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REDUCING FISCAL DEFICIT : CANADIAN EXPERIMENT AND LESSONS FOR INDIA

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K Gayithri*

Abstract

The fiscal mess that the Canadian Federal Government got into, following large-scale increase in the fiscal deficits and debt burden resulted in corrective measures since 1984. Introduction of "Spending Control Act" in 1991 and its effective implementation up to 1996 aided in deficit reduction. The process, however, resulted in adverse effects like increased debt burden at the provincial level, caused by cuts in federal transfers during the spending control regime. These developments have large-scale implications on the vertical imbalances in a federation like Canada. Nevertheless, the spending control measures and their effective implementation do have good lessons for countries in similar pursuit.

Introduction

Government activity measured in terms of the proportion of government expenditure in the Gross Domestic Product (GDP) expanded considerably across the globe during the sixties (The World Bank, 1997). This was the result of the immense faith many countries had in the state-led growth strategy. Market failure accorded governments a central role in making corrective interventions in essential areas such as allocation, production, distribution and regulation. Governmental control prevailed in almost all sectors. The enormous growth in government expenditure coupled with revenue shortfalls that occurred during the state-led regime has eventually resulted in mounting fiscal deficits in the case of many countries.

There has been a sea change in recent thinking on the role of government, which has led to the launching of the economic reform/ structural adjustment programme process in many countries. The economic reform process emphasises the need to reduce the fiscal deficit

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for bringing about higher growth. Thus, fiscal deficit reduction has been an important component of the stabilization measures initiated in many countries. While some countries have been able to successfully reduce their deficit levels, a few other countries are still struggling to find appropriate measures to bring down the same.

In the case of two countries, India and Canada, which the author has had an occasion to study the fiscal deficit at the federal government level has been brought down in Canada whereas the deficit level in India is still high. The so-called successful reduction in the fiscal deficit in Canada was however associated with some costs such as enhanced fiscal burden at the level of provincial governments. Such developments are likely to occur in a federal form of government, wherein the fiscal actions of the federal government can constrain the provincial finances. This is especially true in Canada due to the existence of a high degree of vertical redistribution mechanism over a long period. The Federal Government in Canada uses its taxing and spending powers to redistribute vertically through transfer payments; their magnitude has considerable implications for vertical imbalances. A sharp increase in such transfer payments would hike the federal deficit and, on the contrary, cuts in the transfer payments would have similar effect on the provincial finances. The federal and provincial-local deficits for the year 1987 with and without inter-governmental grants reveal[1] that federal deficit with grants was over $23 billion and that of Provincial-local deficit was $ 4.6 billion. The scenario with out grants reduces the federal deficit level to $0.5 billion and sharply hikes provincial-local deficit to $27.3 Billion. In the context of deficit reduction process, federal governments usually tend to offload their responsibilities, which are often thrust upon provinces thus resulting in an increased cost pressure. Vertical fiscal imbalances widen on account of such developments. These were precisely the developments experienced in the Canadian Federation in the aftermath of the fiscal deficit reduction process. Nevertheless, the deficit reduction experiment which was attempted by imposing strict control on public expenditure offers certain good lessons for countries like India that are attempting to reduce their deficit burden.

Against this backdrop, the paper seeks to examine

- The public expenditure control measures in Canada
- Growth and behavior of overall trends in government spending in Canada between 1980 and 1996 with special focus on the time period 1991-96.
- Programme-wise changes during the expenditure restraint period in order to understand the changing role of government.
- Expenditure by levels of government

Expenditure management system of Canada

Lessons India could draw from the Canadian experience.

Growth in Government Activity

Government activity in Canada had grown enormously until the recent past, so also the size of fiscal deficit[2]. Deficit increased from about 1.5 percent of GDP prior to 1974-75 to 8.7 percent of GDP by 1984-85.This increase was largely caused by the rapid increase in programme spending and public debt charges. While higher budgetary expenditures accounted for 83 percent of the rise in deficit by 1984-85, decline in revenue as a proportion of GDP contributed less than 20 percent of the rise in deficit. (Government of Canada, 1991). Hence, the Canadian government resorted mainly to expenditure control measures to reduce the size of fiscal deficit These measures helped in the reduction of fiscal deficit to 4.5 percent of GDP in 1990-91.While the proportion of spending declined from 19.6 percent in 1984-85 to 16 percent in 1990-91, the debt charges persisted and rose, thus countering the positive effects of reduction in the programme spending.

The Federal Government proposed the Expenditure Control Plan for the period 1991-96. However, this rapid growth in government expenditure was proposed to be brought down during the period 1991-96 in order to reduce the size of the fiscal deficit, thus bridging the gap between government revenue and expenditure. It was proposed to reduce the expenditure to the tune of $615.3 billion between 1991 and 1996. Giving effect to this, government had introduced 'Spending Control Act' in 1992 to limit the programme spending between 1991-92 and 1995-96. The proposed restraint measures regarding various expenditure programmes have brought in considerable changes in the growth and composition of government expenditure and are thus expected to have considerable implications for the economy.

Analysis of the Canadian public finances reveals that fiscal situation has improved substantially after the implementation of the spending control measures. The success that the Canadian government has been able to achieve, more so on account of expenditure reduction, presents a very interesting case for detailed study. This is in view of the fact that expenditure reduction is one of the tougher options that a government can resort to. Incremental budgeting is a popular practice in most countries.

Government has also played an important role as an employer as indicated by the rapid increase in the number of government employees in Canada. There is a marked deviation in the Government's role in this regard also of late, as it is making efforts to reduce the size of public service. The Canadian Government has taken many measures to control expenditure, such as freezing of wages and salaries in various departments, dissolution of certain crown corporations, mergers and privatization. The Federal Government has sold or dissolved over 20 such crown corporations since 1985. Such measures are expected to have considerable financial implications for the Government. A study of the financial implications and the employment and remuneration effects of such measures gains considerable importance. These aspects however do not form a part of the present study.

Deficits

Fiscal deficit in Canada was on a rapid increase at all the levels of Government, especially during the 70s and 80s. The sharp increase that occurred between 1971 and 1988 was very significant at the federal level of Government. As in 1992, the consolidated Government deficit, inclusive of federal, provincial and local levels of government was the highest among the G-7 countries. Canada also recorded the highest level of public debt. Deficit constituted 6.8 percent share in GDP. Therefore, high levels of debt and interest costs prevailed in the Canadian economy. Various factors were responsible for the rapid growth in the deficit level since 1975. Slackening of economic growth and sharp increase in government expenditure without an equal increase in the revenue resulted in increasing imbalance between revenue and expenditure. The period was marked by a sharp increase in the spending on social programmes.

Following the first oil shock of 1973, the real rate of growth slowed down and this got accentuated with the 1981 recession. On the fiscal front the Canadian Government introduced a number of social programmes inclusive of old age pensions, family benefits, universal health care etc., after the Second World War. Due to the indexation of these programmes to inflation in mid-70s, there was an in-built increase in the programme spending. Sharp increases in these expenditures are revealing in terms of their share in the GDP.

On the other hand, revenues were declining during the second half of the 1970s. Decline in tax revenue was caused by the declining growth of the economy and also the indexation of taxes. Personal income tax brackets and exemptions were indexed to inflation in 1974. These resulted in reduction in the yield as the government could no longer benefit from the 'inflation tax', when people moved to higher tax brackets. At the same time, Government increased "tax expenditures" and reduced the sales tax rates and the base.

The growing fiscal deficit, which was an outcome of all these factors, resulted in high interest rates, lowered bond ratings and increased foreign borrowings, thus making the country's economy vulnerable to foreign markets. In order to overcome these problems, the country took various measures since 1984.

