

# THE ECONOMIC AND FISCAL UPDATE



CANADA'S NEW GOVERNMENT

Presentation by  
the Honourable James M. Flaherty, P.C., M.P.

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## Check Against Delivery

### Introduction

Mr. Chairman and members of the Committee:

I am pleased to report that the economy is strong, government spending is focused, our debt is lower and taxes are coming down.

We intend to reach higher and go farther for the benefit of families, students, workers and seniors from coast to coast to coast.

Canada's New Government has a bold new Plan to make our country a world leader by:

- Eliminating Canada's total government net debt in less than a generation;
- Reducing personal income taxes for Canadians each year with the interest savings from this lower debt;
- Reducing the paper burden on businesses by no less than 20 per cent;
- Giving Canada the lowest tax rate on new business investment in all the G7 countries; and
- Building modern infrastructure through innovative public-private partnerships.

Mr. Chairman, today we are setting a new, national goal of eliminating Canada's total government net debt by 2021.

From this year forward, every dollar of every surplus of the Government of Canada will be applied to bringing down the debt.

How will this benefit Canadians?

Lower debt means lower interest payments. We believe those savings should be passed on directly to Canadian taxpayers.

As we pay down Canada's national mortgage, the interest savings generated by this reduced debt will be returned directly to Canadian taxpayers each and every year, through a reduction in personal income taxes.

Lower debt means less interest means lower taxes.



Based on the \$13.2-billion debt repayment we made for 2005–06, I am pleased to announce that personal income taxes will be reduced by almost \$700 million starting in 2007 and, with future debt reduction, the tax savings will rise to \$1.4 billion by 2011.

We will do this every year: pay down debt, achieve interest savings, and apply those savings to personal income tax reductions. This “Tax Back Guarantee” will give Canadians a direct stake and a direct benefit in how we manage government finances on their behalf. We will do so just like any responsible family.

Mr. Chairman, this is a unique and far-sighted initiative that will benefit Canadian families across the country, not just for today, but tomorrow as well.

Today’s *Economic and Fiscal Update* sets out an additional \$22 billion in new tax relief for Canadians over the next six years through:

- Our “Tax Back Guarantee”;
- Our Tax Fairness Plan for seniors and pensioners;
- A reduction in the EI premium rate, which will take effect in January; and
- A second reduction in the GST to 5 per cent no later than 2011.

This is in addition to the \$20 billion in tax relief over two years for individuals announced in Budget 2006.

Mr. Chairman, these historic measures will lead to significant positive change for all Canadians today and tomorrow.

Our new Government’s first *Economic and Fiscal Update* is a positive story. We know where we are headed and we are confident we have the road map to get us there.

Mr. Chairman, as you know, presentations such as these are filled with numbers. But what really matters is the people behind the numbers: the Canadians who get up every day and go to work, pay their taxes, abide by the laws of the land, and try and set a few dollars aside for retirement.

Canada is great because hard-working Canadians made it great.



It is thanks to their efforts that we live in a country that rewards hard work, helps people get ahead, and provides services like health care and post-secondary education that are the envy of the world.

The foundation that supports all that we do is a strong economy and well-managed government finances.

In less than a year, Canada's New Government has taken significant new steps to strengthen our economy and better manage our public finances on behalf of all Canadians.

Today, we take the next step.

I am pleased to present *Advantage Canada: Building a Strong Economy for Canadians*. This is a long-term economic plan designed to improve our economic prosperity today and in the future.

It proposes steps to give individual Canadians even greater opportunities to fulfill their dreams of a good job, a home of their own and a retirement they can count on. Its purpose is to make their lives better by allowing their skills, their ambitions and their dreams to flourish.

## **A Strong Economy**

Mr. Chairman, Canada is back.

We stand on the best economic footing of any G7 economy.

We are in the second-longest period of economic expansion in our history.

We are an emerging energy superpower that is taking concrete action to improve our environmental sustainability and competitiveness.

Today, the unemployment rate is near its lowest level in over 30 years, with more than 260,000 new jobs created so far this year, all of them full-time.

More jobs and lower taxes have contributed to higher incomes for Canadian workers.

