February 20, 1990

the Budget Speech

Canada

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Since 1984, this government has been following a consistent and comprehensive plan to ensure that Canadians can benefit from a rising standard of living and a quality of life second to none in the world.

As a vital part of that plan, we have been striving to gain greater control over our nation's finances.

We have attached a very high priority to this objective. Because as we achieve it, we will gain greater flexibility and independence of action to meet the priorities of this government and of Canadians.

Last year I set out a five-year deficit reduction plan to achieve this objective. It was, and is, the right course to follow.

The deficit for this year is on track at $30.5 billion. But our future progress is endangered by deeply entrenched inflationary pressures.

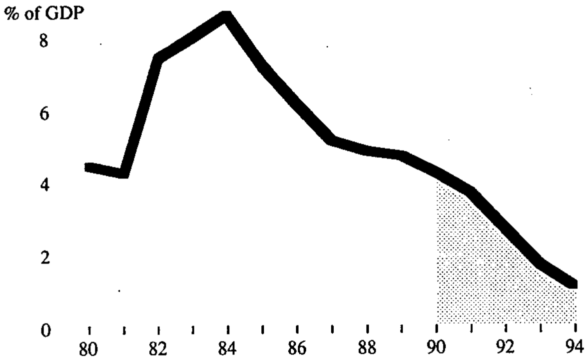
Today I am asking Canadians to join in a broadly based program to reinforce our efforts to control government spending. This program will keep us on a track that will allow us to achieve the goals that I set out in my last budget:

- We will reduce the deficit to $28.5 billion next year.

- We will cut it in half to $14 billion in three more years.

- We will reduce it further to $10 billion in the year after that.

Reducing the Deficit



This will mean that within five years the government will begin to buy back its bonds and Treasury bills. The country will be on a clear path of substantially reducing the burden of debt.

Last year I said that for every dollar the government collects, the interest on our debt was 35 cents and rising. That is money we can't use now to get taxes down or to address priorities such as environmental protection, research and development and skills training. We must pay those interest costs. In this budget I will show how, over the next five years, we can reduce tha 35 cents to 26 cents - and keep it going down.

Reducing the share of revenues we pay out in interest will increase our capacity to meet the aspirations of Canadians.

That is one important reason for reducing our deficit. There are other important reasons.

Every additional dollar of deficit we incur today means an increased burden of debt for future generations. We have a responsibility to our children and grandchildren. To build for them, not to borrow from them.

Reducing the federal deficit will help ease inflationary pressures. That will help reduce interest rates.

Reducing the federal deficit will reduce Canada's reliance on foreign lenders. It will strengthen our sovereignty as a nation.

These are all powerful reasons for holding to the plan we started in 1984.

Much progress has been made since then. We have significantly reduced the burden of government. The growth of spending on all government programs and services has been well below the growth of the economy and even below the rate of inflation.

We have reduced the size of the public service by 12,000. The public service today is the same size as in 1973, despite the fact that Canada's population has increased by about one-fifth. Overall, spending on government operations is less now than it was in 1984.

When we first came to office, the federal government was spending $16 billion more on programs – everything except our interest costs – than it collected in revenues. Today our program spending is $9 billion less than revenues. We have turned an operating deficit into an operating surplus – a turnaround of $25 billion in just five years. And 70 per cent of this progress results from expenditure restraint. To achieve that progress, we have reduced program spending as a share of the economy to the lowest level in almost 20 years.

Canadians know that this progress has been hard-earned. They have felt the impact of the tough but necessary decisions to protect and strengthen Canada's future. While our actions have meant difficult adjustments for many Canadians, the economic results have been good. The economy has expanded for seven consecutive years. Employment has grown strongly. After-tax incomes have risen. Economic opportunities have been increased. Poverty has been reduced by the best kind of social policy – more jobs.

The actions in this budget will ensure that we make continued progress in the years ahead by facing squarely the twin problems of high deficits and high inflation.

I am proposing a two-year expenditure control program that will affect all areas of government spending with the exception of income support programs for seniors, families and veterans, unemployment insurance, as well as the equalization program and Canada Assistance Plan payments to lower-income provinces.

