Breakout session 4B: Revenues, Financial Relationships & Modern Treaty Implementation
Mike Joyce's speaking notes

Presentation to the Land Claims Agreement Coalition Conference

Making modern treaties work: the federal fiscal context

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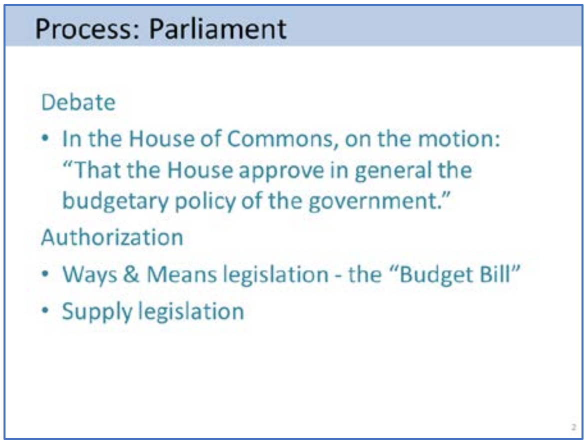
Slide 1 - Overview

Overview

- Process
- Numbers
- Targets
- Reserves

- In 15 minutes, I can't do justice to the full budget development process
- So, my focus is on the final stage of decision-making on what goes into the Annual Budget by looking at four basic aspects of that process.
    - The ***decision-making process*** itself
    - The ***spending and revenue numbers*** – how they break down and the impact that breakdown has on decision-making
    - ***Targets*** by which a budget's fiscal outcomes are measured.
    - And lastly ***unallocated reserves***, one aspect of which has a particular relevance for indigenous affairs generally

Slide 2 – Process: Parliament



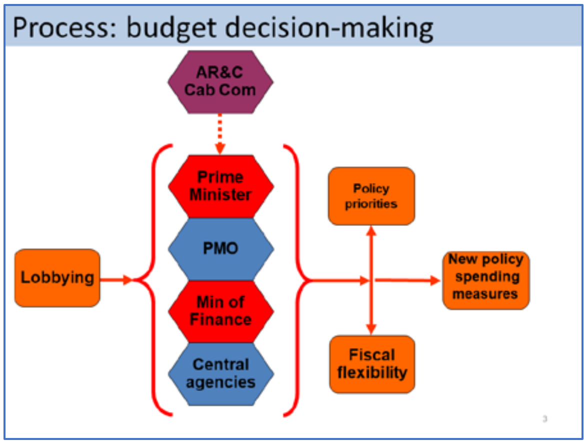
- It may seem odd to start with Parliament's process for dealing with a Budget as that marks the end of the government's decision-making process for the annual budget.
- But it does let me touch on what an annual budget is and is not
    - A lot goes into one - it took 464 pages to lay it all out in the most recent budget
    - But I do want to emphasize that the Annual Budget itself is nothing more than a plan and serves as a communication vehicle for the government
- The Annul Budget is debated in the House of Commons, but the result constitutes nothing more than approval of the motion:

    "That the House approve in general the budgetary policy of the government"

    - As you can see from that wording, Parliament's approval is not binding
    - Governments can and do change their budgetary policies throughout the year without needing to return to Parliament to debate those changes.
- The budget debate is, however, considered a matter of confidence
    - If the government were to lose that vote, the result would be that the Government General either calls an election or invites the Leader of the Opposition to try and win the confidence of the House and form a government

    - Typically, this is only an issue in minority government situations
        - but, with the next Annual Budget only months away, I would suggest, a loss of confidence is unlikely with the present state of the main parties.
- Parliament does however play an instrumental role in authorizing the funds needed to implement the government's budgetary policies
    - New or changed ***tax measures*** must be implemented by what is traditionally know as Ways and Means legislation but has, in more recent years been termed Budget bills that deal with much more.
    - All ***Direct Program spending*** must be authorized annually through Supply legislation
    - And here, it is important to recognize that Supply legislation is introduced three times during a fiscal year
    - It is through these bills, or Supplementary Estimates as they are also known, that the government seeks funding to implement the budgetary polies it has announced in the annual Budget.
- Governments can and do make policy changes after the annual Budget has been tabled
    - In effect, budget decision-making takes place throughout the fiscal year.
    - Many, though not necessarily all such ongoing policy changes are announced in the ***Economic and Fiscal Update*** that is released each Fall
    - While a fiscal update is budget-like, there is no requirement for it to be debated in the House of Commons.

