Tabled in the House of Commons by

the Honourable Michael H. Wilson

Minister of Finance

the Budget

February 20, 1990

Department of Finance
Canada
Ministère des Finances
Canada

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1. The Budget Speech

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

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

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

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

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

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

- We will reduce the deficit to $28.5 billion next year.
- We will cut it in half to $14 billion in three more years.
- We will reduce it further to $10 billion in the year after that.

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

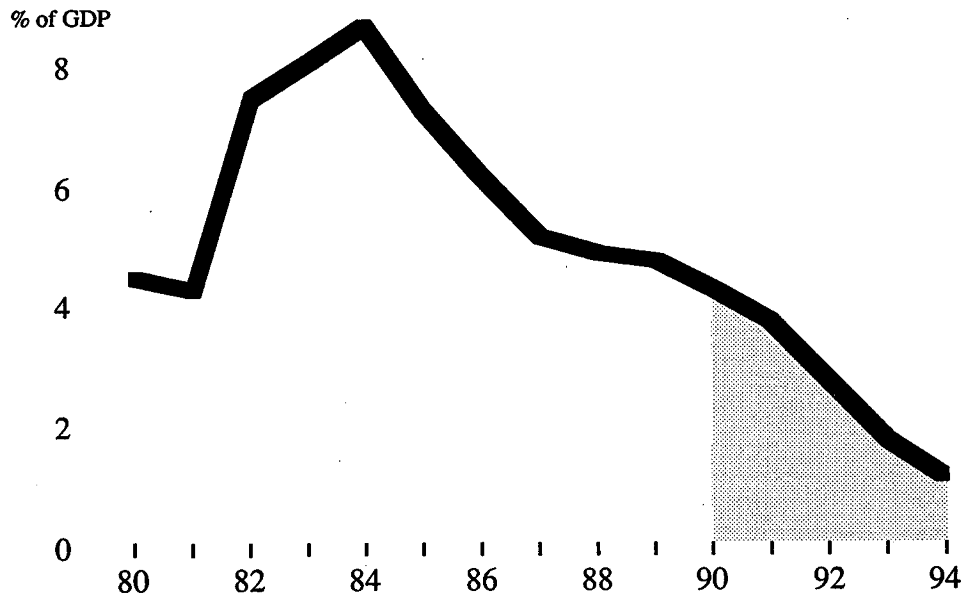
Last year I said that for every dollar the government collects, the interest on our debt was 35 cents and rising. That is money we can't use now to get taxes down or to address priorities such as environmental protection, research and development and skills training. We must pay those interest costs.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

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

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

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

Reducing the Deficit



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

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

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

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

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

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

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

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

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

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

There will be no new taxes in this budget.

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

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

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

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

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

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

- a responsive government with the financial room to manoeuvre to maintain valued services and tackle new challenges;
- a dynamic economy that provides rising living standards and growing opportunities to build full, satisfying lives;
- a confident, economically sovereign country that is competitive abroad and in control of its destiny at home.

This is the future we have been building since 1984.

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

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

Building the Foundation for a Better Future

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

The plan has two main thrusts: to put the government's financial house in order; and to foster a dynamic, innovative and competitive private sector.

Our actions have challenged Canadians and encouraged them to change their ways of doing things.

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

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

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

Expanding our Economic Potential

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

Toward this goal, our economic plan has proceeded with many initiatives designed to strengthen the basic structure of the economy and provide a better framework to allow our economy and Canadians to adjust to change. These structural reforms will increase our competitiveness and expand our potential for growth and job creation. They encourage private initiative, remove obstacles to economic growth, secure access to markets, increase investment and improve efficiency. They contribute to a more productive and prosperous Canada.

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

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

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

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

Privatization and Crown Corporations

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

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

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

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

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

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

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

Sales Tax Reform

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

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

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

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

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

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

Realizing the Potential

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

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

Getting Off the Deficit Treadmill

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

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

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

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

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

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

Reducing Government Expenditures

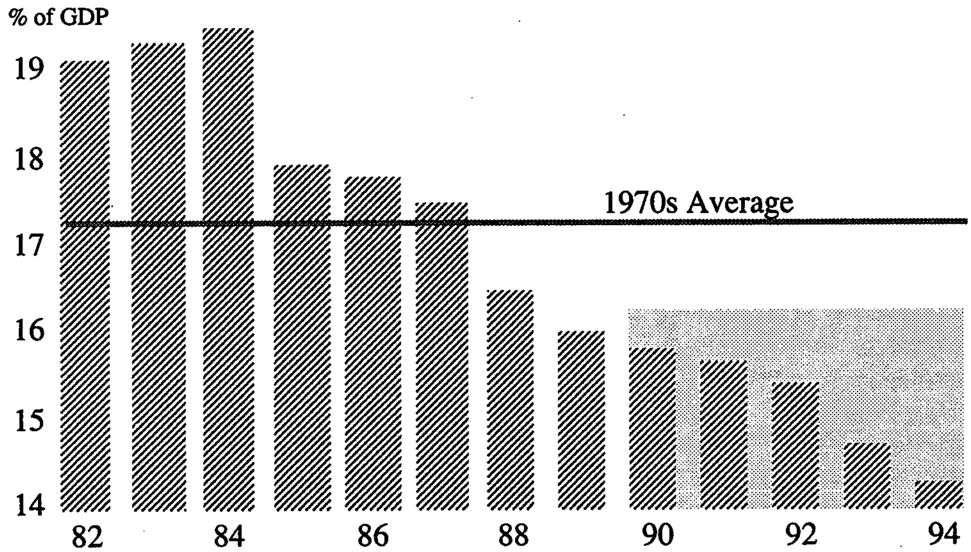
As part of a measured, long-term plan to restore a better fiscal balance, we immediately launched a broad and sustained effort to reduce expenditures.

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

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

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

Controlling Spending



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

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

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

Solving the Debt Problem

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

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

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

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

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

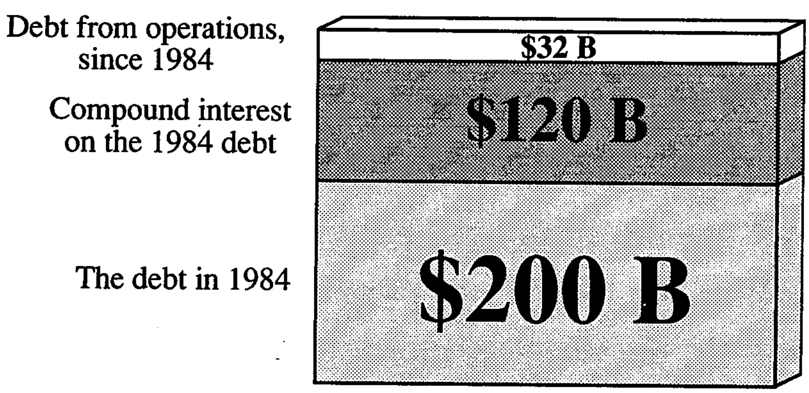
This year alone, interest payments will cost us close to $40 billion – equal to $1,500 for each and every Canadian. That is ten times higher than 15 years ago.

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

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

With the expenditure control actions in this budget, we will ensure that our operating surplus continues to grow. This is essential. But we also need to ease the

The Debt Treadmill



burden of rapidly growing interest payments. And to do this effectively we must continue to deal firmly with the greatest single threat to our continued fiscal and economic progress: high inflation.

Current Fiscal and Economic Challenges

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

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

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

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

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

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

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

Reinforcing Expenditure Control

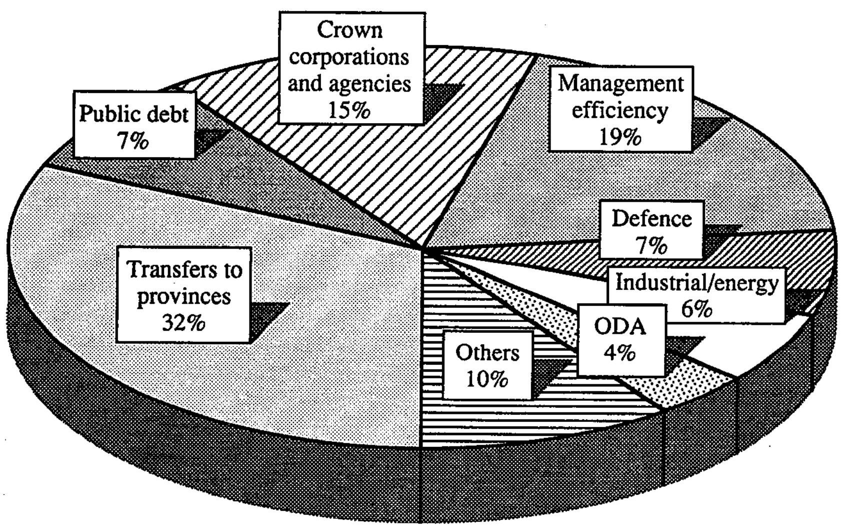
The expenditure control measures in this budget are tough. They reflect the fact that after several years of restraint, there are no painless ways to cut spending. The notion that spending can be substantially reduced without having a real impact outside of government simply does not fit with the reality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

Expenditure Control Plan

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

$3 Billion of Savings

1990-91



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

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

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

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

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

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

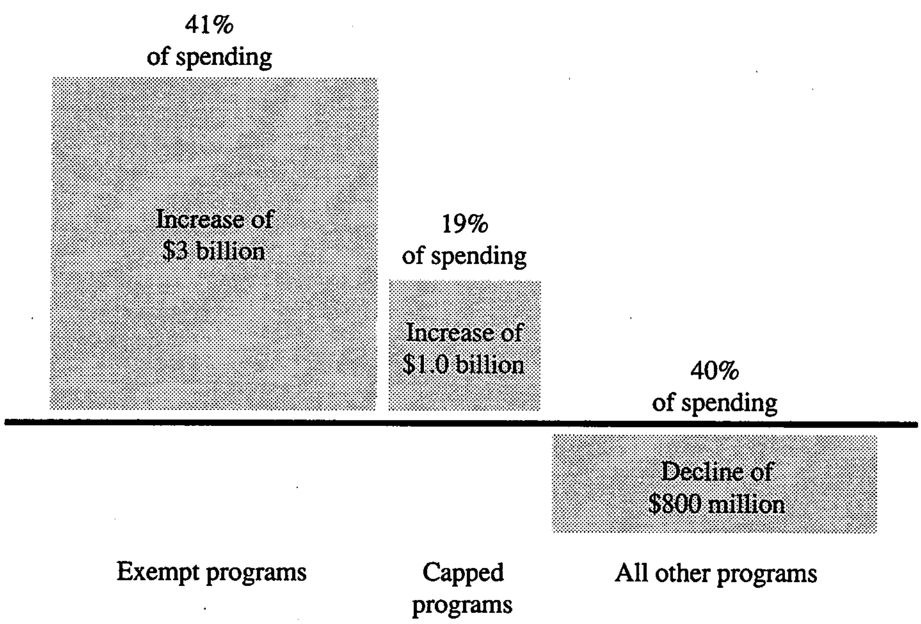
It is clear that with these measures the federal government has tightened its belt; we have restrained our own costs and we will continue to do so.

Total expenditures on programs other than those that are exempt or capped will decline over the next year to a level $800 million below that of the current year. Total federal program spending will grow by 3 per cent next year, well below the expected rate of inflation. Total entitlements for the major federal-provincial transfer programs are expected to grow at about the same rate as federal program spending next year. They will average about 2.3 per cent for Ontario, Alberta and B.C. and 4 per cent for the Atlantic provinces. The lower-income provinces will continue to receive proportionately more federal support than the higher-income provinces.

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

The Expenditure Control Plan

1990-91



Sustaining Fiscal Progress

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

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

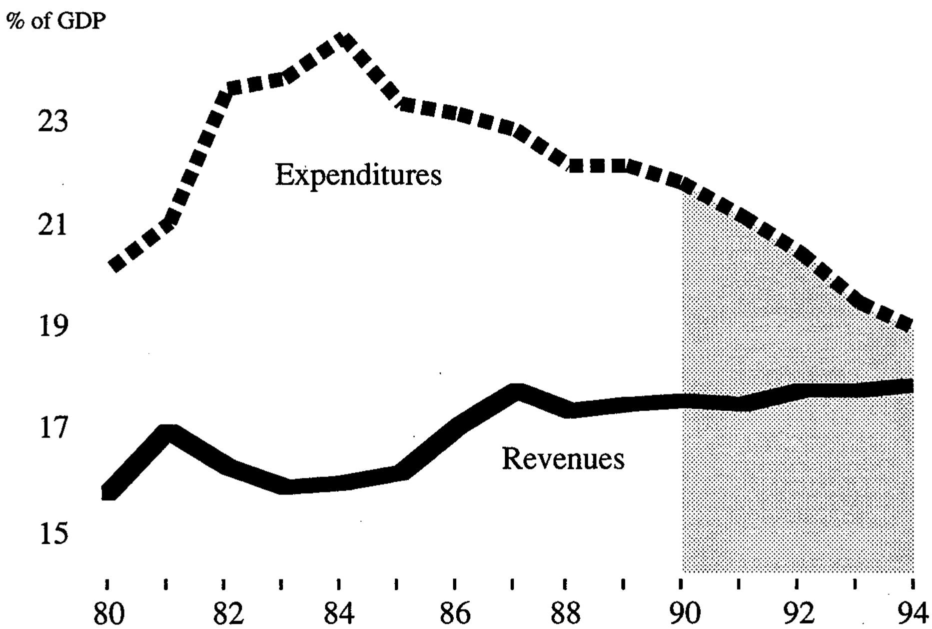
In Canada and abroad, we are witnessing a major change in peoples' attitudes and actions towards the environment. My colleague, the Minister of the Environment, is currently engaged in an extensive dialogue with Canadians on the steps we must take to address the difficult problems related to the pollution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

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

Impact of Budget Measures

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

Restoring Fiscal Balance



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

- The deficit will be further reduced to $10 billion.
- The government will begin to pay down its bonds and Treasury bills.
- Program spending will fall to 14.2 per cent of national income, the lowest level since the late 1960s.
- The surplus of revenues over program expenditures – our operating surplus – will reach $31 billion.
- The burden of debt will be reduced as the public debt shrinks relative to our national income.
- As a direct result, the portion of every revenue dollar that today goes for debt interest will be reduced from 35 cents and rising, to 26 cents and falling.

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

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

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

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

Conclusion

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

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

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

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

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

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

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

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

2. Canada's Economic Performance and Prospects

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Overview

Canada faces important opportunities and challenges in the 1990s. Prosperity has resulted from the long expansion which followed the devastating 1981-82 recession. This expansion has been almost without precedent since the Second World War. Its benefits have in recent years become more evenly distributed among all the regions.

As the expansion has matured, however, demand has increasingly outstripped the economy's capacity to produce. Inflation pressures have increased and imbalances have emerged in the economy to threaten further expansion. The challenges facing the country are to put the economy back on a path of sustained non-inflationary growth and enhance that growth.

If the right economic conditions are created now – principally lower inflation and inflation pressures – Canada's prospects for the medium term will be bright. The economy's capacity to expand – its potential growth – has already been strengthened. Structural initiatives like deregulation of the energy and transportation sectors, the Canada-U.S. Free Trade Agreement, Income Tax Reform, the proposed Sales Tax Reform, and the new Labour Market Development Strategy are increasing economic efficiency, improving competitiveness and encouraging investment. These economic advances will lead to higher living standards for Canadians. The economy's potential growth rate in the first half of the 1990s is now estimated at 3¼ to 3½ per cent, compared with 2¾-per-cent growth potential estimated for this period as recently as the mid-1980s. Indeed, until the Government of Canada launched its structural initiatives, concern was widespread that the country's potential growth rate would actually decline due to a slowing in the growth of the labour force and weak growth in total productivity.

The world is coming to realize that economies can function more efficiently with less regulation and fewer trade barriers. Many other countries have also been making important structural changes. New competitors are emerging and new markets are opening up. These changes in the global economic environment complement the opportunities opened by our domestic policy initiatives. They also raise a challenge: Canada must be competitive. Only through a competitive economy can we generate the growth, jobs and wealth necessary to secure our national and individual goals.

Inflation pressures must be controlled and inflation reduced for Canada to achieve the strong potential growth that the recent structural changes to the domestic and global economies have made possible. Failure to reduce inflation will exact a high and ongoing price in Canada's competitiveness. But the costs of inflation run much deeper than this. Inflation impairs the functioning of the economy, distorts economic decision-making, and hurts people least able to protect themselves. And the longer inflation pressures are allowed to build, the more difficult they become to eradicate. The experience of the 1970s and early 1980s clearly demonstrated this.

With growth now slowing and expected to remain weak for a while, some encouraging signs of lower inflation and easing inflation pressure have appeared. It is imperative that further progress against inflation occur as quickly as possible. The government remains committed to this objective. This is the only way of getting interest rates down, keeping them down, and putting the economy on a firm and sustainable footing.

The fiscal deficit must also be reduced. Further action is being taken in this budget to accomplish this. Fiscal policy, by assuming more of the burden for lowering inflation, will complement monetary policy and increase the scope for interest rates to come down. A lower fiscal deficit will also reduce the country's dependence on foreign savings, and help free domestic savings to finance the productive investment needed to improve our competitiveness and sustain non-inflationary economic growth.

The Expansion Since 1983

Canada's economic performance from 1983 to 1988 was impressive. Real GDP grew by 4.5 per cent a year (Chart 1a), the fastest rate among the major industrial countries. Employment growth, at 2.4 per cent, was also second to none. The unemployment rate fell dramatically (Chart 1b).

At first the economic recovery was narrowly based and heavily dependent upon the surging U.S. market. Improving inventory investment and rising net exports led growth in 1983 and 1984. From 1985 onward, the expansion broadened and became based on domestic sources of spending: consumption, housing, and investment.

Household spending was a driving force behind the expansion in the mid-1980s. As growth gained momentum and employment recovered, consumer confidence revived from its record lows of the recession and the household savings rate dropped dramatically. The growth of spending on consumption and housing soared, outstripping general economic growth during the period.

