The Budget Plan

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

February 1994

Canada

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Department of Finance Canada
Ministère des Finances Canada

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OVERVIEW

This budget represents the first phase of a two-stage process which will culminate in the 1995 budget. Together, the measures in these two budgets will lead to a fundamental reform of programs in most policy areas to enhance their impact on growth and job creation, to raise their efficiency, and to secure the government's interim target of a 3 per cent deficit-to-GDP ratio by 1996-97.

The Budget Plan is based upon a set of credible economic planning assumptions, chosen to be clearly less optimistic than the average of private sector forecasts.

Measures are taken in this budget to sustain economic growth and create jobs.

- Funding is provided to launch the initiatives outlined in *Creating Opportunity*.
- Funding is provided to develop innovative approaches for social security and adjustment assistance programs.
- Funding is provided to assist the space sector in areas where Canada has established competitive international advantages.
- Unemployment insurance premiums are being lowered in 1995 to help create jobs and put Canadians back to work.
- In total, $1.7 billion is being provided in 1994-95 and $7.5 billion over three years to support these initiatives.

Measures are also being taken which will secure steady reductions in the deficit beginning in 1994-95.

- The measures in this budget, which reduce the deficit, result in gross savings of $3.7 billion in 1994-95, rising to $13.6 billion by 1996-97. Over the three-year period, the gross savings total $28.6 billion.
- With the financing of the initiatives to support economic growth and create jobs and the recently announced action plan against smuggling, the net savings over these three years amount to $20.4 billion.
- There is five dollars of net expenditure restraint for every dollar of net revenue enhancements.

These fiscal actions, combined with the impact of prudent economic planning assumptions described in Chapter 2, result in the deficit declining from $45.7 billion in 1993-94 to $39.7 billion in 1994-95 and to $32.7 billion in 1995-96.

- Of the $13 billion projected decline in the deficit from 1993-94 to 1995-96, 60 per cent is attributable to the net savings generated by the measures in this budget.

Detailed fiscal projections are presented to 1995-96 only, given the sensitivity of the fiscal projections to economic developments over time. However, the decisions presented in this budget set the deficit on a path to meeting the government's deficit-to-GDP target of 3 per cent in 1996-97.

With moderate economic growth in 1996, roughly similar to that expected for 1995, the deficit target of 3 per cent of GDP is achievable.

A more definitive view of fiscal prospects for 1996-97 and beyond will be outlined in the 1995 budget. The fiscal projections will incorporate:

- the results of the actions taken in this budget. These initiatives will generate net savings of $10.9 billion in 1996-97.
- the results of the program reviews announced in this budget and for which no fiscal savings have been incorporated, will be included in the 1995 budget results.

The fiscal projections will also take into account the recommendations of an independent external review of the Department of Finance's economic and fiscal forecasting methods and performance.

ECONOMIC PLANNING ASSUMPTIONS

Introduction

For several years, the Canadian economy has been performing below potential. Until recently interest rates have been high, the recovery from the recession has been painfully slow and unemployment remains unacceptably high.

This poor economic performance has created substantial excess capacity in output and labour markets. This, combined with good productivity performance, has pushed inflation and cost pressures down to the lowest levels in a generation. Interest rates are also close to 23-year lows, setting the stage for a rebound in interest-sensitive spending by households and businesses.

In December 1993, 38 leading economists from across Canada participated in a roundtable discussion with the Minister of Finance on the economic and fiscal outlook and related policy issues. The consensus view was that growth would pick up over the next year lead by strong export growth. Household spending would, however, lag the pace of expansion.

A key recommendation given at the December meeting of economists was that budget planning should not be based on overly-optimistic economic assumptions. This had been done in the past and had resulted in fiscal forecasts that went substantially off track and in policy actions that were inappropriate. To minimize the risk of this happening again economic assumptions below the middle of the range of private sector forecasts have been used in developing the budget plan.

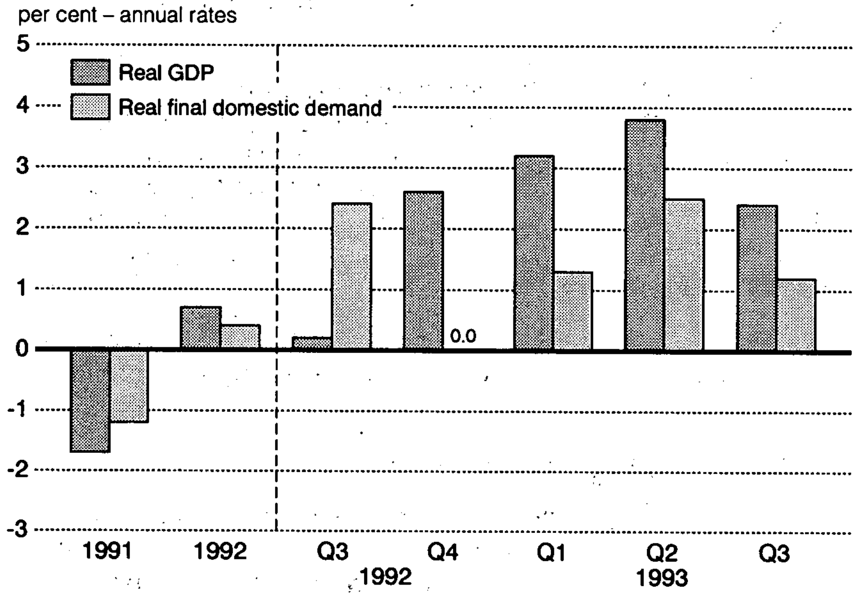
The Present Economic Situation

Weak household spending has held back the recovery

Real GDP growth has firmed over the past year, although it remains modest compared to previous recoveries. The recent strengthening reflects a strong export performance resulting from improved Canadian competitiveness and sustained growth in the United States. Business investment, particularly in machinery and equipment, has also supported economic activity, reflecting increased profitability and lower interest rates.

Chart 1

Real GDP and real final domestic demand growth



The recovery has, however, been held back by the slow growth of domestic demand (Chart 1). Slow employment growth has restrained the growth of income and hurt consumer confidence. This, in turn, has weakened household spending on goods and services. Lack of confidence has also held back residential investment, despite very substantial declines in mortgage interest rates. In fact, residential investment remains substantially below its pre-recession peak.

As a result of the slow recovery, progress has yet to be made in eliminating the substantial excess capacity that emerged during the recession.

Inflation and cost pressures are low

Inflation measured by the consumer price index (CPI) has been below 2 per cent for two years, despite the upward pressure on the price of imported goods arising from the depreciation of the Canadian dollar. As well, unit labour costs have increased at an annual rate of only 1 per cent since early 1991. Combined with the depreciation of the Canadian dollar, this has substantially improved Canada's competitiveness.

Interest rates are also low

The lowest inflation in a generation has paved the way for significant declines in both short-term and long-term interest rates.

By mid-February 1994, short-term rates have fallen more than 1000 basis points from their peaks in the spring of 1990 and are the lowest since 1971. The differential between Canadian and U.S. short-term rates has narrowed to less than 50 basis points. Indeed, the prime lending rate in Canada is now 5.5 per cent – the lowest rate in over 30 years and a half percentage point below that in the United States.

Long-term interest rates have also fallen, but remain high in the context of Canada's recent excellent inflation performance.

Factors Shaping the Outlook

The strength of the expansion over the next several years will depend largely on the international economic environment, and the timing of the pick up in household spending in response to past and future reductions in interest rates and greater consumer confidence. Confidence will be directly linked to perceptions of employment prospects.

- Most observers expect the U.S. economy to perform well over the short term. The Japanese and European economies are, however, in recession and the timing and strength of their recoveries are uncertain. Asia and Latin America are expected to continue to grow strongly.
- The dramatic fall of interest rates over the last several years has set the stage for a rebound in interest-sensitive spending, but limited employment growth and low consumer confidence make it difficult to say when this will occur.

Forecasters' Views On Economic Prospects

The average of private sector forecasts shows real growth strengthening to 3.5 per cent this year and 3.9 per cent in 1995. Given the many factors that can affect the outlook, there is a wide range of views on Canada's economic prospects.

For example, private sector forecasts of real growth this year range from 2.9 per cent to 4.3 per cent. In 1995 the range extends from 2.9 per cent to 4.8 per cent.

Private sector forecasters expect employment to grow 1.7 per cent this year, picking up to 2.2 per cent in 1995. Strong labour force growth, however, means that in most of their forecasts, the unemployment rate remains above 10 per cent in 1995. The most optimistic forecast is that the unemployment rate will fall to 9.4 per cent next year and the most pessimistic outlook has an unemployment rate of 11.0 per cent in 1995.

In January 1994, private sector forecasters expected CPI inflation to average 2 per cent this year and next. These forecasts were completed prior to the announcement of a reduction in tobacco tax rates which will reduce the rate of inflation in 1994. The forecasts showed short-term interest rates rising from current levels of just under 4 per cent, averaging about 4.3 per cent this year and about 4.5 per cent in 1995.

Charts 2 to 5 show the private sector forecasts for real GDP growth, the unemployment rate, CPI inflation and the interest rate on 90-day commercial paper.

The International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD) also prepare short-term economic forecasts of the Canadian economy. The IMF and the OECD outlooks are similar to the private sector average, but they take a more optimistic view of growth prospects in 1994 and a more pessimistic view of interest rates, particularly in 1995.