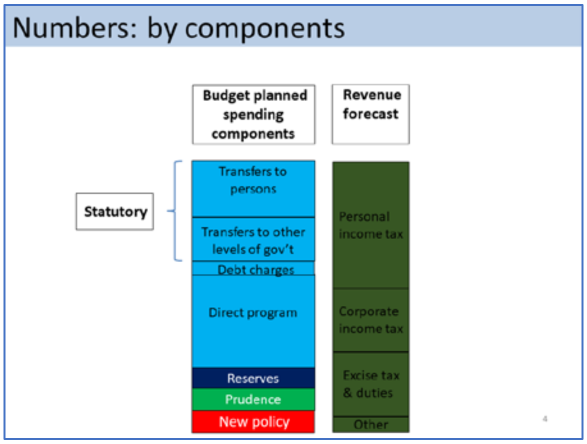
Slide 3 – Process: budget decision-making



- This slide illustrates who is directly involved in budget decision-making:
    - The ***Prime Minister*** and the ***Minister of Finance*** alone are jointly responsible and accountable for the decisions on which a Budget is based
    - They are supported by their departments and, in the case of the Prime Minister, by his office, the PMO
    - Although individual ministers may be consulted on specific issues, no Cabinet committees are formally engaged in the process
- Outside the formal process, primary sources of influence include:
    - The Cabinet committee that deals plan and priorities and that is typically chaired by the Prime Minister
    - That committee provides ministers who are members with both formal and informal opportunities for influence
        - Presently that committee is called the Committee on Agenda, Results and Communications
    - Externally, lobbyists will try their best to meet with anyone with direct or indirect influence on the process
- The process itself is messy, iterative, contentious, highly centralized and secretive
- It is framed or constrained by the need to trade-off two opposing factors
    - On one side there is affordability, or ***fiscal flexibility*** as it is known
    - This is the simple arithmetic calculation of the difference between forecast revenue and the planned cost of delivering the existing base of programs

    - More on this when we get to the numbers
    - On the other side there is the cost of implementing the government's ***policy priorities***.
- Final decisions on the annual budget are driven by:
    - the date that will have been set for tabling the Budget; and
    - trade-offs that yield a politically acceptable subset of policy options that can be delivered with a politically acceptable planned fiscal outcome -
        - surplus, balance or deficit.

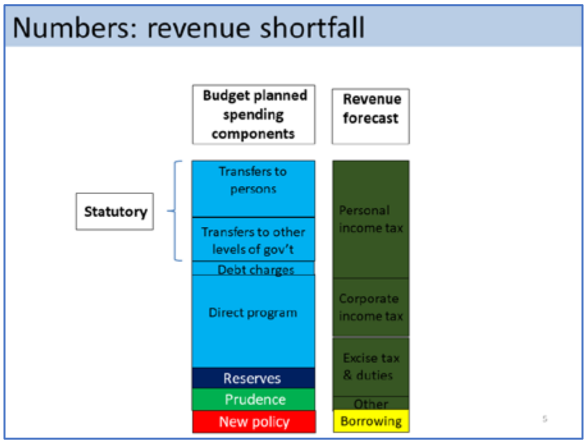
Slide 4 – Numbers: by component



- This slide illustrates the major categories of the planned spending total
- The four light blue boxes represent the existing program base
  - ***Transfers to persons*** constitute elderly, EI and Canada Child benefits
  - ***Transfers to other levels of government*** constitute principally the Health and Social transfers, Equalization, and Territorial Formula Financing
  - **Debt charges** are the interest payments on the government's debt
  - ***Direct program*** spending, is the cost of running all other existing government programs
- The last three components complete the planned spending picture.
  - ***Reserves*** consist of planned funding that has not been allocated or announced in the budget but has been set aside to deal with high-risk pressures
  - ***Prudence*** represents similarly unallocated funds set aside to guard against the risk that revenues might fall short of forecasts or that spending required for the existing program base might increase above that planned
  - And, finally, funding for ***new policy*** measures announced in the budget completes the illustration

