Manitoba's Balanced Budget, Debt Repayment and Taxpayer Protection Act

J. Patrick Gannon

Manitoba's balanced budget law, as it is commonly known, has been well-received. The Canadian Federation of Independent Business and the Canadian Taxpayers Federation both describe it as "model" legislation which should be adopted by other governments. The Canada West Foundation and the International Centre for the Study of Public Debt both rate it as the "best balanced budget law" in Canada. On the other hand, critics of the legislation argue that it unduly restricts fiscal policy options. This article summarizes the Government's reasons for adopting tough balanced budget legislation, and outlines the main provisions of the Act.

The 1995 Budget was a significant event in Manitoba's fiscal history. Not only was it the first balanced budget in 22 years, but the budget document included draft legislation that would require the Government to continue running balanced budgets, pay down the general purpose debt, and obtain voter approval before increasing the rates of major taxes. After the Budget was approved by the Legislature, there was a general election in April 1995 which returned the Government to office. Following public hearings on the legislation, *The Balanced Budget, Debt Repayment and Taxpayer Protection Act* was passed by the Legislature and received Royal Assent last November.

Why Balanced Budget Legislation?

For about three decades after the Second World War, Canadian governments acted with an impressive degree of commitment to fiscal responsibility. Sometimes they ran small deficits; sometimes they ran small surpluses. But the surpluses were generally greater than the deficits over time, and the total amount of government debt actually declined during this period. Not coincidently, the economy was generally very prosperous.

Beginning in the mid-seventies, Canadian governments began to run deficits on a regular basis, even through periods of strong economic growth. Surpluses became rare. The reasons for this are a subject of some dispute, but the results are quite clear. A high level of debt accumulated, and interest payments became a major expense of government. In Manitoba, annual interest costs rose from about $80 million in 1980 to $600 million last year.

The high and rising level of interest payments led governments throughout Canada and elsewhere to raise taxes significantly during the 1980s. However, the higher taxes did not fund additional programs. Rather, they funded part of the rising interest bill. Most governments incurred continuing deficits as well, since even steep increases in taxation did not keep pace with the cost of compound interest on a very large debt. This led to increasing disillusionment with government on the part of many citizens, who experienced an increasing gap between what they were asked to pay in taxes and the level of services they received. Moreover, the situation appeared to be getting worse as deficits persisted.

As taxes increased, they reached a level where they had a significantly negative effect on the economy. The high debt level, by pushing interest rates up, also hurt the economy. A lower rate of economic growth restrained

J. Patrick Gannon joined the Manitoba Department of Finance in 1969 and was appointed Assistant Deputy Minister of Federal-Provincial Relations and Research in 1982. In this position, he led the team which developed Manitoba's balanced budget legislation. He was appointed Deputy Minister of Finance effective April 1, 1996.

tax revenue and increased the demands made on government programs such as unemployment insurance and social assistance, which, in turn, added to pressures on deficits and debt and interest costs.

As all governments in Canada have found out, once the public debt has risen out of control, it is very difficult to restore balance to public finances. The Progressive Conservative government of Premier Gary Filmon, which was first elected in 1988, set itself the objective of balancing the budget by controlling spending and not by raising taxes. Despite the high interest rates in the late 1980s and early 1990s, and the severe national recession, continued attention to prudent spending management left Manitoba positioned to achieve the objective of a balanced budget in 1995/96. The Province took full advantage of the higher revenues generated by the growing economy along with continued careful control of spending to achieve this positive result.

Tax revenues have increased, but not because of rate increases. Indeed, the rates of the major taxes – personal and corporate income tax, retail sales tax and payroll tax – have either been frozen or reduced in each of the nine budgets since 1987.

The balanced budget legislation is intended to ensure the province continues to live within its means. By enshrining the balanced budget requirement in legislation, and by providing clear penalties for Ministers in the event of non-compliance, the legislation has imposed a greater measure of self-discipline on government. Responsibility for balancing the budget is now more clearly a collective responsibility and objective of all Ministers, not just the Finance Minister. This new shared responsibility is becoming more evident in the approach taken to budget making by officials in all departments. By specifying clear and limited exceptions, and providing for a Fiscal Stabilization Fund, the legislation establishes the means to deal with economic fluctuations. By incorporating a plan to eliminate the debt, pressures to raise taxes or cut programs in the future can be avoided. By requiring a referendum prior to increases in major tax rates, Manitobans are guaranteed a direct say in whether or not to raise those rates. This provision is having a significant positive impact on both consumer and investor confidence since Manitobans know that major tax rates will not be increased unless there is a sufficiently compelling case on which they themselves will be the final arbiters.