Investment growth at first lagged behind the cycle and was unbalanced both regionally and sectorally. By 1985, however, it was recovering. Between 1985 and 1988, it averaged a particularly strong 10.6 per cent, at annual rates (Chart 1c). Companies rapidly expanded their plants, built new and more productive facilities, and modernized existing ones. Spending on machinery and equipment increased even faster. The mid-1980s investment boom reflected economic fundamentals, in sharp contrast with the rapid pre-recession investment spending which was based

Chart 1

Canada's Economic Performance

Chart 1a

Growth in Real Gross Domestic Product and Real Final Domestic Demand

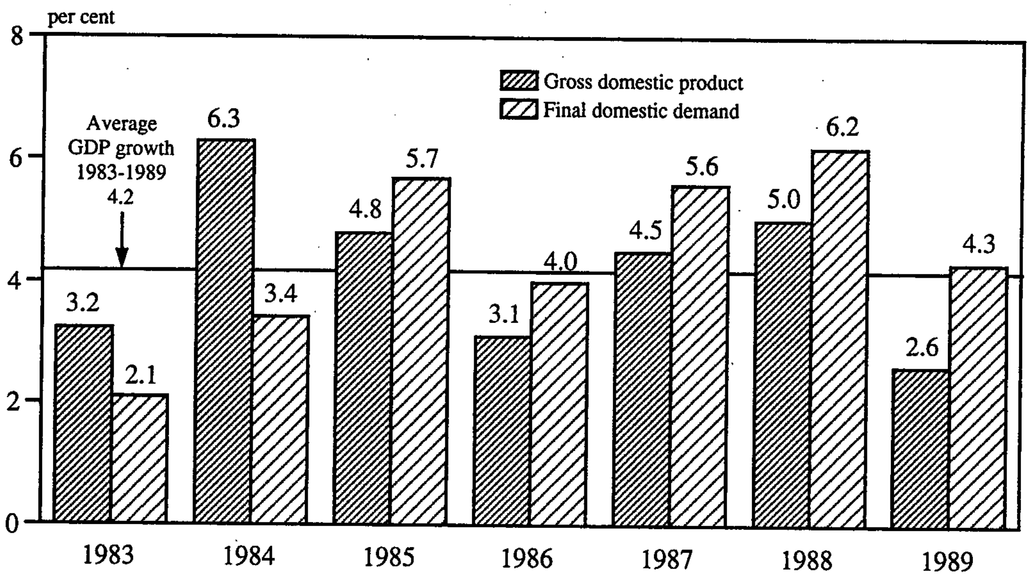


Chart 1b

Canadian Unemployment Rate

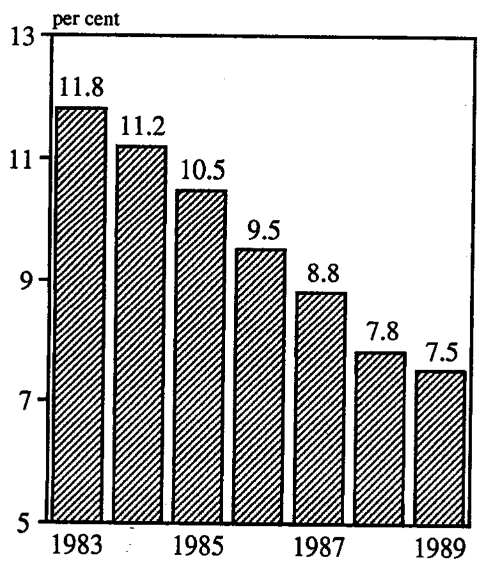
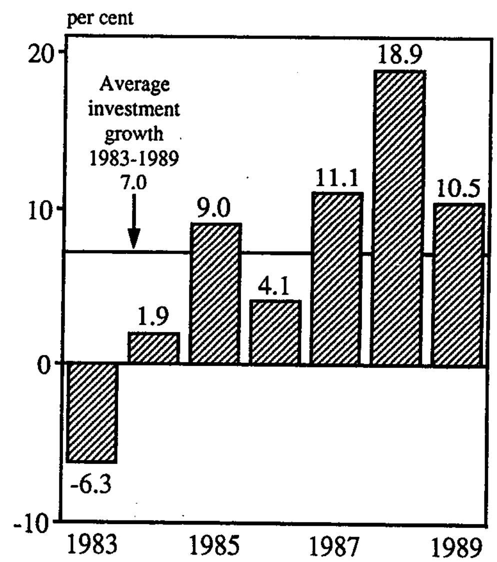


Chart 1c

Growth in Real Business Non-Residential Investment



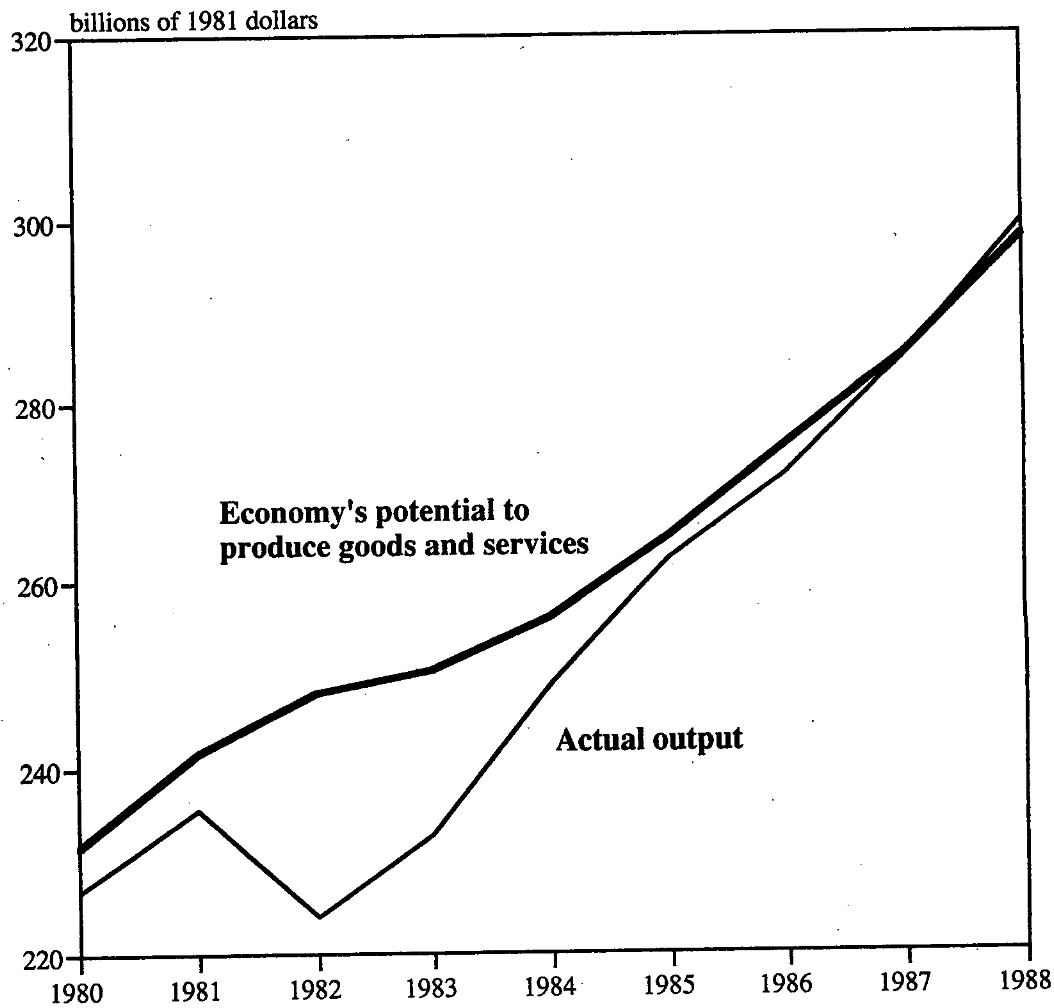
on over-optimistic expectations about resource prices. High rates of capacity utilization in recent years, healthy profit growth, strong sales growth, and a buoyant outlook for the country's economic prospects created by the government's structural reforms have all contributed to the recent investment boom.

The Emergence of Inflation Pressures

By 1988, strong growth had taken up the considerable slack left in product and labour markets by the 1981-82 recession. The economy, in aggregate, had effectively reached its capacity to produce goods and services (Chart 2). Both product and labour markets were tight. The Bank of Canada's measure of capacity utilization attained its highest level in 14 years. The national unemployment rate reached a seven-year low, having fallen significantly in every region. Inflation pressures and imbalances began to emerge. With monetary policy remaining firm, interest rates and the exchange rate rose. The higher value of the dollar slowed Canadian exports while strong domestic demand, particularly for investment, led to greater imports to Canada. As a result, our current account deficit widened. The continuing high fiscal deficit, in the face of a domestic investment boom, was increasing our reliance on foreign savings.

Chart 2

Potential and Actual Real Gross Domestic Product*



* For the commercial sector of the economy.

Rising inflation pressures threatened to undermine the expansion, and the large fiscal deficit was adding to these pressures. The risks of allowing inflation to take hold and become embedded in costs are great: eroding competitiveness, continuing high interest rates and stagnating growth. If this were allowed to happen, the government's fiscal position would deteriorate, serving to increase our reliance on foreign savings and put more pressures on interest rates.

The April 1989 budget recognized the threat inflation posed to continuation of the expansion. It contained strong fiscal measures, aimed not only at putting the federal government on a sounder financial footing but also at restoring balance in the economy by reducing excessive demand pressures. These measures were intended to lower inflation pressure, thus creating an environment for lower interest rates, less dependence on foreign savings, and sustainable non-inflationary economic growth. A period of slower growth, with higher unemployment, was expected as the economy made the transition to lower inflation and sustained higher growth in the medium term.

Growing Dependence on Foreign Savings

Beginning in the mid-1980s, Canada began to use more foreign savings because the needs of the business investment boom started outstripping growth in domestic savings (Chart 3).

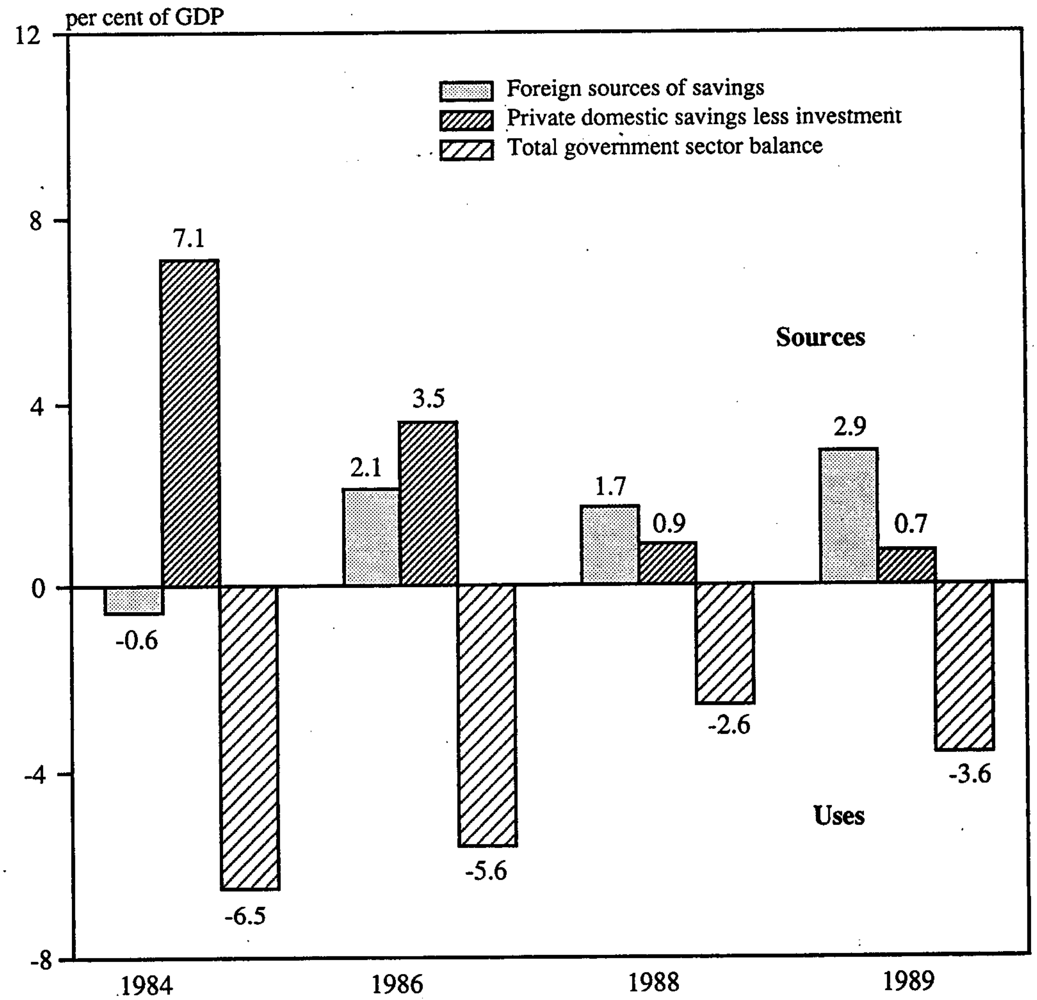
In any country, the three broad sources and uses of savings (private, government and foreign) must balance. Net private domestic savings consist of the difference between total private sector savings and private sector investment expenditures. Government savings, or dissavings in the case of a deficit, are the other domestic source. Foreign savings, in the form of total capital inflows, are the counterpart of a current account deficit. The arithmetic is simple. If private savings are not sufficient to finance the sum of private investment and the total government sector deficit, the difference is borrowed abroad.

During and immediately after the severe recession of 1981-82, private savings were high due to uncertainty about the economic environment. At the same time, private investment was depressed. Even though government sector deficits were large, the funds from private sector savings were more than sufficient to finance both these deficits and private investment demands; indeed, Canadian excess savings flowed to the rest of the world and Canada ran a current account surplus.

As the recovery gained momentum, however, confidence and private sector spending – by both households and firms – increased. Private savings declined. Private investment increased. Even though the government sector deficit declined, due mainly to reduction in the federal deficit, it did not decline fast enough to offset the increased demands for funds by the Canadian private sector. Domestic savings fell short of domestic demand for savings. Since 1985 Canada has had a current account deficit – the counterpart of an increasing reliance on foreign savings.

Chart 3

Sources and Uses of Savings



Strong growth in investment spending, starting in 1985, accounts for a large part of the increase in the current account deficit and the resulting increase in international indebtedness and debt servicing. Indeed, Canadian investment booms have, like the latest one, always been accompanied by a current account deficit. Of the $13 billion decline in the current account balance between 1984 and 1988, over 60 per cent can be attributed to higher imports of machinery and equipment related to Canada's domestic investment performance. The increased investment, by adding to productive capacity, has normally provided the means to service the higher foreign debt.

Today's large government sector deficits are increasing foreign indebtedness by drawing on Canadian savings that would otherwise be available to finance private investment; the use of this saving to finance the deficit does not lead to a matching increase in productive capital to provide the means to service foreign debt. From the savings-investment balance, we see how large government sector deficits divert the funds needed to finance enhancements to the economy's supply capacity. In an economy that is operating at a high level of capacity, government deficits increase our liabilities to foreigners and lower our prospective domestic standard of living. Action to speed up the pace of fiscal consolidation will help to lower our reliance on foreign savings and lower net indebtedness as a proportion of GDP.

Regional Dimensions

In the early stages of recovery, benefits of strong growth in both employment and capital spending were unevenly distributed across the regions. They became more evenly spread as recovery gave way to expansion. More recently, inflation pressures have emerged in all regions and inflation has risen in virtually every province.

Employment Growth Becomes Better Balanced

From 1983 to 1986, employment growth was strongest in Central Canada. In 1987, as resource industries in the Atlantic provinces and in Western Canada began to benefit from rising world demand for some of Canada's key commodities, employment growth strengthened in these regions as well (Chart 4a).

Job creation became better balanced throughout the country in 1988 and strongest in regions with the highest unemployment rates. Employment grew by 4.2 per cent that year in the Atlantic provinces, the fastest pace of growth for the region in the 1980s and the highest rate of growth of any region of Canada in that year. British Columbia recorded the second fastest employment growth in 1988 at 4.0 per cent. Both regions benefited from strong domestic and international demand for their forest products, fish, and metals and minerals.

Developments in 1987 and 1988 brought a better cumulative balance to the economic expansion. Nationally, employment increased 14.7 per cent from 1983 to 1988. All regions shared in this gain, with a 13.9 per cent gain in the Atlantic, 17.3 in Central Canada, 6.8 on the Prairies, and 14.1 in British Columbia. Likewise, all regions shared in the national drop of 3 percentage points in the unemployment rate over this period: 2.6 percentage points in the Atlantic, 5.1 in Central Canada, 1.7 on the Prairies, and 3.5 in British Columbia. The Prairie provinces experienced less improvement in labour market conditions than the rest of the country because of adverse developments in oil and grain markets. International oil and grain prices fell sharply in 1986, the latter largely due to the U.S.-EC grain dispute. Oil prices have not recovered to their pre-1986 levels and the Prairie grain sector suffered a further setback with the 1988 drought.

Investment Spending Rose Outside Central Canada

In the early part of the recovery, the growth of business investment spending was weak in the Atlantic provinces and Western Canada. Led by exports, the recovery

Chart 4
Regional Aspects of Growth and Inflation

Chart 4a
Employment Growth

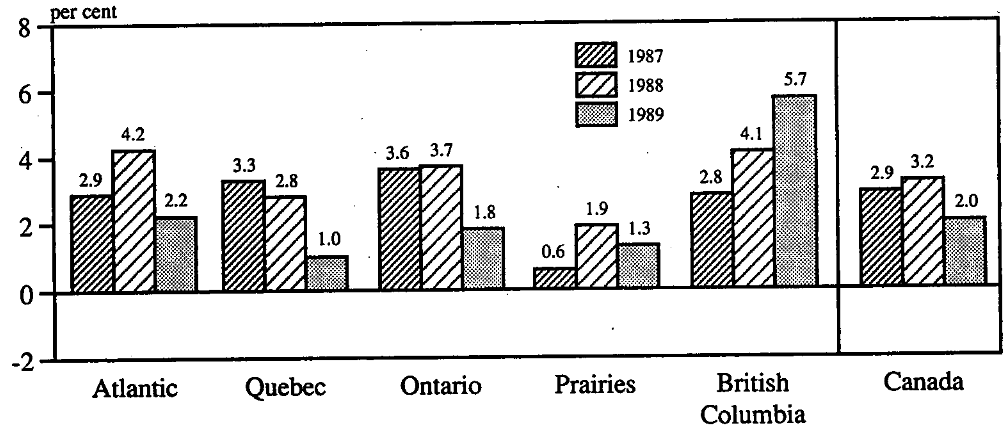


Chart 4b
Investment Growth – July 1989 Public and Private Investment Survey

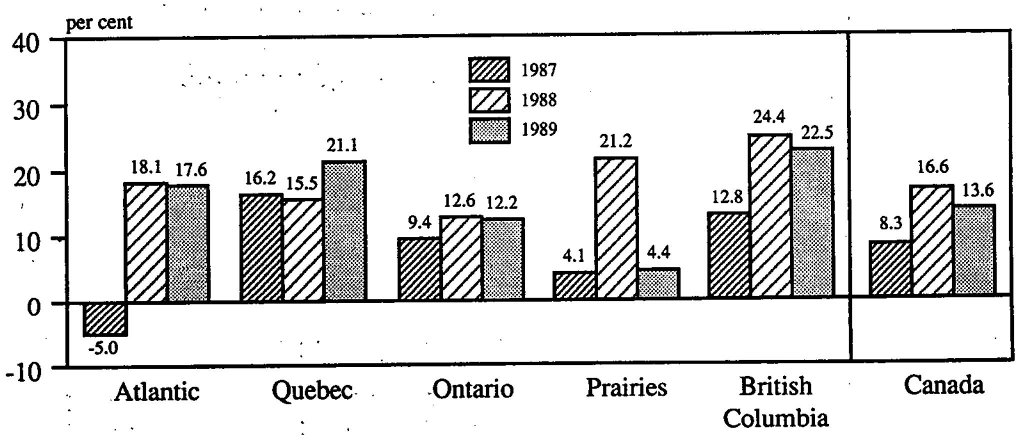
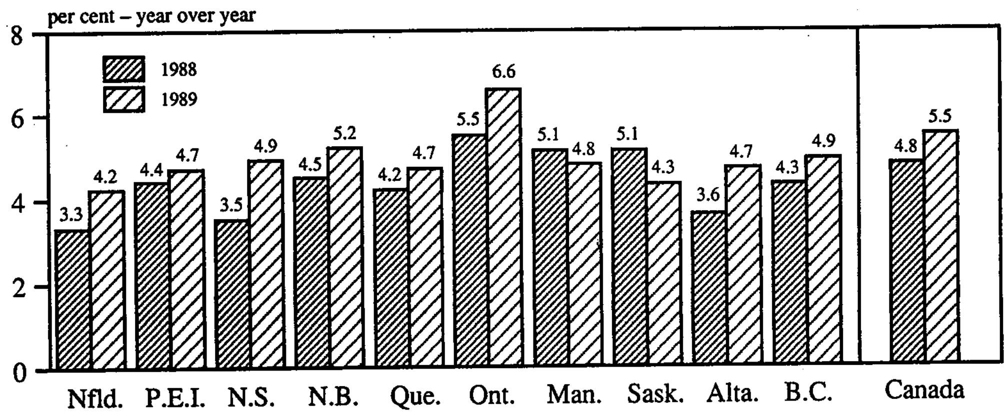


Chart 4c
CPI Inflation – Excluding Food and Energy



spurred investment in Canada's industrial heartland. Business investment took off in 1987 in most of the regions (Chart 4b). It picked up in the resource sector as a strengthening world economy boosted resource prices.