At the same time, we face challenges such as a higher Canadian dollar and an increase in exports from emerging economies overseas—two key factors that have impacted our manufacturing sector in particular.



While this has clearly been difficult for the workers affected and their families, many new jobs have been created in high-wage sectors.

At the same time, manufacturing investment in machinery and equipment is up and production is higher than in 2002, when the dollar began to appreciate.

Mr. Chairman, I am pleased to report the outlook for our economy as a whole is encouraging.

The private sector forecasters surveyed by the Department of Finance see further growth, but at a slower pace than expected a few months ago. They expect the economy to grow around 2% per cent both this year and next.

Every economic forecast is subject to some degree of risk. The forecasts I am releasing today are no exception.

- First of all, the U.S. housing market correction is substantial;
- Secondly, uncertainty exists about the future prices for many of our key commodities—oil, natural gas and industrial metals—which have been hovering well above historical levels; and
- Thirdly, with a growing U.S. current account deficit and the lack of exchange rate flexibility in emerging Asian nations, we face the risk of the U.S. dollar depreciating further against currencies such as ours, resulting in additional pressure on our exporters.

Despite these risks, I am confident in the underlying strength of the Canadian economy and our ability to deal with these and other potential risks, should they arise.

## **A Strong Balance Sheet**

Mr. Chairman, a strong economy requires sensible, strong Government of Canada finances.

We have an obligation to Canadians to manage their hard-earned tax dollars effectively and efficiently.

That's how families in every community in this country handle their finances, and they have every right to expect nothing less from their government.



We made it clear that we would pursue an ongoing strategy to review and scrutinize all government expenditures—a strategy focused on results and value for money.

Mr. Chairman, Canada's New Government will keep our books balanced and maintain a tight rein on spending.

This has not been the case with previous governments.

Over the past five years of the previous government, total program spending grew by an average of 8.2 per cent each year. In 2004–05 alone, growth in spending increased by 14.4 per cent.

This growth was neither sustainable nor desirable.

That's why, when we announced our \$13.2-billion surplus for 2005–06 in September—the third-largest in Canadian history—we also announced detailed actions to achieve a further \$1 billion in savings this year and next, as promised in Budget 2006.

Program spending this year and next is now projected to be lower than expected at the time of the budget, thanks to this Government's greater fiscal discipline.

Spending in 2006–07 will now come in \$1.2 billion lower than anticipated last May.

Mr. Chairman, in our first budget, we announced a new, more transparent and accountable approach to budget planning. This was necessary to restore credibility to the budget process.

Budget planning is now done over a two-year time horizon to provide greater certainty. The former practice of adjusting the budget projections for economic prudence has been discarded.

Canada's New Government is also publicly releasing, for the first time ever, our own fiscal projections along with the fiscal projections of four leading private sector forecasting organizations.

This will allow Members of Parliament and interested Canadians to compare and contrast each of the forecasts, and it will make our forecasts more credible and more predictable.



I will now present the Government's fiscal forecasts for the current year and for each of the five years following that.

These numbers take into account the full cost of measures announced in our May budget and since then, the \$3 billion set aside each year in debt reduction, and further tax relief commitments I am announcing today.

For planning purposes, our expected budget balances are as follows:

- In 2006–07, \$4.2 billion;
- In 2007–08, \$3.5 billion;
- In 2008–09, \$2.4 billion;
- In 2009–10, \$2.0 billion;
- In 2010–11, \$3.6 billion; and
- In 2011–12, \$2.9 billion.

Mr. Chairman, at first glance these appear to be large numbers. Let me put them into perspective.

Out of revenues of more than \$200 billion each year, a surplus of \$4.2 billion represents only 2 per cent.

That leaves government with a very small margin for error.

For example, a small, unexpected decrease of just 1 per cent in revenues would eat up some \$2 billion out of that surplus number.

That's why we must continue to manage carefully each hard-earned tax dollar.

Unlike previous governments, we don't see surpluses as a licence to spend.

In fact, quite the opposite. We see modest surpluses as a chance to focus on the priorities of Canadians.

As you can see, Mr. Chairman, our finances are clearly in order. But we must ensure these surpluses are used wisely and that Canadians and their families get good value for money.

