

The 2003 Federal Budget

Conflicting Tensions

Edited by
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THE SEARCH FOR BUDGET TRANSPARENCY

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Background

Governments in developed countries are under continual pressure to be more open or "transparent" with respect to their activities. This reflects a desire to be assured that the operations of governments can withstand scrutiny and partly a hope that such transparency will prevent the most egregious forms of malfeasance.

The bottom line is that, in my view, the federal government's current financial statements and annual reports do not give policymakers and the American people an adequate picture of our government's overall performance and true financial condition. (David Walker, Comptroller General of the US, 2003, p. 3)

In Canada, the Auditor General has been pointing out the weaknesses in federal reporting since the early 1980s. In 1995, Finance Canada agreed to adopt accrual accounting, and finally implemented it in 2002/03. However, the achievement of full transparency remains elusive.

The notion of transparency hinges on:

- Clarity of roles and responsibilities
- The public availability of information

- Open budget preparation, execution, and reporting
- Assurances of integrity (IMF, Fiscal Affairs Department, 2001)

Progress is being made. The accompanying information for budgets has improved. There are numerous consultations before the budget and some post-budget reviews as well. Yet, there still seems to be a “game” being played between the public and the federal government. “Innovations” are used to sequester funds out of public view (e.g., foundations). Forecasts of perfect budget balance end up as substantial surpluses, serving the purposes of delaying expenditures while reducing the debt *ex post*.

Recent Steps

In response to urgings by the Office of the Auditor General from the early 1980s, the Department of Finance finally made a commitment in 1995 to proceed with full accrual accounting. The change was introduced in the 2003 budget.

Full Accrual Accounting

The key elements of accrual accounting changes identified in the budget (Canada. Department of Finance, 2003, especially Annex 6, pp. 277–298) include:

- capital Assets on Balance Sheet,
- tax revenues when earned,
- recognize Environmental Liabilities,
- recognize Aboriginal Liabilities, and
- recognize Pension Liabilities.

It remains to be seen if departments will adopt capital budgeting with a real option to buy a capital asset instead of leasing or renting. The accrual accounting framework should make such considerations neutral.

Accounting Issues around Foundations

In 1997, the federal government introduced a new form of organization, a publicly-funded foundation, with an independent board of directors and an endowment appropriated by government. The advantage of this approach arises from the opportunity to set up a non-partisan, expert group to deliver something of public interest, with secure long-term funding. Examples include Canadian Institute for Health Information (CIHI), Canadian Institute for Health Research (CIHR), Africa Fund, the Strategic Infrastructure Foundation, and the Canada Foundation for Innovation (CFI).

The problems from a transparency viewpoint is that the funding is shown “as spent” when passed to foundation control, the audit of foundations is outside of the Auditor General’s umbrella, and the fiscal impact is likely to be spread over many years, with little information on timing.

The federal government has taken steps to improve the transparency and accountability for foundations (*ibid.*, pp. 179–181). However, it remains to be seen if these steps will satisfy the Auditor General and the public.

The Budget 2003 measures include: (i) Principles for such Public Foundations, (ii) Requirement for Parliamentary Approval, (iii) Improved public reporting, and (iv) Compliance with Funding Agreements.

Existing foundations will require agreements to introduce a regulatory oversight. Such steps will be likely if additional funding is sought at some point in the future.

Who Sets the Standards for Transparency?

The demand for transparency does not arise naturally. Nor is it seen as a desirable characteristic by most organizations, unfortunately. The main forces demanding transparency are those organizations charged with accounting standards, lenders, and “public opinion” as represented by the media and academics.

Domestic Organizations:

- Office of the Auditor General (OAG) and provincial Auditor Generals,
- Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA),
- Domestic Bond Rating Services, and
- Public Opinion.

International Organizations: United Nations, International Monetary Fund, and the Organisation for Economic Co-operation and Development:

- PSC/IFAC Public Sector Committee (PSC) of the International Federation of Accountants,
- International Bond Rating Services,
- Investors, and
- Other Governments (peer pressure).

Actions Suggested by International Monetary Fund

The International Monetary Fund (IMF) has put one of the more rigorous review processes in place. Although its principal purpose is to assist developing countries, the application of standards covers the developed countries as well. There is a strong demonstration effect if developed countries follow the standards. It also illustrates their feasibility.