The strength of business investment spending continued to spread in 1988 and 1989 to the Atlantic and Western provinces. Among the provinces, New Brunswick led non-residential business investment spending for both years. Business investment was also particularly strong in British Columbia, buoyed by surging residential construction and major investments in forest products and metals industries. Investment spending on the Prairies was weak in 1989 as oil and gas drilling in Alberta and Saskatchewan declined.

Inflation Has Risen Across the Country

As growth became better balanced across the regions, labour and product markets tightened and inflation pressures emerged. The inflation problem is not confined to Central Canada: for 1989, the CPI rate of inflation excluding food and energy – a measure of core inflation – is high everywhere and up in every province except Manitoba and Saskatchewan (Chart 4c).

Recent Economic Performance

General economic growth has slowed since early last year, as projected in the April 1989 budget, but the slowdown has been due almost entirely to a worsening external balance. Over the first three quarters of 1989, final domestic demand was much stronger (Chart 5a) and labour markets remained tighter (Chart 5b) than had been expected. The level of activity in the economy is still high and inflation pressures still strong. Recent signs of moderating inflation took longer than expected to surface. Interest rates remain high. The imbalances that existed at the time of the 1989 budget continue to exist.

Growth Slows

Growth in real GDP and final domestic demand has slowed markedly since mid-1989. Over the second half of 1989, real output growth averaged about 1.7 per cent at an annual rate, and the unemployment rate rose from 7.3 per cent in September to 7.7 per cent by year-end. In January, the unemployment rate was 7.8 per cent.

Consumer spending eased during 1989 but the pattern was erratic. Growth in housing investment has also eased, although housing construction remains strong and starts continue to be well above the 190,000-to-200,000 range that would be expected by the rate of household formation and the normal replacement of older houses. Investment spending decelerated from the unsustainably strong pace of 1988, although it remained the leading sector of growth in the economy.

Chart 5

Unexpected Demand Pressures in 1989

Chart 5a

Growth in Real Final Domestic Demand in 1989

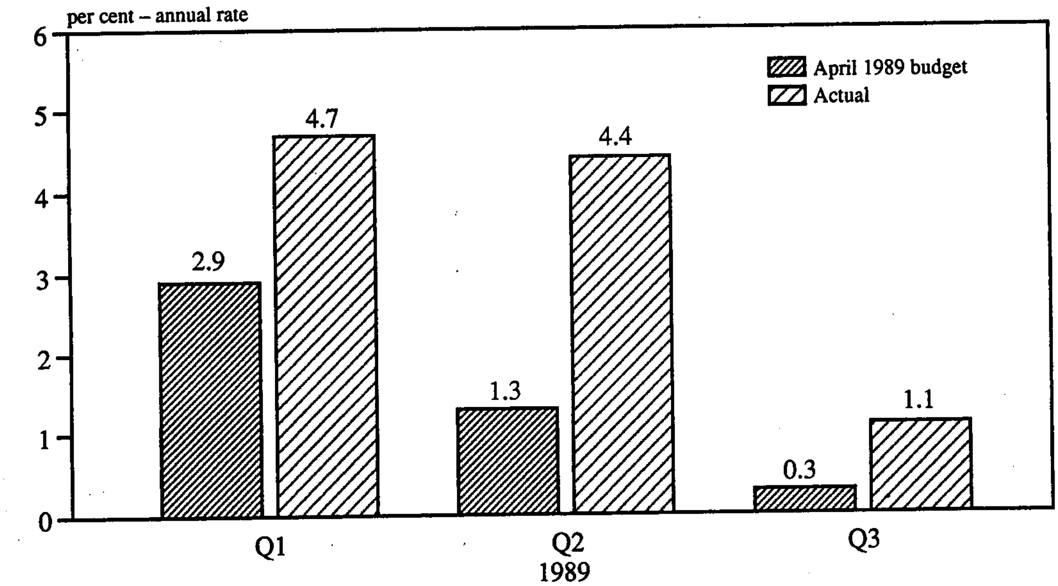
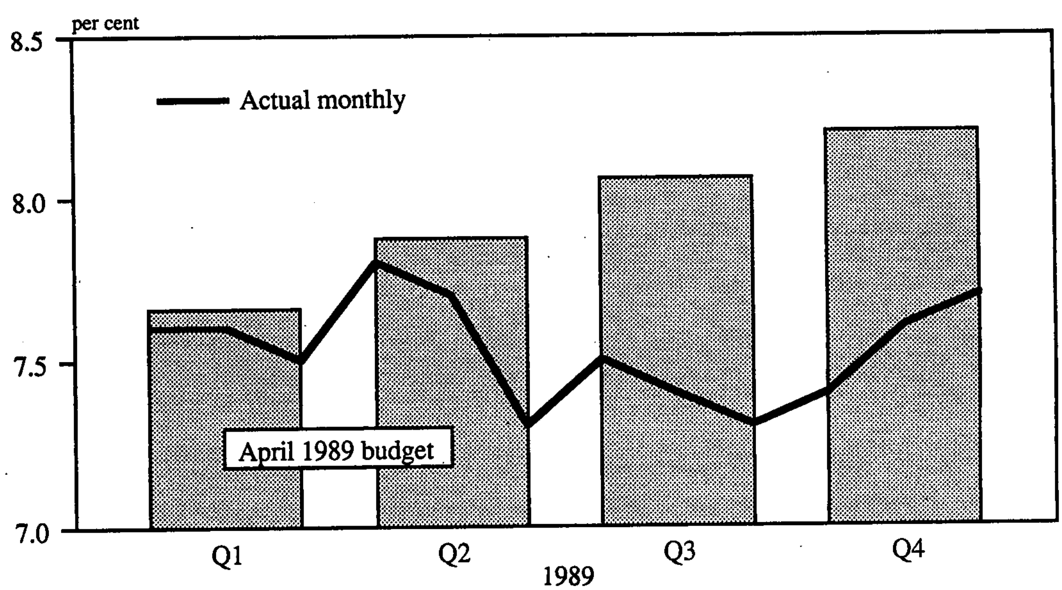


Chart 5b

Canadian Unemployment Rate



Export growth has declined due to a moderation of demand growth in the United States (where about 75 per cent of Canada's exports are sold), a reduction in wheat exports following the 1988 drought, and the impact of the strong Canadian dollar. Investment growth continues to attract imports. Net exports and the current account balance have weakened.

Although growth has slowed, inventories appear generally to be in balance with sales. During the 1980s, advances in managing non-farm business inventories allowed firms to respond quickly to changes in demand, thus avoiding sharp changes in production plans owing to undesired buildups in inventories following unexpected declines in sales.

The slowing pace of economic activity brought lower employment growth in 1989, particularly in the last four months of the year. The unemployment rate rose. Employment growth slowed markedly in the Atlantic provinces and Quebec. The slowing in Atlantic Canada was partly due to the effects of depletion of stocks on a beleaguered fishing industry. Employment growth in Quebec slowed sharply as residential construction and consumer spending weakened. Employment strengthened in British Columbia, buoyed by strong domestic demand growth and international and inter-provincial migration to the province.

In contrast to previous expansions, firms have been prudent in their hiring practices. Rather than hiring employees to meet what could be temporary increases in demand, they have used their existing work forces and increased working hours until the strength of demand became better known. In times of slowing demand growth, this practice works as a buffer and helps to sustain employment levels. Firms can reduce working hours before reducing the size of their work forces. Currently, average hours worked have come down, but from a high level.

Inflation Remains High

In the second quarter of 1988, the Bank of Canada measure of capacity utilization in Canadian industry reached its highest point in 14 years (Chart 6a). The pressures on capacity in 1988 were strongly inflationary. The inflation rate rose from about 4 per cent in most of 1988 to 5.4 per cent by the middle of 1989, then receded to 5.1 per cent by year-end. Excluding the volatile food and energy components, the core CPI inflation rate is now about 5½ per cent (Chart 6b). Without the moderating effect of the appreciation of the Canadian dollar, the inflation rate would have been over 6 per cent during 1989.

New capital and slowing overall demand growth have eased the rate of capacity utilization, returning it to the 1962-79 average. This recent easing should play a role in moderating inflation.

Labour Costs Increase

In 1989, tight national labour markets led to a marked increase in wage costs in 1989, which was not confined to Central Canada. As measured by average hourly

Chart 6

Inflation Pressures and Inflation

Chart 6a

Goods Sector Capacity Utilization Rate

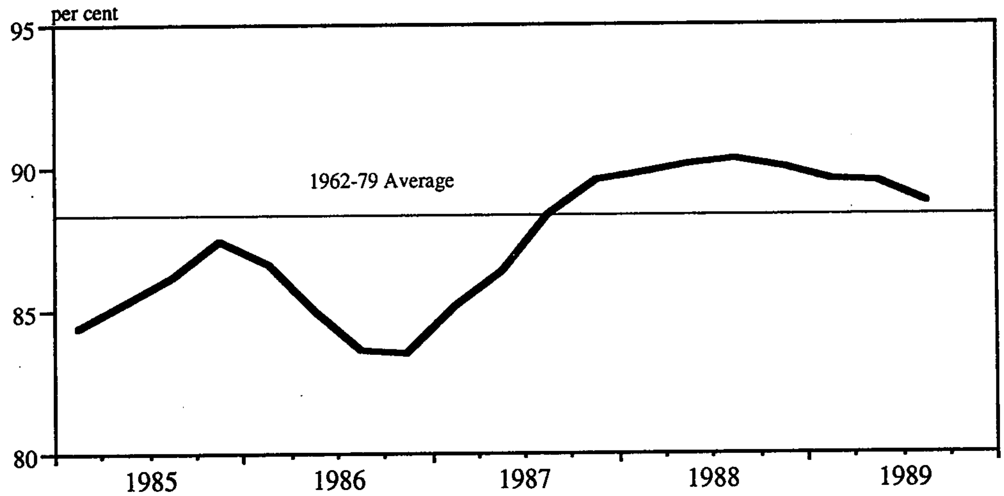
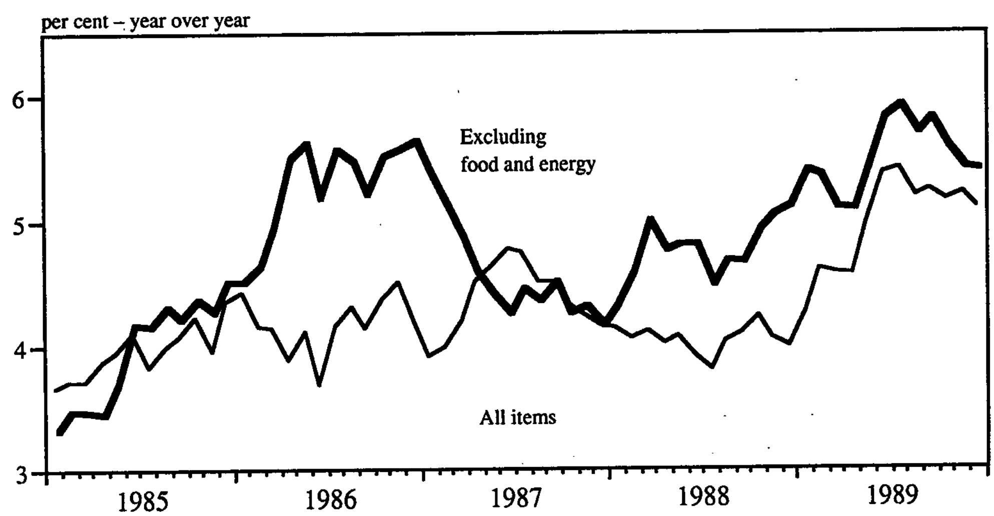


Chart 6b

CPI Inflation



earnings, wage costs are rising in almost every province (Chart 7a). Combined with sluggish productivity growth, these have raised the rate of increase in labour costs. Indeed, Canadian labour costs have increased faster during the last three years than those of our major trading partners, on a domestic currency basis (Chart 7b). Our competitive position has deteriorated.

The exchange rate has significantly appreciated in recent years but this has to be viewed from the perspective of current inflation pressures. If the exchange rate

Chart 7

Labour Costs

Chart 7a

Growth in Average Hourly Wages by Province
1988 and October 1989

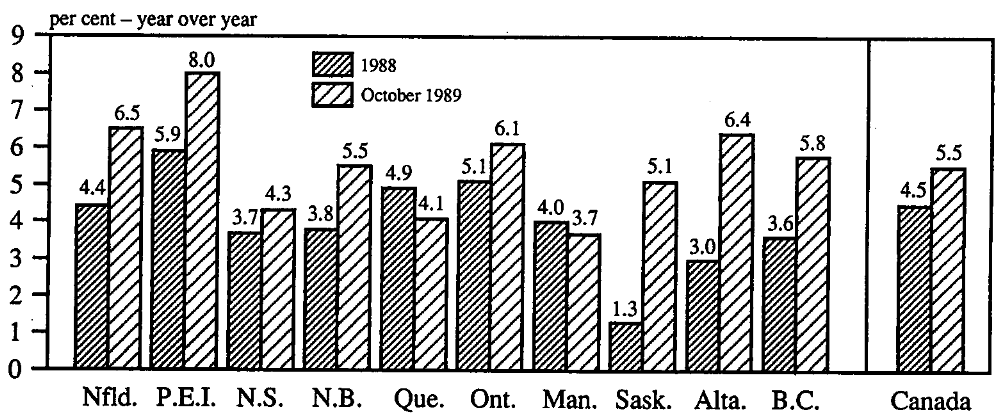
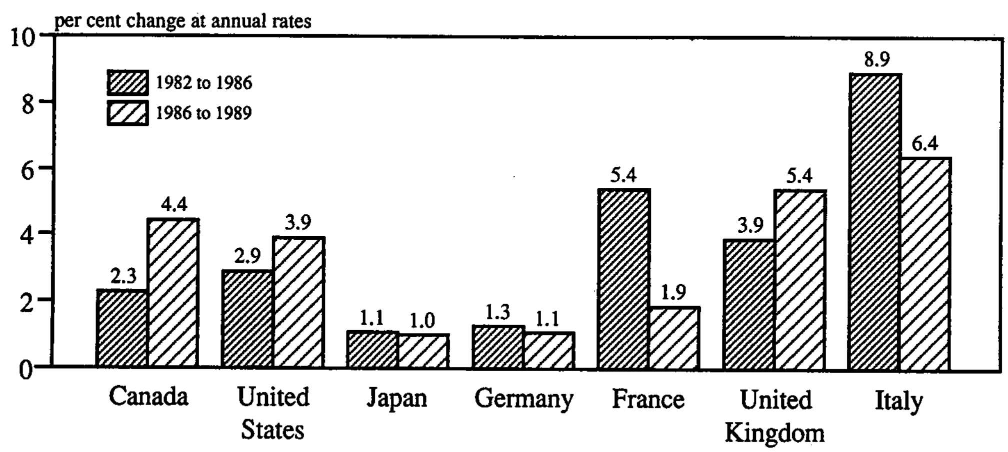


Chart 7b

Growth of Unit Labour Costs
Measured in Domestic Currencies



Source: OECD, *Economic Outlook*, December 1989.

Table 1

Recent Canadian Economic Developments

	1987	1988	1989[1]
	(per cent change unless otherwise specified)		
Expenditures (volumes)			
Gross domestic product (GDP)	4.5	5.0	2.6
Consumption	4.9	4.3	3.3
Residential investment	16.4	4.6	3.2
Business non-residential investment	11.1	18.9	10.5
Machinery and equipment	16.6	23.1	13.5
Non-residential construction	3.3	12.1	5.0
Government expenditure	1.0	3.4	2.5
Final domestic demand	5.6	6.2	4.3
Inventory change (billions of 1981 dollars)	0.8	−0.8	3.2
Exports	6.5	9.5	−0.4
Imports	9.0	13.9	7.3
Net exports (billions of 1981 dollars)	11.5	6.9	−4.4
Current account balance (billions of current dollars)	−9.4	−10.3	−18.5
Housing starts (thousands of units)	245	221	216
Prices and costs			
CPI	4.4	4.0	5.0
GDP deflator	4.4	4.1	4.8
Labour income per employee	5.9	5.6	6.2
Labour market			
Labour force	2.1	2.0	1.7
Employment	2.9	3.2	2.0
Unemployment rate (per cent; fourth quarter level)	8.1	7.7	7.6
Incomes			
Real personal disposable income	3.9	4.1	5.0
Corporate profits before taxes	24.5	10.7	−2.8
Personal savings rate (per cent level)	9.5	9.2	10.3
Financial market (per cent)			
90-day commercial paper rate			
Nominal	8.4	9.7	12.2
Real[2]	4.0	5.7	7.2
Longer-term industrial bond rate (Scotia McLeod average)			
Nominal	10.7	10.9	10.8
Real[2]	6.3	6.9	5.8
Exchange rates			
Canada-U.S.[3] (U.S.¢ per Can. $)	75.4	81.3	84.5
Trade-weighted: G-10 (1981 = 100)	88.2	93.9	98.8
Trade-weighted: Overseas (1981 = 100)	77.8	78.2	87.4

(1) National accounts and wage settlements data for 1989 are based on Department of Finance estimates for the fourth quarter.

(2) Real interest rates are defined as the nominal rates minus the percentage change in the consumer price index.

(3) Average noon rate.

had not risen, our domestic cost structure would have been higher. Our competitive position would have been damaged for a long time.

Production costs must be restrained in the increasingly open and competitive global economy. This is needed for competitive pricing. It is also needed to generate the funds businesses require to finance the capital spending that will permit them to take advantage of new technological and market opportunities.

Inflation pressures must be eased quickly as growth in the economy slows. Yet wage settlements late in 1989 showed few signs of easing, despite indications of slowing demand growth. After opening 1989 with a 4.3-per-cent increase in the first quarter, they rose to 5.9 per cent by the third, owing entirely to increases in public sector settlements. Private sector wage settlements have fluctuated around 5.0 per cent since mid-1988. Public sector settlements, on the other hand, accelerated through the first three quarters of 1989 to reach 6.3 per cent by the third quarter, after averaging less than 4 per cent in 1988 (Chart 8a).