Spending Control Measures in Canada

The rapid growth of spending and the gradual deterioration in the revenue yield since the mid-1970s had created an unsustainable fiscal position by the mid-80s – spending exceeded revenues by over 50 per cent. The Canadian Federal Government adopted a medium term fiscal strategy introducing a range of measures since 1984 to control the fast growing fiscal deficits. This was attempted by reducing the government expenditure rather than mobilising greater tax revenue.

Nevertheless deficits started growing again from 1988, as "the public in general and interest groups in particular became more adroit at dealing with the federal government" (GAO). The 1988 elections also may have contributed to the relaxing of the stringent fiscal measures resulting in a rise in the fiscal deficit after 1988. Later, in the 1990 budget, Government introduced expenditure control plans. A Spending Control Act was implemented in 1991, which placed ceilings on overall programme spending from 1991-92 through 1995-96. In 1992, the Spending Control Act was implemented. It was stipulated that with a few limited exceptions, spending could not exceed the limits projected for 1991-96. Any increases over and above the projection had to be met from the department's own cuts in other areas and could not be financed by borrowing or fresh taxes. However, one year's overspending was possible, which however had to be compensated with under-spending in another year according to the Act.

Spending Control Plan: Main Features

The broad features of the Spending Control Plan (Department of Finance, 1991) were:

1. Expenditure Control through the means of a comprehensive medium-term approach.

2. A limited number of programmes were to be exempted from expenditure control. These included major social transfers (elderly benefits, family allowances, veterans' pensions and allowances, transfers under Indian and Intuit programmes, unemployment insurance benefits) and certain major transfers to provinces (Equalisation and Canada Assistance Plan transfers to equalisation-receiving provinces);

3. Fixation of a ceiling of 5 percent rate of growth per annum on Canada Assistance Plan, transfers to non-equalisation-receiving provinces through 1994-95;

4. Rate of growth of spending on science and technology and foreign aid was restrained to 3 percent per annum beginning from 1992-93;

5. Per capita freeze was announced on established programmes financing transfers until 1994-95;

6. Operating and capital budgets were to be frozen for one year, and the number of executives was to be reduced by 10 per cent with a limited provision for increase in the wages for federal employees.

7. Crown Corporations and special interest groups were to get reduced Grants and contributions.

Ceiling on Programme Spending

In order to carry out the spending control plan effectively the government legislated ceilings on programme spending for the period under consideration The government announced the programme spending ceilings, as given below, in February 1991

- 1991-92 : $115.8 billion;
- 1992-93 : $119.7 billion;
- 1993-94 : $122.8 billion;
- 1994-95 : $126.5 billion; and
- 1995-96 : $130.6 billion
- Five-year Total : $615.3 billion

However, there was a provision that the ceiling in a particular year could exceed the ceiling for economic or policy reasons, provided the cumulative programme spending over the 1991-92 to 1995-96 period did not exceed the programme spending projections in the budget. In addition, there was an exemption in a very limited set of prescribed circumstances.[3] In the event that spending on a particular programme crossed the ceiling and thus resulted in excess total programme spending over and above the stipulated amount for the five-year period, reductions had to be found in other programmes. There was no provision for financing it by way of either borrowing or enhancing taxation. Reallocation of spending between the years was permitted in order to bring in a certain amount of flexibility in the operations. However, the cumulative spending limits over the five-year period could not be exceeded.

Debt Servicing and Reduction Account

The Canadian Government introduced a very important act, 'Debt Servicing and Reduction Account' (DSRA), in order to streamline debt servicing and reduction. In accordance with the act, Government had to strictly use the resources from the Goods and Services tax (net of applicable rebates and refunds), net proceeds from privatization, and contributions by Canadians, towards debt reduction for debt servicing and repayment. These resources could not be diverted for any programme spending.

Expenditure Control and Management

Besides spending restrictions, the Spending Control Act also brought in considerable structural changes in the prioritisation and management of Government expenditure. Government clearly set the priorities as to where money should be spent. It is stated "Meeting this target requires establishing an expenditure management system that results in better strategic planning, the critical review of existing programmes and spending and reallocation from low to high priority initiatives." (Government of Canada, 1995).

The important features of the expenditure management system included

- Budget planning process, which was expected to integrate all the new initiatives and priorities.
- Comprehensive review of the ongoing programmes to bring about meaningful expenditure reallocation.
- Elimination of Central policy Reserves.
- Government priorities to be reflected in all the departmental programmes.
- Flexibility to the departments to prioritise within the given resources.
- Improving the information base on programme performance to facilitate decision-making.

Size, Growth and Composition of Government Expenditure

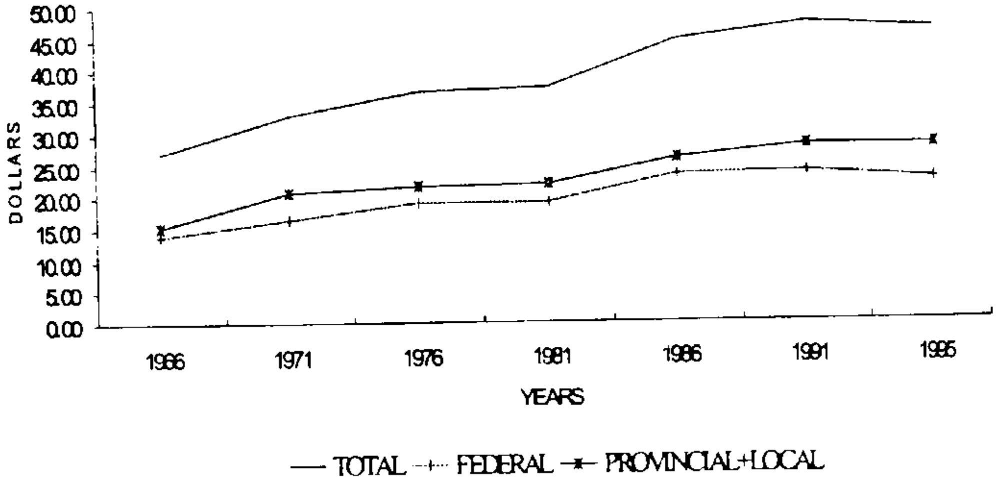
An analysis of the size, growth and composition of consolidated spending comprising federal, provincial and local levels of government is attempted in this section.[4] Data published by Canada is used for the purpose. The analysis, however, is not confined only to 1991-96 but extends from 1966 to 1995, in order to have a long-term perspective on government spending and to understand the changes that have taken place during the spending control regime. The expenditure analysis is entirely in per capita real figures, i.e., after making due adjustments for the growth in price and population factors.

Expenditure in Proportion to GDP

The consolidated Canadian Government spending in relation to the GDP substantially increased from 27 per cent in 1966 to reach its peak in 1992 at 49 per cent, and subsequently declined to 46 per cent in 1996, an effect of the spending control measures of the Government.

Graph 1

GOVT. EXP. IN PROPORTION TO GDP
BY LEVELS OF GOVERNMENT



Although one can observe that there is a decline of government activity vis-à-vis the overall economic activity, it is not sufficient to establish that the size of government is reduced. These variations in the proportion of government expenditure to GDP can also be caused by the variations in the GDP itself; hence, measurement of government activity to GDP is not adequate. The growth in government expenditure needs careful analysis as well.

Per Capita Real Expenditure: Annual Growth

Government spending has increased from $3103 in 1966 to $9493 in 1995 amounting to 206 per cent increase in its level, a substantial increase by any standards. Although the government proposed a medium term strategy in 1984 to reduce the size of government it was not until 1994 that some reduction occurred. Total expenditure was at its peak in 1993, at $9710, and subsequently declined to $9493 in 1995.