A number of programs will be limited to 5-per-cent annual growth for the next two years. Others will be frozen at their current levels. Some will be cut or eliminated. Government operations will be tightened further.

There will be no new taxes in this budget.

The spending control program, together with the restraint measures announced in December, will save $3 billion in the first year and close to $4 billion in the following year. The savings will total well over $19 billion over the next five years. Our operating surplus will grow from $9 billion today to $31 billion in 1994-95.

Implementing the expenditure control program this year will require the patience and understanding of Canadians.

In my budget last year, I spoke of the importance of easing the inflationary pressures that have been building in most parts of the country. Only by easing demand and cooling out these pressures can we re-establish a solid track of sustainable non-inflationary growth.

The economy is in a period of slower growth. This is not surprising. Nor should we try to avoid it.

This will not be an easy year. But as we move through it, let us not forget what we learned together in the early 1980s when inflation got out of control. Let us not relive the sense of despair, the sinking confidence and the personal hardship that resulted from the 20-per-cent-plus interest rates brought on by soaring inflation.

Let us instead remind ourselves of why we must solve our deficit and inflation problems now. To do so will allow us to build a secure and rewarding future on a solid foundation:

- a responsive government with the financial room to manoeuvre to maintain valued services and tackle new challenges;

- a dynamic economy that provides rising living standards and growing opportunities to build full, satisfying lives;
- a confident, economically sovereign country that is competitive abroad and in control of its destiny at home.

This is the future we have been building since 1984.

The way to achieve it is to follow a clear plan of responsible fiscal and economic policies to reduce inflation and create a better climate for lower interest rates; policies that increase our ability as a nation to earn our way in the world and to pay our way at home.

This government will continue to do, not what is easy or popular for itself, but what is right for the country.

Building the Foundation for a Better Future

To ensure a strong economic foundation for the future, we are moving forward with the broad plan that we set out in November 1984.

The plan has two main thrusts: to put the government's financial house in order; and to foster a dynamic, innovative and competitive private sector. Our actions have challenged Canadians and encouraged them to change their ways of doing things.

But let's be clear about the real source of pressure for change. It is not the government. It is the rapidly evolving and increasingly competitive world in which we must earn our way.

The pace of international economic change has been accelerating during the past decade as more and more of our trading partners have implemented major economic reforms. The adjustments that we and others have been making have been spread over many years. By contrast, the adjustments faced now by those in Eastern Europe are daunting in their speed and scope.

The powerful combination of political and economic freedom will increasingly unleash the creative energy of individual initiative, and bring more and more countries into the competitive mainstream of the world economy. We, as individuals and as a country, must be ready to deal with this and take advantage of the opportunities it presents.

Expanding our Economic Potential

In this changing world, Canada needs a dynamic, flexible economy that responds quickly and effectively to new challenges and opportunities; a more open and market-oriented economy that brings out the best of our competitive abilities.

Toward this goal, our economic plan has proceeded with many initiatives designed to strengthen the basic structure of the economy and provide a better framework to allow our economy and Canadians to adjust to change.

These structural reforms will increase our competitiveness and expand our potential for growth and job creation. They encourage private initiative, remove obstacles to economic growth, secure access to markets, increase investment and improve efficiency. They contribute to a more productive and prosperous Canada.

The Canada-U.S. Free Trade Agreement is opening up new opportunities in the large American market. This initiative alone will lead to an ongoing 3.5 per cent increase in our economic output. These gains will be shared by all regions.

Scrapping the National Energy Program and deregulating the energy and transportation sectors have reduced government interference in these key parts of our economy.

The reform of the income tax system lowered tax rates and eliminated tax breaks and loopholes. It has increased economic output by increasing the incentive to work, save and invest.

The new Labour Market Development Strategy will upgrade the skills and increase the flexibility of the work force. Better training means better jobs for Canadian workers. It helps them adapt to new technology and change.

Privatization and Crown Corporations

Our program of privatization and improved management of Crown corporations is contributing both to greater economic efficiency and deficit reduction. Since 1984, the government's holdings in 18 corporations have been sold or reduced. Eight others have been dissolved. The number of Crown corporation employees has been reduced by 75,000 partly through privatization and partly through rationalization and the elimination of waste and inefficiency.

