the government may wish to disclose.

If the government believes it will be very short-lived, it may be inclined to divulge a rather high underlying surplus now, and announce spending and or tax measures quickly. However, if the government believes that it will last long enough to do pre-election spending or tax cuts in the coming months, it may not disclose all of its fiscal room now so that it can “find” more money for pre-election spending later.

HOW BIG IS THE BUDGET SURPLUS FOR FUTURE YEARS? AN INDICATION OF POLITICAL VULNERABILITY

The numbers:

A large underlying budget surplus in the current fiscal year is likely to remain high — and even

grow — in future years. As above, this discussion assumes a “status-quo” scenario, meaning we exclude new taxation or spending measures that would deplete future underlying budget surpluses. Take care to note that we are discussing the *underlying* budget surplus — it is easy to engineer a stagnating or falling budgetary balance in future years by increasing the reserve for economic prudence over time.

Our October forecast estimated the underlying budget surplus at \$12.5 billion for 2006/07 and \$15.4 billion for 2007/08. (We expect the 2007/08 surplus to jump considerably because the spending associated with Bill C-48 — the “NDP deal” — ends in 2007/08.)

How fast the underlying budget surplus should grow is debatable. However, there is no reason for a sizeable underlying budget surplus to fall precipitously after the current fiscal year. It is possible that several negative events could coincide to produce this situation (perfect storms can happen!). If so, the government should have a very compelling explanation for such an unusual conjuncture of developments.

The Spin:

The government may wish to find the fiscal room to implement tax cuts or increase spending in the current fiscal year, but it may be reluctant to divulge the full extent of its fiscal room in the future.

In the event that the government believes that a high current-year budget surplus alone is sufficient to allow it to court voters, then it will be tempted to downplay future surpluses in order to shield it from demands to use this fiscal room for long-term spending increases or tax decreases.

However, if the Liberals judge themselves to be politically vulnerable, they may project sizeable underlying budget surpluses from 2005/06 forward. This allows them the fiscal room to promise tax cuts or spending increases that extend

into the future. However, if they occupy this fiscal room now, it diminishes their flexibility in future years if they form the next government.

HOW TO MASSAGE SPENDING ANNOUNCEMENTS TO LOOK AS IF THE GOVERNMENT IS ACCOMPLISHING A LOT

The numbers:

For argument’s sake, let’s say that the government acknowledges that it has a large underlying budget surplus in 2005/06, and that this surplus grows modestly in future years. Is this enough money for the government to court all of the voters it wishes to attract away from other political parties?

No.

Many of the items that attract voter support have a large price tag attached. The Liberals would like to appeal to supporters of the Conservative Party who want deep (and expensive) personal and/or corporate income tax cuts (or both). At the same time, they would like to court the Bloc Québécois and New Democratic Party voters who demand spending on social programs. Taking serious action on the environment, post-secondary education, the needs of Aboriginal peoples, and a host of other issues will require heavy expenditures. Meanwhile, provinces and other levels of government are pressing Ottawa to alleviate their chronic financial pressure. And, finally, voters on both the left and the right increasingly share the conviction that some very expensive investments in physical infrastructure are required to repair over a decade of neglect.

Taking genuine action on all of these expensive items would easily surpass even a generous estimate of the available underlying budget surplus in forthcoming years. Yet the government wants to appear to be taking action on an impressive list of priorities.

Thus the challenge for its number-spinners is to enable the government to credibly claim that it will be taking action on a wide range of priorities, while minimizing the expenditures that are actually made for many of the items on its list.

The Spin:

The government needs to persuade us to ignore basic arithmetic: it is not possible to cut taxes deeply, spend aggressively, and still post budget surpluses. However, there are many ways to appear busy without committing enough money to actually accomplish something. This is particularly true of spending announcements.

Here are some leading candidates to create the illusion of activity while spending little. (Note that it is possible to blend two or three of the tactics below in a single spending announcement.)

1) The (almost) eternal program phase-in

This is a seemingly sizeable sum of money that is phased in over a long time. To make the money stretch even farther, it can be “back-ended” meaning that most of the money is spent in the later years of the program.