That requires a focused, long-term economic plan.

Mr. Chairman, we have such a plan.





## **A World of Challenges and Opportunities**

Canadians are blessed with one of the world's strongest and most sophisticated economies. We have generous benefit programs and first-rate public services.

This didn't just happen. This success required planning, ambition and hard work over the years, traits that were handed down through generations.

Our parents and grandparents made this country great, and for that we owe them our gratitude.

Now we owe it to ourselves, to our own children and grandchildren to put our minds and our resources to best use so that we can deal with the challenges we will face over the next decade and beyond.

Over the past number of years, the ground rules of the global economy have changed.

We live in a changing and exciting time. People, jobs and investment capital move more rapidly across the globe than ever before.

Advances in communications technology, reduced trade barriers and declining transportation costs affect business decisions across the globe.

Talented, motivated people have become the world's most valuable resource.

Meanwhile, here at home, baby boomers are set to retire in record numbers, testing our capacity to maintain our improved standard of living.

With the right plan, determination and political will, Canada can become a new leader in this fast-changing global economy.



## A Plan for a Better Future

That's what *Advantage Canada* is all about.

Our economic Plan is about giving Canada and Canadians the key advantages needed to compete today and succeed for years to come.

Our Plan aims to improve our quality of life by building a strong economy that is not only fit for the 21st century, but equipped to lead in the 21st century.

It focuses on creating five key advantages:

- A **tax advantage**, by reducing taxes for all Canadians and establishing the lowest tax rate on new business investment in the G7;
- A **fiscal advantage**, by eliminating Canada's total government net debt in less than a generation;
- An **entrepreneurial advantage**, by reducing unnecessary regulation and red tape and increasing competition in the Canadian marketplace;
- A **knowledge advantage**, by creating the best-educated, most-skilled and most flexible workforce in the world; and
- An **infrastructure advantage**, by building modern, world-class infrastructure that ensures a seamless flow of people, goods and services over our roads and bridges and through our ports, gateways and public transit networks.

*Advantage Canada* is based on four key principles, each one of which will act as a prism through which issues will be viewed and policy decisions made in the years to come.

Those principles are:

- Focusing government on what it does best;
- Creating new opportunities and choices for people;
- Investing for sustainable growth; and
- Freeing businesses to grow and succeed.

Let me take a minute to focus on each principle.



## Focusing Government

First of all, focusing government so it is effective, efficient and gets results for people.

Nations don't become world leaders by accident. They excel when their governments focus on the things they need to do, and do them well.

How well they tackle debt is one of those critical areas.

Canadian families instinctively understand why reducing debt is important.

In every household budget, families know that money spent paying off credit cards or making mortgage payments is money not available to spend on renovating their house, paying for the education of their children or saving for retirement.

Mr. Chairman, government debt is nothing less than Canada's national mortgage.

Reducing debt frees up funds to reduce taxes or to invest in other priorities such as health care, education, public services, better roads and bridges, safer communities or a cleaner environment.

Reducing debt helps keep interest rates low, which allows Canadians to borrow money for the things that matter to them and their families.

Reducing debt helps our economy better deal with the risks of external economic shocks that are beyond our control or domestic challenges such as an aging population. It gives us more fiscal room to prepare for these changes.

Most of all, reducing debt is a matter of fairness for future generations. After all, those who benefited from years of overspending have an obligation to help bring it down. To do otherwise is to mortgage the future of our children and grandchildren.

Canada's New Government has made significant progress on this front. We made one of the largest debt reductions in Canadian history: \$13.2 billion. Canada's federal debt now stands at roughly \$481 billion, down \$81 billion from its peak a decade ago.



That's progress, but we clearly need to do more, much more, to bring that debt down and free up resources for the priorities of Canadians.

We believe it's time to mobilize Canadians to make a national commitment to pay off Canada's national mortgage.

We want to lift that heavy weight off the shoulders of the next generation of Canadians so that they can invest more on a better future for themselves and their families.

That is why I'm pleased to announce that *Advantage Canada* is proposing to eliminate Canada's total government net debt by 2021.

As a first milestone, the Government will move up its commitment to reduce the federal debt-to-GDP ratio to 25 per cent by 2012–13, a full year ahead of what had been planned previously and two years ahead of the target set by the previous government.