Chart 2
Real GDP growth

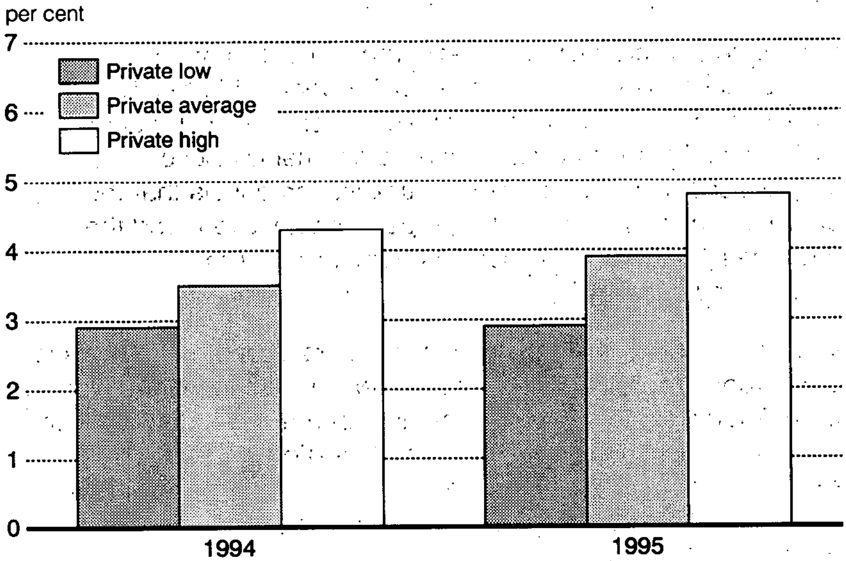


Chart 3
Unemployment rate

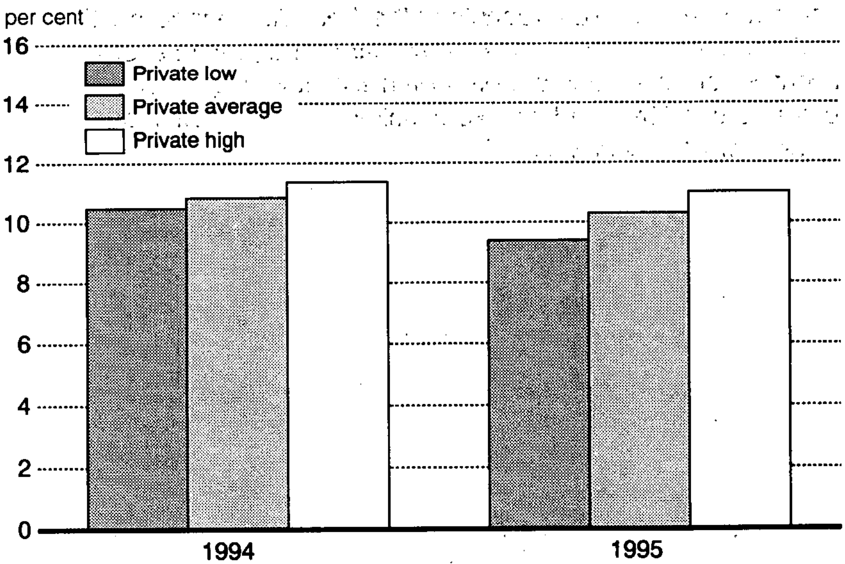


Chart 4
CPI inflation

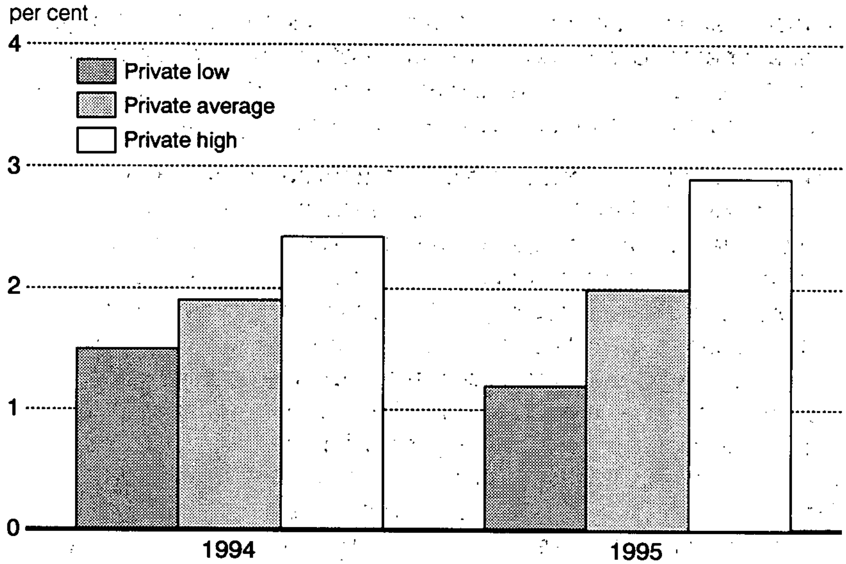
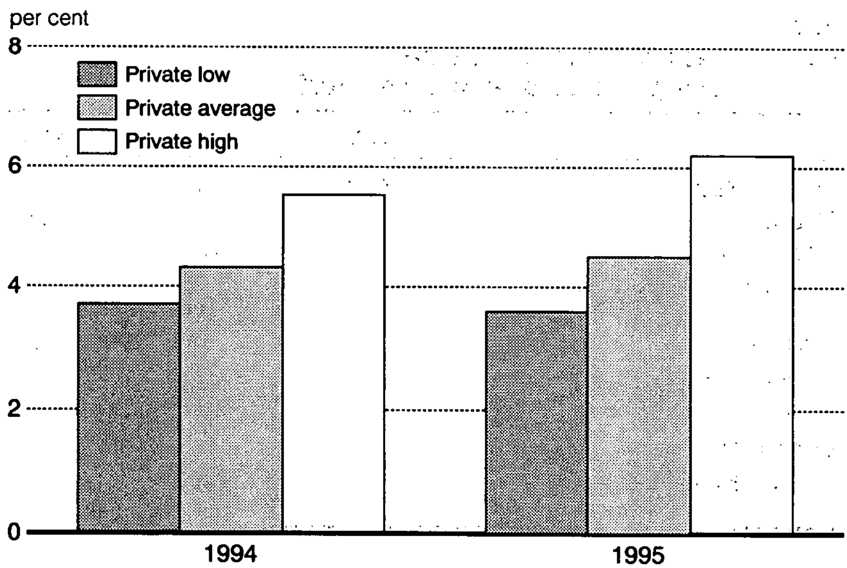


Chart 5
Interest rate on 90-day commercial paper



The Budget Planning Assumptions

After considering the economic forecasts prepared in the private sector, planning assumptions have been chosen for this budget that are near the low end of the range of views. This is consistent with the advice given at the December meeting with economists that prudent assumptions be used for fiscal planning.

The economic assumptions are summarized in Table 1. The projections used for this budget for real growth lie between the private sector average and the low forecast. The inflation projections are, on average this year and next, lower than all private sector forecasts. In good part this reflects the impact of the tobacco tax rate decline. Even excluding this difference, however, the budget planning assumptions for inflation are below the private sector average. Taken together, the real growth and inflation projection gives a forecast for nominal income and expenditure growth – in essence the base for income and consumption taxes – that is the lowest of all private sector forecasts. Interest rates, which have an important effect on debt service charges, are assumed to be slightly higher than the private sector average. Finally, the unemployment rate is at the high end of the forecast range this year and next.

Table 1
Economic assumptions for fiscal planning
(per cent change unless otherwise indicated)

	1993	1994	1995
Nominal GDP	3.3	3.9	5.2
Real GDP	2.5	3.0	3.8
Employment	1.2	1.4	2.5
Unemployment rate (%)	11.2	11.1	10.8
CPI	1.8	0.8	1.3
GDP deflator	0.8	0.9	1.4
90-day commercial paper rate (%)	5.0	4.5	5.0
Long-term government bond rate (%)	7.2	6.4	6.1

FISCAL OUTLOOK BEFORE DEFICIT REDUCTION MEASURES

The Fiscal Situation for 1993-94

Speaking at l'École des Hautes Études Commerciales in Montreal on November 29, 1993, the Minister of Finance indicated that the deficit for 1993-94 would be between $44 billion and $46 billion. The fiscal results to the end of December 1993 suggest that the outcome for the year as a whole will fall within this range. The deficit for 1993-94, excluding the impact of measures contained in this budget, is estimated at $45 billion (Table 2). This is $12.4 billion higher than projected in the April 1993 budget.

The reasons for this discrepancy are:

- Taxable income growth in 1992 turned out lower than earlier estimated, which resulted in higher personal income tax refunds, lower taxes owing on filing, and higher payments for child tax benefits and the low-income GST credit ($2.4 billion).
- In 1993, nominal income growth – the applicable tax base for federal revenues – was lower than projected in the April 1993 budget, because of both lower real growth and lower inflation. Real output is now estimated to have increased 2.5 per cent in 1993, compared with a forecast in the April budget of 2.9 per cent. Inflation, as measured by the GDP implicit price deflator, is estimated to have increased only 0.8 per cent in 1993, compared with 1.6 per cent in the budget ($5.1 billion).
- Underground economic activity was higher than projected, largely because of increased tobacco smuggling ($0.5 billion).

These developments account for $8.0 billion or two-thirds of the increase in the deficit and will continue to affect the fiscal outlook unfavourably.

Most of the remaining $4.4 billion in deficit deterioration, since the April 1993 budget, can be attributed to the following special factors:

- Weakness in 1992 taxable incomes led to fewer quarterly taxfilers. Revenue Canada has informed about 300,000 quarterly taxpayers that, based on their 1992 taxable income, they no longer have to pay their income taxes on a quarterly basis. Instead, they will be remitting their taxes on an annual basis, thereby delaying the receipt of 1993 taxes until 1994 ($0.9 billion).

- Inadequate provision was made for potential provincial claims under the Stabilization program. Under this program, a province may be eligible for an unconditional grant up to a maximum of $60 per capita, if it experiences a year-over-year decline in its revenues, due to economic developments ($1.2 billion).
- The April 1993 budget proposed that the low-income GST credit be paid semi-annually rather than quarterly, starting in April 1994. This would have resulted in a one-time saving of $625 million, but legislation to effect the change was not passed before dissolution of Parliament.
- Processing of personal income tax refunds during the February-March period in 1994 is planned to be faster than in the same period last year due to the increased use of electronic filing and the introduction of new single-sheet returns ($1.2 billion).
- The Supreme Court decision not to hear the government's appeal concerning certain income tax issues dealing with the taxation of resource allowances will result in higher corporate income tax refunds in 1993-94 than forecast ($0.5 billion).

The Deficit Outlook Under Unchanged Policy

In the April 1993 budget, the deficit was forecast to decline from $32.6 billion in 1993-94 to $21.0 billion in 1995-96. Part of this decline in the deficit was attributable to relatively robust nominal economic growth – 7.2 per cent in 1994 and 7.3 per cent in 1995.

Based on the economic assumptions described in Chapter 2, nominal income growth is significantly lower than forecast in the April 1993 budget. This reflects both the projected lower real rate of economic growth and a lower projected rate of inflation. By 1995, the level of nominal income is about $50 billion, or 6 per cent lower than forecast in the April 1993 budget. As a result, in the absence of discretionary measures, revenues would be substantially lower and the deficit correspondingly higher.

As an illustration, with an average effective tax rate of about 20 per cent, the lower level of nominal income in 1995 would result in budgetary revenues falling by about $10 billion in 1995-96. The progressivity of the tax system would result in a further loss of revenues.

A number of non-economic factors, not accounted for in the April 1993 budget projections, also impact negatively on the deficit outlook.

First, the implementation of the successful Uruguay Round of Multilateral Trade Negotiations will result in a significant reduction of tariffs and non-tariff barriers between countries. The lowering of these trade barriers will strengthen economic growth over the medium term. However, there will be a short-term fiscal cost through lower customs import duties as the reductions in tariffs are phased-in. In 1995-96, it is estimated that customs import duties will be about $200 million lower as a result of the tariff reductions. No provision was made in the April 1993 budget for a possible GATT agreement and resulting tariff cuts.

Second, increased smuggling, especially with respect to tobacco products, has contributed to lower indirect tax revenue, from that expected in the April 1993 budget.

Third, the April 1993 budget assumed that the fiscal actions announced in that budget, as well as previous budgets, would be implemented, as specified. These measures included maintaining the unemployment insurance benefit rate at 57 per cent after April 1, 1995, modifications to quarterly income tax instalments, and the extension of reductions to certain statutory grants and contributions. It also included limiting the growth in Canada Assistance Plan transfers to Ontario, Alberta, and British Columbia (the non-Equalization-receiving provinces) beyond 1994-95 to increases in the nominal size of the economy. Legislation to effect these changes was not passed prior to the dissolution of Parliament.

The impact of the economic and technical changes, coupled with the impact of failure of the previous government to pass legislation, raises the deficit by $12.2 billion in 1994-95 and by $19.6 billion in 1995-96. In the absence of policy actions, the deficit would be $41.2 billion in 1994-95 and $40.6 billion in 1995-96.

Table 2
Changes to the April 1993 budget deficit track with unchanged policy

	1993-94	1994-95	1995-96
	(billions of dollars)		
A. April 1993 budget deficit track	32.6	29.0	21.0
B. Changes due to economic and technical factors:			
Personal income tax	6.1	4.3	6.3
Corporate income tax	0.8	1.9	2.8
Unemployment insurance premiums	0.9	1.1	1.7
Indirect taxes	2.8	3.3	4.3
Other revenue	1.0	1.4	1.2
Revenue changes	11.6	12.0	16.3
Stabilization claims	1.2		
Program spending		0.2	-0.2
Public debt charges	-1.0	-0.8	-0.4
Total	11.8	11.4	15.7
C. Changes to the deficit due to failure to pass legislation			
Low-income GST payment change	0.6		
Quarterly income tax instalment change		0.8	0.6
U.I. benefit rate extension			0.4
Capping growth in Canada Assistance Plan transfers to non-Equalization receiving provinces			2.8
Reduction in statutory grants and contributions: *Western Grain Transportation Act*/Atlantic Regional Freight Assistance/ *Maritime Freight Rates Act*/ *Public Utilities Income Tax Transfer Act*			0.1
Total	0.6	0.8	3.9
D. Revised deficit with unchanged policy	45.0	41.2	40.6

Even these updated fiscal projections understate the magnitude of the deficit problem under unchanged policy. The April 1993 budget did not adequately provide for ongoing expenditures in such areas as assistance to the Atlantic fisheries and commitments under the space program.