- Weighed against planned spending are ***revenue*** forecasts
- Serendipitously, in this illustration at least, with enough fiscal flexibility to fund a set of new policy measures
- The budget is in balance – or at least that is the planned outcome

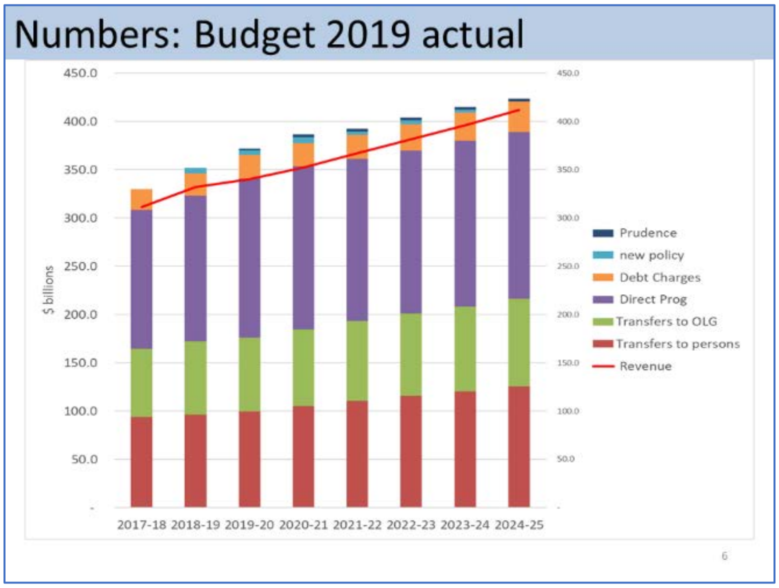
Slide 5 – Numbers: revenue shortfall



- More realistically, at least in recent times, this slide shows a result where forecast revenue is insufficient
- This further illustrates the challenges that typically face the budget decision-makers and why the process is so iterative and politically contentious.
- What are the options?
- Cutting ***planned spending*** in the existing program base is one way of increasing fiscal flexibility, but these components are difficult to cut
  - ***transfer program*** spending is authorized on a continuing basis through constituent legislation
    - changes require that legislation to be amended
    - not to mention some degree of consultation or negotiation with recipient groups
  - ***Debt charges*** are a contractual obligation
  - ***Direct program spending***, which is authorized annually is more amenable to cuts but, unless there is political will to eliminate entire activities or reduce transfer payments, will adversely impact program delivery capacity.
  - Reducing ***prudence and reserves*** carries significant downstream risk.
  - Any of these measures would bring the bottom of the left-hand bar up closer to match forecast revenue
- On the ***revenue*** side, taxes could be increased and so bring the bottom of the right-hand column closer to that of the left
- And, of course the number of ***policy priorities*** could be reduced

- To the extent any action on these options proves insufficient, fiscal flexibility to fund new policy initiatives must be created by ***borrowing***
- Political communication considerations abound!

Slide 6 – Numbers: Budget 2019 actual



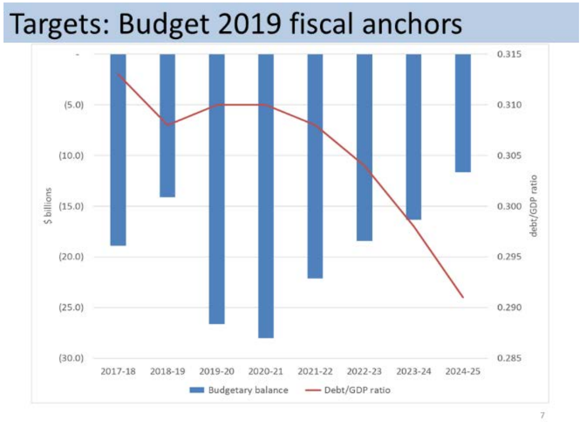
- This slide shows the spending components using actual numbers from the fall fiscal update[1]
- The relative magnitude of the numbers illustrates the degree to which trade-offs were made in the decision-making process that led budget 2019
    - new policy represents a relatively small portion of total spending
        - And not all platform commitments were included
    - deficits are planned in each year – the distance between the top of the spending bars and the red revenue line.
    - Prudence, that should increase each year to reflect the increasing risk associated with forecasts, particularly revenue, is flat-lined at $3 billion in each year.
- CIRNAC and ISC, through which most funding related to First Nations flows sit within the Direct Spending component
- Given that much indigenous program delivery is by way of transfer payments, it is worth noting a key distinction between these transfer payments, that are authorized annually through supply legislation, and the transfers to people and other levels of government shown in the chart that are often referred to as “major” transfers.

