

POLICY SERIES



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Leveling the Spending Field

EVOLVING GOVERNMENT
FOR HIGH QUALITY SPENDING

BY DAVID SEYMOUR



About the Author

David Seymour is joins the Centre from New Zealand as a policy analyst working out of the Centre's Regina office. He holds degrees in Electrical Engineering and Philosophy from the University of Auckland, where he also taught Economics. After working as an engineer in New Zealand he is applying his passion for high performance government to policy issues on the Prairies.



The Frontier Centre for Public Policy is an independent, non-profit organization that under-takes research and education in support of economic growth and social outcomes that will enhance the quality of life in our communities. Through a variety of publications and public forums, the Centre explores policy innovations required to make the eastern prairies region a winner in the open economy. It also provides new insights into solving important issues facing our cities, towns and provinces. These include improving the performance of public expenditures in important areas like local government, education, health and social policy.

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MB: Suite 25 Lombard Concourse, One Lombard Place,
Winnipeg, Manitoba CANADA R3B 0X3
Tel: 204 957-1567 Fax: 204 957-1570

SK: 2353 McIntyre Street,
Regina, Saskatchewan CANADA S4P 2S3
Tel: 306 352-2915 Fax: 306 352-2938

AB: Ste. 2000 – 444, 5th Avenue SW
Calgary, Alberta CANADA T2P 278
Tel: (403) 230-2435

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Executive Summary

- The political history of the Prairie region is a constantly evolving relationship between citizens and government that originated in Europe almost a millennium ago. The Fiscal Constitution presents the opportunity for another chapter in that evolution.
- Provincial government expenditure per capita, adjusted for inflation, increased at a trend average of \$306 in Alberta, \$307 in Saskatchewan and \$188 in Manitoba over the years 1997-2007.
- During this period, these increases amounted to \$3,060, \$3,070 and \$1,880 more spent on behalf of each citizen in 2007 than was spent in 1997.
- Results for common social statistics like Gini coefficients, life expectancy, suicide rate, educational achievement and infant mortality show either deterioration or very limited progress.
- These increases in expenditure without demonstrable results may be attributed to the power of interest groups (the public choice theory of economics) and the predisposition of politicians to focus on inputs (or expenditure) as a proxy for policy outcomes.
- A fiscal constitution would help to refocus government expenditure on getting results by ensuring that inflation adjusted per capita expenditure cannot increase without the explicit permission of voters.
- The onus would be on the increase-expenditure champions to demonstrate the results they expect to achieve, thus leading to higher quality expenditure.
- A fiscal constitution could be introduced through Section 43 of the Constitution of Canada as a federally ratified part of any province's constitutional background.
- By settling the ongoing dispute over expenditure levels and creating a political environment for more productive government service delivery, a fiscal constitution is attractive to both the political left and right.

“
However, those in a position to gain disproportionately from government expenditure are motivated to exercise disproportionate influence in the political system.

A fiscal constitution would help to refocus government expenditure on getting results.

”

Introduction

The current relationship between the Prairie governments and their people began developing a millennium ago in Europe and continues to evolve today. The right to own property; to have a fair trial judged by peers; to vote regardless of race, gender or social status; and to live and work without fear of gender, religious or racial discrimination was established along this journey toward the basic rights of a Canadian citizen.

This Frontier Centre Policy Series paper proposes another chapter in this journey, that of making additional government expenditure require explicit consent from a majority of citizens.

Since the Prairie governments adopted balanced budget laws, deficits were eliminated but expenditure increases have continued. After the population and inflation growth over the 10 years from 1997 to 2007 is adjusted, the trend is clear. Real per capita expenditure in 2007 dollars rose by a trend average of \$306 per year in Alberta, \$307 per year in Saskatchewan and \$188 per year in Manitoba. Since 1997, government expenditure per citizen in these provinces increased by \$3,060, \$3,070 and \$1,880 respectively.

Meanwhile, it is not clear what benefits result from these increases. Life expectancy has continued to increase as it has in Western countries over the past two centuries. However, standardized education assessment results, infant mortality rates, crime rates, suicide rates and income inequality have either stagnated or deteriorated.

Aside from the problem of failing to get results in return for taxpayers' money, increased government expenditure is economically damaging. It is at odds with the international trend of lower tax rates and higher economic growth in Australia, Asia and Eastern Europe and in sync with the higher taxes and sluggish growth of Western Europe.

Increasing government expenditure is failing to achieve the outcomes we might expect from thousands of extra dollars per person. It is time to ask why.

Public choice theory (essentially the economics of politics) predicts that organized interest groups are succeeding in capturing economic rents through the political system. Voters in general are rational to ignore politics; however, those in a position to gain disproportionately from government expenditure are motivated to exercise disproportionate influence in the political system. For this reason, the political system is always biased to more expenditure, but because the extra money is captured in economic rents, there may not be a corresponding increase in productivity.

Another theory is that government expenditure is a political end in itself rather than a means to other ends. A look at the provinces' Speeches from the Throne finds that promises are almost invariably promises to spend rather than to get results.

A fiscal constitution would change the way governments obtain consent to spend and in the process would shift the focus away from expenditure as an end in itself back toward getting results. The mechanics of the Fiscal Constitution would be simple: governments would be required to hold expenditure at the existing rate per person in real terms. That is, the actual figure in each year is the previous year's expenditure adjusted for changes in inflation and population. The opportunity to spend more than this would exist but only with the explicit consent of the voters.

“

Additional government expenditure requires explicit consent from a majority of its citizens.

”

Section 1: Prairie Expenditure — An Upward Trend

This section presents evidence from Statistics Canada's Financial Management System, a system of government accounts that is standardized across Canada to allow comparability over time and amongst provinces.¹ The evidence for the past 10 years shows a clear trend of increased expenditure per person in real terms by provincial governments. These figures were adjusted for the population of each province in each year and for the Bank of Canada's Core Consumer Price Index.

All three provinces introduced balanced budget laws during the 1990s. As a result, revenue for the period 1997-2007 kept pace with, if not

exceeded, expenditure. After the deficit spending of the 1970s and 80s, the interesting trend is no longer the relationship between revenue and expenditure but their absolute levels.

Real per capita expenditure in 2007 dollars rose by a trend average of \$306 per year in Alberta, \$307 per year in Saskatchewan and \$188 per year in Manitoba. Since 1997, government expenditure per citizen in these provinces has increased by \$3,060, \$3,070 and \$1,880 respectively. There is a trend in all three provinces for the governments to spend progressively more per person. The question to ask is what is this extra expenditure delivering?