The IMF publishes a *Report on the Observance of Standards and Codes (ROSC)* based on a review of a country's performance. The major elements from the ROSC on Canada, *Fiscal Transparency Module*, indicates a need for improvement, including:

- Current data on total government not available;
- No forward-looking calculations of Cyclically-Adjusted Balance (CAB) and Cyclically-Adjusted Primary Balance (CAPB);
- No within-year reports on program performance by departments;
- No analysis of fiscal risks or sustainability tests (e.g., public pensions);
- Publish procedures for budget and expenditure management;
- Reconciliation between Public Accounts and SNA — budget by Finance, historical by Statistics Canada;

- Accounting for reserves (*ex post*) and identification of reserves (*ex ante*);
- Add information to budget and update documents to include:
 - functional and economic classifications,
 - tax expenditure summary,
 - fiscal risk, sustainability, reconciliations, and alternative budget measures.
- Publish estimates on quasi-fiscal activities (e.g., Canada Mortgage and Housing Corporation lending).

IMF members from the developed world set the standard by their behaviour. Failure does not mean that the IMF will refuse to take money from Canada!

OECD Shortfalls

The OECD (2001) has also published *Best Practices for Budget Transparency* with participation by Canadian officials in their development. The shortfall assessment below represents my interpretation of the current state in Canada.

OECD recommendations include: (i) budget three months prior to end of fiscal year; (ii) expenditures in gross terms; (iii) supplementary information on functional and economic categories (annual and monthly); (iv) long-term report at least every five years with range of plausible scenarios; and (v) disclose all key economic assumptions.

In addition, the OECD suggests a formal "sign-off" with the finance minister certifying that all government decisions with a fiscal impact have been included in the report, and the deputy minister certifying that best professional judgement was used in producing the report.

Suggested Areas for Improvement

Functional Breakdown

A call for a functional breakdown has been made to the National Accounts Advisory Committee (NAAC) for many years with little reaction and no support from Finance Canada. Canada has been deficient for at least 20 years within the OECD, resulting in a note in the OECD SNA publications about Canada. (See Minutes of NAAC in September 1995 for discussion.)

The current Statistics Canada plan is to produce a set of functional breakdowns by level of government in accord with the COFOG/SNA93/GFS/IMF standards for 2005.

The adoption of accrual accounting may help, since one of the problematic areas has been the development of capital stock and capital cost allowance (CCA) estimates that could be allocated across functions. Recent spats about the shares of health spending are only a small reflection of this inadequacy.

Separate Education and Social Transfers

The intention to create a Canada Health Transfer (CHT) and Canada Social Transfer (CST) out of the Canada Health and Social Transfer (CHST) has been stated in the budget (Canada. Department of Finance, 2003, p. 183). Why not identify a Canada Education Transfer (CET) and CST, thereby moving back to the previous Canada Assistance Plan (CAP) plus Established Program Financing (EPF) framework? This would help in the discussion of education financing as well.

Common Federal-Provincial Framework

Auditor Generals from the various levels of government should agree on adoption of common standards and support of the FMS/SC role historically as well as encouraging Finance Departments to agree on publishing common accounts for forecast purposes.

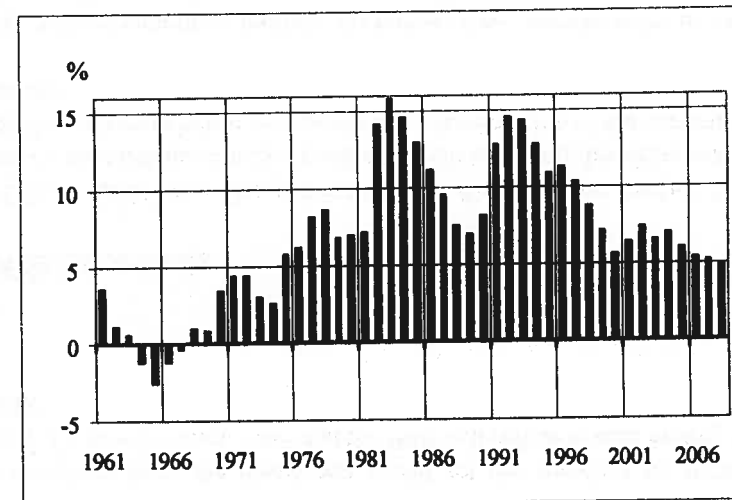
Macroeconomic Budget Indicators

There has been discussion over the years about the output gap and the cyclically adjusted budget balance (CAB) and the measures of fiscal posture (CAPB) and fiscal thrust (first difference of CAPB). This measure is not available publicly at the time of the budget, no forecast is provided, and no sense of what is expected to happen because of the budget appears.

