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# CONSIDERATIONS REGARDING THE 2020 TAX AND SPENDING REVIEW



OFFICE OF THE PARLIAMENTARY BUDGET OFFICER  
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

The Parliamentary Budget Officer (PBO) supports Parliament by providing economic and financial analysis for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

The purpose of this report is to provide an initial overview of how the PBO plans to monitor the Government's plan on achieving its \$1.5 billion in annual savings, starting in 2020-21.

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# Executive Summary

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In the *Economic and Fiscal Update 2019*, the Government announced its plan to launch the first part of a comprehensive review of government spending and tax expenditures. It has indicated that it will generate \$1.5 billion in annual savings, beginning in 2020-21. That being said, many of the details regarding the scope and assessment criteria, as well as how it will achieve these savings, have yet to be announced.

Going forward, the PBO will continue to monitor the implementation of this review and whether the Government is achieving its planned savings. The PBO will review whether organizations are providing sufficient details in their departmental reports.

# 1. Introduction

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As part of the *Economic and Fiscal Update 2019*, the Government announced that it will launch “the first phase of a comprehensive review of government spending and tax expenditures, to ensure that resources are efficiently allocated to continue to invest in people and keep the economy strong and growing.”<sup>1</sup> It has indicated that this will generate \$1.5 billion in annual savings, beginning in 2020-21.

The purpose of this report is to outline previous spending reviews in Canada, potential characteristics of this spending and tax review, as well as how the PBO will continue to monitor this going forward.

## 2. Previous Spending Reviews

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Canada has performed three distinct spending reviews since the beginning of the 1990’s.

Program Review (PR), which was introduced in the 1995 and 1996 budgets, was the first and most wide-ranging spending review. The goal was to return to budgetary balance and reduce public sector debt. The review process was guided by a series of six tests to determine which programs could be targeted, and it applied to all departments and organizations, including Crown corporations.

Overall, PR achieved the desired results of reducing federal spending, and in turn, reduced the budgetary deficit. In conjunction with positive macroeconomic growth and additional reforms, the federal government returned to a balanced budget in 1997-98 and had consecutive surpluses until 2007-08.<sup>2</sup>

The Strategic Review Process, which began in 2007, was the second wave of spending reviews. This process was directly related to the Government introducing a new Expenditure Management System, with the goal to better manage government spending.<sup>3</sup> The initiative required all departments and agencies to review direct program spending over a four-year cycle.

The primary goal of this process was to ensure that programs provided value for money and that they were both efficient and effective. Over the four-year period of reviews, the Government of Canada identified \$2.8 billion in ongoing annual savings.<sup>4</sup>

The third and final spending review was the Strategic and Operating Review, which was announced in Budget 2011. Unlike the previous spending review, all departments were considered in a single year, with the primary focus on fiscal consolidation. This process placed an emphasis on generating savings from operating expenses, improving productivity, as well as examining with effectiveness and relevance of programs.<sup>5</sup>

In total, the Strategic and Operating Review covered approximately \$75 billion of direct program spending. The result of this review process identified \$5.2 billion in annual ongoing savings as part of Budget 2012.<sup>6</sup>

## 3. Current Review

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### 3.1. Overview

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As previously indicated, the Government announced it will commence the first phase of a comprehensive review of government spending and tax expenditures, which will achieve \$1.5 billion in annual savings, starting in 2020-21.

Many of the details regarding the scope and scale of this comprehensive review have not yet been revealed. For example, it is not clear:

- How many organizations will be subject to the review;
- What programs and tax expenditures will be subject to the review;
- Whether all spending will be included in the review, or if it is primarily operating spending;
- Whether the savings are considered ongoing or one-time reductions;
- How long will these annual savings occur in the future; and,
- Whether there will be an impact on service levels.

Given the limited information, parliamentarians may wish to seek further details regarding the scope and assessment criteria of the exercise.

## 3.2. Magnitude of Savings

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In terms of the overall magnitude, the \$1.5 billion in annual savings is less than the total annual amounts identified in the three previous spending reviews. Therefore, based on previous reviews, it should be feasible for the Government to identify this amount of annual savings in the medium term.

However, the PBO notes that the Government has indicated that they plan on achieving these savings starting in 2020-21. Given that many of the details of the review have yet to be announced, realizing savings in the first year could be challenging. In addition, it may be more difficult to reduce tax expenditures in the first year, as the 2020 tax year is already underway.