Actions to Sustain Economic Growth and Create Jobs

In line with the government's economic and social priorities, this budget reflects a balanced approach to job creation and economic growth, on one hand, and deficit reduction on the other.

A number of initiatives are being undertaken which will improve the economic performance of the Canadian economy and help to create meaningful and lasting jobs. These include:

- the priority initiatives outlined in *Creating Opportunity*;
- innovative approaches for social security and adjustment assistance programs;
- stable funding for Canada's participation in space research and development; and,
- lowering unemployment insurance premium rates.

Creating Opportunity initiatives

The document entitled *Creating Opportunity* set out the government's economic and social policy agenda. It proposed initiatives to foster economic growth and to provide the skills Canadians need for lasting and meaningful jobs. A number of these initiatives are already underway or have just recently been announced. These include the **national infrastructure program**, involving all levels of government; and the re-institution of the **Residential Rehabilitation Assistance Program**.

The Minister of Human Resources Development is taking important initial steps towards an integrated employment and learning strategy for youth. The three pronged approach includes:

- the **Youth Services Corps** shortly to be piloted at up to 20 leadsites will help young people gain meaningful work experience and develop personal skills;

- new **Youth Internship Programs** (apprenticeship programs), under which a variety of models will be developed, in collaboration with the provinces and private sector, focused on providing young people with alternative training opportunities to acquire the skills required for the new and emerging sectors of the economy; and,
- options for reform of the **Canada Student Loans Programs**, which the Minister of Human Resources Development will be discussing with provincial Ministers of Education at the end of February 1994.

The government is launching with this budget a consultative process to improve the environment for small and medium-sized businesses to grow and innovate. There are, however, a number of initiatives of immediate benefit to the small business community, some of which were outlined in *Creating Opportunity*, which the government believes must be undertaken now.

The government will work with private partners and the financial community to identify the best way to provide long-term capital to innovative companies through a **Canadian Investment Fund**. Building on existing federal programs, such as the Industrial Research Assistance program, the government will create a **Canadian Technology Network**, which will bring together the entrepreneurial drive of our small firms with the cutting edge of technology, to design and market globally competitive products.

The government is also committed to establishing a **Business Networks Strategy**, in collaboration with the private sector and the provinces, to encourage cooperation among small firms to help them achieve the critical mass needed to compete in international markets. The Minister of Industry will also work with the provinces and industry to design an **Engineers and Scientists Program**, which will help small firms to hire staff with technological expertise.

The government will undertake a comprehensive **review of federal spending on science and technology**, to put in place a more effective policy for research and development. This review will begin with the release, by the Minister of Industry, of a paper on Canadian S&T policy this spring.

Table 3
Creating Opportunity initiatives

	1994-95	1995-96	1996-97
	(millions of dollars)		
A. Research and technology			
Venture capital	25	25	25
Spending on R&D	100	200	300
Canadian Technology Network	15	20	25
Engineers Program		10	10
B. Investing in People Youth			
Youth Internship Programs (Apprenticeship)		96	192
Youth Service Corps	25	50	100
Literacy	5	5	5
Child care		120	240
National Forum on Health	3	3	3
Women's health	3	3	3
Prenatal nutrition	10	15	30
Aboriginal Headstart	10	20	30
Aboriginal education	20	20	20
C. Equality			
Law Reform Commission	3	3	3
Court Challenges Program	2	2	2
Canadian Race Relations Foundation	24		
D. "Action 21" Campaign	3	3	3
E. Culture	15	20	25
F. Capital investments			
Infrastructure	702	996	293
Residential Rehabilitation Assistance Program	50	50	
G. Total	1,015	1,661	1,309

In the meantime, the government is taking a number of immediate measures to promote greater innovative activities in Canada. The government intends to proceed with some new research and development initiatives to encourage the development of **environmental technologies** to support sustainable development. In addition, the Minister of Industry will establish a **Technology Partnerships Program** with funding made available for 1994-95, which will foster increased cooperation between public and private institutions to help turn research excellence into new products and jobs. The **Defence Industry Productivity Program** will be re-designed for 1996-97, so that it can more effectively assist with the job of helping industry to convert from defence to high technology civilian production. The broadened scope of the Program will also allow it to serve a greater variety of firms. Measures will be taken to ensure that the program benefits from improved repayments of contributions.

Additional resources will be provided in 1994-95 to allow the **National Research Council** to continue to achieve its mandate. Funding to the **Networks of Centres of Excellence** has already been stabilized at an adequate level to launch the second phase of the program. The federal **granting councils** have been excluded from budget cuts and their budgets will increase at 1.5 per cent a year after next year. As announced in the Speech from the Throne, an **information highway strategy** will be developed over the coming year.

To advance social policy priorities, new programs in the area of **women's health, prenatal nutrition, and Headstart**, a program for aboriginal children, will be introduced. The government has announced that it will provide stable multi-year funding and borrowing authority for the **Canadian Broadcasting Corporation**. In addition, the government, if it can obtain the agreement of the provinces, will increase the number of child care spaces, once real economic growth exceeds 3 per cent.

As announced in the Speech from the Throne, the Prime Minister will chair a **National Forum on Health**, to foster, in cooperation with the provinces, a national dialogue on the renewal of Canada's health system. The government is firmly committed to such a dialogue while maintaining the principles of the *Canada Health Act*.

This budget sets the stage for a fruitful dialogue on health by confirming that no further restraint measures will be taken in respect of **health transfers under Established Programs Financing**, pending further progress toward renewal of the health system.

The cost of these initiatives amounts to $1.0 billion in 1994-95, $1.7 billion in 1995-96, and $1.3 billion in 1996-97.

Innovative approaches for social security and adjustment assistance programs

The Speech from the Throne announced the government's intention to renew and revitalize Canada's social security system within two years. This reform will create a system that better rewards effort and performance and offers incentives to work. Canada needs a social security system that invests in people to create hope and opportunity, not dependency, while continuing to offer security to those in need. An important consideration for governments, and all Canadians, is that reform produce a system which works for people and is financially sustainable. Reform will also contribute to the creation of new jobs by bringing about significant reductions in unemployment insurance premiums.

The challenges before governments in restructuring the social security system are well known. There are many new and **innovative approaches** to assisting and investing in people which have been suggested. A number of provincial governments have specific proposals for which they are seeking federal financial support. These new approaches are important first steps towards strengthening the social security system but cannot be undertaken within the current structure of programs. This budget provides $400 million in each of 1995-96 and 1996-97 so that new approaches can be tried in cooperation with provinces and territories while the reform process itself is underway. As a result of these initiatives and the lessons learned from them, millions of Canadians will eventually be helped through alternative and more effective programs and services.

The previous government did not provide any funding to assist the **Atlantic fishery** after May 1994. This budget provides $1.7 billion over the next five years in new spending for a long-term adjustment program for the Atlantic groundfish industry. A key challenge for the government is to establish a smaller but viable groundfish sector that provides adequate earnings without the requirement for ongoing federal income transfers. The Minister of Human Resources Development and the Minister of Fisheries and Oceans, working with provincial governments, the private sector and other federal departments and agencies, are developing innovative approaches, which will be based on sustainable job creation strategies, capacity reduction, and restoration of the environment. The focus for displaced workers will be on providing meaningful employment and training opportunities outside the fisheries sector. The objective is to protect and enhance Atlantic Canada's natural and human resources. These innovative programs can also make an important contribution to the reform of the social security system.

Space plan funding

The government will move to establish, on a long term basis, a space plan that is affordable and yields the most benefits for Canada, technologically and commercially. The government will provide additional funding of $800 million to the space sector over the next 10 years ($220 million over the next three years). This long term space plan will focus on areas where Canada has established a competitive international advantage, such as earth observation, remote sensing and satellite communications – areas which benefit all Canadians.

The previous government did not provide sufficient funding both to meet Canada's commitment under the Space Station program and to carry out other essential space activities. The government is faced with the reality that Canada's current partnership role in the International Space Station Program is not within its fiscal means. Therefore, the decision has been taken to negotiate an orderly withdrawal from current commitments to the Space Station program.

Lowering unemployment insurance premium rates

X

In December 1993, the 1994 unemployment insurance premium rate for employees was set at $3.07 per $100 of insurable earnings. The government announced that the rate for 1995 would not be allowed to increase. In the absence of any government action, the rate for 1995 would automatically increase to approximately $3.30, as required under the *Unemployment Insurance Act*.

This budget proposes to roll back the 1995 premium rates to their 1993 levels. For employees, the rate in 1995 will be $3.00 per $100 of insurable earnings. These rates will also apply in 1996, unless the overall position of the Unemployment Insurance Account allows for further reductions.

By lowering the premium rates, payroll costs will be reduced and businesses will find it easier to create jobs and put Canadians back to work.

Other actions

This budget contains proposals to encourage homeownership and charitable giving and to provide a fair tax treatment for contributions to qualifying mine reclamation trust funds. This budget proposes establishing a task force to develop effective economic instruments to protect the environment. It also proposes a review of the tax treatment of capital gains in the small business and farm sectors.

The **Home Buyers' Plan**, which was introduced as a temporary measure to stimulate activity in the housing market, will terminate as scheduled on March 1. It will be replaced by a permanent program which will allow first-time home buyers to use RRSP funds to purchase a home.

The voluntary sector plays a crucial leadership role in the life of Canadians. To enhance the **incentive for charitable giving**, the government proposes to reduce the threshold at which the higher tax credit (29%) applies from $250 to $200. This will provide a moderate increase in the level of tax support for charitable giving.

In an effort to ensure that mine sites are not abandoned without proper reclamation being carried out, governments have required mining companies to post performance bonds, letters of credit or other financial guarantees. Recently, some jurisdictions in Canada are taking a new approach, requiring that companies contribute to mandated **mine reclamation trust funds**. The budget proposes to permit an income tax deduction for contributions into qualifying mine reclamation trust funds in the year in which they are made. Under current rules, reclamation expenses can only be deducted when expenses are actually incurred.

The government is interested in finding effective ways to use economic instruments to protect the environment, where such instruments can offer the lowest cost and most flexible methods of achieving environmental goals. To translate this interest into action, the government will be establishing a task force involving interested parties in this area, including representation from environmental organizations and from industry.

Table 4
Initiatives to support economic growth and create jobs

	1994-95	1995-96	1996-97
	(millions of dollars)		
1. *Creating Opportunity* initiatives	1,015	1,661	1,309
2. Innovative new approaches to social security and adjustment programs	500	800	700
3. Space Plan funding	14	88	120
4. Lowering unemployment insurance premium rates	125	500	500
5. First-time home buyers' plan	15	55	60
6. Charitable donations credit		15	15
7. Mining reclamation funds	15	15	15
8. Total new funding	1,684	3,134	2,719

An action plan against smuggling

The Prime Minister announced, on February 8, 1994, an aggressive action plan to deal with the serious problem of tobacco smuggling. The federal and certain provincial governments have undertaken a number of measures, including increased enforcement, health promotion, the lowering of the excise tax on tobacco products, a surtax on tobacco manufacturers and the reimposition of an export tax on tobacco products. These measures will curtail the current smuggling problem. However, there will be a fiscal cost in both 1994-95 and 1995-96. Thereafter, there will be net savings, as the measures to address tobacco smuggling bring this problem under control.

Table 5
Fiscal impact of action plan against smuggling

	1994-95	1995-96	1996-97
	(millions of dollars)		
A. Impact on revenues			
Change in indirect tax revenues	-300	-25	150
Inventory rebate	-150		
Tobacco manufacturers' surtax	70	70	70
Net impact on revenues	-380	45	220
B. Impact on spending			
Increased enforcement/ health promotion	160	205	200
C. Net impact on deficit	540	160	-20

Deficit Outlook for Planning Purposes

Providing the resources needed to support the government's priorities, coupled with the net impact of the actions against smuggling, increases the deficit for planning purposes to $43.5 billion in 1994-95 and $44.0 billion in 1995-96 (see Table 6).