[1] Chart data taken from the Economic and Fiscal Update 2019 (https://www.budget.gc.ca/efu-meb/2019/docs/statement-enonce/intro-en.html) tables A1.4, A1.5, A1.6 and A2.2.

- As indicated earlier, these major transfers are authorized on a continuing basis by each of their program's constituent legislation
- The fact that any changes to major transfers would require legislative amendment and all that would involve provides a relatively greater degree of certainty than that for any of the annually authorized transfers, even with a multi-year block funding commitment.
- In terms of total program funding amounts
    - For 2018-19
        - ISC represents 8.9% of total direct spending at $11.6 billion
        - And CIRNAC 2.8% at 4.5 billion
    - For 2019-20, out of a total of $5.0 billion incremental spending announced in the 2019 Budget[2], the following allocations are directly related to indigenous policies[3]:
        - $0.694 billion, the total for Chapter 3 – Advancing Reconciliation
        - $0.082 billion for supporting indigenous education (within Chapter 1, Supporting the Middle Class); and
        - $.028 billion for building a better future for Canada's North, (within Chapter 2, Building a Better Canada)

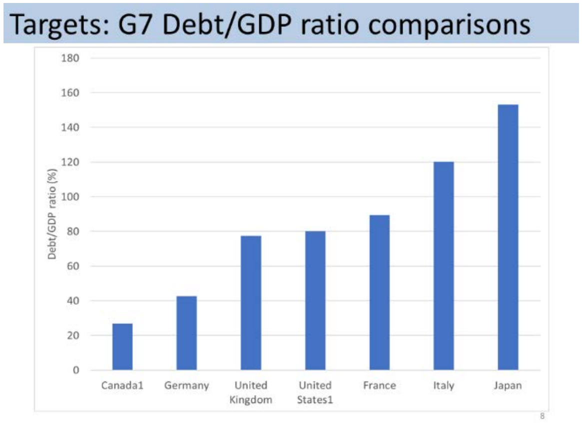
[2] Budget 2019, Table 1 (p.8), Total policy actions and investments since FES2018.
[3] The amounts are from the tables at the end of each of the referenced chapters in Budget 2019

Slide7 – Targets: Budget 2019 fiscal anchors



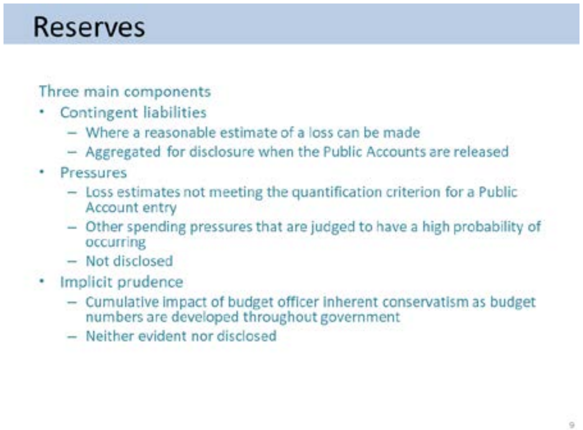
- Turning now to targets
- Traditionally, the primary fiscal outcome target has been the budgetary balance – the planned surplus or deficit
    - o Shown on this slide by the blue bars and the left-hand axis
- The government is, however, trying to shift focus to emphasize towards the debt/GDP ratio as a target
    - o Shown here by the red line and the right-hand axis
- There are likely three reasons for this shift
    - o One is the volatility of the budgetary balance – a relatively small number compared to compared to the revenue and expense forecast on which it is based.
    - o A second is the predicted year over year improvements in the debt/GDP ratio that look better than that for budgetary balance
        - ▪ But that could well be countered if
            - If the budget's GDP growth rate forecasts prove optimistic
            - if annual deficits increase above target as that increase adds directly to debt, the numerator in that ratio; or
            - if interest rates on the stock of debt were to increase

Slide 8 – Targets: G7 Debt/GDP ratio comparisons



- This slide shows the third reason
    - that Canada's debt/GDP ratio has and continues to compare very favourably with other G7 countries
- a comparison that might well continue to be favourable, even if Canada's ratio were to worsen.