## 3.3. Government Spending

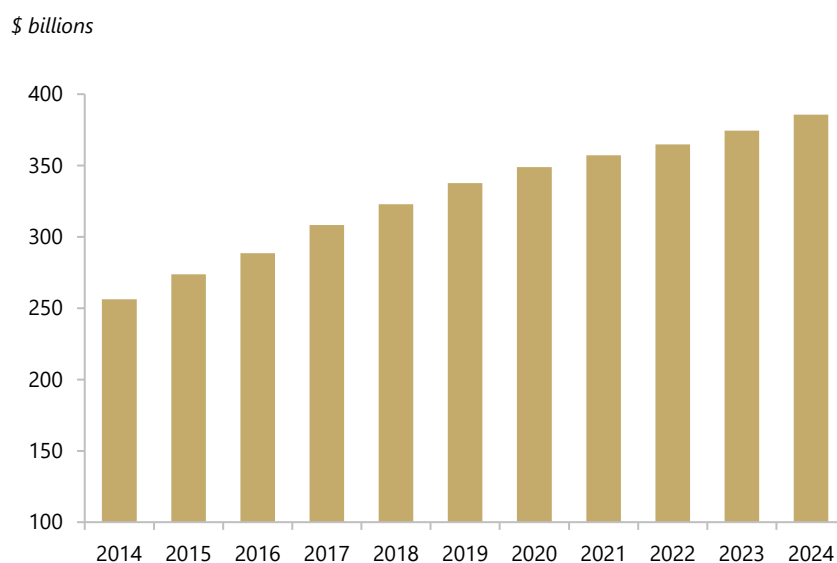
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One of the ways that the Government has indicated it will achieve the \$1.5 billion in annual savings is reviewing government spending. Many of the details, including the scope and scale of this review, are still unclear at this point, such as whether it will focus on certain programs or type of expenses, or if it will include all organizations and spending.

The Department of Finance, in response to an Information Request, indicated that for planning purposes, the savings are currently split equally between operating expenses and personal income tax revenue; however, they indicate that it could change based on further work and decisions by the Government.

Over the past decade, total program expenses have steadily increased. This includes both major transfers to persons and to other levels of government, as well as all direct program expenses. The PBO projects that this growth will continue over the medium term, as shown in Figure 3-1.

**Figure 3-1 Total Program Expenses**



Sources: Public Accounts and PBO's Economic and Fiscal Outlook – November 2019.

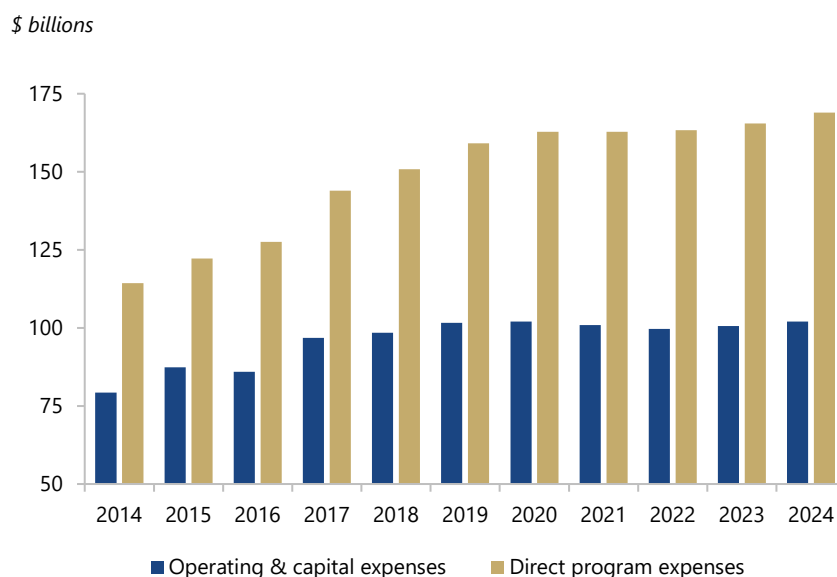
Notes: This data is presented on a fiscal-year basis where 2014 refers to 2014-15. Data prior to, and including 2018-19 are actuals, while all subsequent years are PBO projections.

While there has been constant growth in total program expenses, it is not yet clear if the Government will be targeting all of these areas, specifically major transfers to persons or other levels of government. Previous spending reviews have largely focussed on direct program expenses, in particularly reducing operating spending.

As shown in Figure 3-2, both direct program expenses (which includes operating and capital expenses, other transfer payments and the fuel charge) and operating and capital expenses have grown over the past few years. The PBO projects that both will flatline over the medium term, which means that potential savings in these areas could result in negative growth.



**Figure 3-2 Direct Program Expenses and Operating and Capital Expenses**



Sources: Public Accounts and PBO's Economic and Fiscal Outlook – November 2019.

Notes: This data is presented on a fiscal-year basis where 2014 refers to 2014-15. Data prior to, and including 2018-19 are actuals, while all subsequent years are PBO projections.

Another important factor that should be considered as part of the review process is how will the planned spending reductions impact service levels for Canadians. When federal spending is reduced, the quantity or quality of public services generally decreases, unless the Government is able to find efficiencies. That is, being able to do more, or an equal amount, with fewer resources.

As many of the details regarding the overall review process have not yet been determined, parliamentarians may wish to continue to request updates on the review as more details are developed, including how it will impact services provided to Canadians.