The financial health of many Crown corporations has substantially improved. Canada Post has turned a $400 million deficit into a profit and is continuing to improve its service. Canadian National has reduced its long-term debt from $3.5 billion in 1986 to less than $2 billion in 1989. To ensure a better return on the public's investment and to contribute to deficit reduction, profitable Crown corporations will return more to the government as shareholder in the form of dividends.

We will continue to privatize Crown corporations and sell investments where government ownership is no longer needed to meet public policy objectives.

In 1984, Petro-Canada was mandated to operate as a commercial corporation in a competitive private sector environment. Further expansion of Petro-Canada depends on having access to the full range of financing opportunities available to private sector corporations.

Following consultations with senior management of the corporation, the government has decided that the time has come to allow direct public ownership of Petro-Canada. The Minister of State for Privatization will provide further details in the near future and legislation will be introduced later this year. The government is confident that a privately owned, Canadian-controlled Petro-Canada will play a strong and growing role in Canada's energy sector.

We intend to sell the government's shares in Telesat Canada, which has now achieved commercial success as a satellite communications carrier. This sale will help encourage even greater innovation in a key high-technology sector of the Canadian economy.

We are also winding up a number of Crown corporations and other agencies whose functions can be handled effectively by other organizations.

Sales Tax Reform

The replacement of the existing manufacturers sales tax with the Goods and Services Tax is a key part of our economic plan. It will strengthen economic competitiveness, contribute to deficit reduction and lead to a fairer sales tax system.

Replacing a hidden tax with a tax which will be visible and comprehensive is difficult. It isn't popular, but it is necessary.

The existing tax destroys jobs. It makes our exports less competitive and favours imports over Canadian-made products. It costs Canada $9 billion in lost annual output. The GST will unlock that potential for new growth and jobs. The benefits will be felt in every region of Canada.

The existing federal sales tax is subject to significant tax avoidance. By replacing this unreliable tax, the GST will put our deficit reduction plan on a stronger foundation.

Through the GST refundable credit, the fairness of the tax system will be improved. Families with incomes up to $30,000 will be better off than under the existing system. Three-quarters of all families headed by seniors and single parents will have more after-tax income under the GST.

In response to concerns expressed by the small business community, the government is continuing to work with the provinces to seek ways of minimizing the compliance burden of the tax.

Realizing the Potential

Taken together, all of these reforms will significantly increase the capacity of the Canadian economy to produce goods and services. They raise our potential sustainable growth from an average of 2 3/4 per cent annually to more than 3 1/4 per cent. Achieving that growth will mean more jobs and a higher standard of living for Canadians. Over a five-year period, it will lead to a gain of about $2,500 for a household of four.

The challenge we face is to realize this higher potential for growth so that we can achieve those benefits. The record shows that Canadians have responded well to the challenge of change and adjustment since 1984. We have an outstanding record of growth and job creation. Almost 1.6 million more Canadians have a job today than in 1984. Average incomes have steadily increased, not just in total dollars but in real, after-tax income. This means there are now 750,000 fewer Canadians exposed to poverty.

Getting Off the Deficit Treadmill

To achieve our potential for greater economic growth and job creation, we must build on the hard-earned fiscal progress we have made.

Let me explain clearly the deeply rooted nature of the problem we are facing, and why it can be solved only with patient, determined, year-by-year effort.

In a real sense, we have had to fight not one deficit, but two.

In 1984, the federal government was living far beyond its means. It had to borrow $16 billion just to cover the difference between spending on programs and services and the revenues it collected. That was the first deficit - the operating deficit.

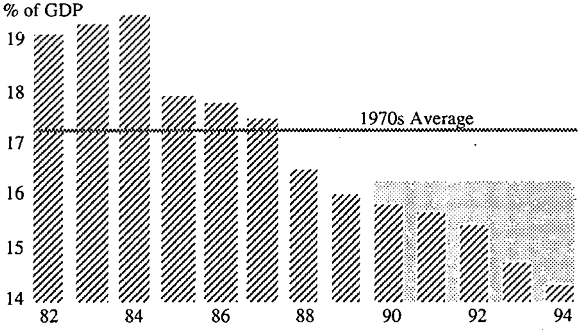
At the same time, a $200 billion mountain of debt was generating more than $22 billion in annual interest charges. Every penny of this interest was paid by additional borrowing. This was the second deficit.