Consider this example: The government announces \$30 billion to spend on Program X. This spending is being phased in over 15 years, starting with an initial amount of \$1 billion per year and accelerating only after, say, the 5th year. Such an announcement would allow the government to actually spend \$5 billion over the next five years on Program X, while citing the much more impressive-sounding lump-sum amount of \$30 billion.

2) The Trust Fund

Trust funds are monies set aside from the current year’s surplus and put in “trust” to pay expenses associated with some announced initiative.

Because this money is put into a third-party trust, accountability is weak. While trust funds typically are labelled with names that sound as if they

are accomplishing some important public policy priority, in actuality we do not know how the money will be spent. It is possible that the money is used for many purposes in addition to the objectives implied by the name of the trust fund.

3) Jurisdictional games to create an unusable spending announcement

In this situation, the government announces money for a program in partnership with other jurisdictions. But it structures the program in such a way that the other jurisdictions will not agree to participate in the program. Since Ottawa can be reasonably sure that this money will never be accessed (in budget parlance, it won’t be “taken-up”), this is a cost-free way of appearing to take action. It has the added benefit that the other jurisdiction can later be blamed for inaction if the funds are not accessed.

4) The recurring spending announcement

Often spending that has been previously announced is re-packaged and announced multiple times. The government wishes to create the impression that it is devoting substantial funds to a program when in fact it is merely generating the illusion of new spending.

For example, the “Federal Affordable Housing Program” was announced during the 2000 election campaign by then Housing Minister Alphonso Gagliano. It involved federal/provincial, federal/territorial arrangements to build affordable housing, and its funding was rolled out over several years. The National Housing and Homelessness Network has determined that this same funding has been re-announced 11 times in Ontario, most recently in August 2005⁴.

Detecting a recurring spending announcements is difficult. The announcements of these programs is often depicted in a confusing manner in official documents. Naturally, the government wishes to avoid the impression that it

is simply recycling old money, so it may combine a small amount of new money with a great deal of old money.

If you are suspicious that a spending announcement is being re-packaged, we suggest that you phone the Finance Department. (Near the front of the Economic and Fiscal Update there is a contact person) Ask: “How much **new** money is contained in the announcement about Program X?” They should be able to provide an explicit costing for each year of the program in question, and they should indicate how much new money is committed in every year.

At the very least, if enough of us demand that government officials disclose this information, perhaps they will be compelled to include it in their initial announcements of new programs. This would greatly enhance the transparency of the government’s financial disclosures.

DO YOU BELIEVE THOSE NUMBERS? A REALITY CHECK OF THE PLAUSIBILITY OF REVENUE AND EXPENDITURE ESTIMATES

The numbers:

This section uses slightly more arithmetic, but it is very powerful spin-busting tool.

A useful reality check for the plausibility of total revenue and expenditure estimates is provided by looking at the ratios of program spending to gross domestic product (GDP) and revenue to (nominal) GDP. These ratios should be fairly stable over time. If the revenue/GDP ratio unaccountably drops, or the spending/GDP ratio unaccountably rises, this is suggestive of a low-balling of the budget surplus.

Of course, a big tax cut will lower the revenue-to-GDP ratio, and a big boost in spending will raise the spending/GDP ratio. Our task is to determine whether the size of tax or spending measures

included in the Economic and Fiscal Update or Budget justifies the revenue/GDP or program spending/GDP ratio presented by the government.

Consider an imaginary fiscal year in which the only substantive change affecting federal government revenues is a tax cut. The government claims that this tax cut will cost \$1 billion in forgone revenues per year. The Finance Department also claims the revenue/GDP ratio will fall from 15.3% before the tax cut to 14.8% in the year the tax cut takes effect. Is it plausible that a \$1 billion tax cut alone could generate a drop of 0.5% in the revenue/GDP ratio?

To perform a reality test on ratios of revenue/GDP or spending/GDP ratios, you have to have some idea of what the projected GDP is for the year in question. Unfortunately, the Finance Department does not make it easy to find the value of GDP it assumes in its ratios. This is inexcusable, since it makes it difficult for the public to perform these reality checks with the government’s GDP ratios.