Table 6
Deficit for planning purposes – summary

	1993-94	1994-95	1995-96
	(billions of dollars)		
A. Deficit with unchanged policy	45.0	41.2	40.6
B. Initiatives to support economic growth and create jobs		1.7	3.1
C. Action plan against tobacco smuggling		0.5	0.2
D. Deficit for planning purposes	45.0	43.5	44.0

THE PLAN FOR RESTRUCTURING PROGRAMS AND REDUCING THE DEFICIT

In *Creating Opportunity*, an interim fiscal target of reducing the deficit to 3 per cent of GDP by 1996-97 was established. This involves bringing the deficit down from $45.0 billion before budget actions in 1993-94 to around $25 billion by 1996-97.

To set the stage for meeting this fiscal objective, this budget proposes to:

- Legislate the measures assumed in the April 1993 budget. The only exception is the previous government's proposal to pay the low-income GST credit semi-annually rather than quarterly;
- Finance many of the initiatives in *Creating Opportunity* through internal departmental reallocations;
- Restructure and reduce government spending and enhance efficiency; and
- Generate additional revenues by broadening the tax base.

These measures will be supplemented in the 1995 budget with further initiatives to reform major spending programs. Together, the measures in this two-stage budget process will be targeted to securing the achievement of the government's interim deficit target for 1996-97 and ensure that the deficit continues to decline thereafter.

Financing the Initiatives in *Creating Opportunity*

Currently, the federal government spends about $120 billion on programs, and about $40 billion on the public debt. As outlined in *Creating Opportunity*, the challenge facing the government is to do more with what is spent. This involves, among other things, a re-examination of existing programs, to ensure that they are fully contributing to job creation, are targeted to those most in need and are delivered in the most cost effective way.

In *Creating Opportunity*, the initiatives listed on page 111 are described as being funded through cuts to Defence and operating budgets. These cuts are not only secured in this budget – but in fact are deepened. In addition, the fiscal deterioration requires that many of the new initiatives in

Creating Opportunity be funded through internal departmental reallocations so a fuller portion of the savings from expenditure reductions identified in *Creating Opportunity* goes to lowering the deficit.

Table 7
Creating Opportunity – financing the initiatives

	1994-95	1995-96	1996-97
	(millions of dollars)		
A. Total cost of initiatives	1,015	1,661	1,309
B. Initiatives funded through internal departmental reallocations	183	505	736
Wholly-funded:			
Youth Internship Programs (Apprenticeship)			
Youth Service Corps			
Literacy			
National Forum on Health			
Women's health			
Law Reform Commission			
Court Challenges Program			
"Action 21" Campaign			
Culture			
Residential Rehabilitation Assistance Plan			
Partially-funded:			
Venture capital			
Spending on R&D			
Canadian Technology Network			
Engineers Program			
Prenatal nutrition			
Aboriginal Headstart			
Canadian Race Relations Foundation			
C. Amount to be funded through reductions in spending	832	1,156	573
Of which:			
infrastructure	702	996	293

Restructuring Government Programs

In addition to securing the fiscal impact of previous budget measures and the financing of many of the new spending initiatives through internal departmental reallocations, this budget proposes reductions in program spending amounting to $2.2 billion in 1994-95, $5.5 billion in 1995-96 and $7.3 billion in 1996-97.

Reductions in operating costs

As outlined in *Creating Opportunity*, the government is imposing further restraint on operating budgets which will generate savings amounting to $400 million in 1994-95, increasing to $620 million in 1995-96 and beyond. This is in addition to the incremental cuts in operating budgets announced in the December 1992 Economic and Fiscal Statement and the April 1993 budget. Reductions in the budgets of Ministers and the Prime Minister's Office, proposed in *Creating Opportunity*, have been secured. Additional savings have been proposed through elimination and/or increased cost recovery of certain privileges and benefits available to Members of Parliament.

In order to meet the government's deficit reduction target, further reductions in the operating budgets of government departments and agencies will be necessary. The current salary freeze affecting all federal government employees is to be extended for an additional two years. For most contracts the freeze will extend to fiscal 1996-97. In addition, annual pay increments within grade will be suspended for two fiscal years beginning in 1994-95.

Legislation will be introduced as part of the budget to effect the two-year extension of the wage freeze and the two-year freeze on pay increments within grade. In consultation with employee representatives, the government will be conducting a review of all operations to determine if greater efficiencies can be delivered that will provide savings incremental to those identified in this and previous budgets. If sufficient savings are identified before December 31, 1994, the government is prepared to shorten the application of the wage and pay increment freezes.

The compensation measures will affect the salaries for the Governor General, the Lieutenant Governors, the Prime Minister, Ministers, Members of Parliament, Senators, the federal judiciary, public servants and employees of non-commercial Crown corporations. Appropriation-dependent Crown corporations will be funded as if the wages of their employees were frozen. Commercial Crown corporations will be asked to keep their wage compensation in line with this policy. These measures will generate savings from the wage bill amounting to $50 million in 1994-95, rising to about $940 million by 1996-97.

In order to reduce costs and provide Canadians with the best services affordable, the Minister responsible for Public Service Renewal will lead a review of all aspects of departmental spending to ensure that lower priority programs are reduced or eliminated and that the government's diminished resources are directed to the highest priority requirements and to those areas where the federal government is best placed to deliver services.

To the extent that measures are adopted that will reduce Public Service employment, measures will be set in place, in consultation with Public Service unions, to effect this to the extent possible through accelerated attrition.

The Prime Minister, on taking office, had decided to proceed with a review of all federal boards, agencies, commissions, and advisory bodies to assess their need and their effectiveness. The study, to be completed by the fall of 1994, will examine the size of these bodies as well as the salaries paid to the members. This review is being carried out in an effort to reduce the costs of government and improve the efficiency of its operations. The work will be undertaken under the overall direction of the Minister responsible for Public Service Renewal in close consultation with all Ministers concerned.

Under the leadership of the Minister of Intergovernmental Affairs and Public Service Renewal, the government will be working with the provinces to achieve a better alignment of roles and responsibilities and, as a result, a more efficient and affordable federation. This should allow governments to reduce overlap and duplication while improving the delivery of critical services.

Service delivery

The government will ensure that its services to Canadians are more affordable, accessible and responsive. Client centred, one-stop shopping will be expanded. Modern information technology will also result in more convenient access to information and services at reduced costs to the taxpayer.

In cooperation with the provinces and the private sector, new Canada Business Service Centres will be opened in Vancouver, Saskatoon, Toronto, Montreal, Fredericton, Charlottetown and St. John's. These centres, in addition to those already operating in Edmonton, Halifax and Winnipeg, will provide single window access for information, assistance and referrals on all government programs, regulations and services to business.

To take advantage of the opportunities arising out of the North American Free Trade Agreement, a Canada Business Centre will be opened in July 1994 in Mexico City to promote Canadian exports, and to provide a full range of trade-related services.

A single registration number for businesses dealing with the government will be available in May 1994, eliminating current government duplication and overlap and reducing costs for businesses in their dealings with government.

In order to improve efficiency and achieve long-term savings for the Crown, the Department of Transport will review the potential for commercialization of a number of its major activities (such as the air navigation system) in close consultation with all affected parties.

In addition, with a view to developing a highly effective, integrated transportation system, the Minister of Transport will discuss with his provincial colleagues and stakeholders the potential for redirecting spending to new programs to improve the efficiency of surface freight transportation.

The government will establish and publish by 1995 standards of services for each government department. A number are already in place. For example, the 1993 Personal Income Tax Guide states that processing personal income tax returns normally takes four to six weeks and describes how taxpayers can get assistance and have problems resolved. Agriculture Canada has recently announced a Single Access Food Labelling Service for the Canadian food industry, providing the industry with a single window for advice and assessment and a commitment to complete food labelling assessments within ten working days. The government will issue by the summer of 1994 a declaration of quality service delivery standards to Canadians that all departments and public servants will be expected to honour.

Evaluation

The Auditor General has noted that the government should establish better program evaluation as a way of responding to the need for improved information to determine if programs actually deliver the intended results. To this end, the Treasury Board has just established a stronger central role for the Treasury Board Secretariat to do timely and independent evaluations of the effectiveness of government programs. The Treasury Board Secretariat will be establishing analytical frameworks to review new programs such as the Infrastructure Program and the replacement for the Northern Cod Adjustment and Recovery Program. Evaluation practices in departments will also be improved. Evaluation plans and the findings from evaluations will be made available to Parliamentarians and to the public.

Regulation

New more effective ways to regulate can be found to protect health, safety, and the environment. Consideration must be given to competitiveness and economic growth. There are alternatives such as self-regulation, use of voluntary guidelines, use of national consensus standards, and the like that will enable the private sector and the government to work better together to achieve public objectives. The government will establish an internal task force to create on a fast track basis a more flexible legislative regime at the federal level that will help reduce the burden of compliance costs on business.

Reductions in defence spending

Defence policy must recognize the evolving needs for national defence, the fiscal realities, and the ongoing requirement for more efficient public spending. It was within this context that *Creating Opportunity* proposed a number of specific initiatives concerning defence expenditures.

The previous government's decision to purchase forty-three EH-101 helicopters has been cancelled, resulting in savings of $1.7 billion in defence spending over the next three years alone. To meet the target reduction in defence spending proposed in *Creating Opportunity* and to secure additional savings, defence expenditures will be reduced by a further $1.9 billion over the next three fiscal years, including the Department of National Defence's share of the reduction in professional services.

An additional charge of $250 million is recorded in 1993-94 to provide for potential claims associated with the cancellation of the EH-101 helicopter purchase.

The additional savings of $1.9 billion over the next three years will be achieved through a number of initiatives – the main focus of which will be the reduction of overhead expenses, including the closure and reduction of Canadian Forces bases and units. Details on the affected bases are provided in a separate document entitled *National Defence: Budget Impact*.

There will also be significant reductions in National Defence Headquarters, subordinate headquarters and units, as well as in the resources devoted to financial support, personnel support, material support, research and development, construction, communications, and the management of capital procurement.

In implementing these reductions, the overriding objective is the preservation of effective, if smaller, combat-capable forces, by striking a better balance between the operational and support elements of the Canadian Forces. To achieve this objective, the Department of National Defence must reduce its infrastructure, which has for some time been in excess of any probable defence need, and adopt more efficient ways of managing resources.

These measures will result in an absolute reduction in defence program spending of about 5 per cent in 1994-95 over the planned reference level for 1993-94. For planning purposes, Defence needs to project its spending over a longer timeframe than specified in the budget. Accordingly, Defence program spending is being set to undergo further 1 per cent reductions in each of the next four years, resulting in total savings of $7 billion over five years, relative to the funding provided in the April 1993 budget. These savings exclude the impact of the extension of the salary freeze and two-year suspension of annual salary increments. Defence spending in 1996-97 will be almost 8 per cent lower than in 1993-94.

To facilitate the required restructuring within National Defence, the government is putting in place a voluntary departure incentive program for National Defence employees, who are implicated in the reductions. This program is consistent with similar programs offered in the private sector. The total one-time cost is estimated at $450 million, which is being charged to fiscal year 1993-94. The President of the Treasury Board is consulting with public sector unions and public servants on the details of the program.

The spending cuts will not pre-empt the comprehensive review of Canada's defence policy which has been announced. The savings are designed to be policy-neutral and will be achieved through overhead reduction and productivity improvements. The policy review will focus on how best Canada's highly trained Armed Forces can meet the challenges of the new world order while moving towards a smaller and more efficient establishment.

Reduction in grants and contributions

The federal government spends about $16 billion a year on major subsidies and other transfers. These are in a variety of areas, including international assistance, agricultural subsidies, support for science and technology, education, heritage, assistance to aboriginal peoples, student loans, job training, and business subsidies.

In this budget, funding allocated to a number of these areas has been or will be redirected to finance the government's economic and social priorities outlined in *Creating Opportunity*. Given the fiscal realities, the budget also proposes that funding in a number of areas be reduced or the rate of growth restrained.