Before we could even begin to deal with this second problem, we had to eliminate the operating deficit that was caused by too much program spending and eroding revenues.

Reducing Government Expenditures

As part of a measured, long-term plan to restore a better fiscal balance, we immediately launched a broad and sustained effort to reduce expenditures.

Controlling Spending



The first priority was spending on government operations – the cost of running the government. In 1984, this cost $17.4 billion. We have cut this to $16.8 billion in spite of a larger workload.

In December, the President of the Treasury Board announced further steps to eliminate waste, improve efficiency and save $1.4 billion over the next three years. We have imposed a freeze on federal government construction in Ottawa and travel restrictions on Members of Parliament and public servants. We are closing some parliamentary restaurants, selling two government jets and amalgamating or closing some government agencies.

Waste is being eliminated. Productivity has been improved; it will be further improved by measures in this budget. We will continue to seek out ways to eliminate waste and inefficiency in the months and years ahead.

We also eliminated outdated programs and restructured or restrained others. We eliminated energy subsidies, closed heavy water plants, reduced the VIA subsidy and eliminated the Canadian Exploration and Development Incentive Program. With tight discipline and good management, the program spending that amounted to 19.5 per cent of the economy in 1984 has been reduced to 16 per cent this year. That is equivalent to a $22 billion reduction in spending.

But the problem we faced in 1984 was not just too much spending. Federal government revenues had been declining as a share of national income since the mid-1970s. This happened for a number of reasons, including the growth in special tax breaks and the flaws in the federal sales tax. We eliminated those breaks, closed loopholes and increased revenues. Revenue, as a share of national income, is now back to the average level of the 1970s.

In 1987-88, we reached the first major milestone in the battle against the deficit when we turned the operating deficit into a surplus which now stands at $9 billion. This is major progress. It is a fundamental structural change in the balance of spending and revenues.

Solving the Debt Problem

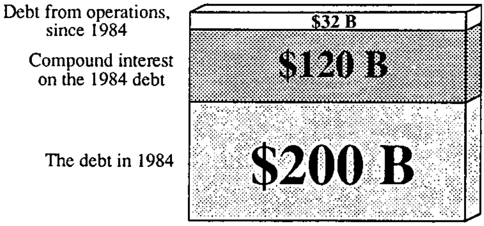
Because we now have an operating surplus, the total deficit today is less than the borrowing required to pay the interest on the debt. The reason for the rapid increase in borrowing costs needs to be better understood.

Compound interest - the interest paid on interest - is a great friend when you have money in the bank. Money invested at a compound rate of 10 per cent doubles in about seven years. It quadruples in about 14 years and grows to almost eight times its original size in 21 years.

But the same thing happens in reverse when you have to keep borrowing to pay the interest on a debt. In the time it takes a newborn child to reach the age of 21, a $200 billion national debt at a compounded rate of 10 per cent would grow to almost $1.5 trillion, all on its own.

Despite the fact that we have cut the annual growth of the debt from 24 per cent to less than 10 per cent since 1984, the debt is still growing faster than the economy - faster than our ability to pay.

The Debt Treadmill



Our public debt has grown from $200 billion to $350 billion in five years. Fully $120 billion - more than 80 per cent - of this increase consists of the compounding interest on the original $200 billion. That shows dramatically how important it is to get off the treadmill of borrowing money to pay interest on the past debt. It also helps to explain why the deficit is still at $30 billion in spite of the reduction in spending and increased tax revenues over the past five years.

This year alone, interest payments will cost us close to $40 billion - equal to $1,500 for each and every Canadian. That is ten times higher than 15 years ago.