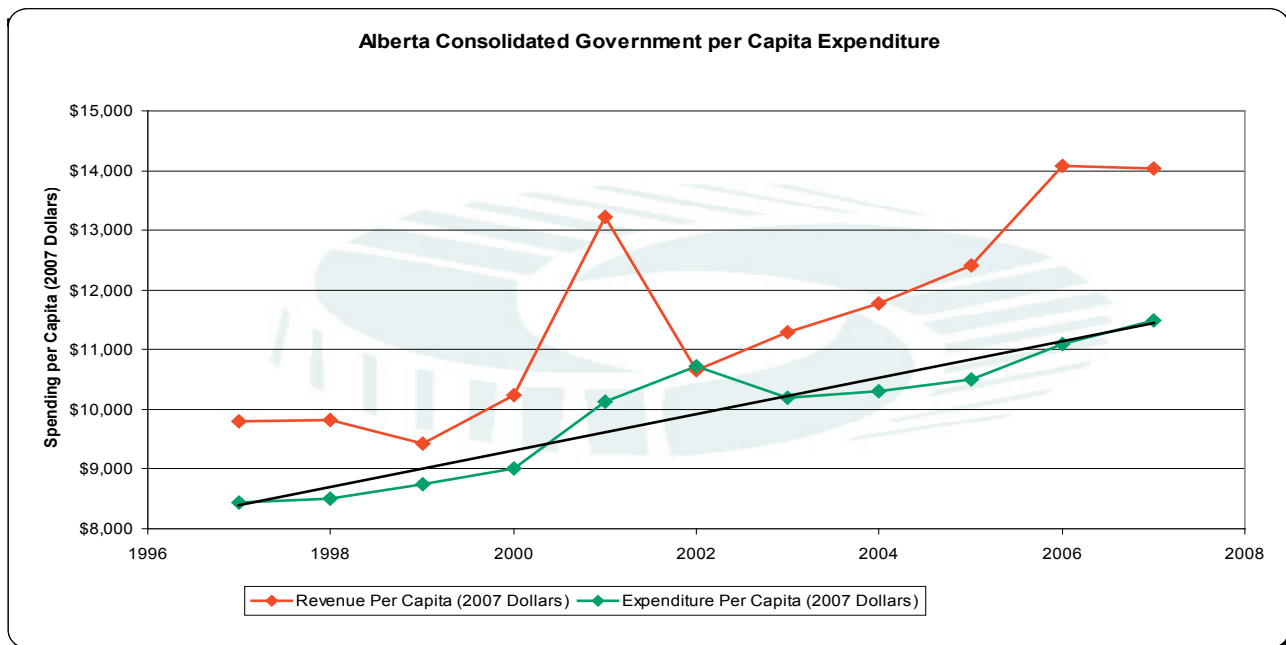


Figure 1. Alberta expenditure per capita grew at \$306 per year in real terms.²

1. The source used is Statistics Canada's CANSIM table 385-0001. This table presents the following definition of the government expenditure it measures: Local and provincial government is a consolidation of all local, provincial and territorial level, non-market producing entities engaged in the creation and implementation of government policy and in the delivery of government services within their jurisdictions. The components that comprise local, provincial and territorial statistics contained in this table are: (i) local general government, (ii) school boards, (iii) provincial and territorial general government, (iv) provincial and territorial non-autonomous pension plans, (v) universities and colleges and (vi) health and social service institutions.
2. Sources: Expenditure, Statistics Canada CANSIM Table 385-0001. Population: Statistics Canada CANSIM Table 051-0005. Inflation: Statistics Canada Consumer Price Index 62-001-X Table 6. Calculations by the author.

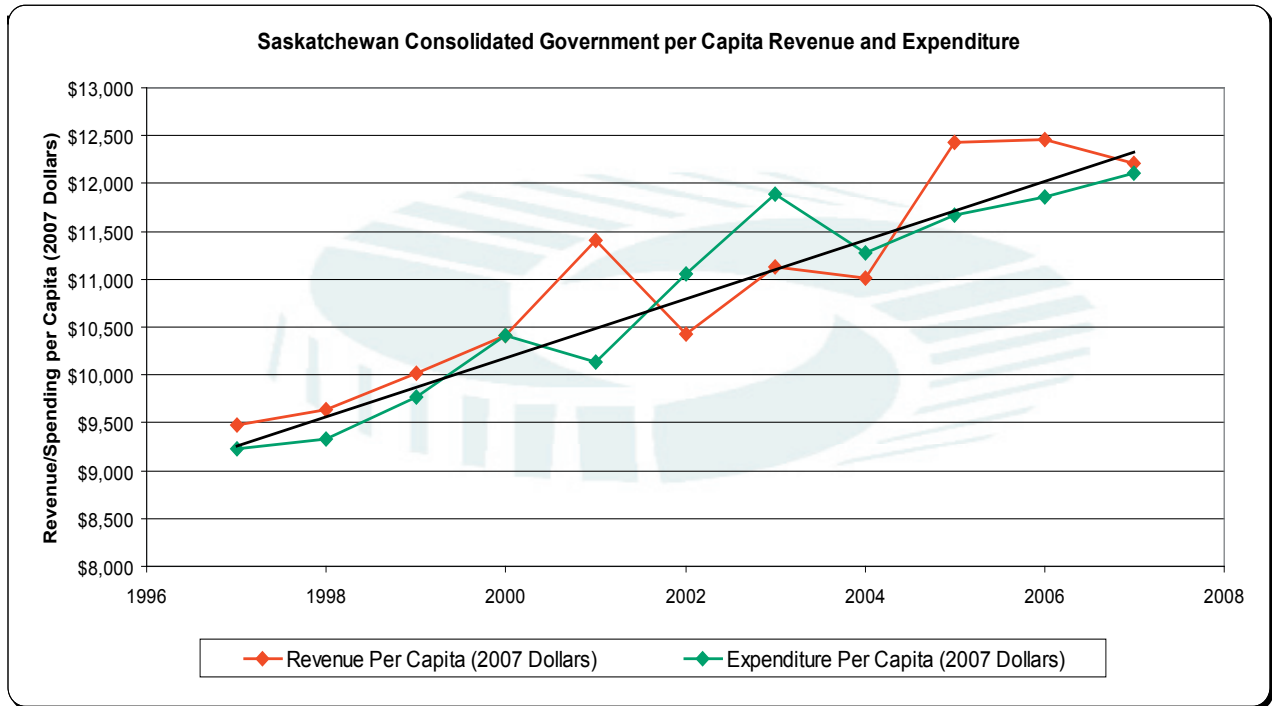


Figure 2. Saskatchewan expenditure per capita grew at \$302 per year in real terms.³

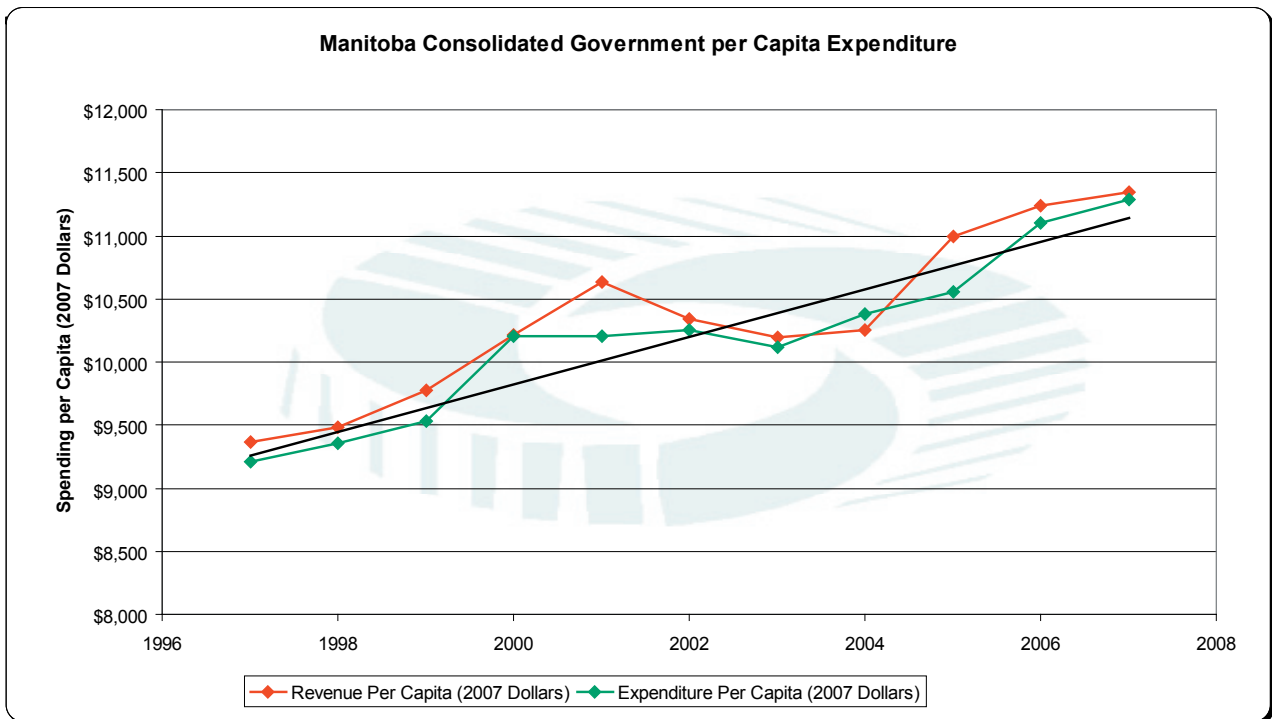


Figure 3. Manitoba expenditure per capita grew at \$188 per year in real terms.⁴

3. *ibid.*
4. *ibid.*



Taxes are the price we pay for a civilized society.



Oliver Wendell Holmes saying may well be true, but it tells us nothing about what is happening at the margin. That is to say, what extra benefits are we getting for the extra expenditure? This section looks at six basic social indicators to see what sort of society the average citizen has gotten for an extra two or three thousand dollars over the past decade.

This section looks at six indicators of a society’s economic and social well-being and judges them to be improving, deteriorating or inconclusive. Indicators were improving when they were materially better toward

the end of the 1997-2007 period than they were toward the beginning, and there is reason to think government spending could have contributed to the result.

Indicators were deteriorating when they showed materially worse results at the end of the period than at the beginning and there is reason to think government expenditure could have influenced the outcome. Inconclusive indicators are those where the trends are negligibly weak or it is implausible that government spending contributed to the trends observed.

Life Expectancy

Life expectancy at birth increased in all three provinces over the eight years for which data is available from 1997-2005.