Growth rates are computed (Table 1) for the time period 1966 to 1983 - the rapid growth phase of Government expenditure in Canada; 1984 - the year in which some restraint measures have been initiated - to 1995 and 1992-1995, the period during which all-out effort was made to reduce government spending. Total expenditure increased at the rate of 5 percent per annum between 1966 to 1983, which slackened to 1.81 per cent during 1984-95, and declined at 0.76 per cent per annum during 1992-95. Among the items that recorded a high rate of increase during 1966 to 1983 were housing (20 per cent), research establishments (12 per cent), transfers to own enterprises (10 per cent), labour, employment and immigration (9 per cent), resource conservation, industrial development and debt charges (8 per cent) each. On the other hand, protection of persons and property and transportation and communication had very small annual growth.

Table 1: Growth Rates of Consolidated Canadian Government Expenditure

Items	66-83	84-95	93-95	66-91	66-95
Total expenditure	5.04	1.81	-0.76	4.40	4.01
General services	5.83	0.69	-2.96	4.01	3.36
Protection of property	1.92	0.57	-2.31	2.52	2.30
Transport and communication	1.25	-1.14	-1.78	0.77	0.45
Health	6.06	2.57	-1.28	5.11	4.66
Social Services	6.07	3.35	0.26	5.02	4.84
Education	2.72	1.72	-1.16	2.29	2.22
Resource conservation and industrial development	7.77	-4.27	-7.35	4.92	3.46
Environment	5.54	3.50	1.27	3.72	3.44
Recreation and culture	7.52	1.61	-3.24	5.24	4.49
Labour, employment immigration	9.25	4.30	0.65	7.32	6.73
Housing	20.11	0.73	0.71	12.90	10.67
Foreign affairs and international assistance	4.54	4.36	3.89	5.35	5.09
Regional planning and development	6.80	0.26	-4.61	4.17	3.30
Research establishments	11.83	1.27	-2.63	6.62	5.56
Transfers to own enterprises	9.53	-4.55	-3.00	7.38	5.50
Debt charges	7.56	3.45	1.42	8.00	7.29
Other expenditure	-7.11	-1.26	19.89	-0.07	0.16

Source: Computed from the data published by Statistics Canada.

The period 1992-95 recorded a negative rate of growth for the majority of the items with the exception of social services (0.26 per cent), environment (1.29 per cent), labour, employment and immigration (0.65 per cent), housing (0.71 per cent), foreign affairs and international assistance (3.89 per cent), and debt charges (1.42 per cent). The negative rate of growth accounts for the fact that spending control has been effectively implemented during the 1992-95 spending control phase.

Factors Accounting for the Changes in Government Spending

The rapid rate of increase observed for the period 1966 to 1983 is guided by various factors. In the first place, the Canadian Government, especially at the provincial level, initiated a number of social programmes such as hospital insurance, medicare and social assistance programmes. As some provinces initiated these, issues pertaining to equity and efficiency resulted in measures by the federal Government to have nation-wide social infrastructure. A number of shared cost programmes emerged out of this effort such as medicare and hospital insurance, post-secondary education and Canada assistance plan. Federal transfers recorded a large increase because of this.

The period after 1970s however was marked by slow-down in the economic growth and rise in prices. The rising prices led to indexation of many transfer programmes – old age benefits, unemployment insurance benefits, public assistance etc. The number of people covered under the income assistance programme also increased on account of the increasing unemployment rate. The rapid growth in expenditure, which was not matched by an equal increase in revenue, resulted in increasing deficits and the Government debt increased, resulting in rapid increase in debt charges.

All these adverse fiscal trends especially at the federal level called for some fiscal restraint, which was initiated in 1984. These measures were discussed at length earlier. Therefore, the rate of growth of expenditure slackened during 1984 to 1995. However, the actual decline in expenditure occurred only during 1992-95, caused by the Spending Control Act.

Composition of Expenditure

The structure and evolution of consolidated Government expenditure during the last three decades is examined here. This analysis is based on the Financial Management System (FMS) categorization of Government expenditure that provides details by functional categories such as defence, health, education, social services etc. Statistics Canada provides the consistent data set required for the purpose. The structure of expenditure by these categories is presented in table 2. The rapid growth phase of Government expenditure (1966-83) has most of the items increasing their share in the total expenditure. Health, education (although it has a declined share), social service and debt charges (with a sharp increase) account for larger shares. Protection of persons and property and transport and communication had a large share in1966 but a very sharp decline in 1983.

Table 2: Composition of Expenditure by Functional Categories (%)

Items	1966	1983	1992	1995	Aug
General services	5.62	5.86	5.51	5.10	6.18
Protection of property	13.18	7.59	7.25	6.85	8.65
Transport and communication	12.49	6.28	4.56	4.39	7.14
Health	9.75	12.27	13.35	13.17	12.42
Social services	18.08	21.02	23.28	23.99	20.81
Education	17.33	12.92	12.44	12.28	14.74
Resource conservation and industrial development	5.06	8.16	4.88	3.95	5.94
Environment	2.53	1.96	2.10	2.25	2.21
Recreation and culture	1.50	2.17	2.16	2.02	2.13
Labour, employment immigration	0.30	0.74	0.89	0.93	0.72
Housing	0.13	1.41	1.04	1.07	0.82
Foreign affairs and international assistance	0.92	0.86	1.11	1.38	1.04
Regional planning and development	0.46	0.56	0.54	0.45	0.59
Research establishments	0.40	0.67	0.58	0.58	0.63
Transfers to own enterprises	1.57	2.46	1.76	1.43	1.72
Debt charges	9.98	14.85	20.01	19.95	13.99
Other expenditure	0.71	0.23	0.19	0.22	0.27

Source: Computed from the data published by Statistics Canada.

Between 1983 and 1992 also very few items such as health, social services, debt charges continued to have increased shares. While health, social services had very small increases in their shares, debt charges continued their sharp increase and had the second largest share. Between 1992 and 1995, during the spending control phase, social services had a marginal increase, the other items that had an increase such as labour and employment, housing and foreign affairs had a very small share in the total expenditure. Debt charges had a very small decline in its share. It retained its second largest share.

The changes observed in the structure of expenditure reveal that a large portion of expenditure is incurred on programmes pertaining to education, social services, and health, apart from the debt charges. Accounting for the growth in expenditure in the area of health, it is observed that (Department of Finance, Canada, 1992) there were significant differences among provinces in the hospital spending. Wages and benefits accounted for over two thirds of the growth in hospital spending per patient day. Many factors such as the rapid increase in the number of physicians, advent of new technologies and new treatment, aging population, etc., account for the growth in health spending in Canada. However, this occurred more at the provincial level.

About spending in education, it has been observed that decline in spending in education is more pronounced for post-secondary education. Decline in the elementary-secondary spending is due to the decline in the corresponding school-aged population. Teacher's salaries accounted for almost two-thirds of the growth in elementary secondary spending per student.

Expenditure by Levels of Government

Canada has a federal system comprising two levels of government – the Federal and the Provincial – consisting of ten provinces and two territories. The division of responsibilities between the federal and provincial governments is listed in the box given below. The municipal or the local level is under the jurisdiction of the Provincial Government.

Division of Responsibilities

Federal	Provincial
Defence, Foreign aid, Unemployment, Insurance, Old age pension, Family allowances (child tax benefit)	Health care, Education, Social assistance

Although these responsibilities are clearly earmarked, the Federal Government is responsible for provincial equalisation in providing comparable levels of public services. The fiscal equalisation programme exists based on the standards of five provinces – Ontario, British Columbia, Quebec, Saskatchewan and Manitoba. There is also another transfer programme, the Established Programme Financing (EPF), wherein the Federal Government provides financial assistance to all provinces for health care and post-secondary education. The Federal Government also provides contributions for income support and social services for those in need under the Canadian Assistance Plan.