International assistance

Canada has long been a strong advocate of international development assistance in support of basic health and education needs, sustainable development and poverty reduction in developing countries. Canadians have a world renowned reputation for their generosity, support and achievements in this field. The government remains committed to continuation of this strong tradition of support for a significant aid program.

In tackling the immediate fiscal difficulties, however, discretionary spending must be subjected to further restraint, including funding under the international assistance envelope. International assistance funding is, therefore, being reduced by 2 per cent for 1994-95 from the 1993-94 level, with funding frozen thereafter at this reduced base level. This will result in savings of $400 million over the next three years. International assistance funding will still exceed $2.6 billion annually. Canada's aid program and level of support will continue to compare favourably with that of other industrialized countries.

At the same time, the government recognizes that the world has changed considerably over the past decade. Both for fiscal reasons and in the face of changed international pressures, there is need for a full review of Canada's aid policy and objectives to ensure these are in tune with world needs and Canada's capacity to influence world development. The government will be undertaking a broad review of the aid program in which Canadians of all backgrounds will be invited to participate.

Business subsidies

Creating Opportunity proposed that grants to business be reduced by $225 million a year. A number of measures are being implemented to achieve this objective. Funding to the regional agencies – Atlantic Canada Opportunities Agency, Federal Office of Regional Development – Québec, and Western Economic Diversification – as well as programs directly managed by Industry Canada, will be reduced. These reductions are over-and-above the reductions in grants and contributions announced in the April 1993 budget. Most grants to business delivered by other departments will be cut by a further 5 per cent from the levels established in the April 1993 budget, including certain statutory benefits. By 1996-97, grants to business will be on the order of $3.1 billion, down by just under 10 per cent from $3.4 billion in 1993-94.

Assistance to business is also delivered through tax expenditures. Measures in this budget to reduce these tax expenditures are described below. Beyond 1994-95, the combined reduction in these business transfers, both direct spending and tax expenditures, reduces such subsidies considerably more than the target amount of $225 million per year.

Table 8
Restructuring government programs

	1994-95	1995-96	1996-97
	(millions of dollars)		
A. Reductions in operating costs			
Cut in operating budgets	400	620	620
Cuts in budgets for:			
Ministerial staff/PMO	13	13	13
Parliament (proposed)	5	5	5
Reduction in wage bill	50	510	940
Total	468	1,148	1,578
B. Reductions in defence spending			
Cancellation of EH-101 helicopters	395	654	657
Additional defence cuts	350	425	759
Total	745	1,079	1,416
C. Reductions in grants and contributions			
International assistance	91	132	173
Business transfers			
Regional agencies/Industry Canada	69	141	140
Other departments	48	59	54
Other	45	49	42
Total	253	381	409
D. Building a responsible social security system			
Unemployment insurance	725	2,400	2,400
Social security transfers to provinces		466	1,540
Total	725	2,866	3,940
E. Gross spending cuts (excluding initiatives funded through internal reallocations Table 7 Panel B)	2,191	5,473	7,343

KAON factory project

In 1991, the federal government made an offer to contribute to the costs of the KAON Factory project, the proposed upgrade to the TRIUMF particle accelerator laboratory. However, the very significant financing demands of the KAON facility cannot be met within the current fiscal circumstances facing the government. The fiscal costs of KAON are compounded by the fact that contributions from foreign governments towards the construction of KAON – a condition for federal contribution to the project – have not been forthcoming. Therefore, the federal government will not be able to proceed with the KAON project. The government recognizes the importance of the TRIUMF facility to the Canadian scientific community's contribution to the global effort in particle physics. Towards this end, the government will be evaluating the future of TRIUMF with the goal of ensuring that it continues to play an important role. Additional interim funding of $4 million will be provided to TRIUMF for 1994-95 to stabilize its activities while this evaluation is underway.

Other grants and contributions

Finally, most other non-statutory grants and contributions will be reduced by 5 per cent, starting in 1994-95. This is on top of the reductions announced in the April 1993 budget.

The government provides funding to many special interest groups in order to assist them in carrying out their activities. Some of these groups carry out community functions, while others have a narrower and more special interest agenda.

The fiscal imperative requires that the government priorize among these competing claims. The government will review its current policy with respect to funding of interest groups with a view of reducing its overall level of effort and encouraging greater reliance on funding from other sources. The results of this review will be incorporated in the 1995 budget.

Building a Responsible Social Security System

As noted earlier, the government intends to renew and revitalize Canada's social security system within two years. This reform will create a system that better rewards effort and performance and offers incentives to work. Canada needs a social security system that invests in people to create hope and opportunity, not dependency, while continuing to offer security to those in need. An important consideration for governments, and all Canadians, is that reform produce a system which works for people and is financially sustainable. Reform will also contribute to the creation of new jobs by bringing about significant reductions in unemployment insurance premiums.

Unemployment insurance

Unemployment insurance is one of Canada's largest social security programs, providing almost $20 billion in benefits over the past year in support of some 1.6 million unemployed Canadians.

In December 1993, the government announced that the employee premium rate for 1995 would not be allowed to increase to $3.30 per $100 of insurable earnings, as would be required under the *Unemployment Insurance Act*. Instead, it indicated that steps would be taken to freeze the premium rates at their 1994 level – $3.07 per $100 of insurable earnings for employees. In this budget, the government proposes to roll back the rates to their 1993 levels (for employees, the 1993 rate was $3.00 per $100 of insurable earnings).

To maintain the financial integrity of the unemployment insurance program and to improve its effectiveness, immediate measures will be taken to begin unemployment insurance reform. These changes will reduce unemployment insurance expenditures by $725 million in 1994-95 and $2.4 billion per year thereafter. These measures will strengthen the link between work history and unemployment benefits and enhance benefits to those with lower incomes who are supporting dependants:

- Effective April 1994, there will be a restructuring of unemployment insurance benefit entitlements for new beneficiaries such that the maximum duration of unemployment insurance claims will be reduced. The amount of the reduction for individuals will be in part determined by the employee's work history.
- Effective July 1994, the minimum entrance requirement will be increased to twelve weeks from the current ten weeks. The benefit rate for new beneficiaries will be adjusted from the current 57 per cent of insurable earnings to a new two-part rate structure. Claimants with dependants and insurable

earnings below one-half the maximum insurable earnings will receive 60 per cent of their insured earnings and other claimants will receive 55 per cent. Maximum insurable earnings currently stand at $780 per week. The method of determining maximum insurable earnings will not be changed.

- To improve fairness, there will be amendments to the provisions governing workers who quit their jobs voluntarily or were fired for misconduct.

Further details of these measures are provided in a separate document entitled *Proposed Changes to the Unemployment Insurance Program*.

The unemployment insurance program is an integral component of the social security system. It is fully anticipated that unemployment insurance will be significantly restructured by 1996-97 as a result of social security reform. In this sense, the unemployment insurance changes being proposed now are interim measures until the full social security reform is in place. That reform will lead to further significant reductions in unemployment insurance expenditures. The reform will build on the measures contained in this budget and on the projected improvement in the economy, to allow further significant reductions in unemployment insurance premiums paid by both employers and employees. By lowering these payroll taxes, businesses will find it easier to create jobs and put Canadians back to work.

Transfers to provinces and territories

Transfers from the federal government to other levels of government amount to some $40 billion per year. Transfers in respect of social security – the federal sharing of provincial and territorial social assistance costs through the Canada Assistance Plan (CAP) and the post-secondary education component of Established Programs Financing (EPF) – account for approximately $14 billion of that total.

The federal government also transfers about $8 billion a year to lower-income provinces under the Equalization program which enables them to provide public services including social security programs that are reasonably comparable to those provided in other provinces.

The current Equalization legislation expires on March 31, 1994. In recognition of the program's unique redistributive role and objectives – which are enshrined in Canada's Constitution – the government has tabled legislation which renews the program for a further five years. This will provide a stable financing regime for the provinces receiving Equalization.

Establishing a predictable environment for reform

The federal government believes that social security reform must be pursued as an active, cooperative effort among federal and provincial governments. Both the federal government and provinces are facing significant deficit and debt problems at the same time as they must build a system which serves people better. A better system will be one that both federal and provincial governments can financially sustain. To that end, it is important to establish fiscal parameters and a predictable funding environment for reform.

For its part, the federal government will require that entitlements under the social security transfers to provinces and territories (CAP and the post-secondary education component of EPF, or any successors to these transfers) be no higher after reform in 1996-97 than they are now, in 1993-94.

Relative to current projections of growth of CAP and EPF post-secondary education transfers in the absence of reform, this will enable the federal government to secure a minimum of $1.5 billion in savings in 1996-97. These savings are in addition to the savings from current and future proposals for reform of the unemployment insurance system. These expenditure reductions will make the social security system more financially sustainable, and with careful redesign will ensure the system is more effective and responsive to the needs of people.

As noted earlier, the federal government will provide $800 million to help fund innovative approaches to social security, while reform is underway. It will also provide a two-year period of predictability and modest growth in social security transfers to provinces.

In 1994-95, no new restraint measures will be applied to either CAP or EPF transfers. As a result, CAP transfers will grow by a projected 5.4 per cent in 1994-95, while EPF entitlements will grow by a projected 1.3 per cent.

In 1995-96 and beyond, existing legislation provides for EPF entitlements to grow in line with the growth in gross national product (GNP) minus three percentage points. No further changes will be made to the formula governing EPF transfers, pending social security reform in 1996-97. As a result, EPF entitlements are projected to grow by an additional 1.4 per cent in 1995-96.

Starting in 1995-96, CAP transfers to each province and territory will be kept to 1994-95 levels, until superseded by social security reform in 1996-97.

The federal government recognizes that this interim measure will not substantially alter the disparities in federal financial support for social assistance in different parts of the country that have resulted from the implementation in 1990 of the 5 per cent limit on growth in CAP transfers to better-off provinces. One of the objectives of social security reform will be greater fairness in federal financial support for the social security system throughout Canada.

The federal government recognizes provinces' need for longer-term predictability in the arrangements governing the transfers they receive from the federal government. It has already tabled legislation to provide stable fiscal arrangements over the next five years with respect to Equalization transfers. Once a sustainable set of programs emerges from social security reform, a comparable degree of stability will be established for the fiscal arrangements which underpin them.

The objectives for social security reform are clear; the savings parameters are firm. Accordingly, if social security reform fails to achieve these savings by 1996-97, alternative measures to take effect in 1996-97 will be implemented to ensure that the savings are realized.

Table 9
Social security reform: transfer entitlements to provinces

	1993-94	1994-95	1995-96	1996-97
	(Total entitlements, cash plus tax, in millions of dollars)			
A. Pre-reform				
EPF – Post-secondary education	6,070	6,146	6,232	6,250
Canada Assistance Plan(1)	7,740	8,161	8,627	9,100
Total entitlements	13,810	14,307	14,859	15,350
B. Post-Reform				
EPF – Post-secondary education	6,070	6,146	6,232	*
Canada Assistance Plan	7,740	8,161	8,161	*
Total entitlements	13,810	14,307	14,393	13,810
C. Savings			466	1,540
Reference				
EPF – Health	15,034	15,224	15,438	15,450
Equalization	7,974	8,480	8,924	9,400
Social security transfers post-reform	13,810	14,307	14,393	13,810
Total entitlements under major transfers to provinces (2): Post reform	36,028	37,195	37,913	37,800

* These programs may be modified or replaced pursuant to the social security review.

(1) Projected on the basis of the 5 per cent growth ceiling, assumed in the April 1993 budget, for non-Equalization-receiving provinces.

(2) Equalization associated with the EPF tax transfer, which is paid under the Fiscal Equalization program, appears under both programs. In order to avoid double counting in totals, the Associated Equalization is deducted.

Preparing for an aging population

The proportion of people in Canada over age 65 will almost double over the next 40 years – to 23 per cent in year 2030 compared to 12 per cent today. The number of workers supporting each retired person will drop from five to three. The share of national output going to support the public pension system is projected to increase from 4.8 per cent to 7.8 per cent during this period.

Canadians should start preparing for the years ahead when Canada will be supporting an older population. As well, Canadians need to know how the retirement income system will evolve in the future so that they can plan for their retirement while they are working.