Life expectancy at birth rose by a trend average of 8.7 weeks per year in Alberta, 3.8 weeks per year in Saskatchewan and

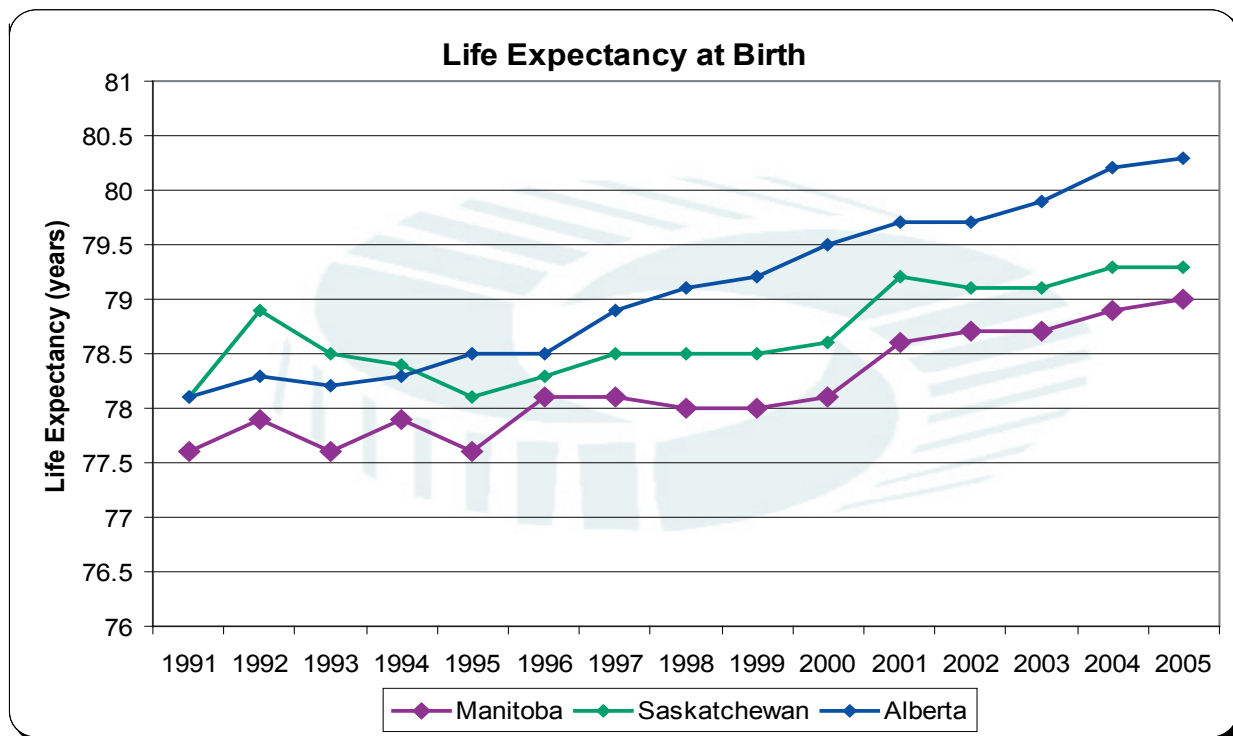


Figure 4. Life expectancy at birth in the three provinces.⁵

5. Source: Statistics Canada CANSIM Table 102-0511

5.1 weeks per year in Manitoba. However, this data should be put into the context of continually increasing life expectancy over the past century. From 1921 to 2004, Canadian life expectancy at birth increased at a rate of 14.4 weeks per year.⁶ In this context, the current increases are very slow; however, it may be that increasing life

expectancy is merely subject to diminishing marginal returns. The result for this measure is inconclusive. It is simply not possible to say whether the current rate of increase would be lower or higher in response to lower or higher government spending because it is not clear what increases should be expected given the historical context.

Infant Mortality

Available data for infant mortality (number of deaths before one year of age per 1,000 live births) show varying trends across the three provinces. In Alberta, this number increased at a trend rate of 0.22 per year, while it fell by 0.10 and 0.05 per year in

Saskatchewan and Manitoba respectively. This measure could plausibly be influenced by government action in the 10-year period. Infant mortality improved for Saskatchewan and Manitoba but declined for Alberta.

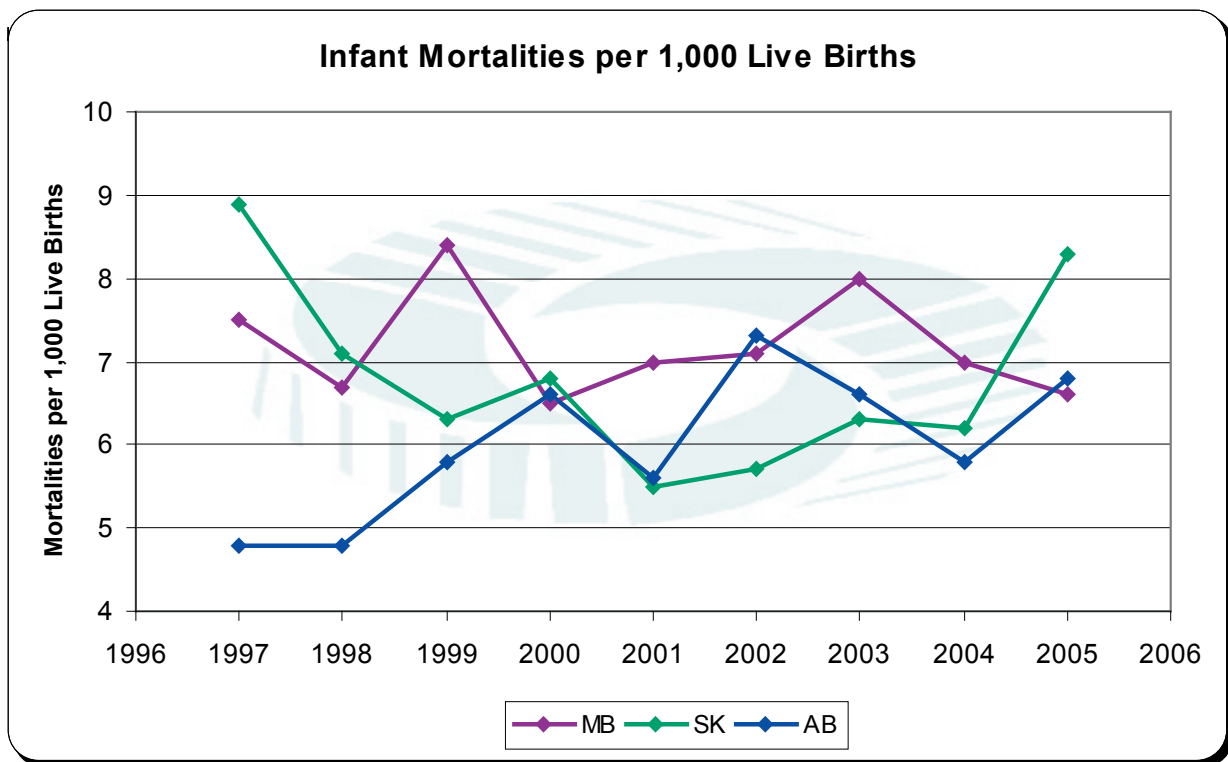


Figure 5. Infant mortality rates.⁷

6. Canada Life Expectancy at Birth, The Human Mortality Database, University of California, Berkeley. Accessed online: <http://www.mortality.org/> on 15/03/2008.

7. Source: Statistics Canada CANSIM Table 102-0507

Educational Achievement

Every three years, the Organisation for Economic Co-operation and Development (OECD) tests 15-year-old students in its member countries as well as some others for aptitude in mathematics, reading and science. The Programme for International Student Assessment (PISA) is the most comprehensive standardized international test of educational achievement.

The scores for each province are estimated averages for students in each jurisdiction and are comparable from one survey to the

next. PISA has been running since 2000 and reported results in that year as well as in 2003 and 2006.

The results show the three Prairie provinces' average scores for reading mathematics and science over the three surveys. Strikingly, of the nine combinations of subject and province, only Alberta's science scores are higher in 2006 than in 2000. All other scores fell inexorably or partially recovered from the 2000-2003 losses in 2006.