There should be regular and timely publication of historical estimates by Statistics Canada of the output gap, the CAB, and CAPB. Finance should provide projections of these measures as part of its budget. Illustrations of these measures are provided below.

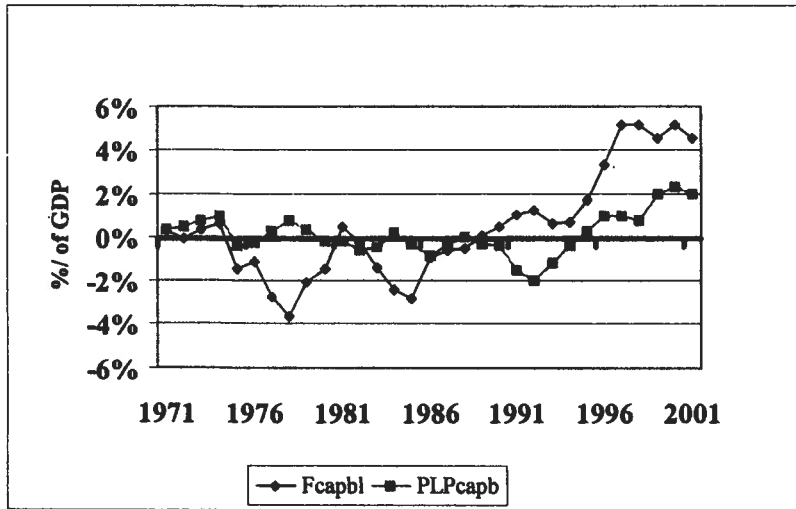
Size of Output Gap

Figure 1: Output Gap



Size of output gap, based on a 4% unemployment rate for full employment (perhaps too high?) and application of Okun's Law to define potential.

Figure 2: Cyclically-Adjusted Primary Balances

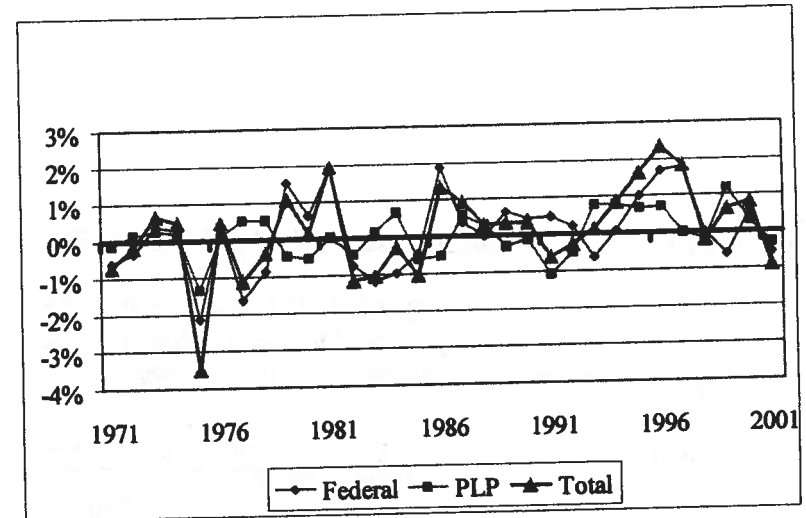


Note that federal government measure is about 5%, historically high, and sustained for a number of years (Canada. Department of Finance, 2002). Yes, there is restraint in the system!! There is no indication of their measure of “full employment”, or the methodology employed here.

Provincial, Local, and Pensions combined sector is also running surpluses — about 2% of GDP.

Note that forecast values are not available. Nor are actual 2002 calculations provided in the budget documents. Statistics Canada should publish the historical data on a quarterly basis.

Figure 3: Fiscal Thrust



A similar story emerges here. There has been some apparent relaxation in 2001, but what about since then?

Conclusion

Progress has been made. Finance Canada has moved to full accrual accounting and appears to be improving the transparency of their foundations. There is room for more improvement, particularly with respect to measures of macroeconomic performance, functional breakdown of expenditures, and coordination of measures across governments.

Continuous pressure for more transparency is important. Without it, the natural tendency is to hide activities behind the opaque walls of bureaucracy.

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