This is the right thing to do. But we can and must do more.

As we lift the debt burden, we must also lift the tax burden.

That's why our "Tax Back Guarantee" will dedicate all interest savings from the shrinking federal debt to personal income tax reductions.

As debt reduction continues and interest savings accumulate, so too will the tax reductions for Canadian families and taxpayers.

Less debt means less interest means lower taxes.

Mr. Chairman, to show we mean business, we will set aside funds in the next budget for tax reduction equivalent to the interest savings associated with the \$13.2-billion debt reduction this past fiscal year—almost \$700 million that will be allocated to permanent and ongoing tax reduction.

Combined with the interest savings from the planned \$3-billion debt reduction set aside for this year and future years, this tax relief will rise to about \$800 million for taxpayers in 2007–08, and will rise to an even greater tax reduction of \$1.4 billion by 2011–12.

It's time to give Canadian taxpayers a direct stake and a direct benefit from balancing the budget each year and reducing government debt.



Let me stress that these tax reductions are on top of other tax measures this Government will introduce or has already announced.

Mr. Chairman, also key to a sound financial footing is low, stable and predictable inflation.

Maintaining low inflation goes right to the bottom line of every household budget. It makes mortgage rates affordable, allowing more families to purchase new homes. It secures the value of incomes and keeps buying costs stable.

In 1991, the Government and the Bank of Canada adopted an inflation-target regime that has kept inflation low and stable. This has allowed households and businesses to benefit through lower mortgage and loan costs.

Today, I am pleased to announce that the Government and the Bank of Canada have agreed to renew Canada's inflation-control target for a further five years, to 2011.

The inflation target will continue to be the 2 per cent mid-point of the 1 to 3 per cent inflation-control range.

Focusing government also means responsible spending—ensuring value for money and focusing on areas of federal responsibility.

Building on last year's lower spending, our new economic Plan proposes to keep the growth rate of program spending on average below the rate of growth of the economy.

To that end, the President of the Treasury Board will outline shortly the Government's new Expenditure Management System.

It will ensure that federal spending delivers results, is guided by clearly defined objectives and goes towards the highest priorities of Canadians.

Mr. Chairman, restoring fiscal balance is also an important part of *Advantage Canada*. Provinces and territories will be key partners in delivering this Plan.

Budget 2006 set out a clear plan to restoring fiscal balance in Canada based on key principles. We are proceeding with this plan.



Consultations have been held for the past several months at many levels with provincial and territorial governments on all aspects of fiscal balance. Next month, I will be meeting my provincial and territorial colleagues for the second time this year. Canada's New Government is committed to open federalism and respect for the roles and responsibilities of each order of government.

We can build a stronger economy for all Canadians through long-term, predictable federal funding in infrastructure and post-secondary education and training, a return to principles-based Equalization and Territorial Formula Financing programs, and a more efficient, effective economic union.

*Advantage Canada* will help us build this stronger economy for all Canadians.

### **Creating New Opportunities and Choices for People**

Mr. Chairman, the second principle of our *Advantage Canada* Plan is to create new opportunities and choices for people.

With a smaller, more focused government, we can lower taxes to create incentives for Canadians to save and to succeed.

We will be able to keep our best and brightest in Canada, while attracting the people our country will need to build a strong economy.

We believe our role as government is to ensure equality of opportunity for Canadians, not equality of outcomes.

That starts with a lower tax burden. Canadians simply pay too much tax compared to other countries we compete with for talent, skilled workers and foreign investment.

Canada's New Government began to reduce taxes in our first budget last May. We reduced the GST, increased the amount Canadians can earn without paying federal income tax, permanently reduced the bottom rate, introduced the Canada Employment Credit and brought in several targeted tax relief measures. Twenty-nine separate tax reductions in every area the Government collects revenue.



The Tax Fairness Plan we announced on October 31 went even further for Canada's seniors. We increased the age credit amount by \$1,000 and introduced income splitting for pensions to increase the rewards from retirement saving.