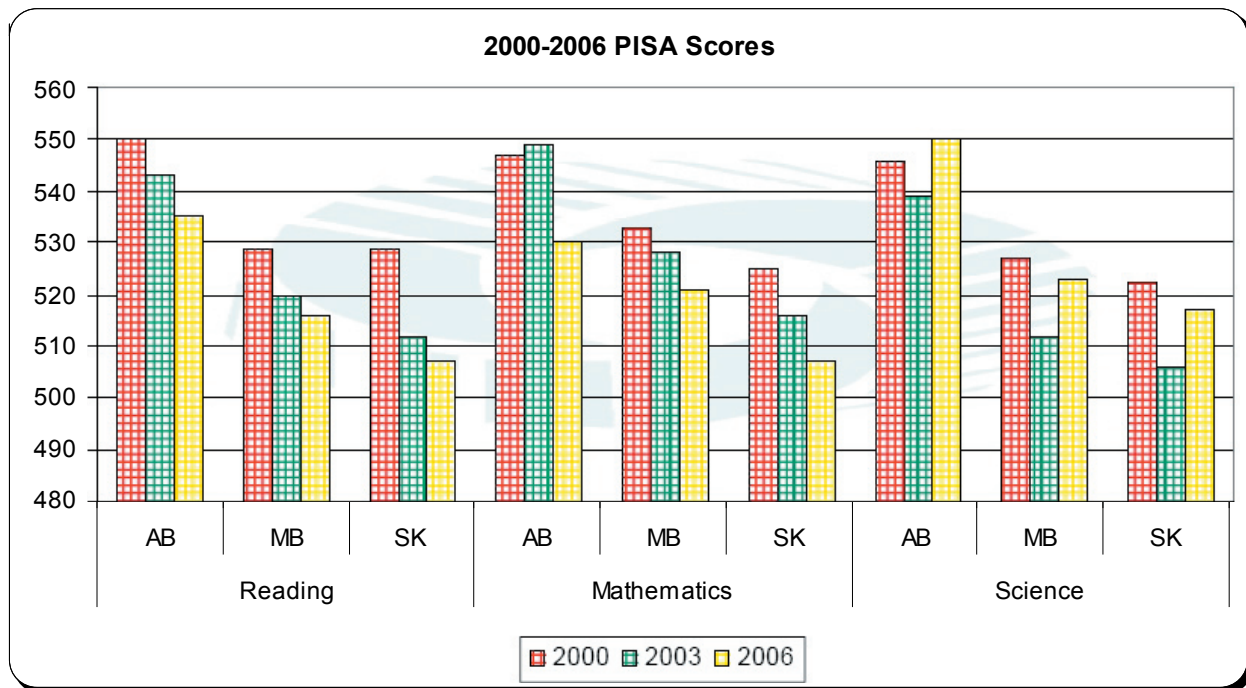


Figure 6. Average PISA scores 2000-2006.⁸

“
*...only Alberta's science scores
 are higher in 2006...*
 ”

8. Source: Statistics Canada, 2000, 2003 and 2006 editions of "Measuring up: The Performance of Canada's Youth in Reading, Mathematics and Science OECD PISA Study - First Results for Canadians aged 15."

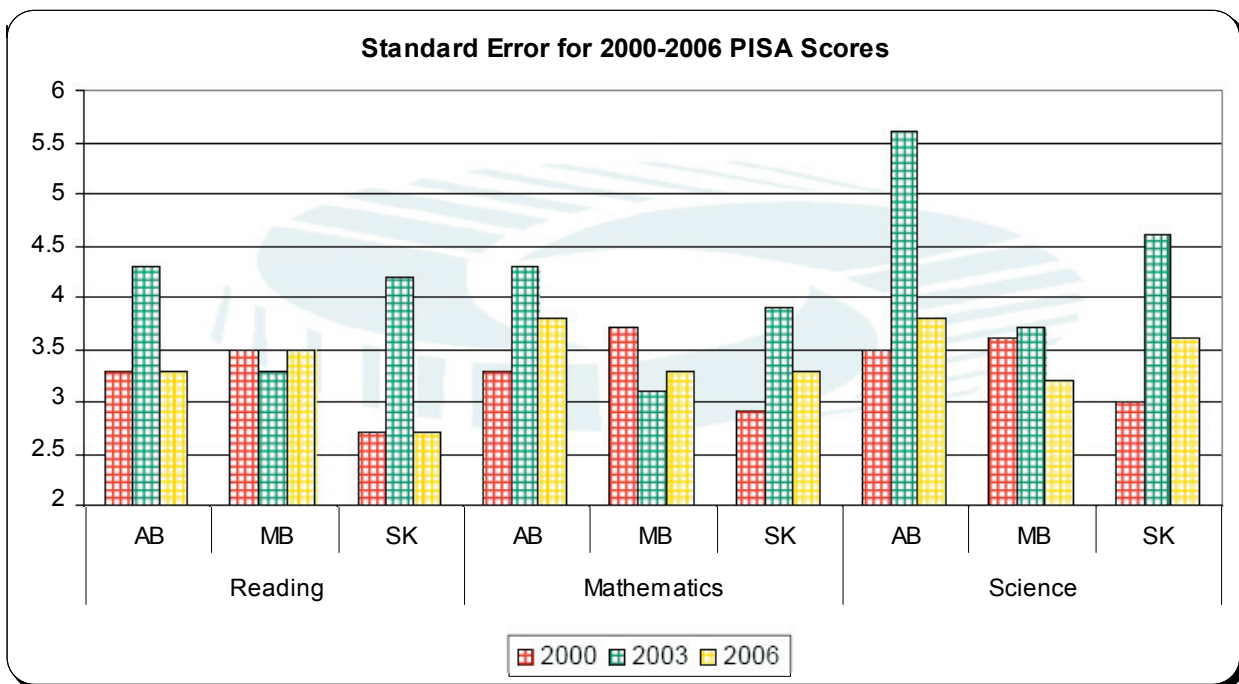


Figure 7. Standard Error for PISA scores 2000-2006. ⁹

The standard error (Figure 7) is presented as a measure of spread. A large standard error means large differences between higher scoring students in the jurisdiction, and a small standard error means students have more equal achievement levels. From 2000-2006, standard error fell in two of the nine subject-province combinations while it rose in four and stayed the same in three.

The 2003 results are higher than in either 2000 or 2006 for most subject-province

combinations. The results could plausibly be influenced by government action in the measured period.

Children who took the 2006 tests had the benefit of six years of schooling between the time the original cohort sat the tests and when they did. Given the almost universally declining absolute scores and the generally increasing spread or inequality between students, this measure deteriorated for all three provinces.

“
...2003 results are higher than in 2000 or 2006 for most subject-province combinations...
 ”

9. *ibid.*

Suicide Rates

Complete data for suicide rates over the decade 1997-2007 are difficult to obtain. This data series, concatenated from a set of single-year figures (1996) and another data set from the four years between 2000 and

2004, shows a general trend of decline from 1996-2004 in Alberta and Saskatchewan, with a slight increase in Manitoba. However, the 2000-2004 data set shows no clear trend for any of the provinces.

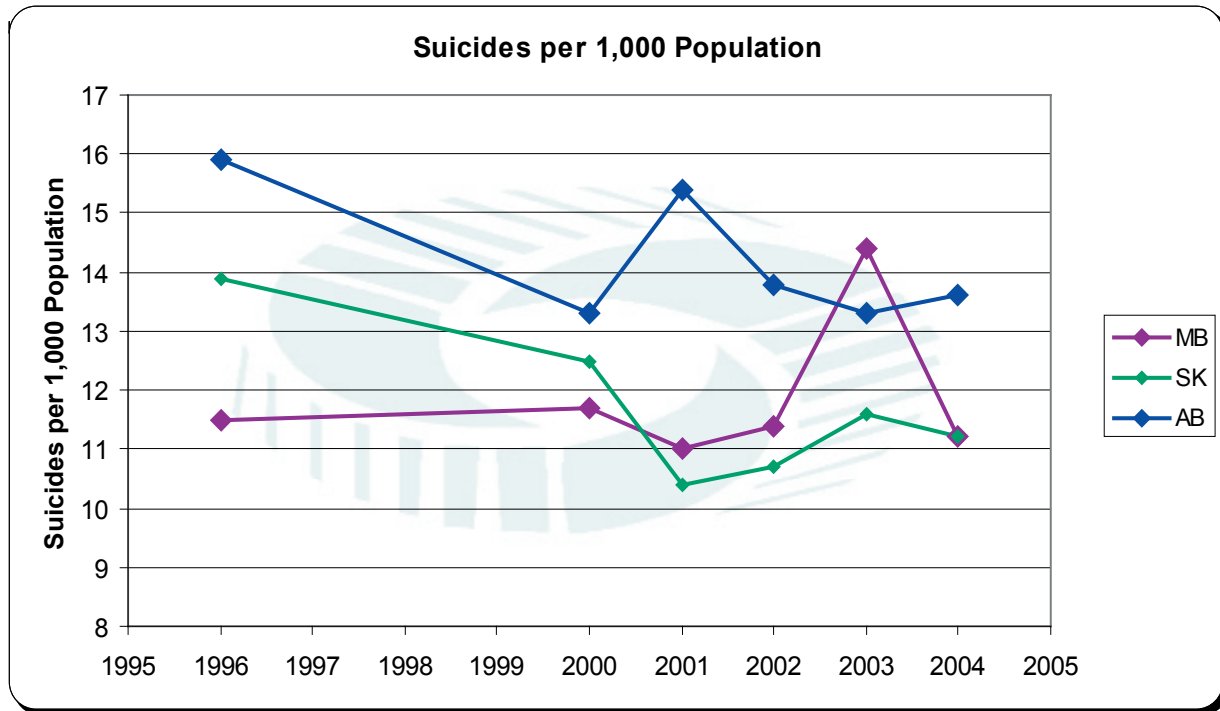


Figure 8. Suicide rates per 1,000 population.¹⁰

“
A suicide kills two people - that's what it's for.
Arthur Miller 1915-2005, from 'Death of a Salesman'

10. Sources: 2000-2004 Data: Statistics Canada CANSIM Table 102-0552. 1996 Data: Statistics Canada CANSIM Table 102-0014

Recorded Offences (excluding traffic offences)

Recorded offences in the three provinces trended upward over the past decade.