Chart 8

Wage Settlements

Chart 8a

Private and Public Sector Wage Settlements

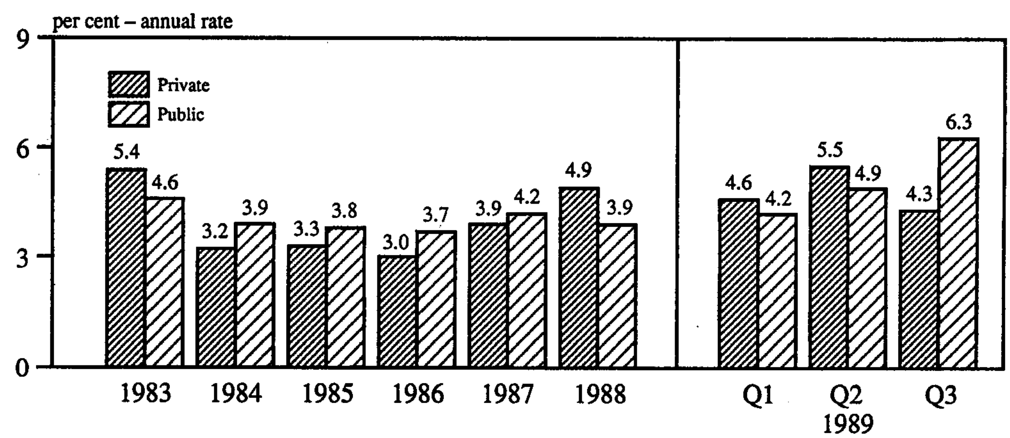


Chart 8b

Public Sector Wage Settlements by Jurisdiction

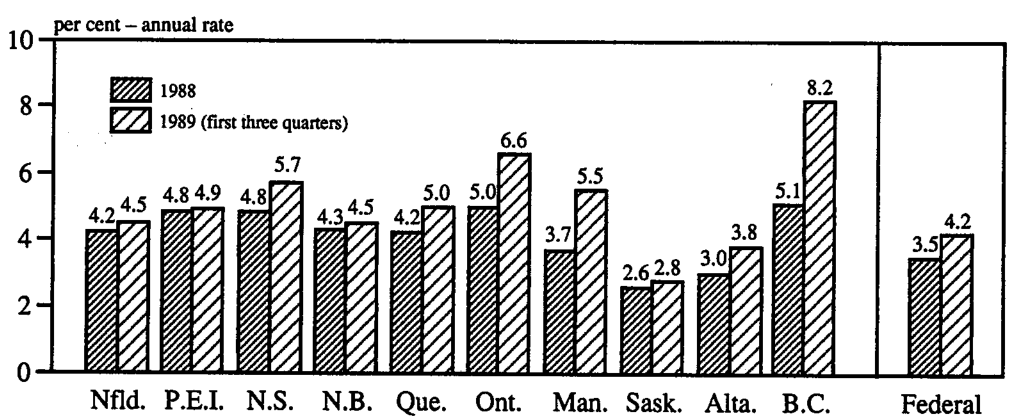


Chart 9

Personal and Corporate Debt

Chart 9a

Growth in Household and Business Credit

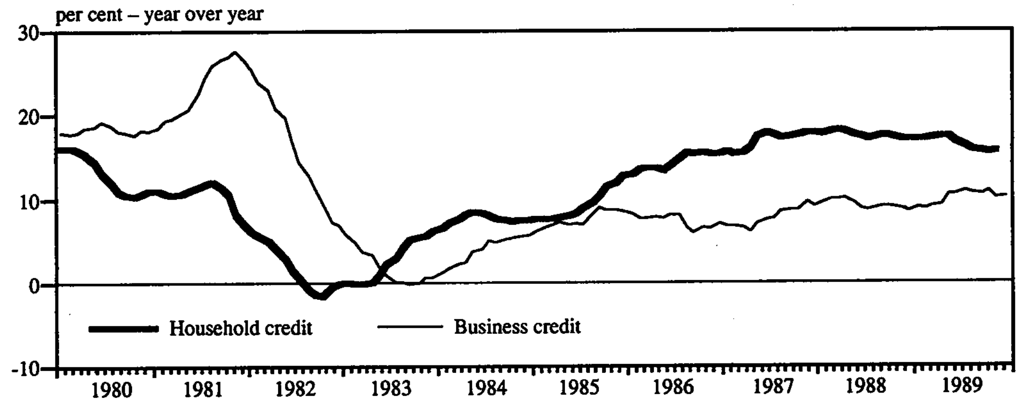


Chart 9b

Personal Debt Relative to Financial Assets

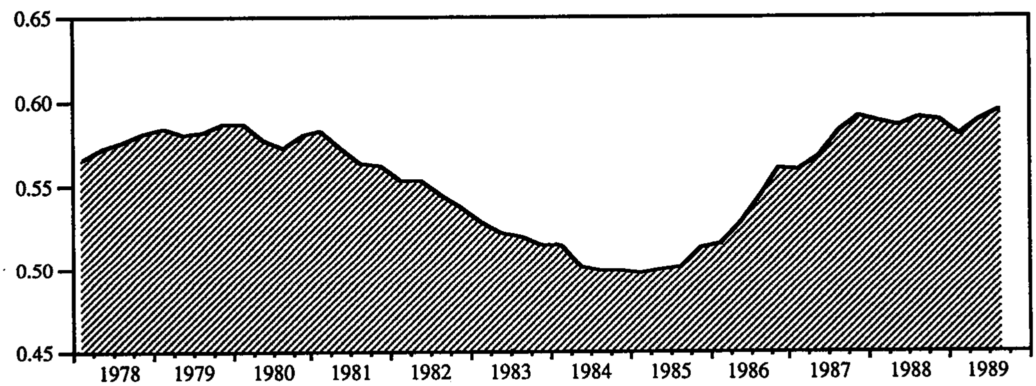
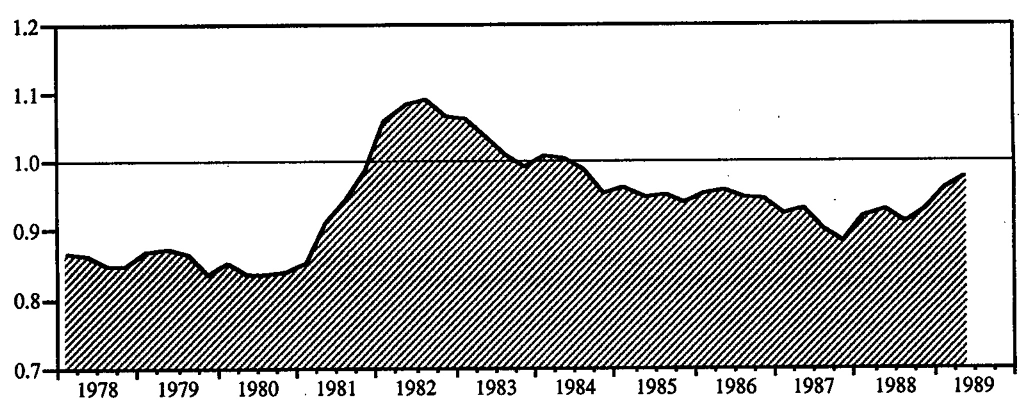


Chart 9c

Large Industrial Corporations Debt-Equity Ratio



Wage settlements in provincial jurisdictions led the 1989 increase (Chart 8b). By the third quarter, education-health-and-welfare settlements had reached 6.6 per cent, just above average provincial administration settlements of 6.4 per cent. By contrast, wage settlements in the federal administration remained virtually unchanged at 4.2 per cent; they continued to be below the rate of inflation.

Public sector wage settlements in British Columbia were higher than in all other regions and sectors in the first three quarters of 1989, averaging 8.2 per cent, compared with only 3.5 per cent in the B.C. private sector. Settlements in Ontario averaged 6.6 per cent in the public sector, 5.7 per cent in the private. Only on the Prairies were wage settlements in both sectors less than 5 per cent.

High public sector settlements are adding to inflation pressures. It is crucial that all levels of government as well as the private sector contain and lower cost increases. Since 1984, federal government wage increases have been less than the rate of inflation and, on average, below the pace of wage increases in the private sector. The government will continue to exercise such leadership in wage restraint. Within the framework of collective bargaining, the government remains committed to fiscally responsible wage settlements that will contribute to reducing inflation pressures.

Corporate Profits Are Being Squeezed

Strong investment has been a major source of growth in recent years. Now rising labour costs and weakening demand are squeezing profit margins. By the third quarter of 1989, corporate profits before taxes were 5.7 per cent below – and unit labour costs 5.8 per cent above – their level a year earlier. The squeeze on profits threatens to dampen investment at a time when firms need to expand plant and equipment to realize the full benefits of structural initiatives like the Free Trade Agreement and Tax Reform.

Credit and Debt Growth Increase

Strong demand growth and inflation pressures are reflected in fast expansion of credit. By late 1989, business credit was up over 10 per cent from the previous year and total household credit was up over 15 per cent (Chart 9a). The growth in these credit aggregates stems principally from the strong spending on consumer durables, housing, and business investment in recent years.

In the inflationary environment of the last 18 months, with sustained rapid growth of household and corporate borrowing, the financial health of the Canadian economy has weakened. Personal debt-loads have risen to new highs as a proportion of both personal disposable income and personal financial assets (Chart 9b).

Chart 10

Financial Market Developments

Chart 10a

Short and Long-Term Interest Rates

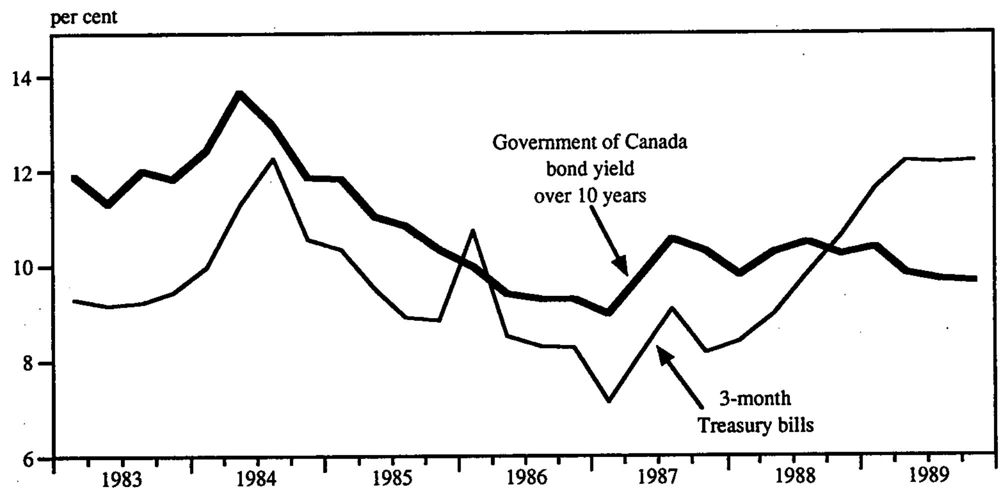
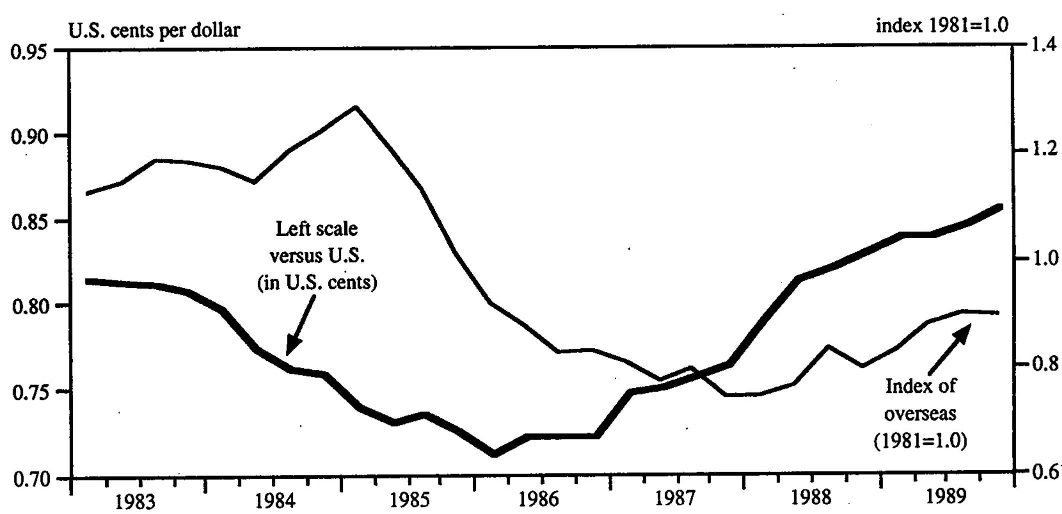


Chart 10b

Canadian Exchange Rates



The debt-to-equity ratio of large industrial corporations fell substantially in the period of recovery and expansion, as firms repaired balance sheets damaged in the 1981-82 recession. Indeed, much of the strong investment spending from 1985 to late 1987 was financed by internal funds and a receptive equities market. The debt-to-equity ratio, though increasing since the stock market plunge of October 1987 made equity financing less attractive, remains well below its previous peak (Chart 9c).

Interest Rates Remain High

Short-term interest rates in both Canada and the United States continued to rise early in 1989 as monetary policy remained firm in the face of increasing inflation pressures. In the spring, however, with signs of emerging weakness in the U.S. economy, the Federal Reserve Board eased monetary policy; short-term rates declined by almost 200 basis points between March and the end of the year. With inflation pressures still strong in Canada, Canadian rates stabilized at about 12.3 per cent from April to early January (Chart 10a). In early February they were about 13.0 per cent.

In contrast to short-term interest rates, long-term rates in Canada declined almost 100 basis points between February and June last year; they fluctuated between 9.6 and 9.8 per cent over the remainder of the year. In early February they were about 9.9 per cent. This inverted yield curve, showing short-term interest rates higher than long-term, is consistent with expectations that short-term interest rates will fall. It reflects confidence that economic policy will succeed in moderating demand growth and reducing inflation. Recently long-term rates were subject to some upward pressure from international financial markets due to mounting concerns about inflation in several major economies.

The short-term interest differential between Canada and the U.S. widened during 1989 and reached about 400 basis points in Canada's favour by the end of the year. The widening contributed to a rise in the external value of the Canadian dollar from just under U.S. $0.84 at the beginning of 1989 to over U.S. $0.86 in early 1990 (Chart 10b). In mid January the Canadian dollar came under some downward pressure and in early February the exchange rate moved below U.S. $0.84.

The Canadian dollar appreciated against overseas currencies through 1988 and 1989, although it has recently fallen back somewhat. Against these currencies, the dollar remains substantially below its peak in early 1985.

Short-Term Economic Prospects, 1990-1991

1990 will be a year of transition. The Canadian economy has just completed seven years of expansion, performing well by most standards. In recent years, domestic demand growth has, however, outstripped our capacity to produce goods and

Chart 11

Economic Performance and Prospects in the United States

Chart 11a

Growth in U.S. Real GNP and Real Final Domestic Demand

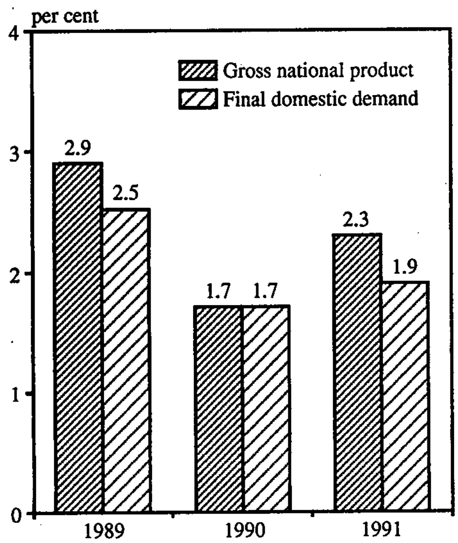


Chart 11b

U.S. CPI Inflation

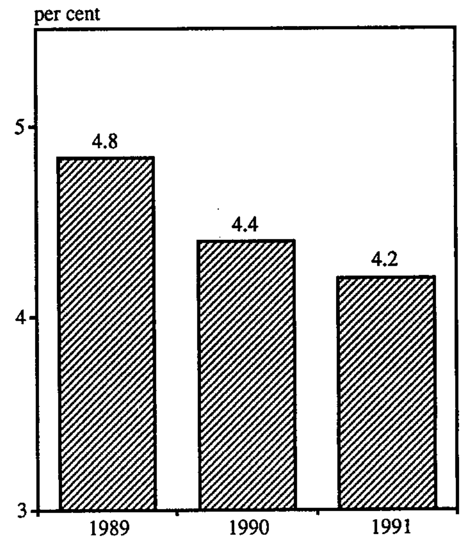


Chart 11c

Fourth Quarter U.S. 90-Day Commercial Paper Rate

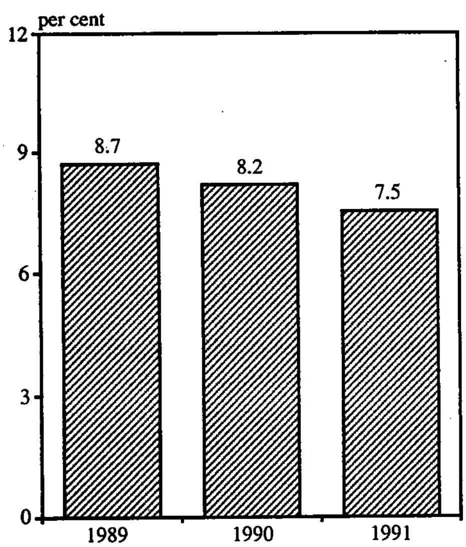
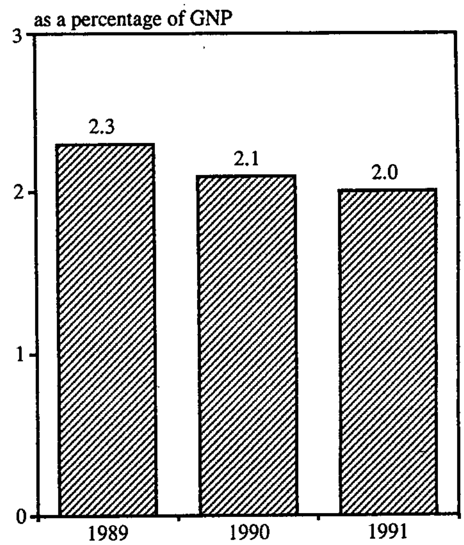


Chart 11d

U.S. Current Account Deficit



services; imbalances have emerged. Capacity utilization is high and labour markets have tightened, greatly increasing inflation pressures, which have been only partly alleviated by the appreciation of the Canadian dollar. Strong inflation pressures have led to high interest rates. At the same time, continued strong domestic demand has been largely met by soaring imports, resulting in a record current account deficit. With continuing large fiscal deficits and strong investment, the country's reliance on foreign savings is increasing.

A period of slow growth is now under way and is expected to continue over most of 1990. This period of adjustment is necessary to reduce pressures in product and labour markets and lower inflation.

The fiscal measures in this budget, together with the April 1989 budget measures, will achieve two goals. First, they will keep the deficit on a downward track. This will free up domestic savings to help finance needed investment and reduce our reliance on foreign savings. Second, they will contribute to lower inflation. By so doing, the budget measures will ease the burden on monetary policy and increase the scope for interest rates to come down. With the expected slowing in growth, a reduction in inflation, and a better balance in macroeconomic policy, declines in interest rates can occur. Lower interest rates, in turn, will contribute to a lower deficit. The stage will then be set for the economy to make the transition to strong, sustained growth in the medium term.

This section presents the short-term outlook for the economy. Prospects are closely tied to those in the rest of the world, particularly the United States, because of the openness of our economy. Thus, the anticipated external economic environment in the years ahead is briefly described first. Then Canada's short-term economic prospects are outlined.

External Economic Environment

In 1989, growth in the U.S. economy slowed from the unsustainable pace of 1987 and 1988. Inflation, which peaked in the middle of the year, started to decline, in part due to lower raw material inflation, flat oil prices, and the strengthening U.S. dollar. The slower growth contributed to improvement in the trade balance, limited by a loss in international competitiveness due to appreciation of the U.S. dollar. The monetary authorities began to ease financial market conditions in the spring of 1989. Short-term interest rates have declined by 1¾ percentage points since their March peak.

Despite the monetary easing, the U.S. economy is widely expected to experience weak growth in 1990 (Chart 11a). Growth will fall below potential, but the United States appears unlikely to experience a recession; consumer confidence has remained strong and personal disposable income has continued to grow strongly throughout 1989. This easing in growth for the U.S. economy is projected to alleviate pressures in labour and product markets and further ease inflation. In this environment, interest rates, which fell sharply during 1989, could fall somewhat from current levels over the course of this year and next (Charts 11b and 11c).

The U.S. economy is projected to regain momentum in the second half of 1990, led by a recovery in capital spending and net exports. Although the current account balance is expected to improve as a percentage of GNP (Chart 11d), it will improve only marginally in absolute terms and remain unchanged in 1991. This is due to the offsetting effects of strong growth abroad and the appreciation of the U.S. dollar in 1989. Over the medium term, however, the current account deficit is projected to decline steadily and substantially.