Expenditures on the elderly have been growing rapidly and will continue to do so, as Canadians live longer and healthier lives. As this trend continues, both the role and needs of seniors will change.

The government will therefore release in the coming months a paper which will examine the challenges and opportunities posed by Canada's aging society. The paper will examine what the aging society will need in terms of services and what, if any, changes are required to the public pension system to make it financially sustainable. The paper will also examine what, if any, changes should be made to the tax treatment of contributions to, and income buildup in, registered pension, profitsharing, and retirement savings plans.

Tax Base Broadening

The budget proposes a number of tax changes to improve the fairness and efficiency of the system and to raise revenues. Details of these measures are presented in the budget paper entitled *Tax Measures: Supplementary Information*.

Personal income tax

Life insurance premiums

Employees receiving benefits in the form of employer-paid premiums in respect of life insurance policies have an advantage over other individuals purchasing similar policies on their own out of after-tax income. Currently, only the portion of employer-provided insurance benefits in excess of $25,000 of coverage is taxable. It is proposed that the taxation of employer-provided life insurance benefits be extended to the first $25,000 of coverage. The proposed change will apply to benefits provided after June 1994.

$100,000 lifetime capital gains exemption

Capital gains which accrue after budget night will no longer be eligible for the $100,000 capital gains exemption. However, qualifying capital gains that have accrued up to budget night will remain eligible for the exemption, provided an appropriate election is filed with the individual's 1994 tax return.

Age credit

Currently, the income tax system provides a non-refundable age credit to all persons age 65 or over, regardless of income. The government proposes that this credit be income-tested. The age amount will be reduced by 15 per cent of an individual's net income in excess of $25,921 – the current threshold for other income-tested credits. The age credit will be completely eliminated when an individual's income reaches $49,100. This measure will be phased in over two years.

Business Income Tax

A number of changes are being proposed to the taxation of business income to make it fairer, to protect the revenue base, and better target the tax assistance delivered to certain businesses. Canadian businesses face global competitive pressures in Canadian markets and abroad. Therefore, care has been taken to propose changes that will not impede the ability of Canadian businesses to grow and create jobs in these markets. Corporate tax rates on business income are not being increased.

Reduce deduction for meals and entertainment

The income tax system presently allows deductions for reasonable expenses incurred for the purpose of earning business or property income and, in some cases, income from employment. With respect to meal and entertainment expenses, there is an element of personal consumption. As a result, the deduction for income taxes is currently restricted to 80 per cent of such expenses.

Although the government believes that these expenditures have a legitimate business purpose, the tax system can be made fairer to better reflect the personal consumption element.

The government proposes that the income tax deduction and Goods and Services input tax credit for eligible meal and entertainment expenses will be reduced after February from 80 per cent to 50 per cent. This will better reflect the personal consumption element of these expenses and will bring the deduction in line with that in Quebec and Ontario and in the United States.

Table 10
Tax base broadening measures

	1994-95	1995-96	1996-97
		(millions of dollars)	
A. Personal income tax measures			
Tax employer-paid private group life insurance premiums	120	200	200
Eliminate $100,000 Lifetime Capital Gains Exemption	30	415	340
Income-tested age credit	20	170	300
Total	170	785	840
B. Business income tax measures			
Business meals and entertainment expenses	235	245	260
Eliminate preferential tax rate for large private corporations	15	40	40
Securities held by financial institutions	60	60	60
Regional Investment Tax Credits		80	95
Private Corporations Dividends		40	40
Reserves of insurance companies	30	35	55
Energy conservation and pollution abatement equipment	10	25	45
Other tightening measures	55	85	95
Total	405	610	690
C. Total fiscal impact	575	1,395	1,530

Eliminate preferential tax rate for large private corporations

Large private corporations will no longer be eligible for certain tax preferences aimed at small businesses. Canadian-controlled private corporations with capital of $15 million or more will no longer be able to claim the small business deduction. In addition, after 1995, these corporations will no longer be eligible for the enriched research and development benefits accorded small businesses.

Securities transactions by financial institutions

The budget proposes several changes to the tax treatment of securities held by financial institutions to clarify the tax treatment of these securities and to ensure that the income from these securities is measured appropriately.

Regional investment tax credits

There are currently three regionally-based Investment Tax Credits – the Special Investment Tax Credit, the Atlantic/Gaspé Tax Credit, and the Atlantic Scientific Research and Experimental Development Investment Tax Credit. These credits have not been cost effective in attracting new investments to designated regions or reducing economic disparity. The budget proposes to eliminate the Special Investment Tax Credit, to reduce the Atlantic-Gaspé Investment Tax Credit rate from 15 per cent to 10 per cent, and to eliminate the Atlantic component of the Scientific Research and Experimental Development Tax Credit, effective December 31, 1994.

Private corporation dividends (Part IV tax)

As a means of providing better integration between the personal and corporate income tax systems, a refundable tax is imposed on certain dividends received by private corporations (and certain closely-held public corporations). The rate of this tax will be increased, as of January 1, 1995, to 33⅓ per cent to bring it more into line with the personal income tax imposed on dividends.

Reserves of insurance companies

To ensure that insurance companies' unpaid claims reserves with respect to non-life insurance business better reflect the economic value of future obligations, these companies will be required to determine these reserves on a fully-discounted basis.

Energy conservation and pollution abatement equipment

The income tax system currently provides accelerated write-offs for energy conservation equipment and pollution abatement equipment. The rate of accelerated write-off for this equipment will be reduced and the range of energy equipment eligible will be expanded to include newer, environmentally positive activities such as electrical energy from geothermal and solar energy and the collection of landfill and digester gas. In addition, the accelerated rate for pollution abatement equipment will not apply to equipment acquired after 1998.

Other tightening measures

A number of other tightening measures will be introduced to both clarify the law and protect the corporate revenue base.

Tariffs

To ensure the tariff regime is responsive to new competitive pressures created by freer trade and to lessen the regulatory burden and associated costs of the existing regime, the government is undertaking a comprehensive review of the Customs Tariff to simplify it and make it more transparent and predictable. The government will consult with the Canadian business community on proposals developed in the course of the review. As part of the review, the government will soon be consulting the Canadian business community on a wide range o proposed tariff cuts on imported manufacturing inputs, which should allow Canadian industry to remain competitive in the global economy.

Air Transportation Tax

The Air Transportation Tax will be restructured to reduce the tax burden on short-haul domestic and transborder flights and to recover a greater proportion of the costs of air facilities and services provided by Transport Canada. Most domestic and transborder travellers will pay less, with the increase primarily directed at long-haul flights. These changes are expected to generate additional revenues of $24 million in 1994-95 and $41 million in 1995-96. These will be utilized by the Minister of Transport to improve facilities and services.

Overview of Fiscal Actions

As set out in Table 11, the gross fiscal savings in this budget – including securing the savings from previous budgets – total $28.6 billion from 1994-95 through 1996-97. Netting the cost of the initiatives for growth and job creation, and the attack on smuggling, there are cumulative savings of $20.4 billion over the three years, 1994-95 to 1996-97. On a net basis, there are five dollars of expenditure reductions for each one dollar of revenue increases.

Table 11
Gross and net fiscal actions – summary

	1994-95	1995-96	1996-97	Three-year impact
		(billions of dollars)		
A. Gross fiscal savings				
Securing savings from previous budgets	0.8	3.9	4.0	8.7
Internal reallocations to finance *Creating Opportunity* initiatives	0.2	0.5	0.7	1.4
Restructuring and reducing government programs	2.2	5.5	7.3	15.0
Revenue measures	0.6	1.4	1.5	3.5
Gross impact of actions	3.7	11.3	13.6	28.6
B. Cost of initiatives	-2.2	-3.3	-2.7	-8.2
C. Net fiscal savings	1.5	8.0	10.9	20.4
D. Summary – balance of net expenditure and revenue actions				
Revenue measures (1)	0.8	1.4	1.2	3.4
Expenditure actions	0.7	6.6	9.7	17.0
Net impact of actions	1.5	8.0	10.9	20.4

(1) Of the $3.4 billion in cumulative revenue measures, $1.4 billion relates to the modifications to quarterly income instalments, which was announced in the April 1993 budget.

THE FISCAL OUTLOOK WITH BUDGET ACTIONS

The Fiscal Outlook to 1995-96

The deficit outcome in 1993-94 is increased to $45.7 billion, due to one-time restructuring charges associated with a departure incentives program within the Department of National Defence, as well as the potential costs of cancelling the helicopter contract.

The underlying deficit for 1993-94, however, is $42.1 billion as there are a number of one-time factors which raised the deficit in 1993-94 but which have no impact on the deficit beyond that year. These include the faster processing of refunds, lower personal income tax quarterly instalment payments, higher corporate income tax refunds relating to resource allowances, and an increase in the liability for stabilization claims. These were all noted earlier. In addition, there were certain transitional costs associated with the restructuring of the child benefit system, which dampened personal income tax collections in 1993-94.

On the other hand, extraordinary Exchange Fund earnings in 1992-93 and 1993-94 reduced the deficit in those years, due largely to the depreciation of the Canadian dollar. The net impact is to yield an "underlying" deficit of $42.1 billion in 1993-94 (see Table 12).

Table 12
Estimating the "underlying deficit" for 1993-94

	(billions of dollars)
A. Deficit in 1993-94	45.7
B. Non-recurring factors affecting 1993-94:	
Processing of refunds	-1.2
Lower instalments	-0.9
Resource allowance refunds	-0.5
Stabilization liabilities	-1.2
Transitional costs of the restructuring of the child benefit system	-1.2
Extraordinary Exchange Fund earnings	2.1
Sub-total	-2.9
Restructuring charges	-0.7
Total change	-3.6
C. "Underlying" 1993-94 deficit	42.1

The actions contained in this budget, coupled with the fiscal impact of the economic planning assumptions, bring significant and steady reductions in the deficit. The deficit declines from $45.7 billion in 1993-94 to $39.7 billion in 1994-95 (5.4 per cent of GDP) and to $32.7 billion in 1995-96 (4.2 per cent of GDP).

- As noted above, $3.6 billion of the $6.0 billion decline in the deficit between 1993-94 and 1994-95 is due to the non-recurring factors affecting the 1993-94 deficit outlook.

The gross discretionary measures taken in this budget reduce the deficit by $3.7 billion in 1994-95 and $11.3 billion in 1995-96. Funding of the initiatives to support economic growth and create jobs, coupled with the net impact of the actions against the smuggling of tobacco, produces an offset of $2.2 billion in 1994-95 and $3.3 billion in 1995-96, resulting in net fiscal actions of $1.5 billion in 1994-95 and $8.0 billion in 1995-96 (see Table 13).

Table 13
February 1994 budget deficit – summary

	1993-94	1994-95	1995-96
	(billions of dollars)		
A. Deficit with unchanged policy	45.0	41.2	40.6
B. Initiatives to support economic growth and create jobs			
Creating Opportunity		1.0	1.7
New approaches to social security and adjustment programs		0.5	0.8
Space Plan funding			0.1
UI premium rate reduction		0.1	0.5
Tax reductions		0.1	0.1
Total new funding		1.7	3.1
C. Action plan against tobacco smuggling		0.5	0.2
D. Deficit for planning purposes	45.0	43.5	44.0
E. Impact of actions to reduce deficit	0.7	-3.7	-11.3
F. February 1994 budget deficit	45.7	39.7	32.7

The decline in the deficit-to-GDP ratio over time is achieved largely through expenditure reductions.

- There is a 1.3 percentage point fall in the program spending-to-GDP ratio from 1993-94 to 1995-96 and,
- Revenues as a share of GDP, adjusted for one-time factors in 1993-94, rise only marginally over time.

Although the net debt-to-GDP ratio continues to rise over the 1993-94 to 1995-96 period, the rate of increase slows dramatically in 1995-96, setting the stage for declines in future years.