Growth and composition of expenditure by levels of government offers interesting insights. A comparison of growth rates of per capita real expenditure (Table 3) of the Federal and Provincial governments reveals that the rate of growth has been faster at the provincial government level and was much sharper during 1984-85 and 1992-95. The observed decline in the spending control regime is also much faster at the federal level and the provinces had a very large burden on account of debt charges. The Federal Government recorded a decline in the rate of growth of debt charges while provincial debt charge increased at 7.93 per cent per annum.

Table 3: Growth Rates: A Comparison at Consolidated, Federal and Provincial Levels

Items	66-83			84-85			92-95		
	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial
Total expenditure	5.04	5.18	6.14	1.81	0.80	2.17	-0.76	-1.11	-0.45
General services	5.83	4.09	8.62	0.69	0.98	-0.12	-2.96	-0.66	-3.65
Protection of property	1.92	0.65	5.56	0.57	-0.25	1.94	-2.31	-2.42	-3.38
Transport and communication	1.25	1.23	1.10	-1.14	-3.14	1.55	-1.78	-1.52	-3.40
Health	6.06	5.29	6.33	2.57	-1.40	2.67	-1.28	-0.92	-0.98
Social services	6.07	5.53	7.18	3.35	2.24	5.26	0.26	-1.28	2.17
Education	2.72	3.88	4.47	1.72	-1.18	0.93	-1.16	2.13	-1.57
Resource conservation and industrial Development	7.77	7.95	7.77	-4.27	-7.00	-2.02	-7.35	-5.82	-11.3
Environment	5.54	20.74	23.07	3.50	2.19	2.19	1.29	7.40	-2.92
Recreation and culture	7.52	5.41	9.54	1.61	1.20	-1.21	-3.24	-3.71	-10.03
Labour, employment Immigration	9.25	7.91	1	4.30	3.99	1	0.65	2.13	-1.43
Housing	20.11	24.34	13.96	0.73	-1.73	5.22	0.71	1.68	-0.07
Foreign affairs and international assistance	4.54	4.54	-	4.36	4.38	-	3.89	3.93	-

Contd.

Items	66-83			84-85			92-95		
	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial
Regional planning and development	6.80	2.80	16.57	0.26	0.66	3.40	-4.61	4.49	-4.84
Research establishments	11.83	11.36	1	1.27	0.24	1	-2.63	-5.79	11.11
Transfers to own enterprises	9.53	6.95	5.51	-4.56	1.08	-3.50	-3.00	-2.35	-6.64
General	7.56	6.25	22.23	3.45	3.05	6.05	1.42	-1.82	7.93
Debt charges	-7.18	7.76	10.57	-1.26		-2.51		1.90	-7.59
Other expenditure	-	-	-		-	-	-	377.66	-

Source: Computed from the data published by Statistics Canada.

Hence, during the spending control phase, while the Federal Government has been able to successfully cut down its expenditure, the provinces have not been able to do so and their debt burden has also been on the increase. Per capita real government expenditure by levels of government is presented in Table 4.

Table 4: Per Capita Real Government Expenditure by Levels of Government ($)

Items	1966			1983			1992			1995			Percent increase		
	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial
Total expenditure	3103	1593	1203	7677	4000	3655	9695	4766	4709	9493	4625	4657	206	190	287
General services	174	82	53	450	172	195	535	204	223	484	200	194	178	143	264
Protection of property	409	315	43	583	369	112	703	428	151	650	393	135	59	25	212
Transport and communication	387	108	200	482	120	260	442	111	210	417	104	190	8	-4	-5
Health	303	86	274	942	197	896	1294	229	1239	1250	236	1206	313	176	340
Social services	561	446	155	1614	1207	521	2257	1576	850	2277	1515	910	306	240	489
Education	538	53	293	992	123	782	1206	127	884	1166	140	856	117	162	192
Resources conservation and industrial development	157	96	67	626	413	255	474	224	271	375	186	189	139	93	183
Environment	78	2	2	150	20	46	203	20	60	213	25	55	172	1169	2814
Recreation & culture	46	10	8	167	27	52	210	39	57	192	35	42	313	238	410

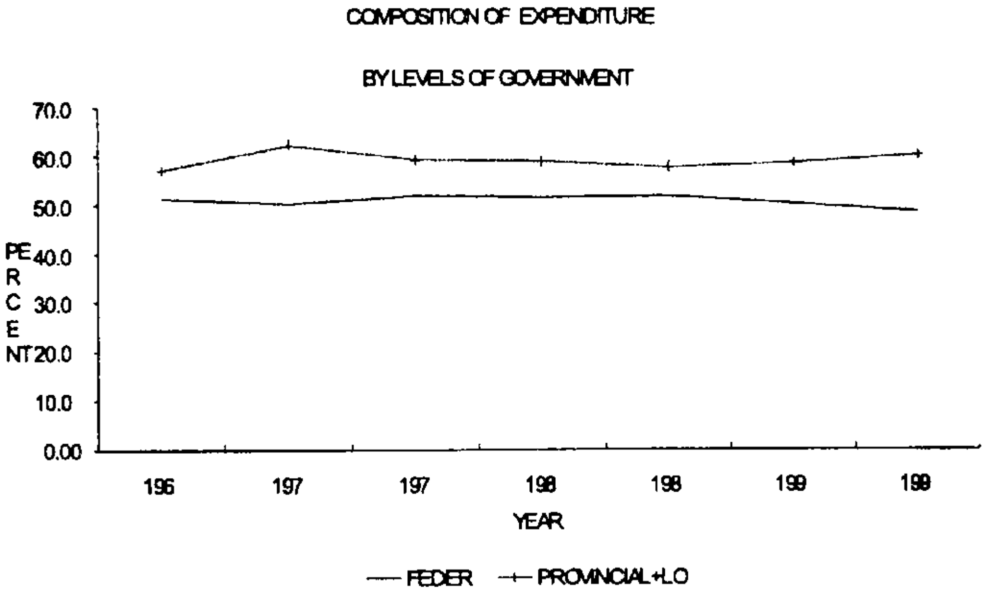
Contd.

Items	1966			1983			1992			1995			Percent increase		
	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial	Consolidated	Federal	Provincial
Labour, employment, immigration	9.2	9	0	57	48	10	86	65	23	88	68	22	856	644	Err
Housing	4.00	3	2	108	77	26	101	54	31	102	56	31	2382	2133	1561
Foreign affairs and international assistance	29	29	-	66	66	-	112	112	.	131	131	-	358	358	-
Regional planing & development	14	5	2	43	7	33	49	11	25	43	12	21	198	118	799
Research establishments	12	12	0	51	48	4	58	48	10	55	41	14	347	238	Err
General	-	78	36	-	264	70	-	285	70	-	289	56	179	271	56
Transfers to own enterprises	49	34	12	189	123	37	140	61	50	136	58	41	511	72	226
Debt charges	310	200	52	1140	720	346	1811	1173	598	1894	1123	694	-4.84	463	1234
Other expenditure	22	25	2	18	0.09	10	15	0.17	-738	21	12	0	-4.84	-51	-100
Deficit	94	30	-32	-1457	-1097	-349	-804	-1083		-1449	-989	-392	1436	-3363	1134

Source: Computed from the data published by Statistics Canada.