A public debt growing faster than national income does more than feed on itself. It consumes more and more of the dollars we need to maintain existing programs, meet new priorities and keep taxes down. Ultimately, it consumes the hope and the opportunity that should be the legacy we pass on to our children. Instead, a runaway debt becomes our legacy.

The children of today and tomorrow do not have a vote in this matter. We do, and with it comes the responsibility to protect their future from a crippling burden of debt.

With the expenditure control actions in this budget, we will ensure that our operating surplus continues to grow. This is essential. But we also need to ease the burden of rapidly growing interest payments. And to do this effectively we must continue to deal firmly with the greatest single threat to our continued fiscal and economic progress: high inflation.

Current Fiscal and Economic Challenges

After seven years of strong economic growth, the economy has exceeded its productive capacity. This has fuelled inflation. The current slowing of the economy is helping to ease the strain, but underlying inflationary pressures remain too high. We must lower inflation as quickly as possible. This is the only way to get interest rates down so that we can put the economy back on a sustainable path of expansion and make further progress on the deficit.

The prospects for lower inflation and interest rates depend crucially on keeping costs under control. If we try to take more out of the economy than it is capable of producing, our inflation problems will worsen and the economy will suffer. Responsible price and wage behaviour will speed the process of getting inflation down.

Federal government wage increases have been below the inflation rate and below the pace of wage increases in the private sector since 1984. The government is today reaffirming its commitment to wage restraint. I have asked my provincial colleagues to join me in that commitment.

This will be a testing year for the Canadian economy. The economic news will not be encouraging in the months ahead. Growth will be slow. Employment is expected to continue growing, but not as quickly as the labour force, and the unemployment rate will rise.

In these circumstances, we can expect to hear increasing demands for quick-fixes, particularly for sharp, sudden reductions in interest rates. The frustration that people feel about the persistence of high interest rates is understandable. I feel it too. But experience makes clear the futility and the danger of trying to solve economic and fiscal problems by dealing with the symptoms rather than the causes. Experience also supports the need for the kind of firm, inflation-fighting monetary policy that the Bank of Canada has been following.

I want to underline the point: High interest rates are the symptom, inflation is the cause. A firm monetary policy helps to ease the demand that is straining the capacity of the economy and creating inflationary pressure. It is dealing with the cause of the problem. Premature easing of credit would lead to an increase in borrowing and demand pressures. This would make the inflationary problem worse, and lead to even higher interest rates in future.

The measures in this budget will work with monetary policy to ease inflationary pressures. They will help to harness the benefits of lower inflation, lower interest rates and lower deficits. They will reinforce each other and lead to a smooth return to strong, sustained growth and job creation. They will help ensure that the greater economic output made possible by our structural reforms will in fact be achieved.

Reinforcing Expenditure Control

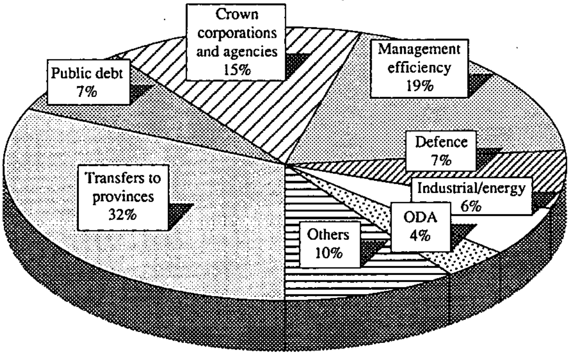
The expenditure control measures in this budget are tough. They reflect the fact that after several years of restraint, there are no painless ways to cut spending. The notion that spending can be substantially reduced without having a real impact outside of government simply does not fit with the reality of how government spends the taxpayers' dollars.

Expenditure Control Plan

Our two-year expenditure control plan will have a major impact on program spending. All areas of program spending were reviewed and a wide range of programs is affected. In designing the measures, we were sensitive to the financial circumstances of individual Canadians as well as governments.

$3 Billion of Savings

1990-91



- We have exempted major transfers to persons. These include elderly benefits, family allowances, veterans' pensions and allowances and unemployment insurance benefits. We have also exempted the equalization program and Canada Assistance Plan transfers to those provinces receiving equalization.