The 1997-2007 trend for Saskatchewan was an average of 286 extra crimes per year or 2,860 more crimes in 2007 than in 1997. Alberta and Manitoba experienced smaller

trend average increases of 131 and 186 additional crimes per year.

Because law enforcement expenditure and initiatives could plausibly influence crime rates over a ten-year period, these measures deteriorated.

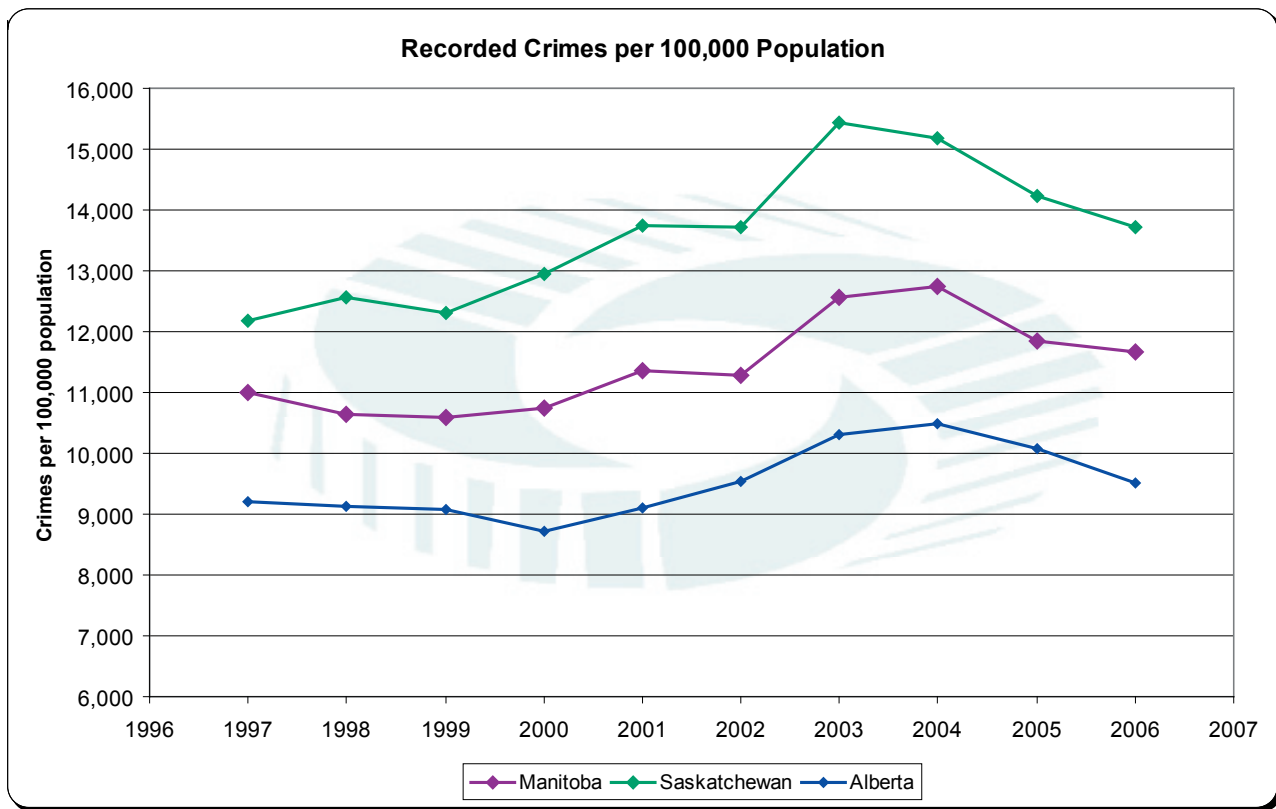
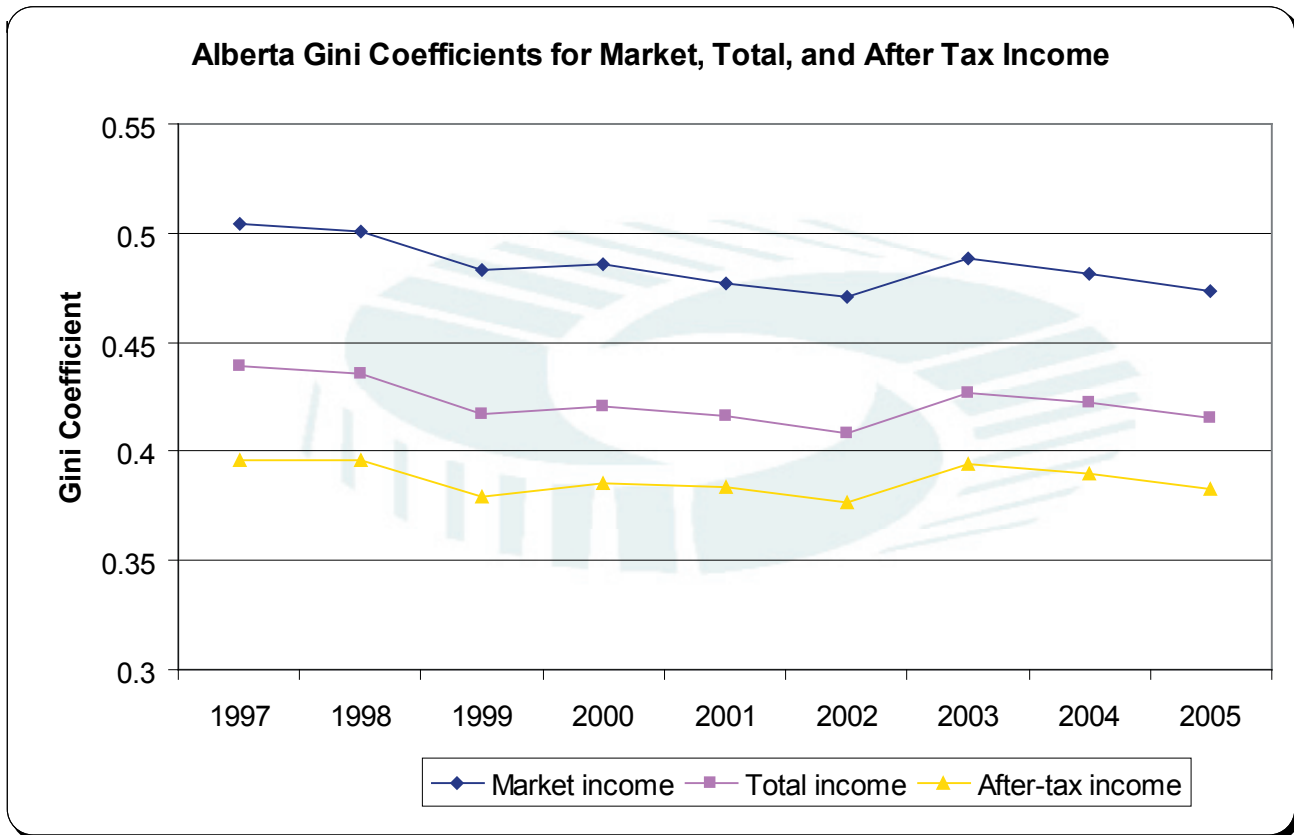


Figure 9. Recorded crimes per 100,000 people.¹¹

“
***Actions receive their tincture from the times,
 And as they change are virtues made or crimes.***
 Daniel Dafoe 1660-1731
 ”

11. Source: Statistics Canada CANSIM Table 252-0013



Income Inequality

Gini coefficients are a standardized measure of income inequality. If all earners made the same amount of money, the Gini coefficient would be 0. If all income were concentrated on a single person, with all other earners earning zero, the value would be 1. Between these extremes, lower figures mean higher income equality. Income equality is often a goal of government expenditure and government policy.

Government might achieve this goal in two broad ways: In the short run, it can use the tax and transfer system to redistribute income, thus evening the income distribution. As can be seen, this practice had a major effect on Gini coefficients, with the total income (including transfers) consistently lower than market income and the after-tax income lower still.