Summary of Main Provisions

The Act has three main divisions: respectively, a balanced budget requirement, retirement of the Province's general purpose debt, and a restriction on tax increases.

1. Balanced Budget Requirement

The government must ensure each year that spending is no greater than revenue. This requirement comes with several important provisions:

- Expenditure is defined to include both current and capital spending. This ensures that the government cannot circumvent the intent of the legislation by redefining certain items to be capital expenditures.
- Exceptions to the balance requirement are strictly limited to war, disaster, and a one-year drop in revenue of 5% or more. There has been only one instance since the 1930s of a revenue decline of that magnitude, and the decline was precisely 5.0%. This occurred in 1992/93.
- If a deficit is incurred, and none of the three allowable exceptions apply, all Members of Cabinet will pay a penalty equal to 20% of their Ministerial compensation, and there must be an offsetting surplus in the following year. If a deficit is incurred for a second consecutive year, the penalty doubles to 40%.
- The Fiscal Stabilization Fund plays an important role in this legislation by providing flexibility to deal with unexpected fluctuations in revenue or necessary expenditure and still achieve a balanced budget. The Minister of Finance must endeavour to maintain the Fund at a level equal to at least 5% of annual expenditure.
- Changes in accounting policy cannot be used to subvert the intent of the legislation.

2. Debt Repayment

The Act establishes a Debt Retirement Fund. A minimum amount of money must be paid into the Fund every year, starting in 1997/98. At least once every five years, all the money in the Fund must be applied to pay down debt.

The annual payment into the Debt Retirement Fund will be $75 million, plus a share of the interest cost savings achieved as debt issues are retired. This share is set at 7% of all amounts which have been paid out of the Fund to retire debt. For example, if $75 million is paid into the Debt Retirement Fund each year for five years, and is invested to earn interest at 8.5%, then $444 million will be available to apply against the debt at the end of year five. This would reduce annual debt service costs by about $40 million. Starting in year six, the annual transfer to the Fund would increase by 7% of

$444 million, or $31 million, which is less than the amount of interest saved. Thus, the amount which is paid against the debt will increase over time, but the actual burden of making debt retirement payments, once the savings in debt service cost are factored in, will not exceed the initial $75 million per year. Under this plan, the debt will be paid off over 30 years.

The legislation also specifies how budget surpluses are to be applied. If the Fiscal Stabilization Fund is not at its target level, any surplus must be used to bring the Stabilization Fund up to its target level. If the Stabilization Fund is at its target level, surpluses are either transferred into the Debt Retirement Fund, or left on the books as a surplus, which reduces short-term cash management borrowing requirements. Either way, the effect is to reduce the Province's net debt more quickly.

3. Taxpayer Protection

The taxpayer protection provisions prevent increases in income tax, sales tax and payroll tax rates unless the taxpayers give their approval in a referendum. In effect, the legislation extends the freeze on major tax rates that Manitobans have enjoyed since 1987.

The Act provides some flexibility to adjust tax rates without increasing the overall tax burden. For example, the federal government could reduce transfers to the provinces, but offer compensation in the form of increased "tax room". This means that Ottawa would reduce its income tax rate, and allow provinces to increase nominal tax rates to accept the federal room with no net increase in the amount paid by taxpayers. This Act provides sufficient flexibility to accept such tax transfers.

In addition, revenue-neutral rebalancing of Manitoba taxes is permitted. For example, the corporate income tax rate could be increased if the payroll tax were decreased and the government obtained no extra revenue from the change. This exception recognizes that there may be reasons to alter the mix of taxes over time.

The Present Situation

For 1995/96, Manitoba budgeted for a surplus of $48 million. Due to stronger-than-expected economic growth, own-source revenues were higher than had been forecast, and the estimated surplus has improved to $120 million. For 1996/97, the Province is budgeting a $22 million surplus. Manitoba has not had back-to-back surpluses since 1969/70 and 1970/71. Both surpluses will be added to the Fiscal Stabilization Fund, bringing the total amount in the Fund to almost $200 million by the end of the 1996/97 fiscal year. The Government will not use this amount for base budgeting, but it is available for use in-year should unanticipated revenue losses or expenditure requirements threaten the achievement of a budget balance.