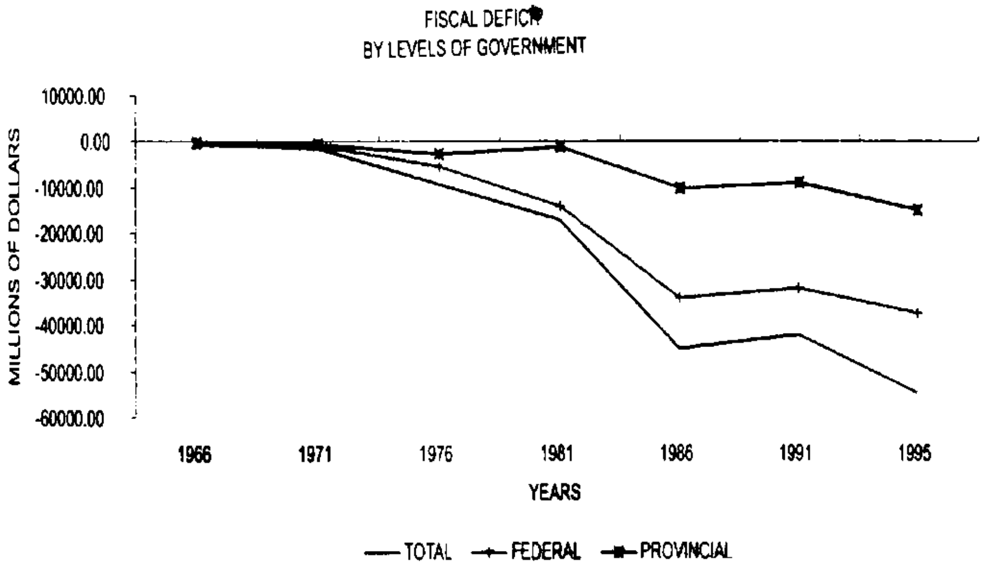
The percentage composition of the consolidated Canadian Government expenditure by levels of government at Federal and Provincial level clearly reflects a decline (Graph-2) in the share of federal expenditure while that of Provincial governments increased sharply in 1971 and has been on the increase.

Graph 2



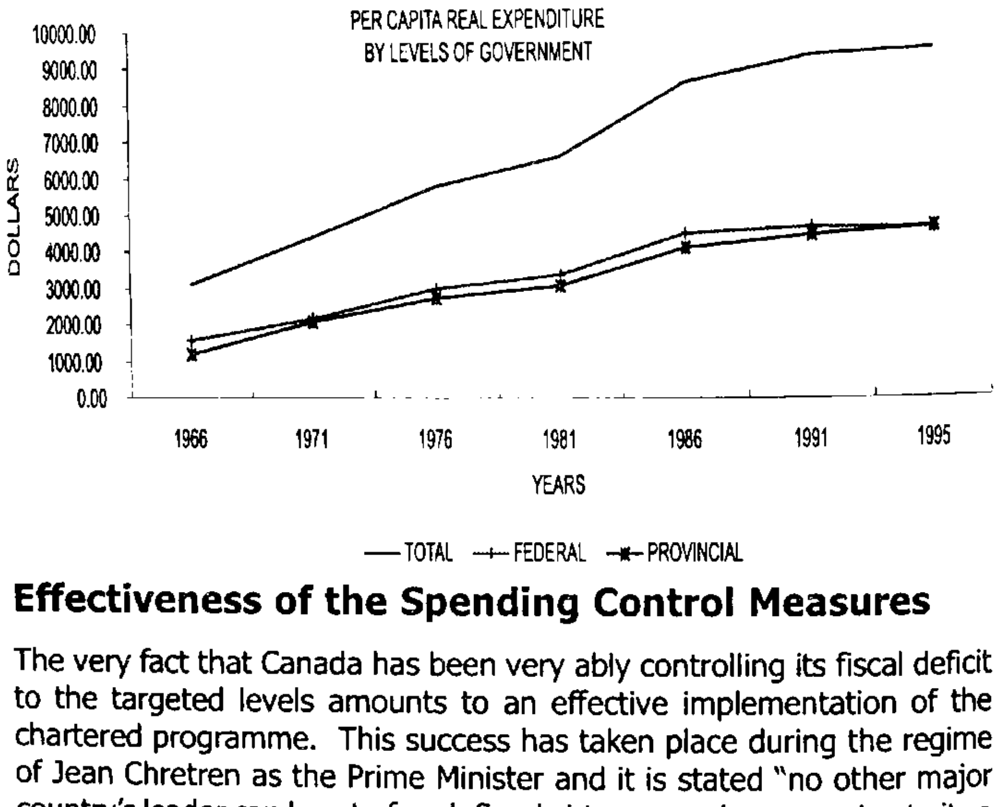
The increase during 1991-95, the spending control regime, is more than in the preceding decade. On the contrary, the share of Federal Government has been on the decline since 1986. These trends reveal that the provincial governments' responsibilities are on fast increase, and are very clear from graphs 3&4 presenting fiscal deficit and per capita real expenditure.

Graph 3



In the course of spending reduction after 1984, there has been a shifting of cost to the provinces. The growth of provincial transfers, EPF and CAP was limited in 1980: 21 per cent of federal expenditure was towards transfers to other levels of government, which came down to 18 per cent in 1993. These provinces had little incentive to control costs as they were open ended, however, once the limits were imposed on transfers, provinces had to either borrow additional funds, or pay more for these services out of their own budgets or restrain their own expenditure. The ultimate result is a rapid growth in the deficits and debts as expenditure could not be contained within revenue. It has been observed that provincial bond ratings have been lowered several times during the 1990s.

Graph 4



Effectiveness of the Spending Control Measures

The very fact that Canada has been very ably controlling its fiscal deficit to the targeted levels amounts to an effective implementation of the chartered programme. This success has taken place during the regime of Jean Chretren as the Prime Minister and it is stated "no other major country's leader can boast of such fiscal virtue, or so large a swing to it so swiftly achieved"[5].

His government inherited a huge fiscal deficit, when he came to power in 1993-94. It was as high as ($42 billion) 5.9 per cent of GDP, which was brought down to $8.9 billion in 1996-97, a meager 1.1 percent of GDP. This is a remarkable achievement as the government had planned to reduce the fiscal deficit to 3 per cent of GDP by 1996-97 but in reality, the reduction has been much higher.

This substantial reduction in the fiscal deficit was brought about in a carefully planned spending programme. As has already been observed, expenditure under the majority of items registered a decline, with the exception of debt charges. This was the case with the spending at provincial level also. Government by and large accomplished this reduction by taking some harsh decisions such as reducing the size of the public force, freezing wage increases and, as stated earlier, pushing off some spending burden to the provincial governments. However, an important step that the Government took during this course was taking all the political parties into confidence and bringing the voters into a broad consensus. Public hearings on issues pertaining to the budget were held in various cities wherein an all-party parliamentary committee explained the problems to the public. These measures helped the Government to reduce the size of the deficit. An important outcome of all these measures is in the form of growing financial burden at the provincial level. However, the ultimate objective of improving the fiscal situation of Canada was undoubtedly achieved. An added advantage was the recovery of the Canadian economic growth in 1995, growing at the annual rate of 5 per cent. Largely expenditure management has been responsible for the success of the fiscal reform process.

A brief account of the expenditure management in Canada is presented here as given in the various publications of the Government of Canada.

Expenditure Management

The Expenditure Management System involved a number of key share-holders – Parliament, the Public, Cabinet and its committees, Privy Council, Finance Department, Treasury boards and various departments and agencies, the ultimate goal being delivery of quality services within the available resources to cater to the needs of the public.

Guidelines were drawn in order to manage the expenditure, which included:

- Departments have to adopt a business-planning approach in order to adjust business to available resources. They are required to frame their strategies to reflect the expenditure needs and priorities. "Business plans are intended to extend beyond the traditional review and approval of expenditure authorities to an integrated, strategic view of department-wide resource management that encompasses the human, financial, technological and capital implications of operating current and future programs. It is expected to foster more fiscal responsibility by departments" (Government of Canada, 1995, p5).
- Cabinet approval to be obtained for all new policy initiatives, even when funded through internal allocation.
- Cabinet approval was also required when reallocations were made from existing programmes to new or other existing programmes

when they have implications for the Government's overall policy agenda and also if these policies affect the programmes of other ministries.