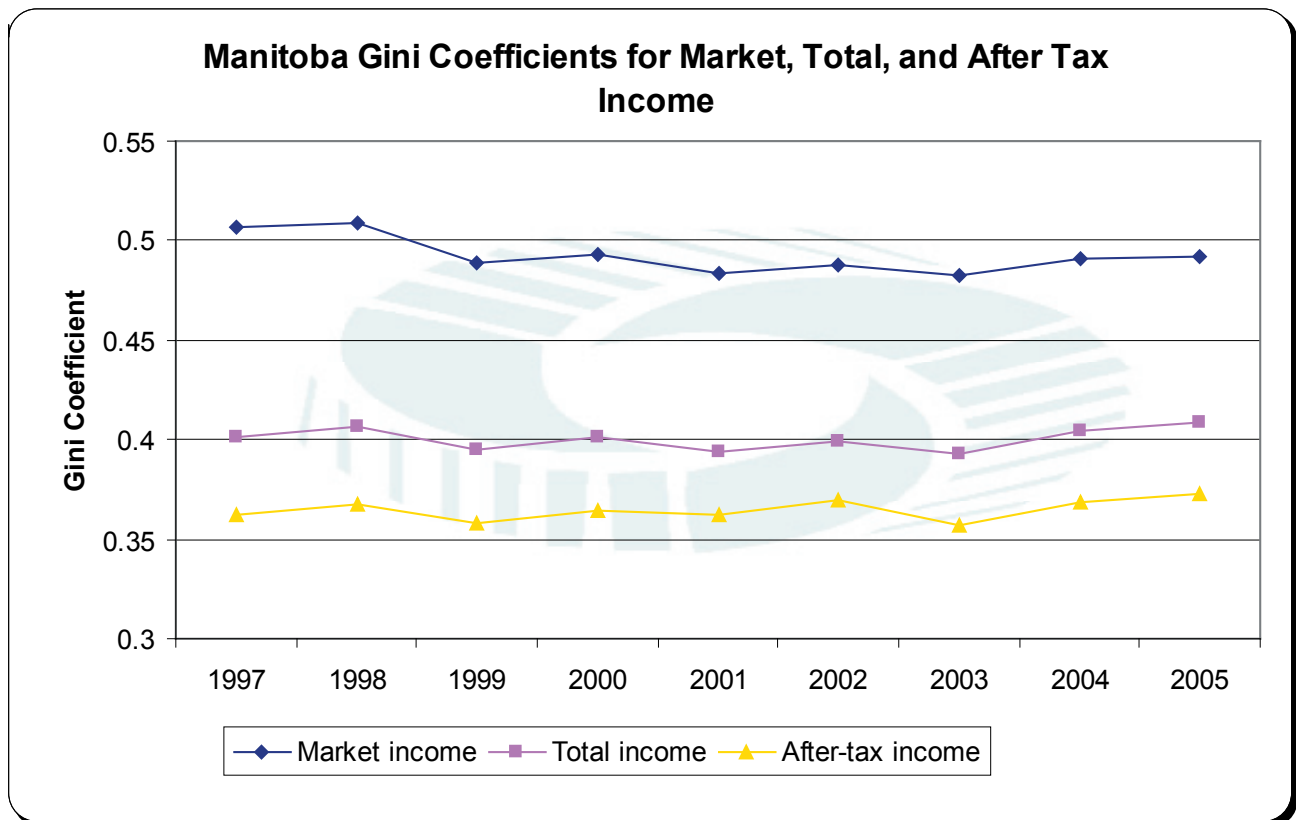
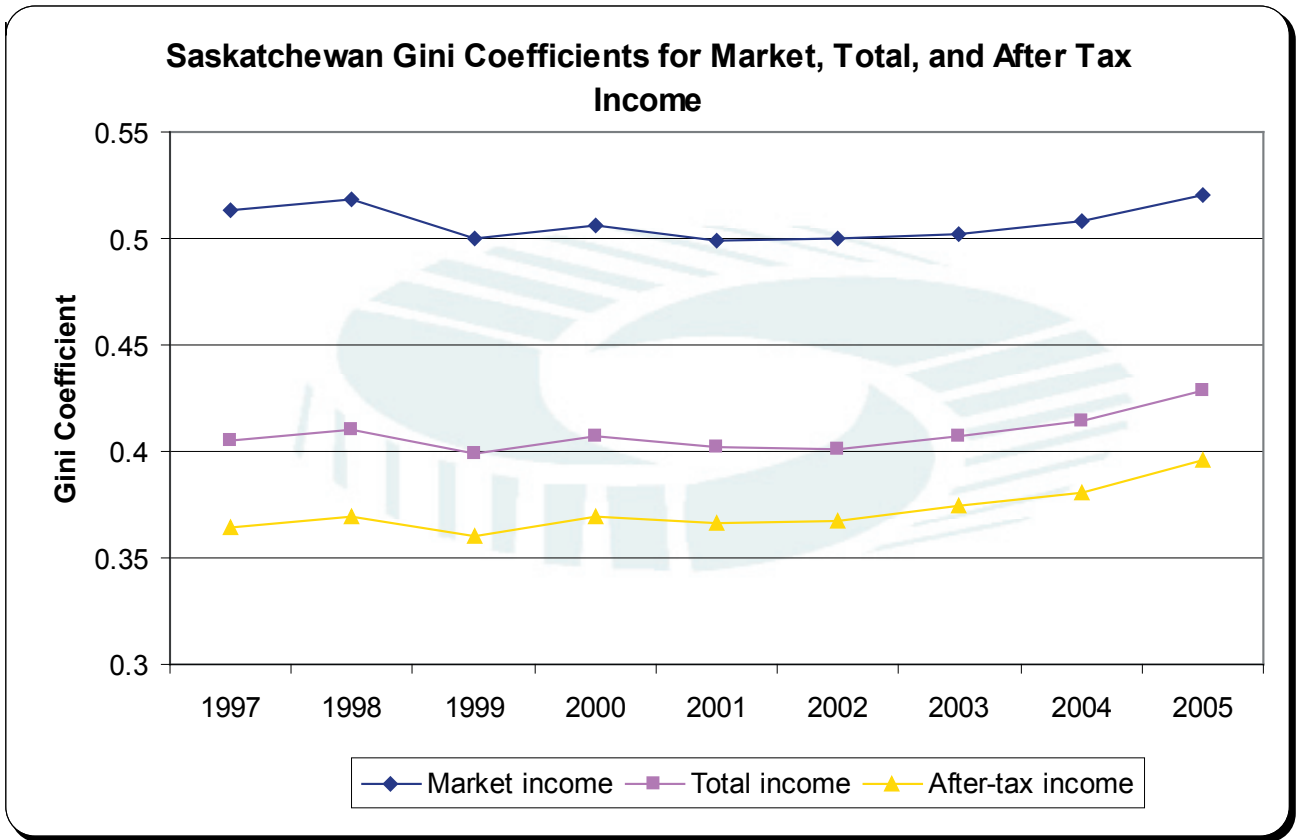
In the long run, government investment in economic capacity through health and education can help lower the Gini

coefficient for market income by enabling the disadvantaged to earn more market income.

An analysis of the Gini coefficients for market, total and after-tax income for the nine years 1997-2005 in each of the three provinces gives strikingly similar results.

- There was a downward average trend in market income Gini coefficients (increasing equality of market income).
- Total and after-tax incomes were distributed more equitably than market income due to the redistributive efforts of transfers and progressive taxation.
- The three are remarkably well correlated.

In conclusion, income equality slightly increased over time due to higher equality in market income. Investment in economic capacity appeared to narrow the gap in market income equality.



However, this can neither be proved nor disproved over a 10-year time span which is much shorter than the time taken for such investment in a generation to reveal itself as more equal abilities to earn market income. Meanwhile, the high correlation of market, total and after-tax income

suggests that any extra expenditure failed to improve this relationship. Because the relationship among market, total and after-tax income had not changed, these measures were inconclusive in terms of government action improving societal outcomes.

Putting expenditure and results together

We have analyzed the patterns of government expenditure along with six social and economic indicators for the three Prairie

provinces for the decade 1997-2007. The following table summarizes the findings. Over the ten years, government expendi-

	Alberta	Saskatchewan	Manitoba
Ten year per capita increase in government expenditure (2007 dollars)	\$3,060	\$3,070	\$1,880
Life Expectancy	Inconclusive	Inconclusive	Inconclusive
Infant Mortality	Deteriorated	Improved	Deteriorated
PISA Performance	Deteriorated	Deteriorated	Deteriorated
Suicide Rates	Improved	Improved	Deteriorated
Crime Rates	Deteriorated	Deteriorated	Deteriorated
Income Equality	Inconclusive	Inconclusive	Inconclusive

ture increased significantly for all three provinces. Yet, of the six social indicators measured, only life expectancy improved (in line with a two-century-old trend). Infant mortality and suicide rates showed weak positive trends in two out of three provinces.