Table 2

International Economic Prospects in the Short Term

	1989	1990	1991
	(per cent change unless otherwise specified)		
United States			
Real GNP	2.9	1.7	2.3
Final domestic demand	2.5	1.7	1.9
CPI	4.8	4.4	4.2
Unemployment rate (per cent level)	5.3	5.8	5.9
Current account balance (billions of dollars)	−121.4	−118.7	−118.4
90-day commercial paper rate (per cent level, true yield)	9.3	8.3	7.6
AAA corporate bond rate (per cent level)	9.3	8.8	8.9
Other major OECD countries			
Real GNP/GDP			
Europe	3.4	2.9	2.2
Germany	4.3	3.2	2.5
France, United Kingdom, and Italy	3.0	2.8	2.1
Japan	4.8	4.4	4.0
Inflation (CPI)			
Europe	4.7	4.2	3.7
Germany	2.8	2.8	2.5
France, United Kingdom, and Italy	5.4	4.7	4.2
Japan	2.3	2.2	2.0

Source: Department of Finance.

The outlook assumes that the U.S. government will adopt measures to lower its fiscal deficit over the next two fiscal years and through the medium term. Fiscal tightening will relieve demand pressures, help to reduce the trade deficit, ease inflation pressures, and provide scope for lower interest rates. These developments will support the return of the U.S. economy to potential growth over the medium term.

The Canadian Economy

Growth Will Slow

The slowing of GDP growth that began in early 1989 is projected to continue over the next few quarters. The weakest period is expected to be from the fourth quarter of 1989 to mid-1990, with growth averaging below 1 per cent at an annual rate. The first quarter of 1990 could be particularly weak. No increase in economic activity from the fourth quarter of 1989 is projected and a one-quarter decline in output is possible. The current slowing will be most evident in final domestic demand, by contrast with conditions in the first half of 1989 when strong final domestic demand growth was more than offset by plunging net exports. Growth is expected to rebound in the latter half of 1990 and in 1991, led by an improvement in net exports. Employment will continue to grow but will lag behind labour force growth; the unemployment rate will rise throughout 1990.

Because the economy has been operating at a high level of activity, a slowing is essential to relieve inflation pressures. Falling inflation, along with further reductions in the fiscal deficit, will create the necessary economic environment for sustained reductions in Canadian interest rates. This is the key to getting the economy on a path of sustained expansion, making further progress in reducing the federal deficit, and realizing the country's bright medium-term prospects.

Final domestic demand growth in 1989 was stronger than expected, particularly in the first half of the year. The level in the third quarter of 1989 was 2.5 per cent above projections in the April 1989 budget. Demand outpaced the ability of the Canadian economy to produce goods and services, resulting in strong import growth and a seriously worsening trade balance. The current account deficit is now at a record high.

To restore our external balance, final domestic demand growth must slow and Canada must become more competitive. The slowing in final domestic demand has begun and should continue; it is projected to grow more slowly than the economy as a whole through 1990 and 1991 (Chart 12a).

Consumption Growth Will Weaken

Consumption growth will slow significantly in 1990, particularly in consumer durables. Strong growth in this category over recent years has satisfied much of the pent-up demand from the early 1980s. Real personal disposable income, which was raised in 1989 by the one-time rebates under income tax reform, will decline slightly in 1990 as employment and wage growth slows. The personal savings rate is expected to decline by 0.7 percentage points from its 1989 level as income growth slows more than consumption.

In 1991, consumption spending will be affected by the introduction of the proposed 7-per-cent GST. There will be a one-time increase in consumer prices of just under 1¼ per cent. Real disposable income will fall, on average, by somewhat

Chart 12

Economic Prospects in Canada

Chart 12a

Growth in Real GDP and Real Final Domestic Demand

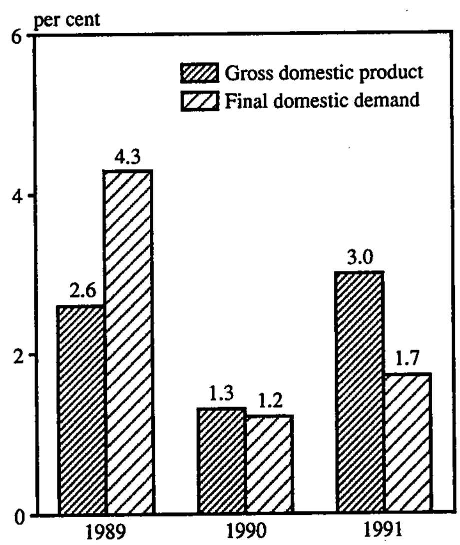
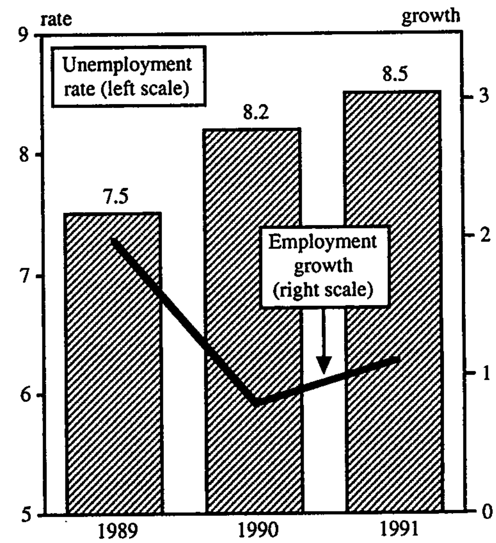


Chart 12b

Canadian Employment Growth and Unemployment Rate



less than 1 per cent from 1990 levels although families earning less than $30,000 a year will have more after-tax income under the GST than under the existing tax system. Only a small increase in consumer spending is expected in 1991. The personal savings rate will decline further.

Residential Construction Will Ease

Growth in residential investment, after several years of strong advance, is also expected to ease, responding to the recent interest rate increases and lower income growth. Annual housing starts have averaged just over 225,000 units in the last three years, reducing some of the pent-up demand from the early 1980s. Starts are expected to decline well below this level in the near term to an average of 190,000 in 1990 and 1991, a rate more in line with household formation and replacement of older houses. The increase in house prices, which has averaged more than 10 per cent annually in recent years, will slow.

Growth in Capital Stock Will Continue to Be Strong

The rate of growth of business fixed investment is expected to slow in 1990, as demand is less robust and profit growth remains weak. The robust growth in investment spending over recent years, however, will ensure a continued strong expansion in capital stock. The share of business fixed investment in GDP has reached a record high of just over 17 per cent. Investment spending is being encouraged by the Canada-U.S. Free Trade Agreement. The introduction of the GST will further boost investment spending in 1991 and beyond since the removal of the existing federal sales tax is estimated to lower prices of capital goods by an average of 4 per cent. Growth in real investment spending, facilitated by a recovery in profit growth, is projected to strengthen to 5 per cent in 1991, partly in response to opportunities created by the proposed sales tax reform.

Growth Will Shift From Domestic-led to Export-led

As growth of domestic demand slows and domestic inflation pressures ease, the volume of net exports will rise. Some strengthening in export growth, combined with a substantial decline in import growth, will increase net exports in the latter half of 1990 and in 1991.

Wheat exports, in particular, are forecast to increase in 1990. The trade balance is expected to strengthen further in 1991 when the GST will replace the federal sales tax and eliminate its bias in favour of imports and against Canadian exports. The shift from domestic-led to export-led growth, coupled with the projected increase in investment and capital stock, will help to set the stage for sustained, non-inflationary growth over the medium term.

The combination of slowing import growth, ongoing export growth, and declining interest rates will improve Canada's external accounts. The current account deficit is projected to remain high in 1990 but decline substantially in 1991.

Labour Market Pressures Will Ease

The near-term slowing in growth will ease labour market pressures (Chart 12b). At present, slowing inflation and strong wage increases are squeezing profit margins. This will lead to a significant slowing in employment growth and hours worked in 1990. Growth in the labour force will moderate only slightly. The unemployment rate is thus expected to rise through 1990, reaching 8.5 per cent by year-end. After weakening in 1990, employment growth will pick up in 1991 with the strengthening of output growth; it is expected to be matched by increases in the labour force leaving the unemployment rate unchanged. The unemployment rate is projected to begin to decline by early 1992, as the economy moves back toward potential.

The easing of labour market pressures will result in a moderation in the growth of labour income per employee from over 6 per cent in 1989 to under 4 by 1991. The moderation in the growth of average hourly wages will be less. The moderation of wage costs is important in improving Canada's competitiveness.

Table 3

The Canadian Economic Outlook: Main Economic Indicators, 1989 to 1991

	1989	1990	1991
	(per cent change unless otherwise specified)		
Expenditures (volumes)			
Gross domestic product (GDP)	2.6	1.3	3.0
Consumption	3.3	0.4	1.0
Residential investment	3.2	−3.0	−2.0
Business non-residential investment	10.5	4.1	5.0
Machinery and equipment	13.5	4.3	4.6
Non-residential construction	5.0	3.9	5.7
Government expenditure	2.5	2.2	2.3
Final domestic demand	4.3	1.2	1.7
Inventory change (billions of 1981 dollars)	3.2	3.5	4.6
Exports	−0.4	2.4	5.2
Imports	7.3	2.2	1.9
Net exports (billions of 1981 dollars)	−4.4	−4.3	0.7
Current account balance (billions of current dollars)	−18.5	−18.1	−14.9
Housing starts (thousands of units)	216	193	186
Prices and costs			
CPI	5.0	4.7	5.1
CPI excluding effect of 7-per-cent GST	5.0	4.7	3.9
GDP deflator	4.8	3.8	3.3
Labour income per employee	6.2	4.7	3.7
Labour market			
Labour force	1.7	1.5	1.5
Employment	2.0	0.8	1.2
Unemployment rate (per cent; fourth quarter level)	7.6	8.5	8.5
Incomes			
Real personal disposable income	5.0	−0.2	−0.9
Corporate profits before taxes	−2.8	1.4	12.1
Personal savings rate (per cent level)	10.3	9.6	8.3
Financial market (per cent)			
90-day commercial paper rate			
Nominal	12.2	11.1	9.5
Real[1]	7.2	6.4	5.6[2]
Longer-term industrial bond rate (Scotia McLeod average)			
Nominal	10.8	10.5	10.2
Real[1]	5.8	5.8	6.3[2]

[1] Real interest rates are defined as the nominal rates minus the percentage change in the consumer price index.

[2] Excludes the effect of the 7-per-cent GST which is estimated to add just under 1¼ per cent to inflation.

Inflation Pressures Will Moderate

The inflation rate is projected to decline from 5.0 per cent last year to 4.7 per cent on average in 1990, and 4.5 per cent by the end of the year (Chart 13). While the introduction of the GST will raise the level of the consumer price index by almost 1¼ percentage points in 1991, it is not expected to have an ongoing effect on the inflation rate. The underlying rate is expected to decline through 1991 reaching 3.5 per cent by year-end on a fourth-quarter-to-fourth-quarter basis.

In 1991, the way business and labour responds to the introduction of the GST will be critical. The benefits from this structural reform can be realized quickly and smoothly if there is a non-inflationary response. In a competitive environment, firms will be under pressure to pass on the savings from the elimination of the federal sales tax to their customers. Given the compensating measures in the 7-per-cent GST package and the prospects for increased employment and income, the one-time increase in the price level following the introduction of the GST is unlikely to be translated into higher wages.

Chart 13

Inflation and Interest Rate Outlook

Chart 13a

CPI Inflation and 90-Day Commercial Paper Rate

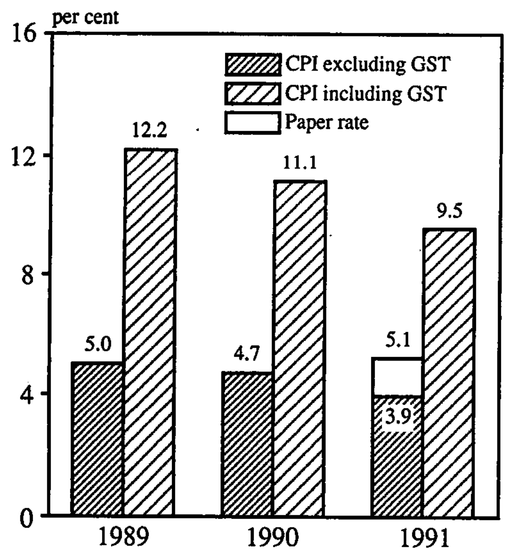
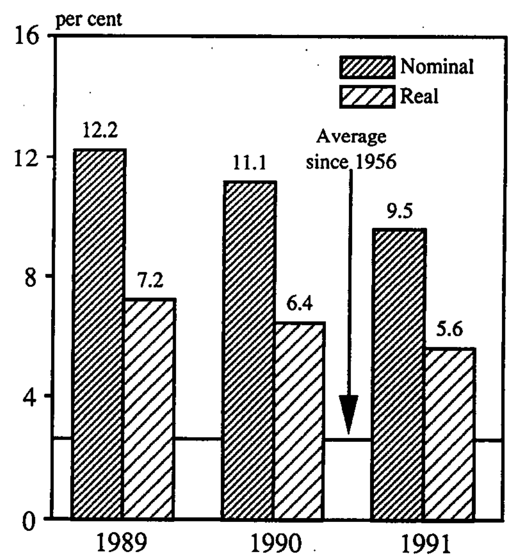


Chart 13b

90-Day Commercial Paper Rates Nominal and Real*



* Nominal rate minus CPI inflation. In 1991, the one-time effect of the GST is excluded.

Scope for Interest Rate Declines Will Increase

The slowing in growth, easing in inflation pressures, and fiscal action of this budget will create the conditions for a decline in both nominal and real interest rates in 1990 and 1991, the decline in nominal rates being the more pronounced. In 1990, short-term interest rates are forecast to average 11.1 per cent compared with the average level of 12.2 per cent that prevailed last year. With reduced inflation pressures and a lower federal deficit, short-term rates are expected to fall further in 1991, averaging 9.5 per cent for the year. Real interest rates will average about 6 per cent this year and next.

More significant declines are projected for short-term than long-term interest rates; and the yield curve is forecast to return to a normal upward slope by early 1991. The short-term interest differential between Canada and the United States, which rose to over 400 basis points early this year, is substantially above its average of 156 basis points in the 1980s, and is expected to narrow over the next two years, reaching its average 1980s spread by the end of 1991. While the differential will narrow substantially over this period, there may at times continue to be volatility in financial markets. The projected narrowing of the differential is consistent with reductions in inflation pressures in Canada, and a lower federal deficit.

Short-Term Transition Effects From the GST

The replacement of the existing federal sales tax by the GST is expected to raise the level of Canada's potential output by 1.4 per cent in the long run. Tax distortions to Canada's competitive position will be removed and the cost of capital will be lowered; both net exports and investment will be stimulated. Real incomes and consumption will decline somewhat initially, but will rise over time.

Overall economic performance will improve beginning in 1991 as the economy moves toward the long-run gains. Output will be raised 0.2 per cent in 1991. By 1994, one-half of the estimated long-run output gain will be realized; output will be up 0.7 per cent, equivalent to $4½ billion in today's dollars. Output gains over the transition period will be led by net exports and investment. As output expands, employment rises and, by 1992, 60,000 new jobs will have been created.

Sales tax reform may affect the timing of certain purchases by households and businesses just prior to and after implementation of the GST in January 1991. Households may shift forward purchases of items not previously directly taxed such as clothing, footwear and most services. In the case of services, households' ability to shift the timing of purchases is limited. For houses, there will be little incentive to change the timing of purchases because, with the rebate system, the typical new house price will rise by less than 1 per cent in most cities. The tax burden on many other items, such as most consumer durables and capital goods will decline. Their prices should be lower under sales tax reform, hence creating an incentive to delay purchases that might have been made in 1990. However, here too, there are mitigating factors. For example, a corporation would defer one-half year's capital consumption allowance by postponing an investment purchase from December 1990 to January 1991. As well, the high import content of consumer durables and capital goods suggests that the impact on total output of any change in final domestic demand will be partially offset by changes in net exports. Overall, the effect on total output during implementation will be muted by the offsetting nature of the shifting in various expenditure categories.

Canadian Private Sector Short-Term Forecasts

The Department of Finance regularly conducts surveys of Canadian private sector forecasts.(1) Chart 14 compares the Finance forecast with the "consensus", or average, of private sector forecasts from the most recent survey, conducted in January 1990, for four key economic indicators.(2) The views of private sector forecasters for 1990 are close to the Department's. Their outlook for 1991 differs from the Department's mainly because of different assumptions about the response of business and labour to the GST's one-time impact on prices.

Slow Growth Expected in 1990

The survey indicates a consensus that 1990 will see weak growth, concentrated in the first half of the year. Few private sector forecasters expect a recession (two consecutive quarters of falling output), although several expect output to fall either in the final quarter of 1989 or the first quarter of 1990. There is general agreement that growth will rebound strongly in the second half of the year.

For 1990 as a whole, the consensus is for growth to slow to 1.2 per cent, roughly the same as the Finance forecast. The individual forecasts, however, range from 0.2 to 2 per cent. The consensus is for pressures in labour markets to ease, the unemployment rate increasing to 8.1 per cent, and inflation declining to 4.6 per cent. Both projections are virtually identical to the Finance forecast. Interest rates are expected to decline with inflation, the consensus expecting slightly greater declines than Finance.

Strength of Recovery in 1991 Depends on Inflation Progress

In the private sector consensus, real growth is expected to strengthen in 1991. Forecasters recognize that reducing inflation is the key to getting interest rates down further in 1991.

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(1) The Department of Finance surveys a sample of 16 to 18 private sector forecasters each quarter. The record of forecast accuracy of private sector and Finance forecasts is set out in the *Quarterly Economic Review*, Finance Canada, December 1989. In most respects, the Finance forecasts since 1985 have been similar to the consensus of private sector views but marginally more accurate.

(2) The averages and ranges from the survey conducted in January 1990 are presented here. All of the forecasts are on a pre-budget basis. They do incorporate estimates of the impact of the proposed 7-per-cent GST in 1991, although some of the estimates are preliminary. The survey included 16 private sector forecasts for 1990 and 13 for 1991.