It was stipulated that the departments had to manage the new programmes also within the existing resources available and that no central reserves would be made available to fund new initiatives. However, Government would operate a contingency reserve to cover the risk of statutory expenditures that exceeded projections. The size and application of reserves was under the control of the Minister of Finance, as "such a reserve will allow the Government to buffer its fiscal targets while providing Parliament with the best available projection of expenditure on statutory programmes".

Besides the contingency reserve, the Treasury Board would manage a small operating reserve, meant to support projects that have significant productivity pay back. However, such assistance would be in the form of credit carrying interest.

The process of expenditure management system and the roles of different agencies are presented in figures 1 and 2. This expenditure management system helps the Government take cautious decisions.

Fiscal Deficit Reduction Experiment in India

Growth in Government Activity

India has been no exception to the rapid expansion in government activity that has occurred the world over until the launch of the economic reform process. This has resulted in rapid increase in the proportion of Government expenditure in the country's GDP, a measure that is generally used to measure the growth in government activity. The proportion of combined expenditure of the centre and states in the Gross Domestic Product (GDP) has increased from 16 percent in 1960-61 to 29 percent in 1990-91. During the fiscal reform process, it showed a marginal decline; it had a 26 percent share in 1996-97. This growth has been at considerable cost to the economy in terms of the growing dis-savings by the Government, caused by the excessive growth of expenditure over that of government revenue. The proportion of Government revenue to GDP has been far below that of the expenditure to GDP during the above period. It was 11 per cent in 1960-61, increased to 18.5 per cent in 1990-91 and declined to 18.4 per cent in 1996-97. An obvious outcome of this is the growing debt burden, both internal and external, and growing deficits.

Trends in Fiscal Deficit

India launched economic reforms in the year 1991 comprising stabilization and structural adjustment measures in order to overcome the macro economic crisis that the country faced in the 1990s. Fiscal deficit reduction was an important element of the fiscal stabilization programme. This was very essential in view of the huge fiscal deficit that the governments both at the centre and state levels had amassed over a period. It was as high as 10 percent of GDP and the rate of inflation, which is generally associated with high fiscal deficits, was 17 percent per annum. The gross fiscal deficit of the centre alone was as high as 8.4 percent of GDP (Table 5). It can be observed that the Government could successfully reduce the size of fiscal deficit in the first two years of the reform process, 5.9 per cent in 1991-92 and 5.7 per cent in 1992-93. Revenue deficit too has had a decline. However, in the year 1993-94, fiscal deficit reached 7.4 per cent of GDP as against the targeted level of 4.7 per cent of GDP. This was caused by both revenue shortfalls (40 per cent) and expenditure overruns (60 per cent) (The World Bank, 1995). Since then there has been no consistent decline in the size of fiscal deficit.

Table 5: Trends in Central Government Deficits

(As percentage of GDP)

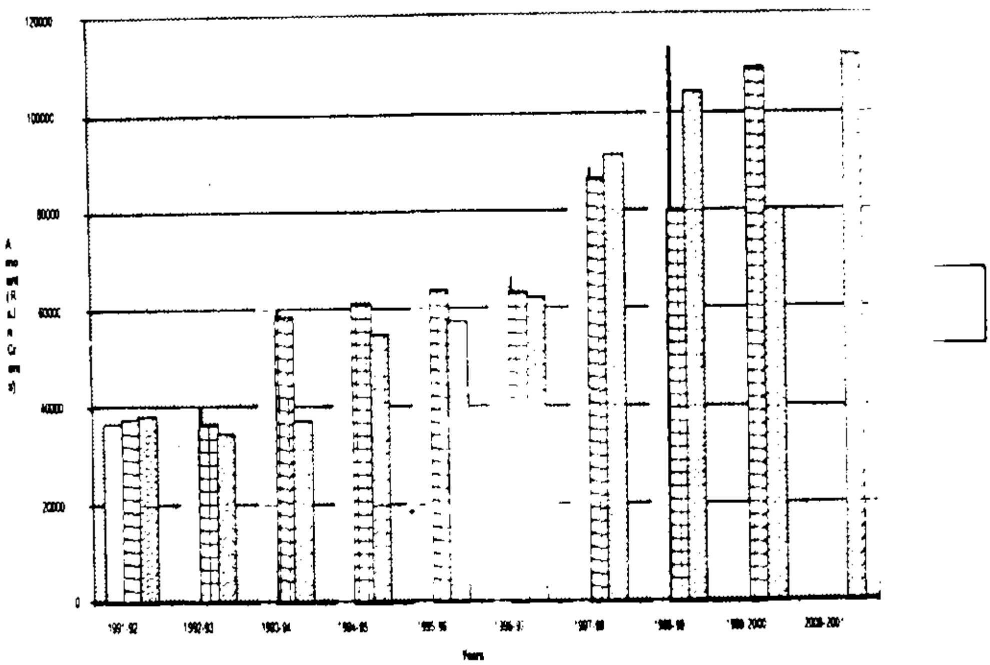
Years	Revenue Deficit	Primary Deficit	Fiscal Deficit
1990-91	3.5	4.3	8.3
1991-92	2.6	1.6	5.9
1992-93	2.4	1.3	5.7
1993-94	4	2.9	7.4
1994-95	3.2	1.4	6.1
1995-96	2.7	0.9	5.5
1996-97	2.6	0.6	5.2
1997-98	3.3	1.6	6.3
1998-99 (RE)	3.8	1.7	6.5
1999-2000 (BE)	3	-0.4	5.4

Note : RE - Revised Estimate
BE - Budget Estimate

Source: World Bank, 1997, India Sustaining Rapid Economic Growth and Government of India, 1999-2000, Budget at a glance

Thus, the fiscal policy change in India has not been able to successfully restore fiscal balance at the end of nine years of fiscal reform process. Although the government has been budgeting for a much lower level of deficit every year, it has not been able to achieve the deficit targets that have been budgeted for (Graph 5).

Graph 5 : Gross Fiscal Deficit: Budget Estimates, Revised Estimates



The burden on account of deficits has been accentuated on account of increased diversion of its borrowings to the current expenditure, thus resulting in huge revenue deficits. Large-scale revenue deficits have restrained the growth in Government's capital investment. There has been a decline in the gross capital formation from budgetary sources from 5 per cent of GDP (1990-91) to 3.36 per cent (1999-2000 BE). The huge public debt stock has resulted in a sharp increase in the interest payments, which almost accounts for 50 percent of the revenue resources. Governmental effort to reduce the level of revenue deficit has not met with great success.

Table 6: Proportion of Net Transfers to the States to Centre's Receipts

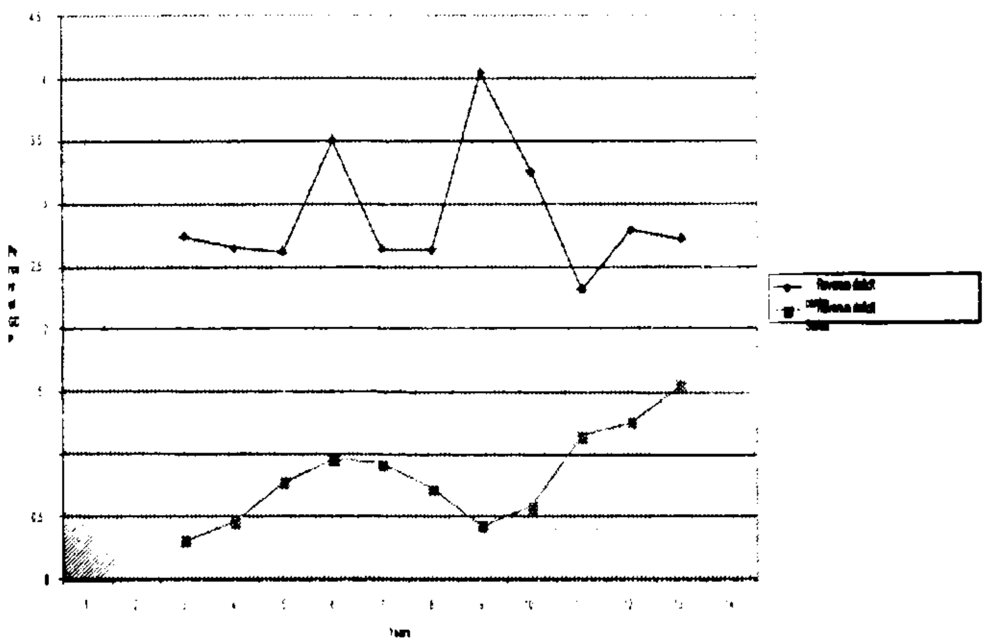
Years	Proportion
1991-92	33.3
1992-93	32.4
1993-94	31.9
1994-95	32.6
1995-96	31.7
1996-97	32.7
1997-98	36.8
1998-99 (RE)	31.1
1999-00 (B.E)	25.4