These measures will result in substantial savings for Canadian seniors. I encourage everyone to check out the Senior's Tax Savings Calculator on the Department of Finance website. It shows, for example, that a senior couple with a single pension income of \$30,000 will save \$1,118 in federal tax. That's a savings of some 27 per cent.

Budget 2006 and our Tax Fairness Plan took significant steps to get this country back on track and to begin to create a tax advantage for Canada.

We need to go further.

To create a greater tax advantage for Canada and Canadians over the coming years, our new economic Plan proposes to:

- Reduce the GST even further to 5 per cent, as promised;
- Deliver a Working Income Tax Benefit in Budget 2007 to help low- and modest-income Canadians get ahead and get over the welfare wall;
- Continue to reduce personal income taxes to make the tax system fairer and to attract and retain highly skilled workers; and
- Reduce taxes on savings, including on capital gains, to make Canada's system more competitive.

Creating a tax advantage will reward initiative and help Canadian families pay the bills. It will help keep highly skilled Canadians in Canada and make our country the destination of choice for highly skilled people from around the world.

Reducing taxes alone is not enough. We must also do a better job of investing in post-secondary education and training.

To secure our quality of life and be a leader in the global economy, we need to retain and attract the best talent in the world—innovators, entrepreneurs, researchers, risk takers and achievers.

That's why our Plan proposes to step up investments in research equipment in universities and colleges and in graduate scholarship support including for science and engineering.



We will also enhance the quality of education and skills of Canadians through stable and predictable funding for post-secondary education and training. We will modernize the student financial assistance system so it does the job better for young Canadians.

Just as crucial will be bringing under-represented Canadians into the country's economic mainstream: Canadians with low and modest incomes, Aboriginal Canadians, older workers, persons with disabilities and immigrants.

Our country simply cannot afford to leave anyone behind. *Advantage Canada* aims to help all Canadians reach their full potential.

We will provide new opportunities for people to contribute their talents and abilities more fully to society by:

- Eliminating barriers to labour force participation;
- Improving the Temporary Foreign Worker Program to respond to employer needs; and
- Making it easier for Canadian-educated foreign students to stay in Canada.

As a society, we will all benefit from their greater participation in our nation's economic life.

## **Investing for Sustainable Growth**

Mr. Chairman, the third principle of *Advantage Canada* is investing for sustainable growth.

Canada's New Government will show leadership and make the smart investments our country needs to excel in three crucial areas:

- Research and development;
- The environment; and
- Infrastructure.

Each of these is critical to ensure long-term economic growth and opportunity for Canadians.

*Advantage Canada* aims to make Canada a clear research and development and innovation leader.





The federal government currently invests some \$3 billion a year in research in post-secondary institutions and \$2 billion a year on its own research. This primary research can pave the way for later-stage, potentially profitable research by industry.

We will improve public investment in R&D. At the same time, we will make sure that investment reflects national priorities and focuses on the best projects.

Although Canada leads the G7 in public sector R&D investment, that unfortunately is not the case for our private sector.

*Advantage Canada* will create the right kind of tax and business environment that will encourage the private sector to turn bright ideas into new products, services and technologies to generate more economic growth and create new well-paying jobs for Canadians.

Our Plan proposes to develop and implement a new, comprehensive, excellence-based science and technology strategy. This strategy will allocate government funding and resources to the highest research priorities, better align post-secondary research with the needs of business, and fully prepare young Canadians for work in a knowledge-intensive economy.

To retain and attract highly skilled and mobile people, however, we must go beyond science and technology strategies and public investments in R&D.

We need to provide a clean and healthy environment in which to work, live and raise our families. *Advantage Canada* recognizes that creating more liveable communities also makes good economic sense.

The issues of the economy, the environment and energy are inextricably interwoven. Our Plan recognizes these integral and concentric relationships. These issues will advance together in our Plan.

Canada's new Clean Air Act provides a direct path towards this goal. It will deliver:

- The first-ever comprehensive federal regulation to reduce air pollution;
- The first-ever federal regulation that will reduce greenhouse gas emissions in Canada, *not* use taxpayers' money to buy emission reduction credits abroad; and
- The first-ever federal clean air regulation of all industrial sectors in Canada.



This Government will continue to focus on environmental improvements based on results, not unachievable targets. And we will invest in sustainable environmental technologies where Canada can lead the world.