Chart 14
Private Sector Short-Term Forecast Views

Chart 14a
Comparison With Private Sector Forecasts for 1990

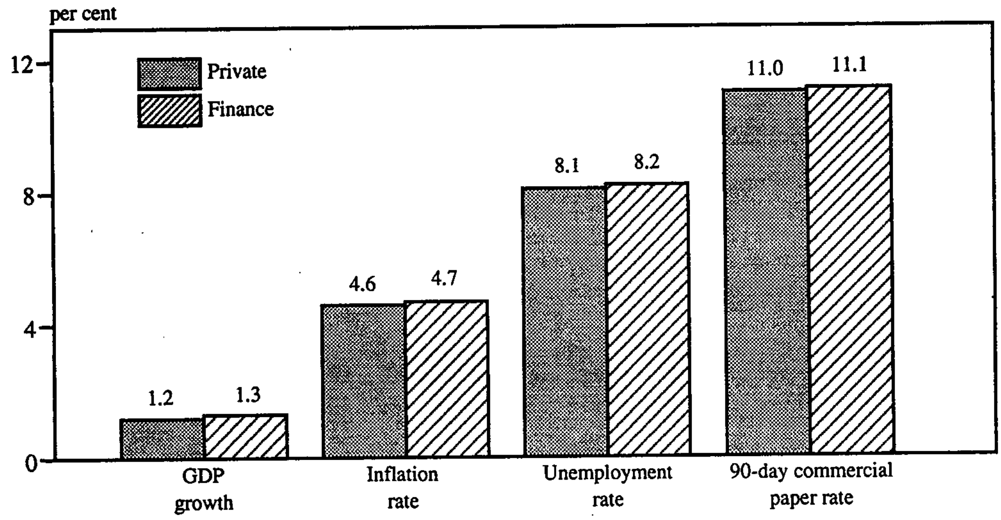
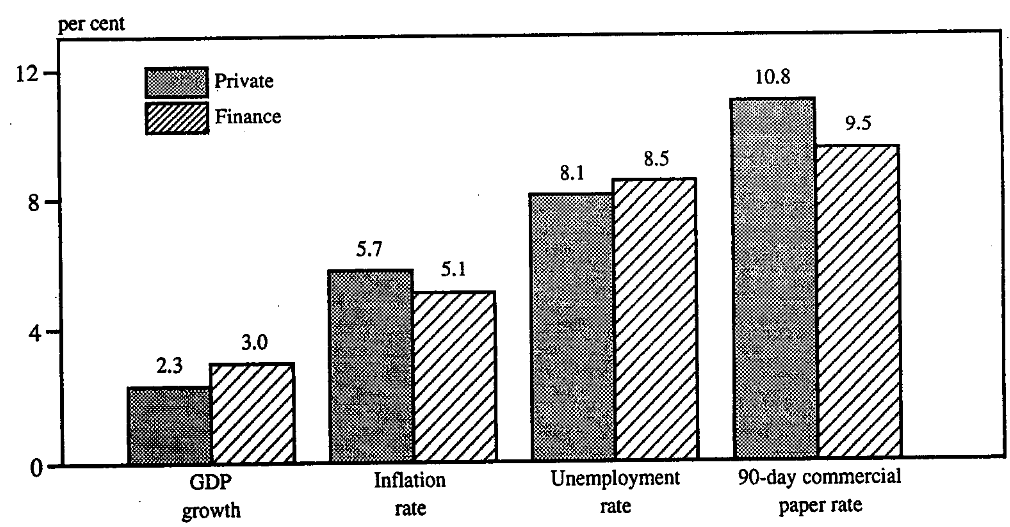


Chart 14b
Comparison With Private Sector Forecasts for 1991



Forecasters who assume that firms pass on the savings from the elimination of the federal sales tax to final prices, and that there will be no pass-through into wages of the one-time increase in prices, expect much lower inflation and interest rates and stronger growth than those who assume the reverse. Short-term interest rates are on average generally expected by forecasters to remain little changed in 1991 from 1990. The unemployment rate is not projected to decline. The range of forecasts for the unemployment rate is 7.4 to 8.7 per cent, basically unchanged from 1990.

Medium-Term Economic Prospects, 1992-1995

Appropriate adjustments must take place in the Canadian economy to ensure that it performs strongly over the medium term. On the supply side, the government has proposed or already adopted a number of measures that will increase the economy's potential to satisfy a higher level of domestic and external demand for Canadian goods and services. The immediate challenge is demand management. It must ensure that the gains from enhanced potential output are not lost in a resurgence of inflation and undue reliance on foreign savings.

The budget measures will help meet the challenge. They will create the appropriate environment to attain sustained, strong economic growth over the medium term. The budget measures put the fiscal deficit on a firm and steady downward track. Inflation pressures will decline, but the pace of decline will depend on how quickly firms and employees respond to the changed economic environment. A sound fiscal position and continued progress in reducing inflation will permit further declines in interest rates, a condition for achieving further fiscal progress and sustained economic growth over the medium term. A reduction in the government sector deficit directly frees up domestic savings to finance domestic investment, cuts the country's reliance on foreign savings, and diminishes its net indebtedness as a proportion of GDP.

Canada's Potential Growth Has Been Raised

Structural initiatives and policies introduced by this government will enhance the economy's ability to meet the growing demand for Canadian goods and services:

- The Free Trade Agreement has opened new opportunities for Canadian firms by providing them with access to the large U.S. market. The stock of capital will be raised and productivity enhanced from larger production runs and a better allocation of resources. Analytical studies conducted by the Department, and broadly supported by work of research organizations, estimate that, once the agreement is fully implemented and the economy has adapted to it, real GDP will be 3.5 per cent higher than it would otherwise have been.

- The deregulation of the energy and transportation sectors will increase economic efficiency and productivity by reducing government interference in economic decision-making and encouraging entrepreneurship, innovation, and competition.

- Income tax reform has reduced distortions in the tax system by removing or reducing many tax incentives and reducing tax rates. This will increase the incentive to work, save and invest, thereby raising potential output. Investment decisions are now based more firmly on economic considerations and less on tax advantages. It is estimated that the labour force will increase 0.5 per cent due to the personal income tax measures, and total productivity 0.3 per cent due to the corporate tax changes.

- The new Labour Market Development Strategy will upgrade the skills and increase the flexibility of the work force. This will raise the effective supply of labour and increase potential output.

- The proposed replacement of the federal sales tax with the GST in 1991 will further enhance the economy's ability to produce goods and services to meet demand at home and abroad. The GST will remove both the penalties to exporting and investing, and the bias against domestic producers in favour of importers inherent in the antiquated federal sales tax. Resource allocation will improve when relative price distortions inherent in the federal sales tax, with its narrow base and multiple rates, are significantly reduced. Analytic studies indicate sales tax reform will raise real GDP by 1.4 per cent once its impact is fully felt.

In the mid-1980s, it was widely expected that Canada's potential growth would be stuck at 2¾ per cent.[3] Indeed, there was concern that the rate of potential growth would decline owing to slowing population growth, an ageing population, weak productivity, and weak investment growth. The government's structural initiatives since 1984 address many of these concerns. Canada's potential growth rate for the first half of the 1990s has been boosted to between 3¼ and 3½ per cent (Chart 15). This will mean higher incomes and a higher standard of living for Canadians. For example, for every five years that the rate of potential growth is raised ½ percentage point per annum, the level of potential output is raised 2½ per cent. This higher level of output is equivalent to a $625 increase in real income in today's dollars for each Canadian, or $2,500 for a household of four.

The sources of this increased potential growth from the labour force, from the capital stock and from total factor productivity are set out in Chart 15. Reform of the personal income tax system, the Labour Market Development Strategy, and higher net immigration will raise the growth of the effective labour supply: labour's contribution to potential output growth will be higher than in the early 1980s. Owing to incentives to invest arising from the Free Trade Agreement and the proposed replacement of the federal sales tax with the Goods and Services Tax, growth of the capital stock will contribute substantially to an expansion in potential output.

The Free Trade Agreement will increase investment spending as firms expand plant and equipment to take advantage of the opportunities provided by secure

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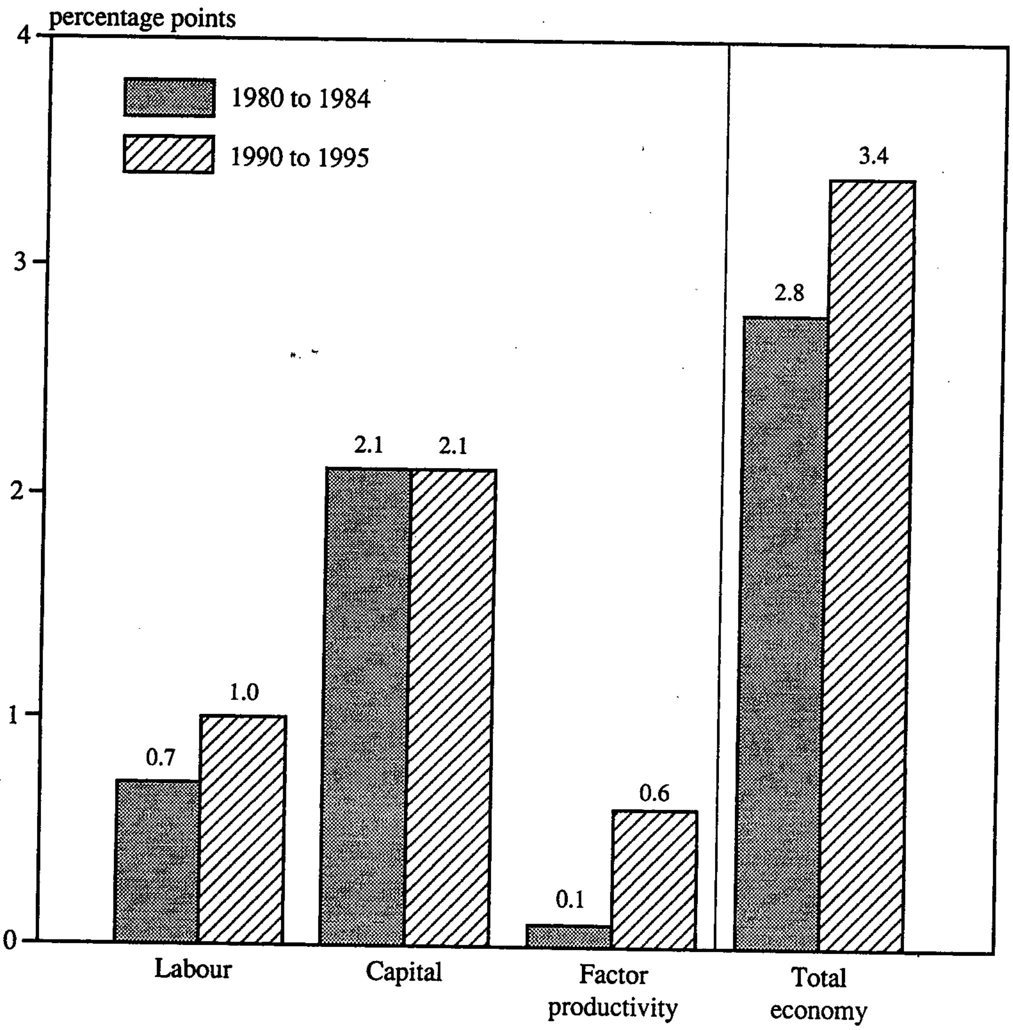
(3) For example, see *World Economic Outlook*, IMF, August 1987. Potential growth for the period 1989 to 1995 was estimated to be 2.7 per cent (page 24).

access to the large U.S. market. Analytical work done in the Department of Finance estimates that investment spending will be raised by 6 per cent by 1994. The proposed replacement of the federal sales tax by the Goods and Services Tax will raise investment by directly lowering the prices of capital goods an average of 4 per cent. Investment is estimated to be raised an additional 4 per cent by 1994.

Total factor productivity growth in Canada has been very weak since the late 1970s. In the absence of economic reforms since 1984, there would likely be no productivity growth during the first half of the 1990s. The structural initiatives introduced since 1984 have changed this outlook. The Free Trade Agreement, corporate income tax reform and the proposed sales tax reform will combine to

Chart 15

Sources of Potential Output Growth*



*The labour, capital, and factor productivity contributions are for the commercial sector of the economy. Potential growth for the total economy is slightly lower than that for the commercial sector because the non-commercial sector is growing less rapidly.

raise total factor productivity growth 0.5 percentage points per year as the economy adjusts to the higher level of potential output they will generate. The Free Trade Agreement is estimated to increase productivity growth almost 0.3 percentage points per year. Corporate income tax reform is raising productivity growth almost 0.05 percentage points per year. The proposed 7-per-cent GST is estimated to raise total factor productivity growth 0.15 percentage points per year.

The Economy Will Become Better Balanced

By the end of 1991, many of the imbalances now facing Canada will be diminishing. Inflation pressures in both product and labour markets are projected to wane. The federal government has restructured expenditures and revenues to ensure significant declines in the deficit. Final domestic demand growth is expected to slow enough to permit the trade balance to improve significantly. Interest rates, both nominal and real, are expected to fall.

Over the medium term, further progress will be made in remedying the imbalances. The total government balance on a national accounts basis is projected to be in surplus by the end of the forecast period, permitting a substantial decline in our reliance on foreign savings.

Table 4 summarizes the medium-term projection for 1992-95 based on the policy measures taken. Although output growth will be strong from 1992 onwards, averaging 3.5 per cent, it will be virtually matched by potential output growth.

Table 4

Medium-Term Economic Outlook:
Selected Economic Indicators, 1989 to 1995

	1989	1990	1991	Average 1992-95
	(per cent change unless otherwise specified)			
Real GDP	2.6	1.3	3.0	3.5
Employment	2.0	0.8	1.2	2.2
Unemployment rate	7.5	8.2	8.5	7.6
Inflation (CPI)	5.0	4.7	5.1	3.0
90-day commercial paper (per cent)	12.2	11.1	9.5	7.2
Real 90-day commercial paper rate[1] (per cent)	7.2	6.4	5.6	4.2

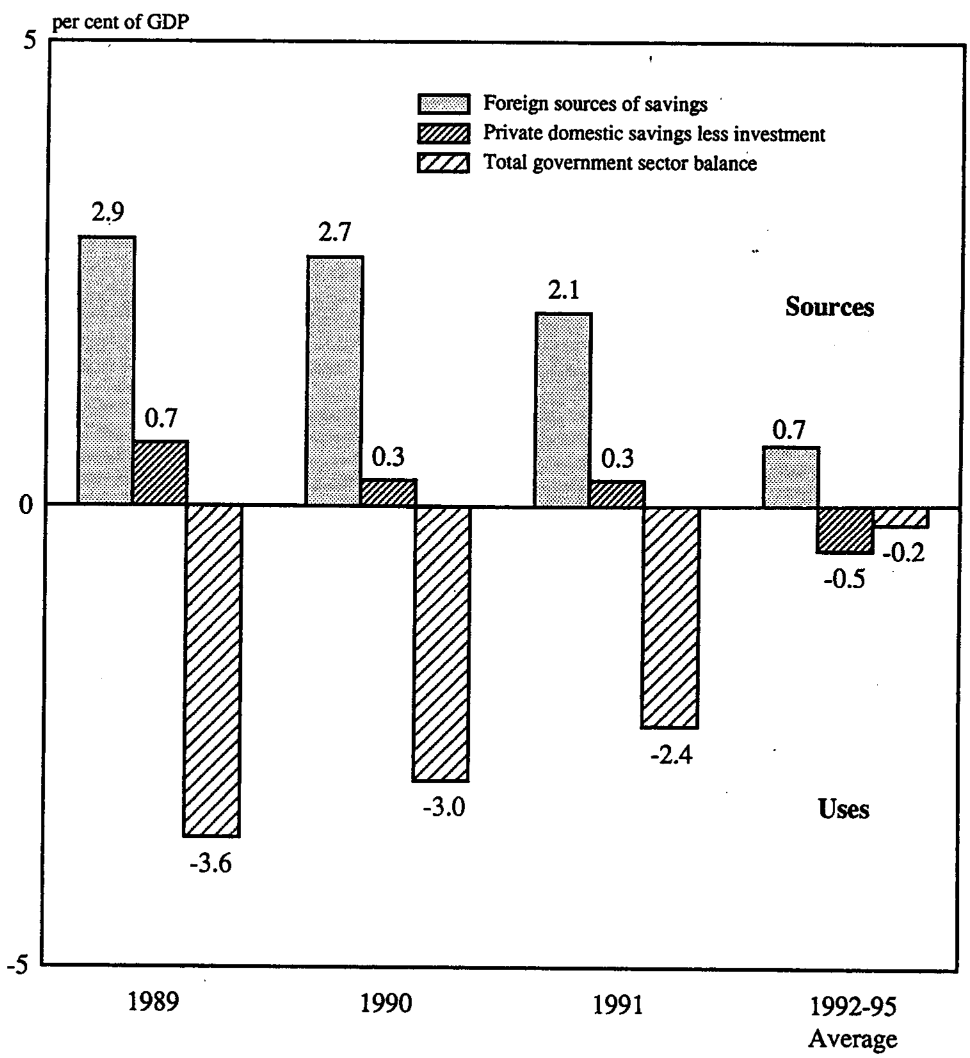
[1] Excludes the one-time effect of the 7-per-cent GST which is estimated to add somewhat less than 1¼ per cent to inflation in 1991.

The easing of inflation pressures will continue and inflation will fall to an average of 3.0 per cent. With inflation and the fiscal deficit falling, interest rates are expected to fall further in both nominal and real terms. From the 1989 high level of 7.2 per cent, real short-term interest rates are expected to decline steadily and average 4.2 per cent in the medium term. This real rate is well below the average of the 1980s, although still well above historical norms. Since the mid-1950s, real short-term rates have averaged 2.6 per cent.

The lower fiscal deficit will help restrain growth in final domestic demand, which will average well below the economy-wide growth rate. Canada's competitive position will be improved by lower inflation. An improvement in net exports will lead growth. The current account deficit is projected to decline from 2.9 per cent of GDP now to an average 0.7 per cent over the medium term (Chart 16). The unemployment rate is also projected to decline in the medium term.

Chart 16

Sources and Uses of Savings



3. Expenditure Control Plan

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Overview

Since 1984, restraining growth in program spending has been the cornerstone of the government's approach to reducing the deficit. To date, substantial progress has been achieved. This has been brought about through the elimination and modification of many programs, and through a more disciplined approach to the management of government operations and finances.

Government spending consists of two main parts – programs to meet the policy objectives of the government and interest payments on the public debt. In the 15 years prior to 1984-85, program spending had been rising at an average annual rate of 13.9 per cent, or nearly 6 per cent in real terms. From 1984-85 to 1989-90, program spending growth has been held to 3.6 per cent on average, well below the average inflation rate of 4.3 per cent and less than half the rate of growth of the Canadian economy. As a result, federal program spending, which amounted to 19.5 per cent of all the goods and services produced in Canada in 1984-85, fell to 16 per cent of GDP by 1989-90. This 3.5 percentage point decline in program spending as a proportion of GDP has been the main factor in reducing the deficit from its peak of 8.6 per cent of GDP in 1984-85 to 4.7 per cent in 1989-90.

Spending restraint has affected all aspects of government. The government is spending less money this year on its operations than it did in 1984-85. Transfers to the energy sector under the National Energy Program were eliminated, and growth in transfers to the provinces and spending on defence and Official Development Assistance (ODA) have been reduced. A number of transportation subsidies (such as those to VIA rail) have been cut back while payments to Crown corporations have been restrained. Many direct subsidies to business have been eliminated or reduced. In total, if government spending as a percentage of GDP had not been reduced from its 1984-85 level of 19.5 per cent to today's level of 16.0 per cent, program spending would have been $22 billion higher in 1989-90.

While the growth of program spending has been highly constrained since 1984-85, public debt charges have grown at roughly 12 per cent per year on average. The increase in public debt charges is larger than the increase in all of program spending over this period. Public debt charges now account for 28 per cent of budgetary expenditures – almost three times the level of fifteen years ago. Soaring debt and interest payments have increased the vulnerability of the government's fiscal situation to movements in interest rates. They have also limited the extent of the government's progress in controlling total budgetary expenditures, and in reducing the deficit.

Despite the pressure on the deficit from rapidly growing interest payments, the deficit has been reduced from 8.6 per cent of GDP in 1984-85 to 4.7 per cent in 1989-90 – a 45 per cent decline. The substantial decline in program spending as a share of GDP – a drop of 3.5 percentage points since 1984-85 – has been the main factor in this reduction.

Progress towards medium-term fiscal consolidation was given added impetus with the measures in the April 1989 budget. These actions were designed to hold the deficit to $30.5 billion in 1989-90, and then generate sizeable year-over-year deficit declines thereafter.

Since the April 1989 budget, inflation has been higher than anticipated and inflation pressures have proven to be more deeply rooted than was thought. Monetary policy has remained firm, and interest rates have remained high longer than forecast. The fiscal consequence has been to put significant upward pressure on budgetary expenditures, hence on the deficit, in 1990-91 and beyond.

The current fiscal situation requires that further action be taken now to control the build-up of public debt, and to ensure that the medium-term fiscal objectives set out in the April 1989 budget are achieved. There are only two ways that such action can be taken: further reductions in program spending or additional tax increases. Neither is easy. But the deficit must continue to fall year after year to break out of the dynamics of growing debt and escalating debt service payments that have kept the government trapped on a treadmill of $30 billion deficits since 1986-87.