Source: Government of India, 1998, Indian Public Finance Statistics, 1999-2000

Net transfers to states as a proportion of total receipts of the central government has declined (Table 6) from 33.3 percent in 1991-92 to 29.6 percent in 1998-99 (BE). These observations reveal that while the Central Government has on the one hand not been able to adhere to the targets, it has also been passing on the fiscal burden to the lower levels of government to a certain extent.

This however does not imply that state governments are not responsible for the fiscal imbalances in the country. States have also been increasingly contributing to the fiscal problems by way of the increased mismatch between their resources and expenditure. Hence, the fiscal consolidation in the country should take a holistic view of the extent of fiscal problem in the country.

Graph 6 : Revenue Deficits



The serious fiscal imbalances that have been persisting in the finances of the Indian Union also need to be addressed by way of harsh but meaningful corrections. Nevertheless, this exercise cannot be completed in a hurried and unplanned manner, as it will have adverse implications on the economic growth and welfare of the nation. Hence, there is a need to devise a medium term plan with necessary adjustments both in government revenue and expenditure. These have to aim at maximizing the growth by way of eliminating inefficiencies. On the expenditure front, the items to be dropped have to be carefully reviewed and chosen in order to ensure that the productive element of government expenditure does not suffer while the unproductive expenditure is eliminated. Since any changes brought in the expenditure or the revenue reflect on the broad fiscal policy of the nation, which in turn has considerable macro-economic implications, the restructuring of finances has to be attempted with great care.

Learning from the Canadian Experiment: Lessons for India

The fiscal mess that the Canadian government got into on account of large-scale increase in the fiscal deficits and the resultant increase in debt burden forced corrective measures since 1984. However, the mission was not very successful until the introduction of the "Spending Control Act" in 1991 and its effective implementation up to 1996. Reduction in the fiscal deficit on account of these measures met with greater success than that targeted for. Fiscal deficit was reduced to 1.1 per cent of GDP by 1996 as against the 3 per cent targeted level. The key to this success lay in the strict control that was effected on the growth of Government expenditure both at the federal and the provincial level. An analysis of the growth and composition of Government expenditure during the period 1966 to 1995 reveals that while a majority of the items had very rapid increase between 1966 and 1983, their rate of growth decelerated between 1984 and 1992 and declined between 1992 and 1995. During the spending control regime (1992-95), there was a negative rate of growth for the majority of the variables with the exception of social services and debt charges.

A significant development in this regard pertained to the shifting of fiscal burden from the Federal government to the provincial level. This is revealed from the fact that the debt burden at the provincial level grew at a rapid rate as opposed to a decline at the federal level during the spending control regime. Spending burden at the federal level had declined considerably as most of the items have had negative rates of growth while at the provincial level expenditure continued to increase under many heads.

The essential issues that emerge out of these findings are that while there has been a successful reduction in the fiscal deficit level, there appears to be a growing burden at the level of the provincial governments. These developments have large-scale implications for the vertical imbalances in a federation like Canada. These are issues which need further careful analysis.

Fiscal reforms constitute an important component of the economic reform process. They need to be carefully designed with a clear perception of the changing role of Government and by fixing norms for an appropriate size of government expenditure. Government has to redesign its expenditure priorities in accordance with the changed role. Such an exercise would ensure savings on account of programmes that have become redundant and there would be no paucity of funds for priority sectors. However, this cannot be attempted in one financial year. There is need to formulate a fiscal management strategy involving the framing of medium- to long-term fiscal objectives. Government of India has only been referring to this in the budget speeches while no efforts are made to frame an actual plan. Fiscal consolidation in Canada was attempted mainly through expenditure reduction based on a medium-term plan.

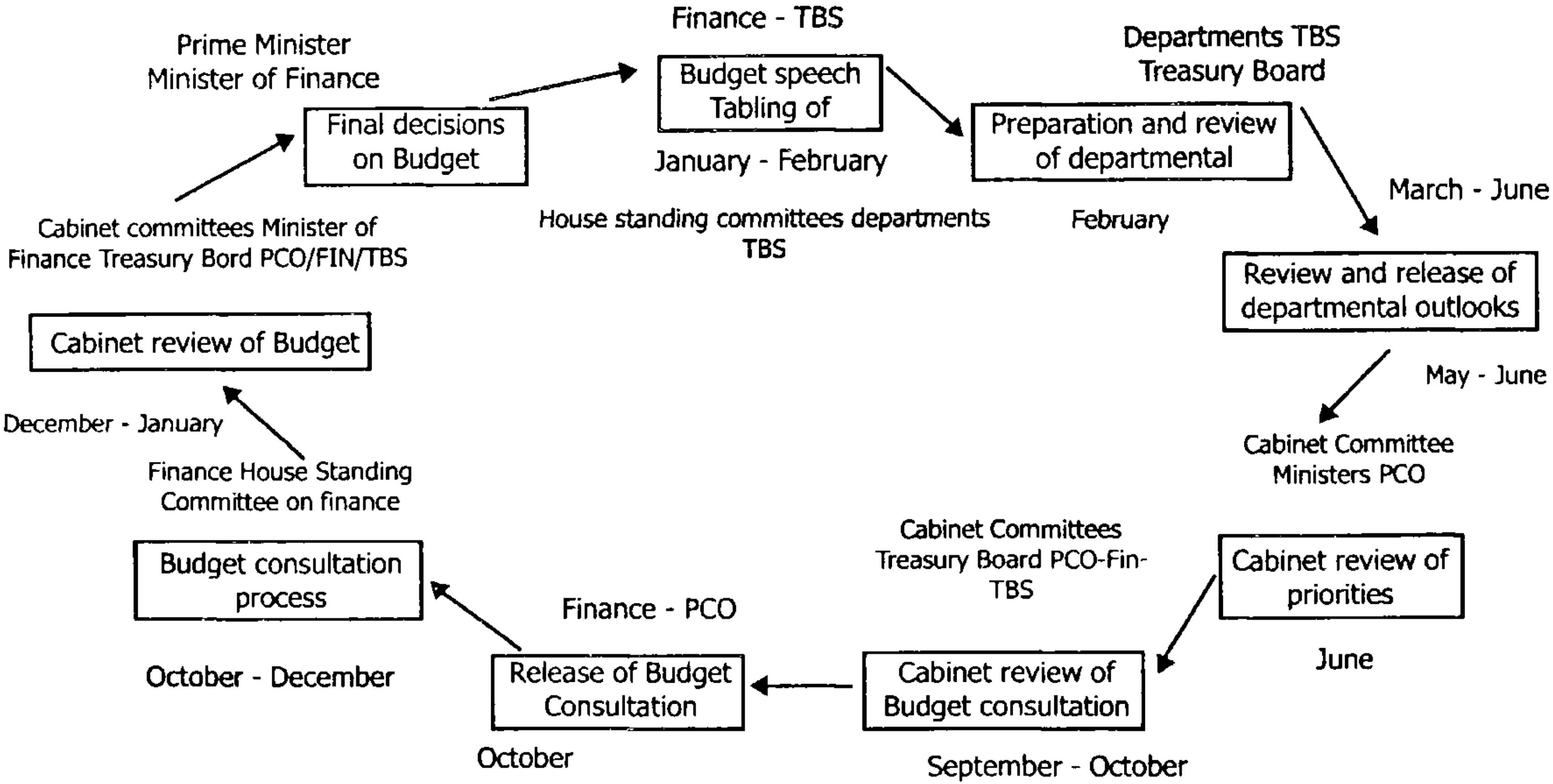
The efficiency of operation of Government services has been a major area of concern. Ineffective and inefficient delivery of services results in considerable wastage of resources. Measures are needed to improve the efficiency of service delivery by targeting eligible recipients. In the Indian context, the Government can save to a considerable extent by eliminating the ineligible beneficiaries under many schemes. Cost recovery in the form of appropriate user charges has to be ensured in order to bring about a phased reduction in subsidy. Cost recovery has been very low in India even for the commercial services rendered by the Government. Canadian Government ensured appropriate cost recovery by privatising a number of Government services. Fees were raised for providing Government services to ensure provision of these services without adding to the fiscal imbalances.