Table 14
Summary statement of transactions

	1992-93	1993-94	1994-95	1995-96
		(billions of dollars)		
Budgetary transactions				
Budgetary revenues	121.5	114.7	123.9	132.0
Program spending, of which:	-122.5	-121.8	-122.6	-122.7
Restructuring charges		(-0.7)		
Operating balance	-1.1	-7.1	1.3	9.3
Public debt charges	-39.4	-38.5	-41.0	-42.0
Budgetary deficit	-40.5	-45.7	-39.7	-32.7
Non-budgetary transactions	6.0	12.0	9.5	10.0
Financial requirements (excl. foreign exchange)	-34.5	-33.7	-30.2	-22.7
Net public debt	465.3	511.0	550.7	583.4
Gross domestic product	688.5	711.2	739.1	777.7
		(percentage of GDP)		
Budgetary revenues	17.6	16.1	16.8	17.0
Program spending	-17.8	-17.1	-16.6	-15.8
Public debt charges	-5.7	-5.4	-5.5	-5.4
Budgetary expenditures	-23.5	-22.5	-22.1	-21.2
Deficit	-5.9	-6.4	-5.4	-4.2
Financial requirements	-5.0	-4.7	-4.2	-3.1
Net public debt	67.6	71.9	74.5	75.0

(-) indicates a net requirement for funds
(+) indicates a source of funds
Details may not add due to rounding.

Chart 6
Public accounts deficit

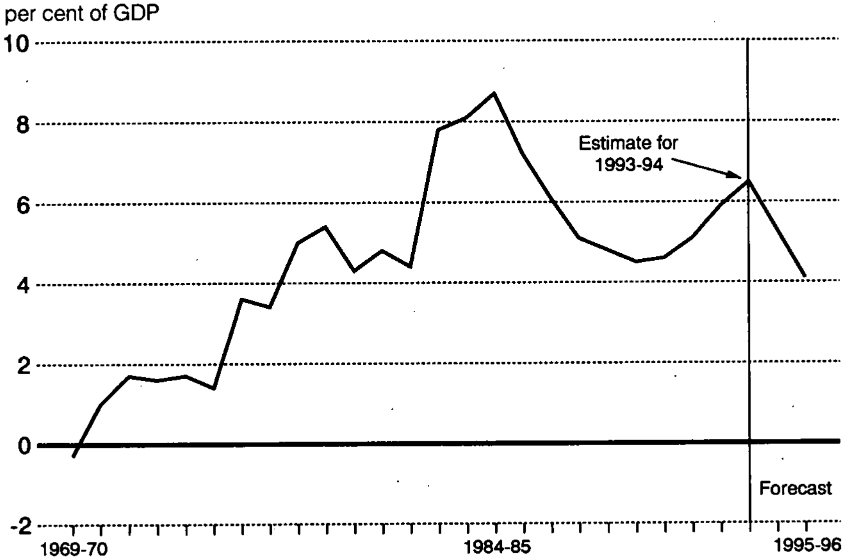
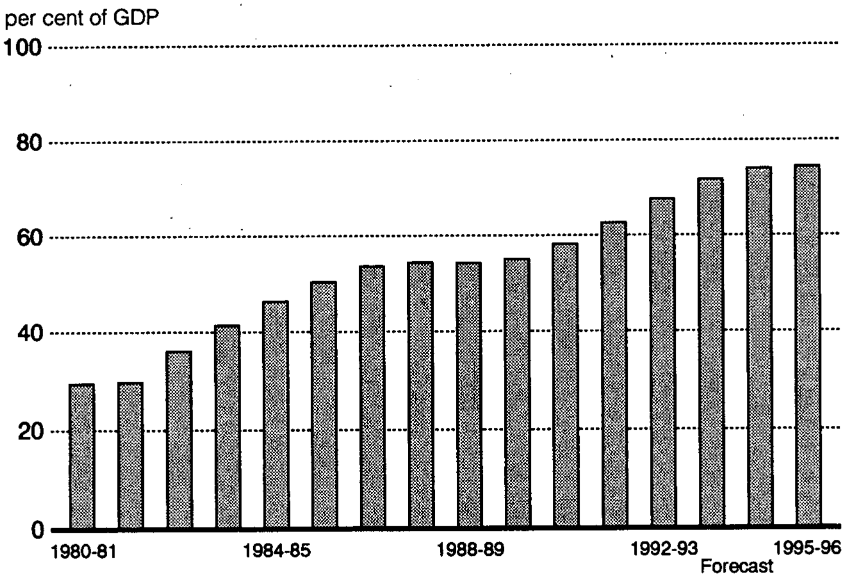


Chart 7
Federal government net debt



Revenue Outlook

Table 15 gives an overview of the revenue outlook to 1995-96.

As a percentage of GDP, budgetary revenues are expected to fall to 16.1 per cent in 1993-94, from 17.6 per cent in 1992-93. The ratio is expected to rebound to 16.8 per cent in 1994-95 and increase gradually thereafter.

Table 15
Budgetary revenues

	1992-93	1993-94	1994-95	1995-96
	(billions of dollars)			
Personal income tax	58.3	52.1	59.5	64.4
Corporate income tax	8.3	8.8	10.3	12.2
Unemployment insurance contributions	17.5	18.0	19.3	20.3
Goods and Services Tax	14.9	15.6	16.5	17.5
Excise taxes/duties	11.2	10.5	10.1	9.8
Other revenues	11.3	9.7	8.2	7.8
Budgetary revenues	121.5	114.7	123.9	132.0
Per cent of GDP (%)	17.6	16.1	16.8	17.0

The extent of the decline in the ratio in 1993-94 and resulting rebound in 1994-95 is largely attributable to one-time factors, which dampened budgetary revenues in 1993-94. These are set out in Table 16 and include, among others:

- transitional costs associated with the restructuring of the child benefit system and the netting of the child tax benefit from personal income tax revenues;
- reductions in the personal income surtax announced in the February 1992 budget;
- faster processing of personal income tax refunds and higher corporate income tax refunds in 1993-94;
- lower personal income tax instalment payments in 1993-94;
- extraordinary Exchange Fund earnings in both 1992-93 and 1993-94;

- extraordinary recovery of overpayments from the Provincial Tax Collection Account in 1992-93; and,
- net impact of revenue measures proposed in this budget.

Table 16
Budgetary revenues

	1992-93	1993-94	1994-95	1995-96
		(billions of dollars)		
Budgetary revenues	121.5	114.7	123.9	132.0
Per cent of GDP (%)	17.6	16.1	16.8	17.0
Special factors affecting the profile of revenues:				
Child tax credit	2.4	1.2		
Child tax benefit	1.3	5.5	5.4	5.3
Reduction in surtax	0.5	1.3	1.3	1.3
Exchange Fund earnings	-3.2	-2.7	-1.1	-0.6
Budget 1994 measures			-0.8	-1.5
Other measures				
Faster processing of refunds		1.2		
Lower instalments		0.9		
Resource allowance refunds		0.5		
Provincial tax collection Account transfer	-1.4			
Net impact on revenues	-0.4	7.8	4.8	4.5
Implied "underlying" revenues	121.1	122.5	128.7	136.5
Per cent of GDP (%)	17.6	17.2	17.4	17.6

Adjusting for these factors, the revenue-to-GDP ratio falls from 17.6 per cent in 1992-93 to 17.2 per cent in 1993-94. This decline primarily reflects the impact of the higher payment of personal income tax refunds and receipt of lower taxes owing on filing in 1993-94 pertaining to the 1992 taxation year – a year in which personal income tax payable declined due to slow growth in incomes and the impact of an indexation factor for the personal income tax system (2.8 per cent) which was more than double the growth in income per taxfiler.

Modest increases in the revenue-to-GDP ratio are expected after 1993-94, due to the non-indexation and progressivity of the personal income tax system, with higher marginal tax rates at higher levels of taxable income. Although corporate profits are expected to improve significantly, the impact on corporate income tax collections is expected to be moderated by the provisions in the corporate income tax system for carrying forward losses.

Expenditure Outlook

Total budgetary expenditures are expected to increase by $2.8 billion over the 1992-93 (the last year for which audited results are available) to 1995-96 period. Nearly all of this increase is due to public debt charges ($2.6 billion).

Although the average effective interest rate on the federal debt is expected to decline over the 1992-93 to 1995-96 period, its impact on public debt charges is offset by the higher borrowing requirements. The decline in the average effective interest rate is due to the term structure of the outstanding debt. About half of the debt is of a short-term nature and rolled-over within a year. The remaining debt has an average term structure of about four-and-a-half years. The average effective interest rate, therefore, should continue to decline as the longer-term debt matures and is re-issued at the current lower interest rates.

Program spending is expected to increase by $0.8 billion between 1993-94 and 1994-95 and is expected to be virtually unchanged in 1995-96. This implies a decline in program spending in real terms, i.e., after adjusting for inflation. This is being accomplished despite the fact that reserves have been increased for contingencies.

The actions announced in this budget will continue to put downward pressure on program spending post-1995-96. The proposal to rebuild the social security system will result in incremental savings in 1996-97 which, coupled with the impact of the other measures, should result in a decline in program spending in 1996-97. The second phase of UI reform will secure additional savings, which have not been incorporated in the deficit projection, as they go to lowering premiums.

The decline in transfers to persons – the largest component of program spending – in 1993-94 reflects the replacement of the monthly family allowance benefit program by the child tax benefit, which is netted from personal income tax revenues, and lower unemployment insurance benefit payments. The decline in unemployment insurance benefits largely reflects the measures introduced in the December 1992 Economic and Fiscal Statement and the first-round restraint measures announced in this budget. The impact of the second-round reform has not been incorporated into the projections. The annual increases in old age security benefits are due to increases in the eligible population and in average benefits, which are fully indexed to increases in the consumer price index.

Major transfers to other levels of government include Equalization, the Canada Assistance Plan (CAP) and Established Programs Financing (EPF). Entitlements under these three programs are projected to increase by $1.9 billion between 1993-94 and 1995-96, reflecting increases in EPF Health transfers and Equalization entitlements. The social security reform process will ensure that social security transfers – CAP and the post-secondary education component of EPF, or any successors to these programs – are no greater in 1996-97 than in 1993-94.

EPF entitlements are paid in the form of tax point transfers and cash. The value of tax point transfers is dependent upon economic developments affecting the applicable tax bases. As the growth in the value of the tax point transfers exceeds the growth in entitlements, cash transfers under EPF are expected to continue to decline on an annual basis.

Table 17
Budgetary expenditures [1]

	1992-93	1993-94	1994-95	1995-96
		(billions of dollars)		
A. Major transfers to persons				
Old age security	19.1	19.9	20.6	21.4
Unemployment insurance benefits	19.1	18.4	18.3	17.3
Family allowances	2.2	–	–	–
Veterans' allowances and pensions	1.8	1.9	1.9	1.9
Total	42.1	40.3	40.8	40.7
B. Cash transfers to other levels of government	27.1	27.1	26.3	26.4
Total entitlements under major transfers	35.1	36.0	37.2	37.9
C. Major subsidies/other transfers				
Grants to business	3.2	3.4	3.3	3.1
Grants to Indians and Inuit	3.1	3.5	3.8	4.1
Grants to agriculture	2.9	2.4	2.3	2.2
Grants for international assistance	3.0	2.7	2.6	2.6
Infrastructure program			0.7	1.0
Other	4.0	4.0	4.5	4.9
Total	16.2	16.0	17.2	18.0
D. Payments to Crown corporations				
Canada Mortgage and Housing Corporation	2.0	2.1	2.1	2.1
Canadian Broadcasting Corporation	1.1	1.1	1.1	1.1
VIA Rail	0.4	0.3	0.3	0.3
Other	2.3	1.4	1.1	1.0
Total	5.8	4.9	4.6	4.5
E. Defence	11.2	11.3	10.8	10.5
F. Reserves net of lapse			2.4	3.0
G. Restructuring charges		0.7		
H. Government operations	20.1	21.5	20.5	19.6
I. Program spending	122.5	121.8	122.6	122.7
J. Public debt charges	39.4	38.5	41.0	42.0
K. Total budgetary expenditures	161.9	160.3	163.6	164.7

[1] Restructuring of government departments has changed classification of some components.