- We have capped the growth of a number of programs at 5 per cent per year for the next two years. These include Canada Assistance Plan payments to the fiscally stronger provinces of Ontario, British Columbia and Alberta; and certain expenditures for science and technology, and Indian and Inuit programs. In the 1989 budget, defence and foreign aid expenditures were substantially reduced. In view of the tight fiscal situation, their growth will also be limited to 5 per cent from this lower expenditure base.

- We have held a number of programs at their 1989-90 levels for the next two years. Total per capita cash and tax transfers to the provinces under Established Programs Financing will be held constant. These transfers will continue to grow with provincial populations.

- We have reduced or eliminated a number of programs. In light of the economics of the project and the present fiscal environment, the government will not proceed with the offer of assistance for the construction of the OSLO oil sands project. The Canadian Exploration Incentives Program is cancelled effective midnight, February 19. The government will not proceed with the Polar 8 icebreaker project, due to significant increases in the estimated costs, delays which have contributed to these increases, and changes in the international environment.

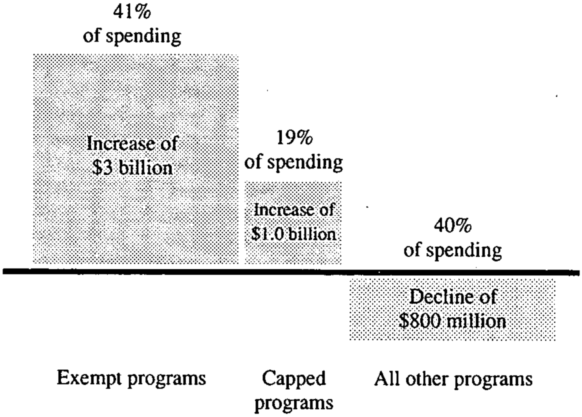
- We are taking a more businesslike approach to assistance to business. With limited exceptions, grants will be eliminated and financial assistance will be repayable on more rigorous terms. This will place the emphasis more clearly on investing in economic development rather than subsidizing the private sector.

- We are implementing a wide range of other measures to increase efficiency and reduce the cost of government operations. These include the privatization and Crown corporation measures that I dealt with earlier. The 2-per-cent annual limit on the growth of government operations and maintenance budgets, which has been in effect since 1986-87, will continue until 1994-95.

It is clear that with these measures the federal government has tightened its belt; we have restrained our own costs and we will continue to do so. Total expenditures on programs other than those that are exempt or capped will decline over the next year to a level $800 million below that of the current year. Total federal program spending will grow by 3 per cent next year, well below the expected rate of inflation. Total entitlements for the major federal-provincial transfer programs are expected to grow at about the same rate as federal program spending next year. They will average about 2.3 per cent for Ontario, Alberta and B.C. and 4 per cent for the Atlantic provinces. The lower-income provinces will continue to receive proportionately more federal support than the higher-income provinces.

The Expenditure Control Plan

1990-91



The deficit is a national problem. It demands a national solution. If we are to restore health to the nation's finances, provincial governments must do their part, just as they too will reap the rewards of lower inflation, lower interest rates and sustained economic growth.

Sustaining Fiscal Progress

These measures, with the expenditure restraint of previous years, have made it possible to restore the deficit to a downward path without increasing taxes in this budget. With the Expenditure Control Plan in this budget, we are taking the actions now to ensure that the government's fiscal position in the 1990s can support the priority programs Canadians value.

I have stated on many occasions that it would be irresponsible of our generation if we took the easy option of simply passing our deficit burden to our children. It would also be irresponsible to leave them a legacy of environmental neglect.