The large base of employment created in the Government sector needs immediate attention. Until and unless the Government freezes recruitment for a medium term, there can be no solution. While the Government has implemented the pay revision recommendation of the Fifth Pay Commission, it has not paid heed to the Commission's recommendations on downsizing the Government. The fiscal burden on account of wages and salaries cannot be reduced without reducing the large base created by the Government. In the Canadian context, employment reduction took varied forms like freezing of fresh recruitment, elimination of vacant posts, restraint in the provision of new posts etc. The saving on account of employment reduction was substantial both at the federal and provincial levels of Government. Wage growth was also restrained by setting guidelines or regulations to freeze or restrain public sector wage growth. Interestingly the acceptance of salary restrictions by the Cabinet ministers and the MLAs set the example for Government servants.

More aggressive privatisation of commercial public enterprises would help the Government achieve savings. Privatization efforts in India have not been very successful until now. Privatization helps Government reduce its operating costs and improve efficiency. In the event that Government uses the dis-investment proceeds to clear off a portion of its debt, the interest burden also can be reduced to a great extent. This will partly take care of the revenue deficit as well. Privatization of more than 20 Crown Corporations in Canada helped the Government generate substantial savings in their operating costs.

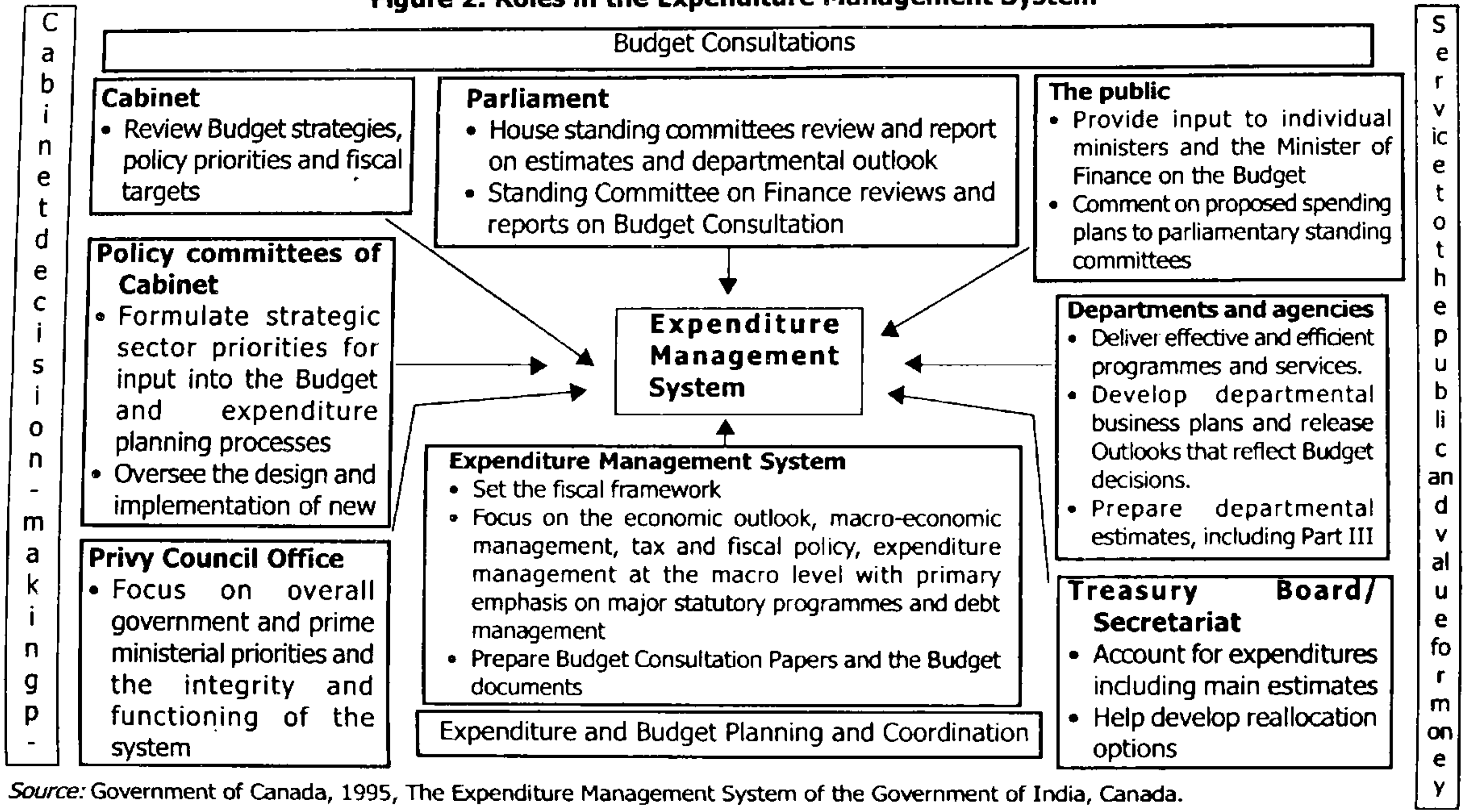
Some departments become redundant in the wake of the economic reform process. Hence, there is a need to reduce and rationalise the number of Government departments, which will help Government to generate savings. Central and State governments have to honour their own responsibilities and should avoid stepping into each other's shoes. The Canadian Government successfully eliminated many departments; they were either restructured or amalgamated to reduce administrative costs. It also reduced the number of boards and commissions and streamlined their administrative operations.

Figure 1: The Expenditure Management System



Source: Government of Canada, 1995, The Expenditure Management System of the Government of Canada, Canada.

Figure 2: Roles in the Expenditure Management System



Source: Government of Canada, 1995, The Expenditure Management System of the Government of India, Canada.

Notes

1 Illustration as presented in Robin Boadway and Frank Flatters 1991 p.96

2 The paper mainly addresses the fiscal deficit and its control measures at the level of federal government and the same is often referred to in the paper .All such references unless and otherwise stated should be read as belonging to the federal government.

3 Exemptions included spending related to emergencies, self-financing programmes etc.

4 Statistics Canada publishes consolidated public expenditure data for all levels of government-federal, provincial and local. This helps in understanding the relative shares of expenditure at each level of government and the changes thereon.

5 *The Economist*, October 25, 1997, p.51.

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