Slide 9 – Reserves



- Lastly reserves – three categories
  - ***Contingent liabilities*** are in a class by themselves and arise primarily from risks associated with
    - litigation
    - the need for environmental remediation.
    - and land claims
  - Under accrual accounting rules, when a reasonable estimate of a loss can be made, the government has no option but to establish reserves against these liabilities in the Public Accounts
    - and, for that reason, they are the subject of discussion with the Auditor General during budget preparation
  - While not resulting in any immediate cash impact, they create a future source of funds whenever a specific liability chicken comes home to roost
    - What distinguishes contingent liabilities from other reserves is that they are a hit on the fiscal framework at the time they are recognized, not at the time the event is expected to occur
    - That is that they reduce the government's fiscal flexibility during budget planning, not at a later date when the event liability occurs.
  - The last two categories listed on the slide are similar in concept to prudence – covering risk through planned spending that is not allocated in the Budget
    - But unlike prudence the neither the total nor individual amounts are disclosed

  - ***Pressures***
    - As they do not meet the accounting standards for contingent liabilities, whether or not to include them is a discretionary decision.
    - But they have no impact on the accounts
  - ***Implicit Prudence***
    - Budget officers, particularly in Finance, tend to be inherently conservative
    - If the opportunity presents itself, they may nudge revenue forecasts down and spending up
    - Sometimes referred to as Finance's rounding reserve.
- These last two reserves are generally significant in budget development for two reasons:
  - First, as mentioned earlier, amounts allocated to them decrease the fiscal flexibility available for new policy decisions in the Annual Budget.
  - Secondly, to the extent that the risk factors that prompted their inclusion reduce as the fiscal year unfolds, the amounts become available for allocation to additional "in-year" new policy measures

Slide 10 – Contingent liabilities

Reserves: contingent liabilities

$ millions	2019	2018
Pending and threatened litigation and other claims	11,192	9,181
Specific claims	9,099	8,151
Comprehensive land claims	5,879	5,420
Provision for guarantees provided by the Government	277	278
Total provision recorded	26,447	23,030

- Significant exposure to a liability could exist in excess of what has been accrued. Claims for which the outcome is not determinable and for which an amount has not been accrued are estimated at approximately $8,528 million ($10,053 million in 2018).
- There are currently:
  - 567 (545 in 2018) specific claims under negotiation, accepted for negotiation or under review
  - 74 (73 in 2018) comprehensive land claims under negotiation, accepted for negotiation or under review.

From 2019 Public Accounts, Vol I, Note 7 to the consolidated financial statements

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- This slide shows the contingent liabilities from the most recent public accounts
- For obvious reasons, the amounts are aggregated, and individual liabilities are not disclosed.
- CIRNAC is responsible for the vast majority of the first three listed
  - o 92% for the 2017-18 numbers, which included an increase of $4.9 billion
  - o And a further increase of 2.2 billion in 2018-19
- The budget issue here is with the continuing dealing between the government and indigenous peoples on a claim or litigation for which a contingent liability has been set.
- For a ***claim***, there is an existing source of funds to pay for the cost of settling it without requiring and incremental funds from the fiscal framework.[4]
  - o The issue here would be the extent to which government officials directly involved in dealing with issue are aware that a contingent liability has been established and the amount in question, even if they are aware.

[4] Unless, of course, the settlement costs exceed the contingent liability amount in which a case that increment would be a hit on the fiscal framework at the time of settlement. There is, however, a relatively small hit on the fiscal framework. Cash to pay for the settlement flows according to timing identified in the settlement and must be raised by borrowing unless some other offset in the fiscal framework is found. Such a borrowing would result in an incremental interest payment.

- For ***litigation***, the situation is similar to the extent that discussions between the parties are focused on settling out of court, though far more limited if the focus is pursuit in court.