Education and crime outcomes universally deteriorated, while income equality improved but not in a manner that government expenditure could have helped. Out of 18 indicators, six have improved, three have shown no useful trend and nine have deteriorated.

Section II: Analyzing the Causes

How did government expenditure in three provinces progressively increase without any apparent improvement in results it achieves? In this section, we examine two closely related explanations for the lack of demonstrable improvement from increased expenditure.



There is No Fury Like Vested Interests Masquerading as Moral Principle.

Oscar Wilde's famous quip could have been said about the public choice theory of economics. Public choice economics views politicians as being involved in a competitive market for votes that, once won, allows them to make significant resource allocation decisions. In other words, politicians who win elections have the ability to spend in a way that maximizes their votes in the future.

In one sense, this is an uninteresting observation of democracy. However, the relevant problem here is that voters have different levels of motivation to vote, and to influence the voting of others.¹

For any rational voter, political participation is not a rewarding endeavor. Unless a voter knows he or she stands to cast the deciding vote on a perfect 50-50 split vote, that vote will make negligible difference. Some voters take the view that participation is still worthwhile, because if all voters took this attitude there would be no democracy. However, the fact remains that the marginal cost of being more informed is not equalled by the additional influence the voter acquires. The most informed voter and the least informed voter still get the same number of votes.

It is only worthwhile for a voter to make additional effort to participate in the democratic process if there is something else to be gained.

Imagine a group of 1,000 people who stand to benefit by \$1,000 each from increased government spending. Donating \$50 each to a \$50,000 lobbying campaign to ensure the spending goes ahead would be a great investment for the group. On the other hand, the \$1-million cost is dispersed over half a million taxpayers, an average of \$2 each. The non-organized taxpayer will not bother to fight over such a small amount; hence, the organized lobby comes out ahead. Spending wins every time. Multiply this dynamic over hundreds of lobby and special interest groups, particularly in the public sector, and we can explain much of the spending momentum in modern-day government.

One example of an interest group using the political process to gain concentrated benefits at a dispersed cost to the rest of the population is the restriction on taxi shields in Winnipeg. The number of taxis permitted has been held at 400 since 1947, and new entrants must pay approximately \$200,000 to purchase a shield from an existing operator.² The restriction lessens competition from new entrants to the market and keeps fare prices artificially high.

The additional price here is reflected in the value drivers put on holding a shield, which at around \$200,000 is many times that of a car. This means the existing taxi drivers earn more at the expense of the public, who might otherwise have more affordable fares. It also affects others who would potentially benefit from entering the Winnipeg taxi market but are discouraged by restrictions. Note that this example demonstrates the concept of concentrated benefits and dispersed costs through market

interventions rather than government spending, but the concept is the same.

Clearly, the restriction is not a just policy. It transfers wealth (roughly the difference between fare prices with and without the restriction) from taxi passengers to taxi drivers. It also restricts would-be drivers from entering the market. Giving a transfer from taxation revenue to taxi drivers would be simpler and have the same effect, but that would not be as politically saleable as the arguments actually used for restrictions. The most commonly used arguments for this purpose are dubious ones about safety and standards.

However, the taxi drivers have the incentive to reframe the debate in terms of these other arguments, arguments that suit their interests at the expense of others.

Restrictions on Winnipeg taxi shields are a political reality despite their underhanded wealth transfer.

The reason is taxi drivers gain a concentrated benefit, but the cost of this benefit is dispersed across a large number of consumers. The incentive for the taxi drivers to lobby for the continuation of the restrictions is stronger than the incentive for any individual citizen to become informed and lobby against it. If the restriction could be removed, all consumers would benefit, but the benefit for any single consumer is less than the cost of lobbying. Meanwhile, the benefit for the taxi industry is greater than the lobbying cost.

In the political marketplace, politicians achieve greater returns in terms of votes for delivering tariffs than for not delivering tariffs.

How might these principles apply to Canadian provincial government expenditure? Could the trend of progressively greater government expenditure be influenced by groups eligible for concentrated benefits from government policy politically overpowering those who pay the dispersed costs of those benefits?

Such claims are almost impossible to test empirically, so what follows is hypothetical.

However, a strong case can be made that government expenditure in the three provinces is subject to the same dynamics that brought restrictions to the Winnipeg taxi market.

To take Saskatchewan as an example, 56 per cent of operating expenses are devoted to learning, health and staff pension plans for these sectors.³ Staff are organized into unions, which carry out extensive lobbying, and the television advertising undertaken by public sector unions during provincial election campaigns is proof of this. The unions are able to significantly influence debate, increasing the political profitability of politicians' decisions to spend on their sectors.

Just as Manitoba voters lack the incentive to out-lobby taxi drivers over tariffs, all Prairie voters lack the incentive to out-lobby highly organized public sector staff members who may derive concentrated benefits from additional expenditure on their sectors.

Of course, it is not fair or necessary to single out any public sector group as the reason for the increased expenditure and poor results identified in Section I. They are simply an example of where the possibility exists for the political equilibrium to favour increased expenditure without necessarily delivering results, a possible explanation for the trends observed in Section I.

This incentive meshes with the fact that there is no explicit political decision made about total spending. As we will see, the current political emphasis on spending as a proxy for results makes it easier for spending increases to pass political scrutiny.

1. See Friedman, D. "Private and Political Markets both Fail" (2004), New Zealand Business Roundtable for a discussion of lobbying in the public choice framework. Online at http://www.nzbr.org.nz/documents/publications/publications-2004/cautionary_tale.pdf
2. Holle, P. *Let's Deregulate Taxis* (2007), Frontier Centre for Public Policy. Online at: http://www.fcpp.org/main/publication_detail.hp?PubID=1650
3. Government of Saskatchewan, 2007-2008 Saskatchewan Mid-Year Report and Budget Update.

You Get Out What You Put In?

There is a broad consensus on the Prairies that some level of government expenditure is a good thing. It ensures education and health care for all, helps the disadvantaged access the necessities of life and provides public goods such as roads and infrastructure.

However, a cursory glance at the rhetoric of politicians shows the expenditure cart appears to have been put before the results horse. Budget documents are obviously full of expenditure initiatives, so we might expect to find a long list of disbursement promises in annual budgets. However, the provincial Speech from the Throne is intended to set out the government's vision for each legislative session. What sorts of initiatives are offered from the point of view of expenditure?

An analysis of the three provinces' 2007 budget documents finds an overwhelming emphasis on explicit promises of additional expenditure along with promises of additional in-kind inputs to existing programs. The antithesis of these input increase initiatives is the policy change initiative.

The following example is a policy change initiative from the 2007 Manitoba Speech from the Throne:

At the same time the province is introducing new measures to reduce red tape, including:

- *Streamlining of business permits and licenses, through the new BizPal service;*
- *Online filing of PST and other provincial taxes;*
- *Online incorporation and registration of trade names; and*
- *The creation of a Manitoba Business Portal, to allow one-stop access for business transactions over the internet.*¹

This is a clear example of four specific and measurable policy changes from the Government of Manitoba. None of the initiatives necessarily requires extra

expenditure, and they may well reduce the cost of certain functions. They all represent an innovation in how the Government of Manitoba delivers its services.

This example of an input increase from the Saskatchewan Speech from the Throne promises to spend more but does not propose any specific change in the way the government operates the service in question.

*Much can be done to improve the services offered to these visitors and build even more pride in our province. To that end, my government will **double tourism funding** to promote added marketing activities and make important capital investments in new tourism facilities.*²

Targeted tax breaks were also included as input increase initiatives because shifting the tax burden away from one group without a concomitant promise to lower taxation on others amounts to an effective transfer toward the exempted group.

Many of the speeches' initiatives did not fit into either the policy change initiative or the input increase category, because they were

- a commentary of past events,
- a summary of economic and social conditions as opposed to government action, or
- too vague for the initiative's execution to be measured.

The 2007 Alberta Speech from the Throne was by far the most non-committal, with very few clear promises to either increase inputs or measurably change how the Government of Alberta operates. Statements such as the following were common:

*Your government will also increase access and quality in post-secondary education while strengthening its support for community education and literacy programs.*³

1. Government of Manitoba, 2007 Speech From the Throne.

2. Government of Saskatchewan, 2007 Speech from the Throne, p 9. (original emphasis)

3. Government of Alberta, 2007 Speech from the Throne, p 8.

The results from reviewing the three speeches according to the criteria above are summarized below.