The Expenditure Control Plan proposed in this budget, together with the spending reductions and management initiatives announced in December 1989 by the President of the Treasury Board, will put the deficit back on a declining track. Program spending in all but a limited number of areas will be frozen or will decline over the next two years. In total, the Expenditure Control Plan will reduce the deficit by $2.8 billion in 1990-91 and by $3.3 billion in 1991-92. Together with the expenditure reductions and management initiatives announced in December 1989, this constitutes $3.0 billion in fiscal actions in 1990-91, rising to $3.8 billion in fiscal year 1991-92. Over the five years of the fiscal framework, the cumulative fiscal savings produced by the Expenditure Control Plan and the December 1989 reductions will be well over $19 billion.

In designing this Expenditure Control Plan, the government has carefully reviewed all areas of program spending. The plan will freeze or reduce large areas of government spending for the next two years. It will not permanently change the structures of most affected programs; this is a two-year Expenditure Control measure yielding substantial and ongoing fiscal savings. Not all programs will be included. Major federal direct transfers to persons – old age security payments, guaranteed income supplement, spouses' allowances, family allowances, veterans' pensions and allowances and unemployment insurance benefits – are exempt. Certain major federal transfers to provinces – Equalization and Canada Assistance Plan payments to equalization-receiving provinces – are also exempt. Further, a limited number of programs such as federal transfers to the non-equalization-receiving provinces under the Canada Assistance Plan, science and technology, native programs, Official Development Assistance, and defence will grow by 5 per cent annually over the next two fiscal years. All other program spending, which comprises 40 per cent of all government spending on programs, will be strictly controlled over the next two fiscal years and will, in aggregate, be lower in 1991-92 than today.

Control of Program Spending Since 1984

Fiscal consolidation was a basic pillar of the government's 1984 Agenda for Economic Renewal, and spending restraint is the cornerstone of that fiscal strategy. While the deficit is affected by total budgetary expenditures, the government can only directly control program expenditures. These expenditures account for just under three-quarters of total federal spending; the rest, public debt charges, now makes up about 28 per cent of budgetary expenditures. Public debt charges can only be reduced indirectly, by getting the deficit and hence debt down and by creating an environment with lower inflation which is necessary for significant and sustainable declines in interest rates.

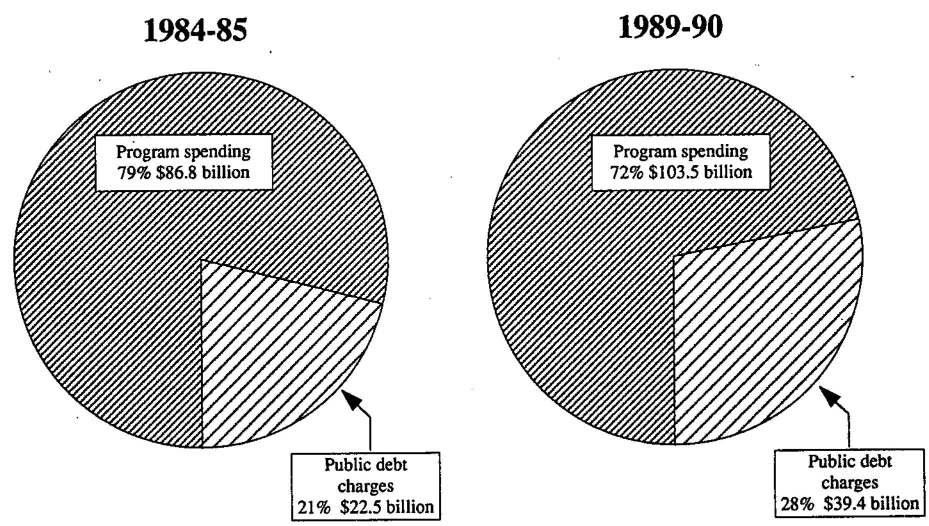
The fiscal problem in 1984-85 was characterized by a basic structural imbalance between program spending and revenue. This imbalance, and the resulting rapid rise in public debt and public debt charges, had taken over a decade to develop and could not be solved overnight. The structure of program spending itself constrained the scope for program expenditure reductions, and the time frame within which substantial expenditure reductions could be achieved. In 1984-85, program spending was $86.8 billion. Of this, as Chart 1 indicates, 29 per cent of program spending went to transfers to persons, 23 per cent to other levels of government, 20 per cent to the cost of other operations of government, 10 per cent to major subsidies and other transfers, 10 per cent to defence, 5 per cent to Crown corporations, and 2 per cent to ODA. With this structure of spending, there were no easy cuts – substantial and ongoing program reductions were required across the full range of government spending.

Over the five-year period 1984-85 to 1989-90, government spending reductions have held growth in total expenditures to an average annual rate of increase of 5.5 per cent. As shown in Table 1, slightly over half of this increase was attributable to higher public debt charges – the cost of servicing the public debt. Program spending – total spending excluding public debt charges – increased by only 3.6 per cent a year, significantly less than the 4.3 per cent average rate of inflation.

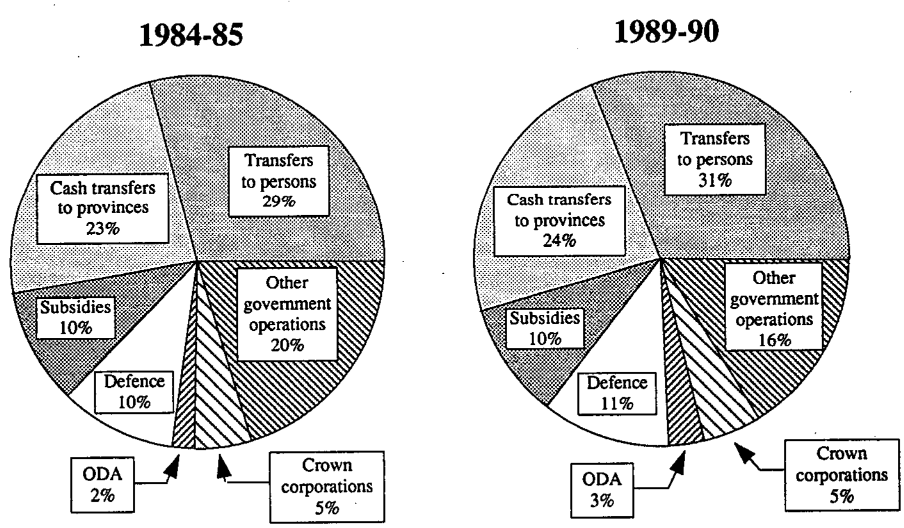
Controlling government spending was neither easy nor painless. Programs have been eliminated. Examples include the Canadian Home Insulation Program, the Canadian Oil Substitution Program, the Petroleum Incentives Program, and the Cape Breton heavy water plants, among others. Family allowances and transfers to provinces have had their growth restrained through changes to their indexation provisions. Measures to better target certain transfers to persons have been

Chart 1

The Structure of Total Government Spending



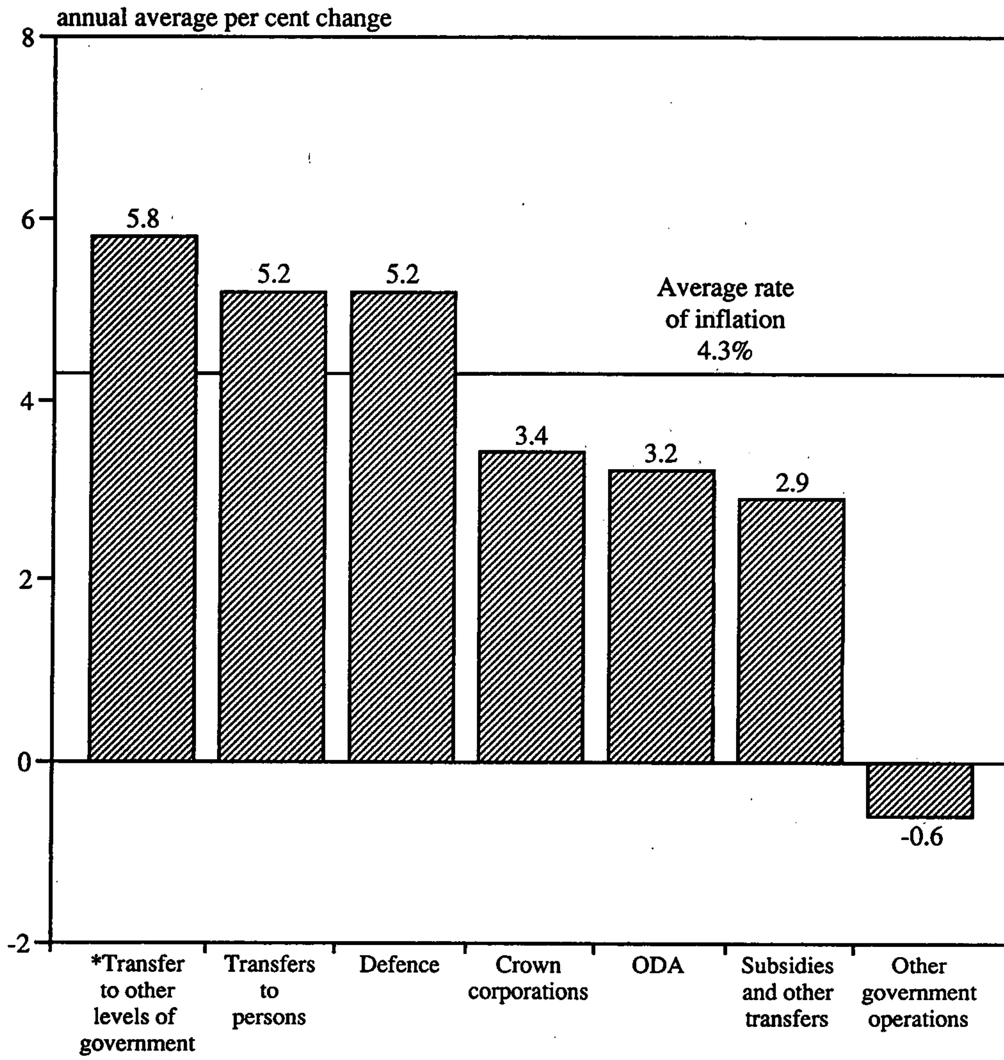
The Structure of Program Expenditures



implemented. A number of transportation subsidies have been scaled back, and payments to Crown corporations have been restrained. Many direct subsidies to business have been eliminated or reduced. The growth of defence spending and ODA has been reduced. The cost of government operations has been cut in both real and nominal terms.

Chart 2

Growth in Program Spending 1984-85 to 1989-90



* Includes cash and tax transfers.

With these actions, nearly three-quarters of the increase in program spending since 1984-85 has been accounted for by higher federal transfers to persons and growth in federal cash transfers to other levels of government. These areas of expenditure have not been immune from restraint, or adjustments, to ensure that payments are targeted primarily to those who need assistance the most. The rate of growth of federal transfers to the provinces has been reduced and changes have been made to the structure of the Old Age Security and Family Allowance programs to recover those transfers from high-income Canadians. The government has also proposed sweeping structural reforms to the unemployment insurance program.

Notwithstanding these measures, however, major federal transfers to persons – elderly benefits, unemployment insurance benefits, veterans' pensions, and family allowances – and federal cash and tax transfers to other levels of government for Equalization, Established Programs Financing, and the Canada Assistance Plan, increased well in excess of 5 per cent a year on average since 1984-85.

The federal government provides substantial financial support to provincial governments to assist them in carrying out programs for which the provinces have the primary responsibility. These payments are in addition to the programs that it delivers directly to individual Canadians. As Table 1 indicates, total transfers to provinces have risen from $25.6 billion in 1984-85 to just over $35 billion in

Table 1

Budgetary Expenditures: 1984-85 to 1989-90

	1984-85	1989-90	Absolute change	Annual average growth
	(billions of dollars)			(per cent)
Major transfers to persons	25.1	32.4	7.3	5.2
Major cash transfers to other levels of government[1]	19.7[1]	24.6[1]	4.9[1]	4.5[1]
(Cash and tax transfers to other levels of government)	(25.6)	(35.1)	(9.4)	(6.5)
Defence	8.8	11.3	2.5	5.2
Payments to major Crown corporations	4.6	5.4	0.8	3.4
Official Development Assistance	2.1	2.4	0.4	3.2
Major subsidies/other major transfers	9.1	10.5	1.4	2.9
Other government operations	17.4	16.8	−0.5	−0.6
Program spending	86.8	103.5	16.7	3.6
Public debt charges	22.5	39.4	16.9	11.9
Total budgetary expenditures	109.2	142.9	33.7	5.5

[1] Certain transfers to other levels of government are made as a combination of cash and a transfer of tax points. Program spending includes the cash transfer component, as well as adjustments to program entitlements for prior years.

1989-90. Of this amount, $24.6 billion, or about 24 per cent of federal program spending, is in the form of cash payments, and the remainder is in the form of tax transfers. Since 1984-85 these entitlements have been growing at an average annual rate of 6.5 per cent, considerably above that of average federal program spending of 3.6 per cent during the same period.

Spending on other programs has been highly restrained, with increases for most programs well below the rate of inflation. Transfers to major Crown corporations increased by slightly more than 3 per cent a year. Further, as a result of the sale of all or part of eighteen corporations and the dissolution of eight other entities, employment in Crown corporations has been reduced by 75,000. While about half of this reflects privatization, the remainder reflects rationalization and the elimination of waste and inefficiency. The financial health of many Crown corporations has substantially improved. For example, Canadian National has reduced its long-term debt from $3 1/2 billion in 1986 to $2 billion in 1989. Productivity improvements and other measures at Canada Post made the corporation profitable for the first time in 1988-89. Overall, the liabilities of Crown corporations have fallen substantially.

From 1984-85 to 1989-90, defence spending increased by about 5 per cent annually. This reflectes the commitment of the government to refurbish Canada's armed forces. In the April 1989 budget, the defence funding level was reduced by $2.7 billion between 1988-89 and 1993-94 because of the difficult fiscal environment. Spending on ODA grew by 3.2 per cent annually between 1984-85 and 1989-90. The constrained growth in ODA funding reflects, in particular, the measures introduced in the April 1989 budget which reduced ODA cash levels by $1.8 billion over the five-year period beginning in 1989-90.

As indicated in Table 2, growth in major subsidies and other major transfers has been held to less than 3 per cent a year since 1984-85. Most of the increase in major subsidies in the past five years was concentrated in three areas – assistance to the agricultural sector, transfers to natives, and regional development assistance – which accounted for almost 50 per cent of all major federal subsidy payments. The only other areas of subsidies and transfers that showed significant increases since 1984-85 were for science and technology and student loans. Subsidies for job creation and training have been held constant and the growth in transportation subsidies has been constrained. Subsidies to the energy sector have declined by $1.9 billion since 1984-85; other industrial subsidies have also been reduced.

A major focus of expenditure restraint has been the cost of other government operations – basically the cost of running the government. From 1984-85 to 1989-90, spending on this component declined in absolute terms from $17.4 billion to $16.8 billion – an absolute reduction of $0.5 billion and a cut of over 25 per cent in real terms. Since 1984-85, departmental operating budgets have been highly restrained. Person-years in the public service are now over 12,000 lower than they were in 1985-86. Federal wage settlements have been lower than those in the private sectors, and below the rate of inflation. The level of contingency reserves has been substantially cut back and capital spending has been reduced. Overall, the environment of fiscal restraint has resulted in a

Table 2

Major Subsidies and Other Major Transfers

	1984-85	1989-90	Absolute change	Annual average growth
	(billions of dollars)			(per cent)
Total	9.1	10.5	1.4	2.9
of which:				
Agriculture	0.8	1.8	1.0	16.8
Indian and Inuit	1.3	2.1	0.8	10.6
Regional development	0.3	1.1	0.8	31.5
Industrial innovation and science and technology	0.8	1.1	0.3	7.4
Student loans	0.2	0.4	0.2	14.7
Transportation	0.8	1.0	0.2	4.7
Job creation and training	1.8	1.8	–	–
Other industrial	0.3	0.2	–0.1	–9.6
Energy	2.5	0.6	–1.9	–25.3

comprehensive examination of government operating policies within departments – it has forced government departments to eliminate waste and inefficiency and introduce more careful management systems.

Overall, program spending as a proportion of GDP has dropped from 19.5 per cent in 1984-85 to 16.0 per cent in 1989-90. The last time government program spending, measured as a percentage of GDP, was at or below 16 per cent was 1970-71. Reducing the program expenditure-to-GDP ratio by 3.5 percentage points has had far-reaching fiscal consequences – if program spending as a percentage of GDP had remained at its 1984-85 level, it would be $22 billion higher than it is in 1989-90.

Despite these substantial actions to reduce program spending, deficit-reduction efforts in 1989-90 and again in 1990-91 have been made more difficult by rising public debt charges. With inflation pressures growing rapidly in mid-1988 as demand in the Canadian economy began to outstrip supply, monetary policy has remained firmly anti-inflationary. The resulting rise in interest rates over the second half of 1988 and into 1989 propelled growth in public debt charges to 18.7 per cent in 1989-90 and further growth is expected in 1990-91. Without substantial fiscal action, the deficit would rise in 1990-91 from its 1989-90 level of $30.5 billion, rather than decline as projected in the April 1989 budget.

A higher deficit, and the associated higher debt, would only lead to further upward pressure on future deficits. This dynamic of higher debt service payments, higher deficits and debt and still higher future debt service payments had to be broken. Substantial additional expenditure actions were required.

The Expenditure Control Plan

In light of these strong fiscal pressures, and the need to hold to the fiscal objectives set out in the April 1989 budget, the government instituted a wide-ranging review of all components of government program spending in late 1989. The first results of this review were announced by the President of the Treasury Board in December 1989, with expenditure reductions and management improvements yielding $1.4 billion over three years. But the review was much more wide-ranging, and led to the Expenditure Control Plan introduced with this budget.

This proposed Expenditure Control Plan produces fiscal savings of $2.8 billion in 1990-91 and $3.3 billion in 1991-92. Taken together with the spending reductions and management improvements announced by the President of the Treasury Board in December 1989, the fiscal savings total $3.0 billion in 1990-91 and $3.8 billion in 1991-92. Over the five years of the budget's fiscal framework – 1990-91 to 1994-95 – the Expenditure Control Plan and the December 1989 actions produce cumulative fiscal savings of well over $19 billion.

The Expenditure Control Plan has the following key features:

- It is a comprehensive two-year approach to expenditure control; it does not entail any permanent structural changes in major programs; it yields substantial and ongoing fiscal savings.