## 3.4. Tax Expenditures

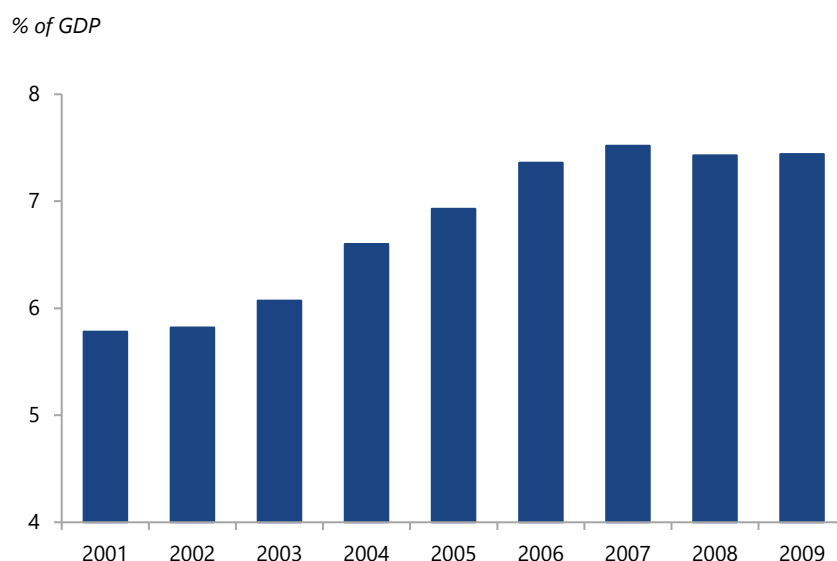
The other portion of the Government's first phase of the comprehensive review are tax expenditures.

As described in the Department of Finance's *Federal Tax Expenditure Report*, tax expenditures are measures that are considered changes from a "benchmark" tax system.<sup>7</sup> The benchmark tax system includes only the most fundamental aspects of the tax system.

Federal tax expenditures, like program spending, are designed to achieve similar policy outcomes; however, they are implemented through a collection of deductions, credits and expansions in the tax system. The value of these tax expenditures are calculated by estimating the amount of forgone revenue by the federal government as a result of these measures. The Canada Child Benefit and the First Time Home Buyers Tax Credit are examples of federal tax expenditures.

In 2010, the Organisation for Economic Co-operation and Development (OECD) published a report titled, *Tax Expenditures in OECD Countries*. It stated that the use of tax expenditures in many countries was “pervasive and growing”.<sup>8</sup> This trend was consistent with the Canadian federal data, where the total value of tax expenditures in Canada, as a percentage of Gross Domestic Product (GDP), increased from 5.8% in 2001 to 7.4% in 2009 (Figure 3-3).<sup>9</sup>

**Figure 3-3** Tax expenditures in Canada (% of GDP)



Source: *Tax Expenditures in OECD Countries*. 2010.

Notes: Tax expenditure data reported by the Government of Canada. Data from 2005 onward were Department of Finance Canada projections at the time of the report.

As stated in previous sections, the details of the scope and scale of the first phase of this comprehensive review are not yet known. Therefore, parliamentarians may wish to request additional information regarding how many tax expenditures will be subject to the review.

## 4. Going Forward

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The PBO will continue to monitor the implementation of the comprehensive review by the Government, and how it plans on achieving \$1.5 billion in annual savings, starting in 2020-21.

The PBO will review the upcoming Budget to determine whether the government has provided sufficient details on how it plans to achieve these annual savings, and whether there will be an impact on service levels. This should include additional information on the scope and scale of the review process (that is, the organizations, programs and tax expenditures that were subject to the review).

As part of the ongoing monitoring of whether the Government is achieving its planned annual savings, the PBO will review the Departmental Plans (DP), Quarterly Financial Reports (QFR) and the Departmental Results Reports (DRR) of the organizations identified as part of the savings exercise.

DPs are considered as the department's annual expenditure plan which highlights its priorities, planned results, as well as required resources for the upcoming three fiscal years. Any organizations or programs that have been identified in the annual savings plan should provide details regarding how it impacts these areas.

QFRs provide in-year updates on planned and actual expenditures, as well as updated information on any changes which impact the financial results, including operations, personnel and programs. Therefore, organizations should continue to provide ongoing updates on the roll out of the savings initiatives.

DRRs are "individual department and agency accounts of actual performance, for the most recently completed fiscal year, against the plans, priorities and expected results set out in their respective DPs. DRRs inform parliamentarians and Canadians of the results achieved by government organizations for Canadians."<sup>10</sup> Thus, organizations should provide actual details of the impact of the savings initiatives, and whether it had an impact on the services provided to Canadians.

# Notes

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2. *OECD Journal on Budgeting*. Volume 2015, Issue 3.
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6. *Budget 2012*. Annex 1: Responsible Spending. <https://www.budget.gc.ca/2012/plan/anx1-eng.html>
7. *Report on Federal Tax Expenditures - Concepts, Estimates and Evaluations 2019*. <https://www.canada.ca/en/department-finance/services/publications/federal-tax-expenditures/2019/part-1.html#Toc2325934>
8. *Tax Expenditures in OECD Countries*. OECD. 2010.
9. This does not include memorandum items as they are not considered to be tax expenditures.
10. Departmental Plans. <https://www.canada.ca/en/treasury-board-secretariat/services/planned-government-spending/reports-plans-priorities.html>