# **Joe Oliver's Big Challenge: Living with Budget Surpluses**

Christopher Ragan
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Federal Finance Minister Joe Oliver expects to have 18 months in the position before his government faces an election. Thanks to the policy decisions made by his predecessor, the broad economic challenges he faces will likely be relatively modest. But Mr. Oliver will nonetheless face significant tests of his political abilities, particularly in how he deals with the government's new problems: Budget surpluses and a declining debt ratio.

The federal government is projecting a $2.9-billion deficit this fiscal year (ending March 31, 2015) and a $6.4-billion surplus next year. If these numbers come to pass, the Conservatives will be able to show, as they enter the next election campaign, that they have returned to their fiscally conservative roots – after their temporary and (to many conservatives) distasteful diversion into crisis-induced fiscal stimulus.

It won't matter that the surplus in 2015-16 will be only 0.3 per cent of gross domestic product (GDP) or only 2.2 per cent of the government's total budget. In absolute terms, a surplus of $6.4-billion is a tremendous amount of money, and its appearance will lead to countless demands. Many people will urge the Finance Minister to reduce taxes, arguing that the government is collecting more than it needs. Others, including some of his ministerial colleagues, will argue for "investing" in all kinds of worthy projects. Some will demand continued surpluses, because only then will Canada's public debt be reduced. Balancing these demands will not be easy.

To avoid these difficulties, Mr. Oliver should make some small but sensible adjustments in an effort to keep surpluses to a minimum. Building a small "contingency" line into the annual budget, which gets used to repay debt only in the absence of a fiscal emergency, is both a sensible economic measure and a good political tactic for deflecting attention away from what would otherwise be a clear budget surplus.

There is also a broader political advantage associated with keeping the budget close to balance: Any political party that does so is free from accusations of fiscal irresponsibility. Balanced budgets are the political gold standard. In contrast, surpluses fail the political cost-benefit test: They earn you few extra points for fiscal responsibility, but invite lots of headaches.

As for the underlying economics, it matters little whether the budget shows a small deficit or a small surplus. What matters much more is the fiscal position of the government as measured by its debt-to-GDP ratio. Whether we have small surpluses or small deficits, the underlying growth of the economy will lead to a decline in this ratio. The federal debt is now

33 per cent of GDP; it is projected to decline to about 30 per cent by 2015-16, and to 25 per cent three years later.

This low and declining debt ratio will present another political challenge to Mr. Oliver and his successors. Once again it will become apparent that the finances of the federal government are in much better shape than those of most of the provinces. The mother of all "fiscal imbalances" will soon be returning.

This term was first used during the early 2000s, when the federal government had budget surpluses and the provincial governments were struggling with the combination of reduced federal transfers and their own growing spending on core programs.

The differences between federal and provincial finances are even larger today, and will remain so for many years. The largest and fastest-growing expenditure item for the provinces is health care, and its rapid growth is driven by two unstoppable forces. The first is the ongoing development of expensive new technologies enabling treatments that were impossible not long ago. The second is the aging of Canada's baby boom generation, which is now just starting to retire and increase its use of the health care system.

As provincial finance ministers struggle to get their own post-recession budgets back to balance, but must also face rising demands for health spending, it is inevitable that they will pressure the federal government for help. The fact that Ottawa will then have approximately balanced budgets and an even lower debt ratio will only strengthen their arguments – and heighten the political tensions.

Mr. Oliver and his successors, of whatever political stripe, will need to think carefully about how to manage the inevitable demands on a federal government whose fiscal capacity will be obvious to all. This will be a political challenge of the first order.

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