Subsidies and other transfer payments are expected to increase by $2.0 billion between 1993-94 and 1995-96. Half of this increase is attributable to the infrastructure program. Another $0.4 billion has been allocated to finance innovative approaches to new social security programs. The government has also agreed to provide $1.7 billion over the next five years in new spending associated with a long-term adjustment program for the Atlantic groundfish industry.

With the exception of transfers to Indians and Inuit, all other major programs in this component are expected to register sizeable declines. Funding for international assistance declines by 2 per cent in 1994-95, from its 1993-94 level, and is frozen at its 1994-95 level thereafter.

In 1992-93, the federal government spent over $5 billion in support of aboriginal peoples. About two-thirds of this spending is dispensed by the Department of Indian and Northern Affairs. Aboriginal programs have been one of the fastest growing areas of federal spending. Spending has increased at an average of about 10 per cent each year over the last decade, compared to 5.3 per cent for spending on programs generally. While it is recognized that funding for aboriginal programs should continue to grow to meet the needs of aboriginal communities, Ministers responsible for programs for aboriginal Canadians will be reviewing them to moderate the pace at which they are growing.

Payments to non-enterprise Crown corporations are expected to decline between 1993-94 and 1995-96.

Defence program spending declines over the period, due to the impact of the measures introduced in this budget. Defence spending declines by about 5 per cent in 1994-95. The funding levels continue to decline on an annual basis thereafter, reflecting the impact of the further 1 per cent per year reduction in funding and the extension of the wage freeze.

The reserves-net-of-lapse component is the difference between reserves to handle contingencies and the anticipated lapsing of appropriated funds. Reserves are required to provide a margin for changed economic circumstances and to deal with possible contingencies during the course of the year. They are not allocated until their ultimate use has been determined. In comparison to the April 1993 budget, the level of the reserves has been increased to more adequately reflect the contingencies that may need to be addressed over the framework period.

Finally, spending on government operations is expected to be lower in 1995-96 than in 1993-94. This is attributable to the effect of reductions in operating budgets announced in the December 1992 Economic and Fiscal Statement, the April 1993 budget and proposed in this budget, and the impact of the two-year salary freeze announced in the December 1992 Statement and extended by an additional two years in this budget.

Compliance with the *Spending Control Act*

Under the *Spending Control Act*, the government must indicate how the current spending projections comply with the spending limits set out in the *Act*. The *Spending Control Act* covers all program spending, comprised of total spending less public debt charges, with the exception of expenditures relating to a limited number of self-financing programs. Actual and projected spending over the 1991-92 to 1995-96 period cannot exceed the limits set out in the *Act*.

Actual spending subject to control, as audited by the Auditor General of Canada, was $1.6 billion below the spending limit for 1991-92 and $0.5 billion above the spending limit for 1992-93. The government proposes to apply some of the underspending in 1991-92 to cover the overspending in 1992-93 and thereby remain in compliance with the *Spending Control Act*, as set out in Section 7 of the *Act*. As a result, the spending limit for 1991-92 is lowered to $96.7 billion, while the limit for 1992-93 is raised to $101.4 billion.

The *Spending Control Act* also requires that the government make a recommendation in the 1994 budget, as to whether or not the *Spending Control Act* should be extended beyond 1995-96. The government will adhere to the spending control limits set out in the current legislation, but is not recommending the extension of the *Act* beyond 1995-96. The control of expenditures which this government is exercising clearly makes the Act redundant.

Table 18
February 1994 budget
Compliance with the Spending Control Act

	1991-92	1992-93	1993-94	1994-95	1995-96
			(billions of dollars)		
A. *Spending Control Act* spending limits	97.2	100.9	104.1	107.4	111.2
B. February 1994 budget[1]					
Program spending	115.3	122.5	121.8	122.6	122.7
Less:					
Expenditures under the *Unemployment Insurance Act*	19.3	20.3	19.7	19.7	18.7
Expenditures under the *Farm Income Protection Act*	0.1	0.1			
Expenditures relating to events occurring prior to April 1991	0.2	0.6			
Expenditures justified by current/future years' increase in revenue		0.1	0.1	0.1	0.1
Program spending subject to spending control	95.6	101.4	102.0	102.8	103.9
C. Excess (+) or underspending (-)	-1.6	0.5	-2.1	-4.6	-7.3

(1) Data for 1991-92 and 1992-93 are final as reported in the Public Accounts of Canada.

Financial Requirements

The government's net financial requirements include both budgetary and non-budgetary transactions. The latter consists of loans, investments and advances, primarily to Crown corporations and to provincial and foreign governments, government employees' pensions accounts, other specified accounts, interest and debt accounts, and other non-budgetary transactions. Total non-budgetary transactions have traditionally provided the government with a net source of funds, lessening its dependence on financial markets.

The principle underlying the distinction between budgetary and non-budgetary transactions is that transactions changing the net indebtedness of the government are classified as budgetary and those involving offsetting financial assets and liabilities (thus leaving net debt unchanged) are classified as non-budgetary. In addition, the government maintains a number of trust accounts held for third parties, such as pension accounts of federal government employees. Other non-budgetary transactions include accounting adjustments to certain budgetary transactions that are recorded on an accrual basis to a cash basis.

Non-budgetary transactions are estimated at $12.0 billion in 1993-94, as certain liabilities affecting the deficit are not expected to result in cash requirements in 1993-94. In 1994-95, the net source declines to $9.5 billion, as these liabilities are realized.

Table 19
Non-budgetary transactions

	1992-93	1993-94	1994-95	1995-96
	(billions of dollars)			
Loans, investments and advances	0.1	-0.5	0.6	1.0
Specified purpose accounts	5.7	7.1	7.7	8.1
Other transactions	0.2	5.4	1.2	0.9
Non-budgetary transactions	6.0	12.0	9.5	10.0

Financial Requirements and Borrowing Authority

The amount of borrowing authority requested from Parliament for a fiscal year has traditionally been tied to the financial requirements forecast for that year. The actual level of borrowing is also influenced by foreign exchange transactions that cannot be forecast in advance.

The government will be introducing legislation seeking borrowing authority of $34.3 billion for 1994-95 to cover financial requirements of $30.2 billion, expected Exchange Fund earnings of $1.1 billion, and a contingency of $3 billion to manage foreign exchange transactions. Borrowing authority to cover Exchange Fund earnings is requested because these earnings, although reported as budgetary revenues, remain in the Exchange Fund account and are not available to finance ongoing operations of government.

Table 20
Borrowing requirements

	1994-95
	(billions of dollars)
Financial requirements (excluding foreign exchange requirements)	30.2
Exchange fund earnings	1.1
Reserve for contingencies	3.0
Total borrowing authority requested	34.3

Fiscal Outlook in 1996-97

The fiscal outlook is largely dependent upon economic developments and the interaction of revenues and program spending to these changes. Public debt charges are determined by the stock of debt outstanding and by interest rate developments, the latter which can react to both economic and non-economic events.

The fiscal projections are, therefore, very sensitive to economic developments. This sensitivity increases rapidly as the forecast period is extended.

This is best illustrated by previous budget projections of economic and fiscal outlooks for the medium term, which have been off track in recent years. To assess and improve the accuracy of such forecasts, an independent external review is being undertaken. The results of this review will be made public in the spring of 1994.

Apart from the increasing economic uncertainties post-1995-96 and the resulting lower accuracy of medium-term projections, the fiscal outlook post-1995-96 will also be influenced by the reform and review processes, described above. These reviews could result in further reductions in program spending.

As a result, this budget does not contain fiscal projections post-1995-96. A more reliable perspective of fiscal prospects for 1996-97 will be provided in the 1995 budget.

However, a simple extrapolation to 1996 of the economic assumptions contained in Chapter 2, coupled with the impact of the fiscal actions contained in this budget, suggests that the government's deficit-to-GDP target of 3 per cent in 1996-97 is achievable.

Gross fiscal savings of $13.6 billion in 1996-97 will be realized, as a result of the measures presented in this budget. The cost of the new initiatives proposed in this budget amounts to $2.7 billion in 1996-97. As a result, net fiscal savings secured in this budget amount to $10.9 billion in 1996-97.

Table 21
Gross and net fiscal savings

	1994-95	**1995-96**	**1996-97**
	(millions of dollars)		
A. Gross fiscal savings			
Internal reallocations to finance *Creating Opportunity* initiatives	183	505	736
Securing savings from previous budgets	800	3,912	4,014
Reductions in operating costs	468	1,148	1,578
Reductions in defence spending	745	1,079	1,416
Reductions in grants and contributions	253	381	409
Building a responsible social security system	725	2,866	3,940
Personal income tax measures	170	785	840
Corporate income tax measures	405	610	690
Gross fiscal impact	3,749	11,285	13,623
B. Cost of Initiatives	-2,221	-3,294	-2,696
C. Net fiscal savings	1,528	7,992	10,927

With a deficit of $32.7 billion in 1995-96, there must be a decline in the order of $7.7 billion in order to achieve the interim deficit target of 3 per of GDP in 1996-97. The net savings from the budget measures rise from $8.0 billion in 1995-96 to $10.9 billion in 1996-97 – thereby contributing $2.9 billion to the decline in the deficit in 1996-97. This means that the interaction of economic developments and the pre-budget fiscal structure must generate about $5 billion of deficit reduction between 1995-96 and 1996-97.

A simple extrapolation of the economic planning assumptions described in Chapter 2 – nominal income growth of 5 per cent in 1996 and interest rates unchanged from 1995 – should generate fiscal savings of this amount. For example, 5 per cent growth in nominal income, coupled with an average effective tax rate of 17 per cent, should generate about $7 billion in additional budgetary revenues. Such a nominal growth profile is lower than that projected by most private sector forecasters.

Revenues should grow somewhat faster than the 5 per cent growth in nominal income due to the progressivity of the income tax system. The incremental expenditure reductions announced in this budget should lower total program spending in 1996-97. With these budget actions, program spending in 1996-97 should be below the level reported for 1995-96 and any year since 1992-93.

Sensitivity of Fiscal Projections

Estimates of the sensitivity of the main fiscal aggregrates to changes in assumptions are presented below for changes in the level of nominal income and interest rates. It must be noted that these are static calculations and do not represent alternative forecasts of the government's fiscal position. They are only intended to capture the direct fiscal impacts of changes in one key economic variable at a time. For example, in the nominal income shock, there is no feed-through of the change in nominal income to other variables, such as interest rates and unemployment.

- A 1-per-cent increase in the level of nominal income leads to higher tax bases and therefore higher revenues. Expenditures are lower, primarily due to lower interest cost resulting from the decline in the stock of debt. The deficit impact would be dependent upon whether the increase in nominal income resulted from an increase in real output or an increase in price or a combination of the two. Assuming the increase in nominal outcome comes solely from an increase in real output, the deficit would be lowered by $1.3 billion in the first year, rising to about $1.7 billion after four years. If the increase in nominal income comes solely from an increase in prices, the deficit impact would be slightly smaller.
- A sustained 100 basis-point decline in all interest rates causes the deficit to decline by about $1.7 billion in the first year. As longer-term issues mature the impact on the deficit increases over time, such that by year four, the deficit is about $3.5 billion lower.

Table 22
Fiscal sensitivity analysis: 1-per-cent increase in nominal output

	Estimated changes to fiscal position[1]			
	Year 1	**Year 2**	**Year 3**	**Year 4**
	(billions of dollars)			
Budgetary transactions				
Revenue increases	1.2	1.3	1.4	1.6
Expenditure reductions	0.1	0.2	0.1	0.1
Deficit reduction	1.3	1.5	1.5	1.7

(1) For the purpose of this analysis, the unemployment insurance account balance has been held at its base case level.

Table 23
Fiscal sensitivity analysis: 100-basis-point lower interest rates

	Estimated changes to fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue reductions	0.3	0.3	0.4	0.4
Expenditure reductions	2.0	2.8	3.4	3.9
Deficit reduction	1.7	2.5	3.0	3.5

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