	Policy Change Initiatives	Additional Input Initiatives
Alberta	6	4
Saskatchewan	14	18
Manitoba	32	49

While this analysis is far from scientific, with the non-committal Alberta speech being particularly difficult to quantify, the emphasis on expenditure as a proxy for results is impossible to ignore. If the Speech from the Throne is the most comprehensive document outlining a government's annual legislative agenda, there is clearly a strong belief that expenditure is a political goal in itself.

Conclusion

This section presented two hypotheses in an attempt to explain the growth in expenditure without results. The political culture and the structure of interests within it have the potential to explain why we should expect expenditure to increase without necessarily delivering results. Section III will investigate the possibility of a fiscal constitution that would redress the balance between spending money and getting results.

So what exactly is the optimum size of government?

John Maynard Keynes was the last century's most influential economist, and his theories provided the intellectual basis for activist, expansionist government. He wrote to a colleague, "the figure of 25 percent as the maximum tolerable proportion of taxation may be exceedingly near to the truth."

A 1997 paper by International Monetary Fund economists Vito Tanzi and Ludger Schuknecht reviewed 125 years of public spending in industrial economies. In 1870, government spending made up 8 per cent of the average industrial economy. By 1994, government spending on average accounted for 47 per cent of the economies of rich industrial countries. Welfare spending accounted for much of the vast increase.

They found that public spending is subject to diminishing returns. As government spending grows past a certain point, the benefits trail off and disappear. Life expectancy and school enrollment are comparable whether the government spends big or not. Indeed, as a rule, those with the lowest spending increase are also the most innovative and efficient. Low-spending countries register more patents and suffer much lower unemployment. Countries with smaller governments also had much higher incomes per capita.

Tanzi and Schuknecht conclude there is considerable scope for reducing government spending in many countries and that average public spending may not need to be any bigger than it was 30 years ago -- around 30 per cent of Gross Domestic Product.

And that may still be too high. Between 1995 and 1996, separate agencies of the New Zealand government commissioned different academics to determine the optimum level of government there. The studies, using dissimilar methods, suggested that the growth-maximizing size lies between 15 per cent and 25% of the Kiwi economy (not the present 40 per cent). -- Frontier Centre for Public Policy (1997)

Section III: The Mechanics and Impacts of a Fiscal Constitution

In Sections I & II we investigated the trends in government expenditure versus social and economic outcomes achieved in each province. We found the Prairie provinces increased expenditure at an average trend rate of \$188 to \$306 per year over the past

decade, and five of the six social indicators monitored deteriorated or were inconclusive. We examined the economics of public choice and the rhetoric of government throne speeches in search of reasons why this expenditure increase took place.

How a Fiscal Constitution Could Work

The introduction referred to the organic growth of the state, dating back to Medieval times in Canada's cultural predecessor, Great Britain. Since then, the relationship between citizens and the government has been constantly refined; this section proposes another chapter in this process.

A fiscal constitution would address the problem of increased expenditure and limited results in the tradition of an evolving relationship between citizens and the state.

- Per capita government expenditure would remain constant in real terms.
- Surplus taxation in any given financial year would be returned to taxpayers in proportion to how it was paid that year.
- Explicit voter consent would be needed for any increase in expenditure beyond that amount.
- It would be beyond the reach of the legislative assembly of the day, i.e., it would have constitutional weighting.
- It would include expenditure by municipal government and school boards to prevent the provincial government downloading responsibilities to other levels of government merely because those levels would not be bound by the Fiscal Constitution.

A study by the Fraser Institute looked into the legal implementation of such legislation and found that there is a possible way using Section 43 of the Constitution of Canada.

The "some-but-not-all-provinces" procedure of section 43 is used for amendments to the constitution of Canada that are peculiar to specific provinces. It requires the assent of the federal Parliament and those provinces affected. In other words, if a province wanted to change aspects of the constitution affecting it alone, it would have to pass said amendment through both the federal parliament and its own legislative assembly.¹

This route to a fiscal constitution appears to fit the criterion of making the Fiscal Constitution beyond the reach, or at least the easy reach, of the government of the day. With ratification and reversal of the constitution requiring approval from both federal and provincial levels of government, the Fiscal Constitution would have to gain wide acceptance to be implemented, and it would be difficult to remove. This inertia is essential for the Fiscal Constitution to be effective, rather than be swept away as easily as the current levels of spending it is intended to govern.

Expected Outcomes

Political Impact

There would be two significant effects on politics. Real per capita increases in expenditure would be examined more closely, because they would require explicit consent from all voters. In practice, these would probably coincide with provincial general elections, where there would be the opportunity to recalibrate the level of expenditure with the prevailing conditions. The interceding four years would see expenditure held constant at that level until public consent for further expenditure is given.

In short, total government expenditure would become an explicit political issue and subject to much more scrutiny than it is now.

The kind of language seen in future Speeches from the Throne would likely be very different from that seen in 2007. With expenditure at a premium, initiatives that make better use of revenue would become more politically fashionable. This would reflect a shift away from expenditure as a proxy for policy toward substantial policy initiatives that would increase the efficiency and effectiveness of government.

The playing field between organized political interest groups seeking concentrated benefits and the voters who pay their dispersed costs would be levelled. The example of lobbying by Winnipeg Taxi Drivers showed how an organized interest group can be motivated enough to influence policy in its favour, and it made the case that similar phenomena are plausible within the current structures. Necessitating referenda for expenditure increases would reduce the effort required from voters to assess the claims of special interest groups that are seeking greater funding.

The status quo of increasing expenditure, whereas the Fiscal Constitution would make constant expenditure the norm. The onus to demonstrate what results increased expenditure will deliver would be placed on those who would like to see additional expenditure.

Economic Impact

From an economic perspective, a fiscal constitution would do the following:

- Improve the productivity of government because the incentive for politicians would shift from promising to spend more toward promising to arrange government services for increased productivity.
- Leave more money in the hands of taxpayers. Had the Fiscal Constitution been implemented in 1997, government expenditure would be the same now (inflation and population adjusted) as it was then. The additional growth in government expenditure would not have happened, thus leaving the average person \$3,060 better off in Alberta, \$3,070 better off in Saskatchewan and \$1,880 better off in Manitoba. The government could either return these sums to taxpayers in proportion to tax paid (disproportional returns would amount to transfers and therefore breach the constitution) or lower tax rates to collect less money in the first place.
- Possibly enhance economic growth through lower taxation unless referenda results stipulate more expenditure.²

A Policy for the Left and for the Right

Another feature of the Fiscal Constitution is that it addresses several concerns of both the political left and right without having any features that either side finds inflammatory. The concerns of the political right are as follows:

- Too-large government allocating too many resources away from the productive sector.
- Provider capture of government service delivery.
- The rational ignorance of voters leads to a lack of control over government expenditure.

The Fiscal Constitution would help alleviate these concerns by:

- holding the size of government constant unless explicit voter consent for an increase is given and
- making expenditure increases more politically conspicuous and lessening the effort required by voters to monitor and control the level of government expenditure.

The political left, for its part, often expresses the following concerns:

- Political changes will mean taxes will be cut abruptly and services will be reduced.
- There will not be enough funding for services to achieve social objectives.

The Fiscal Constitution would address these problems by

- increasing voter confidence in government expenditure, because the emphasis would shift toward better results from government;
- this shift in emphasis toward increases in productivity to achieve better results from constant inputs would help the political left attain its goal of sufficient services without the constant disputes about the level of government expenditure.

Conclusion

The Prairie region is in a time of great prosperity, which is expected to continue for the medium to long term, as demand from the developing world for its commodities contributes to a strong regional income. As this wealth arrives, there is a need for sound public policy in order to lock in lasting prosperity.

The evidence suggests the current political paradigm is wasteful, with government expenditure linked to poor results; yet, politicians promise more expenditure, because it is more politically profitable than trying to deliver actual outcomes.

Without public policy that rewards the best use of the current glut of public funds from a

booming Prairie economy, there is a danger that the opportunity to convert the current wealth into lasting prosperity will be lost.

A fiscal constitution would change the rules of politics toward politicians emphasizing value for money instead of emphasizing expenditure increases. In the process, it would reduce the effort required of voters to control expenditure and inure them against better organized political interest groups.

Here is an opportunity for the Prairie region to look to its political history, a history of constantly renegotiating the relationship between citizens and government to create the citizenship we have today.

A fiscal constitution could be the next chapter in this history.

1 Clemens J., Fox T., Karabegović A., LeRoy S., and Veldhuis N.: *Tax and Expenditure Limitations: The Next Step in Fiscal Discipline* (2003), The Fraser Institute.

2 See forthcoming Seymour D. and Rennie P., "Tax and Growth on the Prairie" (2008), Frontier Centre for Public Policy, for an examination of the relationship between taxation and economic growth.