A clean, healthy environment also requires modern infrastructure. We must improve our roads, bridges, borders and public transit to clear the air, cut the commute and drive the economy.

That includes making smart investments to ensure goods and people move across the country and across our borders safely and effectively, on time and at reasonable cost. It means getting cars off of our roads, and reducing gridlock in our cities.

*Advantage Canada* builds on the unprecedented \$16.5-billion investment in infrastructure outlined in Budget 2006. We will provide long-term, predictable funding and a fair and transparent allocation of program funding supporting, among other investments, improvements to Canada's core national highway system.

We will also look for ways to get more out of infrastructure investments by taking advantage of the innovative financing provided through public-private partnerships.

And let me say, Mr. Chairman, that we believe there is a lot of room for improvement in how we manage infrastructure projects.

Take, for example, the Windsor-Detroit Corridor. Windsor-Detroit is the crossing point for 28 per cent of all trade in goods between Canada and the United States.

It is just not acceptable that, after all these years, governments have not finished the job to make this crossing more efficient and secure.

Surely we can do better, and we will. A financing strategy for this vital crossing will be addressed in the next budget to get the job done expeditiously.



## Freeing Businesses to Grow and Succeed

Mr. Chairman, the fourth and final principle of *Advantage Canada* is to free businesses to grow and succeed.

Businesses don't need more government meddling. They need government to get out of the way, and to free them to do what they do best—invest, expand and create jobs.

Our Plan will eliminate unnecessary and costly regulations and red tape. This will encourage businesses to invest more in training, machinery, equipment and innovation.

We will reduce the federal paperwork burden by at least 20 per cent. We will work with leading small business organizations such as the Canadian Federation of Independent Business to achieve this goal.

Our Plan will open the doors wider to trade and investment within our own country and with the rest of the world.

*Advantage Canada* includes the creation of a new Global Commerce Strategy to extend the advantages we already enjoy through the North American Free Trade Agreement.

Our Plan will build on the corporate tax reduction measures we introduced in Budget 2006. We will lower taxes further to make Canada's businesses more internationally competitive. Our clear objective is to achieve the lowest tax rate on new business investment among all G7 countries. Our determination to do so was made clear with our recent announcement of a further reduction of the corporate tax rate to 18.5 per cent in 2011.

Provinces also have a role to play in creating a positive business environment. We will accelerate discussions with the provinces to eliminate costly internal barriers to trade and mobility and to build on our leading-edge financial system by establishing a common securities regulator. We also encourage the provinces to move ahead with the harmonization of sales taxes with the GST, which would substantially reduce the rate of taxation on new investments.



## Canadians Can Make It Happen

Mr. Chairman, today I have set out the performance and prospects of our economy, the Government's determination to maintain strong finances, and our bold new Plan to improve our country's economic prosperity both today and in the future.

I have set out a new, long-term plan called *Advantage Canada*.

A Plan to build a strong economy for Canadians.

A Plan that will give Canada and Canadians the five key advantages we need to achieve and succeed in today's global economy:

- A tax advantage, by reducing taxes for all Canadians and establishing the lowest tax rate on new business investment in the G7;
- A fiscal advantage, by eliminating Canada's total government net debt in less than a generation;
- An entrepreneurial advantage, by reducing unnecessary regulation and red tape and increasing competition in the Canadian marketplace;
- A knowledge advantage, by creating the best-educated, most-skilled and most flexible workforce in the world; and
- An infrastructure advantage, by building the modern infrastructure we need to sustain our growth.

Mr. Chairman, we have already begun to implement our *Advantage Canada* Plan. We will continue to do so in Budget 2007 and in the years to follow.

With this Plan, and the time-tested courage, compassion and determination of Canadians, we can continue to be a shining example to the rest of the world.

The world needs Canada—our brains, our resources, our skills and our resolve—and the world needs Canada to be strong and successful.

Our Government is mindful of its responsibility and the trust Canadians have placed in us.

We will not betray that trust.

Canada's New Government is getting things done for Canadian families, students, workers and seniors. We are acting in their interest and in the interest of the nation to ensure we are the best we can be, now and in the future.

Thank you.