For the purposes of illustrating our method, we work with the nominal GDP values used in the CCPA October fiscal forecast. At that time, we assumed a nominal GDP of about \$1.36 trillion in 2005, \$1.43 trillion in 2006, and \$1.5 trillion in 2007⁵.

To shift revenue/GDP or spending/GDP by 0.1%, there must be a tax cut or spending increase of between approximately \$1.36 billion and \$1.5 billion.

If the GDP in 2005 is \$1.36 trillion, this means that 0.1% of GDP is \$1.36 billion. So a tax cut of \$1.36 billion would produce a 0.1% change in revenue/GDP ratio. If the government introduces a tax cut that it claims will shift revenue/GDP by 0.5%, the tax cut should have a price tag of about \$6.8 billion in 2005.

Let’s say the government announces a tax cut costing \$1.36 billion in the 2005/06 fiscal year, but the revenue/GDP ratio falls by 0.5%

after the tax cut. Unless some very impressive additional explanation is provided, this suggests that the Finance Minister is low-balling his revenue numbers.

The Spin:

Being alert to the ability to perform reality checks with the GDP ratios can help you to avoid being spun. Dramatic changes in the GDP ratios without justification are often an indication that government officials are massaging underlying budget surplus figures. However, they may feel that they can escape scrutiny by citing a tax cut or spending increase (or some other factor) to justify this change in their ratios. Checking GDP ratios will help you diagnose the extent to which such changes may be legitimate.

CONCLUSION: THE REAL SOLUTION TO TAMING THE SPIN

Since this report is being published prior to the release of the 2005 Economic and Fiscal Update, no doubt the Finance Minister and his advisors will have rehearsed elegant answers to the sorts of questions suggested in this report. Such is the fiscal cat-and-mouse game. When the public — and especially the media — twig to the techniques of spin, the government refines its techniques. But arming Canadians with ways to decode the spin will at least force the officials at Finance Canada to spin with greater finesse.

There is a better way, however, than forcing Canadians to engage in this game. Ideally, we should work towards creating systems that compel the government to give us the accurate, transparent financial information that is our democratic entitlement.

To address the endemic spin of numbers in Ottawa, we would be better served by having a government agency that could produce reliable, objective fiscal forecasts and estimates of the budgetary impacts of policy changes. This agency would be independent of the Finance Department, analogous to the Congressional Budget Office in the United States.

With an independent, objective governmental agency that has access to the information known to the Finance Department, Canadians would not have to acquire special expertise in decoding spin to understand the true state of our public finances. Then we could all move forward with debate about the policies.

ENDNOTES

- 1 The House of Commons Finance Committee does not provide the reports of the four forecasters on its website. Should you wish to locate the other fiscal forecasting reports, they were submitted by the Conference Board of Canada, Global Insights and professor François Vaillancourt of the Université de Montréal.
- 2 The definitions in this paragraph follow the presentation in the “Summary Statement Of Transactions” table in the Economic and Fiscal Update.
- 3 Contingency Reserves are typically \$3 billion per year. Economic Prudence starts low (either \$1 billion in the current fiscal year, or nothing if it is late in the fiscal year and the finance minister is no longer reserving this buffer). However, as the fiscal forecast stretches into the future, the reserve for economic prudence grows. Five years out

from the publication of the Economic and Fiscal Update, the reserve for economic prudence often totals \$4 billion. Thus in the fifth year of the fiscal projections, total prudence reserves (contingency reserves plus economic prudence) would total \$7 billion. With a \$7 billion difference between the budget balance prior to the subtraction of prudence reserves and following the subtraction of Contingency Reserves, it becomes quite important to distinguish between the underlying budget balance and the final budgetary balance.

- 4 The Network scrutinized the various press releases re-announcing this money in Ontario, and found that a cumulative total of 46,332 units of housing have now been promised over three years. As of fiscal year 2004, audited statements indicate that the program has built a total of just 63 units over three years in Ontario.
- 5 The size of GDP in the future will be affected by the rate of nominal GDP growth that the government assumes in its forecast.



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