“Federal Budget: Will the Martin Tradition Continue?”

Tomorrow, February 18, 2003, Canadian Finance Minister John Manley will table his 2003-2004 budget in the House of Commons. It will be the first budget for the new Finance Minister, as the last federal budget dates back to December 10, 2001, under the stewardship of the former Finance Minister Paul Martin. As well, this will be the last budget of the Chrétien government. Will Mr. Chrétien want to leave more of his mark by restricting Manley’s latitude in choices?

As we were able to observe with the “Economic and Fiscal Update” presented by Manley last October, the new Minister will probably keep to the tradition imposed by his predecessor. This means that caution will remain the cornerstone of the budgetary forecasts and, obviously, balancing public finances will be maintained in the years to come. In this vain, the economic contingency reserve, which was Paul Martin’s hallmark, will undoubtedly be extended or even bettered in the 2003-2004 budget.

No large-scale budgetary measures
In the Update published last fall, there was an estimated budgetary surplus of $38.5 billion over the next five years for budget planning purposes. The “theoretical” budgetary surplus did not factor in a contingency or cautionary reserve. Yet, according to the accord on health care renewal that the federal government presented to the provinces early in February 2003, the federal government agreed to inject a cumulative $34.8 billion over the next five years. That is to say the government seems to have used up a great portion of its financial room to manoeuvre with its health care funding scheme.

Despite this, the next budget could include a few new limited spending initiatives. In particular, the amount earmarked for defence should be increased. Additional measures could be determined as regards the environment, public infrastructures and certain programs for children from disadvantaged milieus. Other measures, less substantial in impact, will confirm Canada’s international commitment, especially in terms of the Kyoto Accord and assistance to help poorer countries develop. It also appears increasingly likely that the Minister will unveil an increase in the ceiling for RRSP payments, currently set at $13,500 per year, which has not at all kept pace with inflation over the past few years.

In our opinion, given present-day budgetary guidelines (focused on health care), the federal government will not have all the financial latitude needed to grant further income tax reductions to individuals and businesses. Let us reiterate, however, that the impact of the handful of tax reduction measures announced in the previous legacy will continue throughout 2003-2004. Taxpayers and businesses alike will benefit from somewhat more than an additional $4 billion for the 2003-2004 fiscal year just under former government promises. We must not overlook the fact that the federal government has applied systematic indexing of income tax tables and personal exemption credits since January 1, 2000.

We might also point out that an accounting reform of the federal government will very likely be announced as hinted by the Finance Minister in his update of October last. The goal of the reform will be to apply an accrual basis of accounting to fiscal years, which could have significant repercussions on past and future budgetary outcomes. These changes should not, however, be enough to jeopardize past balancing of public finances. Furthermore, Mr. Manley plans on changing the employment-insurance plan and public consultations should be kicked off soon for this.

A sound fiscal situation
A few words on the state of public finances in general: economic growth perspectives have undeniably darkened since the publication of October’s update. Even so, the real impact on budgetary results risks being quite limited. However, the climate of uncertainty is now greater with the US and Iraq conflict looming in the background. Under these circumstances, the federal government will most likely want to be prudent with its conservative forecasts,
along with contingency and cautionary reserves that last October’s update evaluated at $4 billion for the 2003-2004 fiscal year.

According to the most recent “Financial Update” of the federal government, the surplus accumulated from April to November 2002 amounts to $8.2 billion, that is, much more than the $4 billion announced for the entire 2002-2003 fiscal year in the October 30, 2002 update. Taking into account the vitality of the labour market in 2002 (the strongest job creation percentage since 1987), the upswing in corporate profits and seasonal effects (such as the Christmas shopping period), budgetary revenues should be higher before the end of this budget year. Because spending is more stable, the budgetary surplus for the 2002-2003 fiscal year should be slightly above November’s result, despite certain entries at the end of the fiscal year. However, under the proposal made to the provinces earlier this month on health care financing, the federal government will boost transfers to the provinces by $2.5 billion before the close of the 2002-2003 fiscal year, therefore reducing this surplus. In the end, the budgetary surplus of the current fiscal year could very well peak around $7 billion.

Nevertheless, it would be surprising for the Finance department to announce such a large surplus at tomorrow’s budget. We would have to wait for the official results at the publication of public accounts in late summer 2003, to know with certainty the real scope of the surplus for the 2002-2003 fiscal year. Let us recall that the government has often underestimated its surplus these last few years.

As indicated a few times above, the provincial premiers met with Prime Minister Jean Chrétien in early February, in keeping with a federal initiative for an accord on the renewal of health care. Through the accord, the federal government committed itself to significantly increasing its contribution to the Canadian health care system, based on the recommendations of the Romanow report of the Commission on the Future of Health Care in Canada. Additional federal health investments will therefore total $17.3 billion cumulatively over the next three years, including the immediate $2.5 billion increase in transfers to the provinces in the framework of Canadian Health and Social Transfers (CHST). The following table illustrates how the federal government will allocate the amounts.

### February 2003 Agreement
**New Federal Initiatives**

**Over the next 5 years:**
- Mark-up planned and extension until 2007-2008 of transfers to the provinces in keeping with the CHST, representing $9.5 billion.
- Immediate $2.5 billion increase in CHST transfers.

⇒ **Transfers to the provinces will therefore increase by $12 billion.**
- $16 billion investment in five-year reform fund aimed at primary health care, home care and prescription drug coverage.
- New $1.5 billion fund for medical and diagnostic equipment.
- $1.6 billion investment in health agreement initiatives (patient safety, Canadian Coordinating Office for Health Technology Assessment, etc.).
- $1.3 billion investment in a group of federal government health priorities (revealed at the budget).
- $1.3 billion investment in health care for Native Canadians.
- Information technology and research: $1.1 billion.

⇒ **The other health initiatives will total $22.8 billion.**

**TOTAL = $34.8 billion**

### No major surprises

In general, we should not see any major, unexpected surprises in Tuesday’s budget. The vast majority of new spending initiatives by the federal government will in all likelihood be in the realm of health care—measures that were already announced. What is more, the major budgetary guidelines should reflect Martin’s era of balanced budgets and cautionary measures—the hallmark of the Finance department, generally leaving a greater surplus than what was ultimately expected. That is of course—unless Prime Minister, Jean Chrétien, has decided to underscore his legacy through new spending programs.