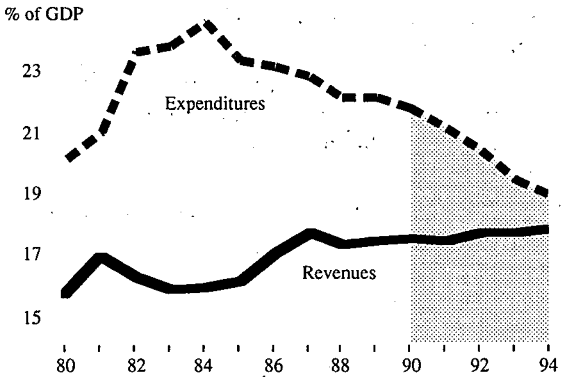
In Canada and abroad, we are witnessing a major change in peoples' attitudes and actions towards the environment. My colleague, the Minister of the Environment, is currently engaged in an extensive dialogue with Canadians on the steps we must take to address the difficult problems related to the pollution of our land, air and water and to deal with the protection of our ecological resources. Later this year, he will table before Parliament, *An Environmental Agenda for Canada: Implementing Sustainable Development.*

Canadians want action to protect our environment. The Agenda will be comprehensive and substantial and will demonstrate the government's commitment to action. It will be introduced in a fiscally responsible manner.

Impact of Budget Measures

The decisive actions in this budget bring us back to the fiscal track set out in the 1989 budget. We will cut the deficit to $28.5 billion in 1990-91. This deficit includes the impact of the one-time transitional cost of sales tax reform, including prepayment of the Goods and Services Tax Credit, the transitional grant to small business and the rebate of federal sales tax on inventories.

Restoring Fiscal Balance



The measures in this budget ensure that the deficit will be more than cut in half to $14 billion by 1993-94. By the following year:

- The deficit will be further reduced to $10 billion.

- The government will begin to pay down its bonds and Treasury bills.

- Program spending will fall to 14.2 per cent of national income, the lowest level since the late 1960s.

- The surplus of revenues over program expenditures – our operating surplus – will reach $31 billion.

- The burden of debt will be reduced as the public debt shrinks relative to our national income.

- As a direct result, the portion of every revenue dollar that today goes for debt interest will be reduced from 35 cents and rising, to 26 cents and falling.

In short, we will regain the flexibility needed to make real choices about the kind of country we will pass on to our children. And we will be able to make those choices in a climate of lower inflation, lower interest rates, durable economic growth and more jobs and opportunities in every part of Canada.

I am tabling the budget document including Notices of Ways and Means Motions. Details of the measures are included in the document.

Pursuant to a motion of this House, I will introduce today a bill seeking borrowing authority for the 1990-91 fiscal year.

I am asking that an order of the day be designated for consideration of those motions.

Conclusion

A nation's true sovereignty is determined by the ability of its people to shape their own future.

In today's world, our sovereignty is not threatened by military force or aggression. Our freedom and opportunity to realize our dreams for ourselves and our children rest on our response to the challenge of a more competitive world in the throes of economic change.

There can be no turning inward from this world. Canada is a major trading nation. We depend on international trade for one-third of our national income, millions of jobs and a substantial part of our ability to pay for important public services.

These benefits do not flow to Canada by right; we have to work hard for them. And when the economic world changes, we have to keep pace. To master our future in a changing world, we must expand our capacity to produce and sell Canadian goods and services at home and in markets around the world.

Canada has the natural resources, the capital and the people with the ingenuity to prosper in a competitive world. The very fact of Canada's existence is a tribute to its adaptability. Our ancestors built this country against formidable odds. Canadians have stuck together through testing periods by reaffirming, time and again, their ability to build on the rich diversity of the nation with realism, determination, foresight and understanding. That was the spirit of Confederation; and it must be the spirit in which we face every challenge to the building of a better future for Canada and Canadians.

Our ability to keep our economic future in our own hands is being challenged by the closely linked problems of inflation and growing debt. The economic plan that I have described, and the firm actions we have taken as part of that plan, have brought us to a clear prospect of relief. But let it not be said that we lost the battle by abandoning it before it was won.

Indeed, if we maintain our resolve, the prospect of lower inflation is within sight and we will have the deficit under firm control. By persevering, we will attain greater control over our destiny, and greater ability to devote our resources to investments in a rising standard of living and a better quality of life for all Canadians: in research and development, education and skills training, and environmental, social and cultural programs.

We must not fail in our resolve. We must continue to face our problems squarely. We must grasp the opportunities that are at hand to build the Canada that we want for ourselves and for future generations.

Department of Finance Canada
Ministère des Finances Canada