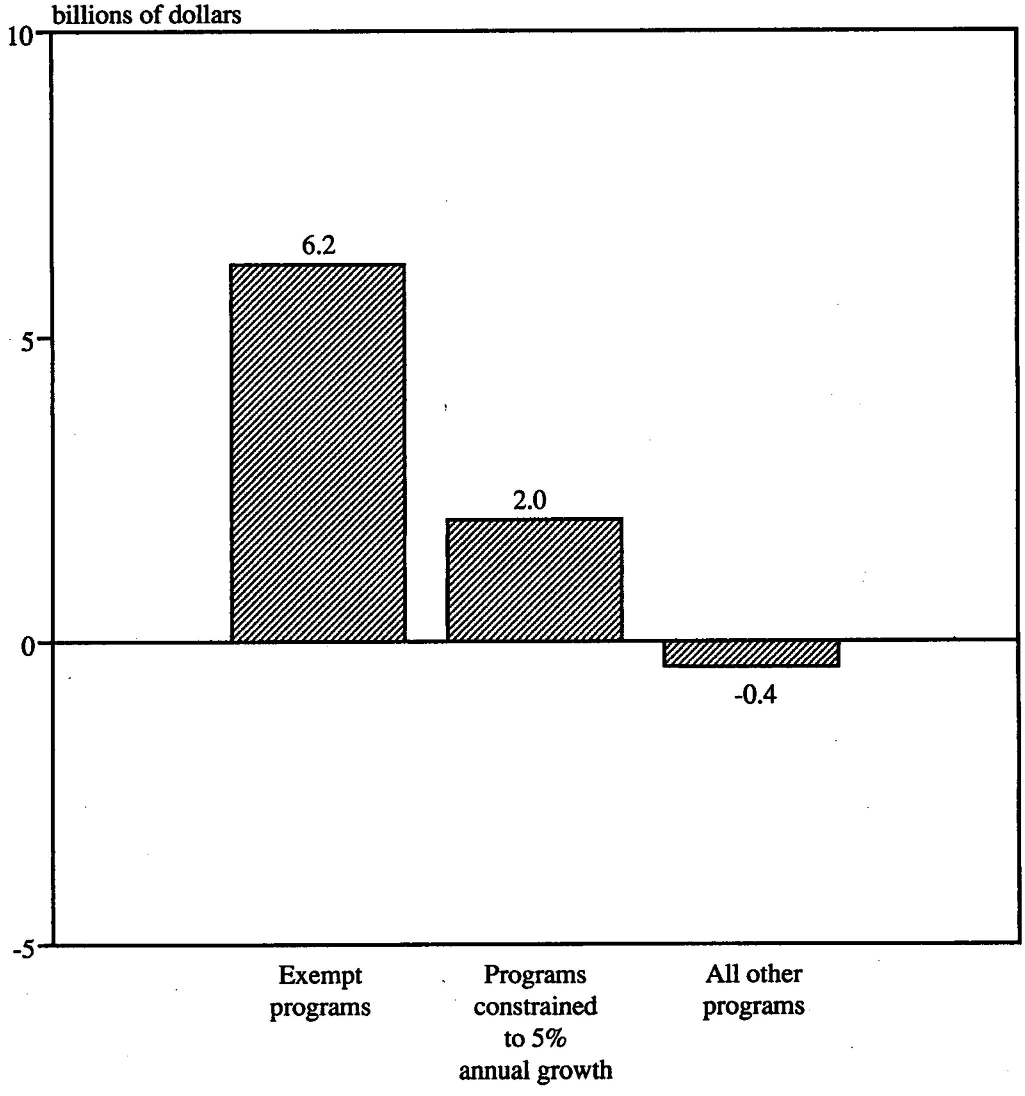
- It exempts a limited number of programs: basically, federal transfers to persons (elderly benefits, family allowances, veterans' pensions and allowances and unemployment insurance benefits) and certain major federal transfers to the provinces (Equalization and Canada Assistance Plan transfers to equalization-receiving provinces).

- It also allows spending growth of 5 per cent per year for several programs (science and technology, natives, Canada Assistance Plan transfers to the non-equalization-receiving provinces, Official Development Assistance, and defence).

- In total, it results in the remainder of government spending – about 40 per cent of all government spending on programs – being reduced relative to 1989-90 levels over the next two fiscal years.

Chart 3

The Impact of the Expenditure Control Plan on Program Spending: Changes in Spending from 1989-90 to 1991-92



A summary of the Expenditure Control Plan is presented in Table 3. Details of the specific measures are provided in the following section. The Expenditure Control Plan affects 60 per cent of government program spending. Apart from a limited number of programs that are either exempt from the Expenditure Control Plan or will grow by no more than 5 per cent, all other government program spending – about 40 per cent of total program spending – will be lower in aggregate in 1991-92 than it is this year. Over the two years of the Expenditure Control Plan, total program spending will increase at an average rate of 3.7 per cent, well below the average rate of inflation.

The plan exempts major federal transfers to persons. Such federal direct transfers to persons include old age security, the guaranteed income supplement, spouses' allowances, family allowances, veterans' pensions and allowances and unemployment insurance benefits. With respect to major transfers to the provinces, the Expenditure Control Plan exempts equalization and Canada Assistance Plan payments to equalization-receiving provinces. Canada Assistance Plan payments to non-equalization-receiving provinces will be allowed to grow by 5 per cent per annum. Established Programs Financing will be frozen in per capita terms for two years.

The Expenditure Control Plan contains measures to bring the growth of major transfers to provinces more into line with general federal program spending. These measures reflect the fact that the federal debt and deficit situation is considerably worse than that of provinces as outlined in Chapter 4 (Annex 2). The Expenditure Control Plan measures affecting major transfers to provinces are structured so as to maintain more support to the low-income provinces than to the provinces with the strongest fiscal capacity.

As a result, the three major transfers to provinces – Established Programs Financing (EPF), Equalization and the Canada Assistance Plan – are expected to grow by about 3 per cent in 1990-91, roughly the same rate as total program spending. Average growth for the three highest income provinces will be 2.3 per cent in 1990-91; average growth for the equalization-receiving provinces will be higher, with 4 per cent average growth for the four Atlantic provinces. The three major transfer programs are expected to reach more than $34 billion by 1991-92, an increase of $1.9 billion over 1989-90 (Chart 4).

A number of other programs were expected to increase at varying rates of growth over each of the next two fiscal years. Under the Expenditure Control Plan, funding for the Public Utilities Income Tax Transfers, the capital budget of the Canadian Broadcasting Corporation, the Canadian Film Development Corporation, the Export Development Corporation and Marine Atlantic are frozen for the next two fiscal years. Grants and contributions administered by the Departments of the Secretary of State, Multiculturalism and Citizenship Canada and National Health and Welfare will be reduced. Program spending under the Small Craft Harbours program will also be reduced as will Canada Mortgage and Housing funding for new social housing. The OSLO and the Polar 8 icebreaker projects are being cancelled and the Canadian Exploration Incentive Program will be terminated.

In addition, a number of management measures are being introduced that affect the operations of government.

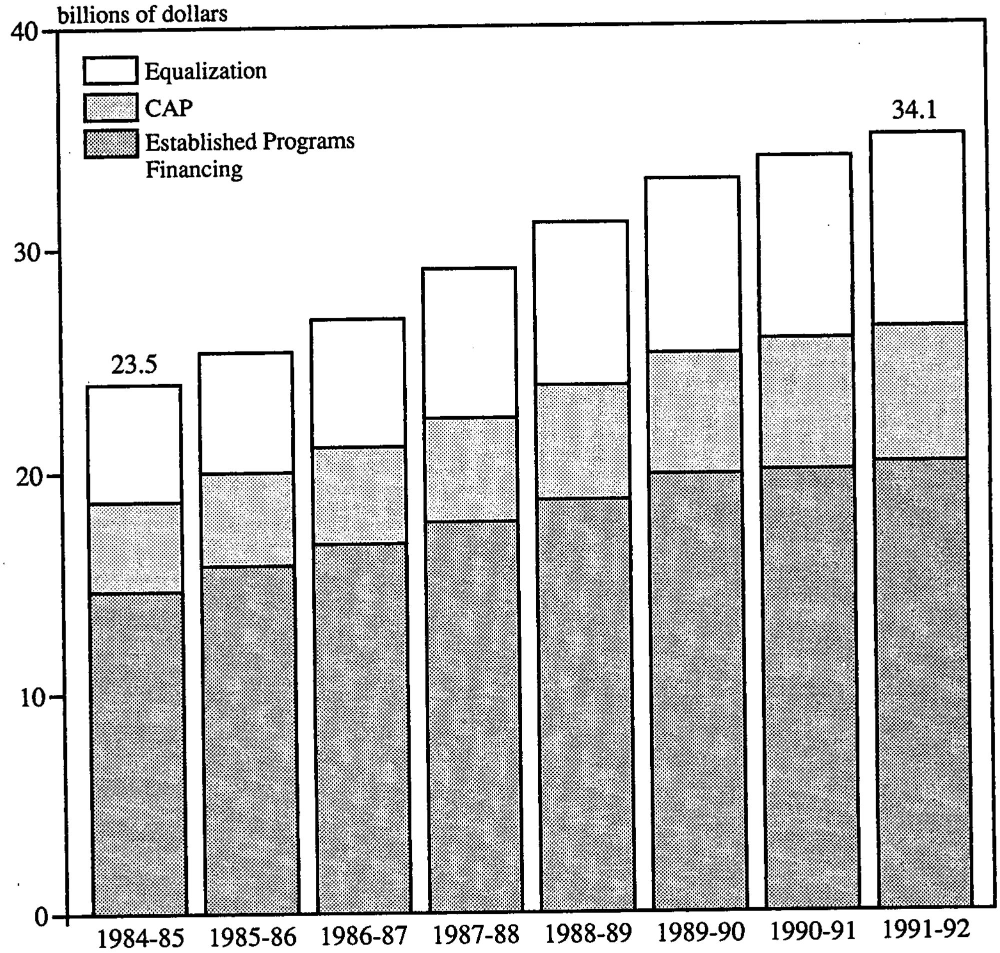
- In December 1989, the President of the Treasury Board announced the extension of the 2-per-cent growth limit on non-salary operations and maintenance spending to 1992-93. This limit is now extended to 1994-95.

- In 1984, Petro-Canada was mandated to operate as a commercial corporation in a competitive private sector environment. Petro-Canada has operated successfully in this environment. Its role as an instrument of public policy is

Chart 4

The Three Major Federal Transfers* to the Provinces

1984-85 to 1991-92



* Entitlements basis – including cash and tax transfers.

becoming increasingly limited due to changes in the world energy environment and the nature of the industry. In addition, the expansion plans of Petro-Canada depend on having access to the full range of financing opportunities available to shareholder-owned corporations in the private sector.

Following consultations with senior management of the corporation, the government has decided that the time has come to allow direct public ownership of Petro-Canada. Legislation setting out the framework for divestiture of the government's holding of Petro-Canada will be presented to Parliament later this year.

- The government will begin actions to sell its shares in Telesat Canada and will proceed with the sale of Nordion International and Theratronics International Ltd. This continues the government's policy of privatizing Crown corporations that it feels are no longer required to fulfil a public policy purpose. This will bring to 22 the number of corporations that have been privatized since the fall of 1984.

- In addition, Crown corporations with profitable operations will be required to pay increased dividends to the government, and surplus cash in the hands of some Crown corporations will be turned over to the government. A number of corporations and agencies will also be wound up and their functions transferred to other organizations. These include Canadian Patents and Development Ltd., Canada Harbour Place Corporation and the Canadian Livestock Feed Board. In addition, the government will not be establishing a Postal Services Review Board, and will wind up the interim Postal Services Review Committee.

- The Department of National Revenue, Taxation will continue to undertake measures to improve the collection of revenues owed to the government. The Bank of Canada will accelerate the remittance of its net earnings to the federal government.

- Beginning in 1990-91, the federal government will be adopting a policy that, with limited exceptions, will eliminate grants to business. Federal financial contributions providing assistance to business will be repayable on more rigorous terms, rather than being straight grants or subsidies.

The government will continue to exercise wage restraint in federal contract settlements. The government recognizes, within a framework of fair collective bargaining, its responsibilities to the taxpayer to keep settlements in line with those in the private sector and its obligation to play a leading role in reducing inflation.

Table 4 illustrates the impact on government spending of the Expenditure Control Plan. Total budgetary expenditures are expected to increase by $4.9 billion between 1989-90 and 1990-91. Of this increase, $1.8 billion relates to the increase in public debt charges. Program spending is expected to increase by $3.1 billion. Most of the increase in program spending relates to higher spending on transfers to persons and certain transfers to provinces (Equalization and the Canada Assistance Plan contributions). At an aggregate level, the programs allowed to grow at 5 per cent will increase by $1.0 billion in 1990-91. All other program spending will decline by $800 million.

Over the two fiscal years, 1990-91 and 1991-92, total budgetary expenditures are expected to increase by $9.8 billion. Public debt charges account for 20 per cent of this increase. Most of the increase in program spending is again due to higher spending in transfers to persons and transfers to provinces. All other program spending – that is, total program spending minus those programs that are either exempt or constrained to 5-per-cent per year growth – will be $400 million lower in aggregate in 1991-92 than in 1989-90.

Table 3

Expenditure Reductions and Management Initiatives – December 1989 and February 1990

	1990-91	1991-92	Five-year savings
	(millions of dollars)		
A. Expenditure control plan			
1. **Key exempt programs**			
• Major transfers to persons: old age security, guaranteed income supplement, spouses' allowances, family allowances, veterans' pensions and allowances and unemployment insurance benefits.			
• Major transfers to provinces: equalization and Canada Assistance Plan for the equalization-receiving provinces.			
2. **Programs constrained to 5% annual growth for two years**			
• Science and technology	38	1	39
• Indian and Inuit Programs	50	50	100
• Canada Assistance Plan (non-equalization-receiving provinces)	75	80	155
• Defence	210	270	658
• Official Development Assistance	116	190	558
3. **Programs frozen for two years**			
• Established Programs Financing (per capita)	869	1,541	7,364
• Public utilities income tax transfers	16	34	50
• Canadian Broadcasting Corporation	5	15	20
• Telefilm Canada	6	7	13
• Export Development Corporation	25	50	100
• Marine Atlantic	4	5	24
4. **Programs reduced**			
• Grants and contributions			
– Secretary of State	23	23	113
– National Health and Welfare	12	12	44
• Small craft harbours	4	5	29
• Canada Mortgage and Housing Corporation	16	35	165
5. **Programs/projects eliminated**			
• Canadian Exploration Incentives Program	50	125	811
• OSLO		46	602
• Polar 8	84	62	373
6. **Management measures**			
• Crown corporations and agencies	401	125	679
• Management initiatives			
– Enhanced collection of accounts receivable	167	230	1,237
– Acceleration of Bank of Canada remittances	400	–	400
– Management efficiencies	12	24	556
7. **Associated public debt charge savings**	200	400	2,600
8. **Total expenditure control plan fiscal savings**	2,782	3,329	16,689
B. December 1989 expenditure reductions and management improvements	246	450	2,806
C. Total fiscal impact of measures	3,028	3,779	19,495

(1) Figures may not add due to rounding.

Table 4

Expenditure Control Plan:
Impact of Restraint on Federal Spending, 1990-91 and 1991-92

	1989-90 spending levels	One-year spending increase to 1990-91		Two-year spending increase to 1991-92	
	(billions of dollars)	(billions of dollars)	(%)	(billions of dollars)	(%)
1. Expenditures	142.9	4.9	3.4	9.8	3.4
2. Public debt charges	39.4	1.8	4.4	2.1	2.6
3. Program spending	103.5	3.1	3.0	7.7	3.7
of which:					
– Exempt programs	42.3	3.0	7.0	6.2	7.0
– Programs constrained to 5% per year growth	19.5	1.0	5.0	2.0	5.0
– All other program spending	41.7	−0.8	−1.9	−0.4	−0.5

Details of the Expenditure Control Plan

These measures result in a saving of $2.8 billion in 1990-91 and $3.3 billion in 1991-92. Including the December 1989 expenditure reductions and management initiatives, total savings amount to $3.0 billion in 1990-91 and $3.8 billion in 1991-92. Over the 1990-91 to 1994-95 period, the cumulative fiscal savings total well over $19 billion.

A. Programs Constrained to 5-Per-Cent Annual Growth for Two Years

Science and Technology

Total funding for science and technology grants and contributions associated with the National Research Council, Canada's space program, the Defence Industry Productivity Program and new industrial science and technology programs such as Sector Campaigns and Strategic Technologies, the Canada Scholarships Program, and the Centres of Excellence will grow by 5 per cent.

Available funding for these grants and contributions programs, estimated at $511 million in 1990-91 and $536 million in 1991-92, will remain sufficient to permit Canada Scholarships and Centres of Excellence program funding to grow as previously planned. Grants and contributions under the Space program, the

National Research Council and the Defence Industry Productivity Program will remain unchanged from previously established levels. Thus, this restraint measure will impact on the other new industrial, science and technology programs, resulting in their full implementation being stretched out over a longer period than originally planned and in fiscal savings of $39 million over the next two years. The Granting Councils, which provide support to university research, and the government's other activities in the science and technology area, are not affected by this measure.

Indian and Inuit Programs

The government provides a wide range of programs and services to status Indian and Inuit peoples including expenditures for health, education, welfare, land claims, housing, public works, band management, and economic development. Spending by the Department of Indian Affairs and Northern Development in this area has grown substantially from $1.4 billion in the 1984-85 Main Estimates to $2.3 billion in 1989-90.

Expenditures on health, education, social assistance and comprehensive claim programs will not be constrained. Other grants and contributions in the Indian and Inuit Affairs Program, however, will be limited to annual growth in the range of 5 per cent in 1990-91 and 1991-92. Constraint will save about $50 million a year, relative to the estimated growth in spending that would otherwise have occurred.

Canada Assistance Plan

Under the Canada Assistance Plan (CAP), the federal government provides funds to provincial and territorial governments to help them pay for social assistance benefits and services.

These transfers, which are based on 50/50 cost-sharing of eligible provincial spending, have grown at an average annual rate of about 6.7 per cent over the past five years. The federal contribution, in the form of cash and transfer of tax points, has increased from $4 billion to $5.5 billion. The average rate of growth in each province has varied: from 2 to 3 per cent in Saskatchewan, British Columbia and Quebec, to about 14 per cent in Ontario.

For the next two years, growth in CAP transfers will be limited to 5 per cent a year in the fiscally stronger provinces: Ontario, British Columbia and Alberta. Other provinces – those receiving federal equalization payments – will be exempt from this ceiling on growth. They will continue to have open-ended access to federal dollars to meet any growth in expenditures eligible for cost-sharing under CAP. Implementation of this measure will provide for resumption of the present regime on April 1, 1992.

Based on projections, this measure is expected to contribute $155 million to expenditure restraint over the next two fiscal years. The actual savings will, of course, depend upon actual growth rates in the provinces affected by the 5 per cent ceiling.

Defence

Defence spending has increased more than 5 per cent annually since 1984, reflecting the high priority that the government has accorded to refurbishing Canada's defence capabilities. While defence remains a high priority, spending growth will be constrained in the next two years because of the fiscal situation.

Growth in defence expenditures will be limited to 5 per cent a year resulting in savings of $210 million in 1990-91 and $270 million in 1991-92 from planned expenditure levels. Total savings for the period 1990-91 to 1994-95 are $658 million. This includes the saving from cancellation of the Polar 8 Icebreaker project, to which Defence was to have contributed $178 million. These reductions are in addition to those announced in the April 1989 budget of $2.7 billion over five years. For 1990-91, the reference level (including statutory payments and excluding transactions internal to the government) is set at $11.9 billion.

Official Development Assistance

Between 1984-85 and 1988-89 Official Development Assistance (ODA) cash levels grew an average of 7.4 per cent annually, compared with 3.5 per cent for all government spending, making it one of the fastest growing government programs. In last year's budget, ODA cash levels were reduced by $360 million per year for both 1989-90 and 1990-91. The ODA program will grow in the new fiscal year, but will be constrained to a 5 per cent annual cash increase in 1990-91 and 1991-92. This will contribute $116 million in 1990-91 and $190 million in 1991-92 to deficit reduction, and $558 million over five years. Budgetary expenditures on ODA in 1990-91 will be $2,565 million.

The principle of formula funding of ODA as a percentage of GNP will be maintained. The ODA-to-GNP ratio, which is affected by both the levels of cash and non-cash ODA, is expected to increase in each year of the fiscal framework. The ratio of developmental assistance to GNP will reach 0.47 per cent by fiscal year 1994-95, as established in the April 1989 budget.

B. Programs Frozen for Two Years

Established Programs Financing

Under Established Programs Financing (EPF), the federal government provides equal per capita financial assistance to all provinces through the transfer of tax points and cash payments. Historically, these transfers were undertaken to assist provinces to carry out their responsibilities in respect of health care and post-secondary education. Since 1977, provinces have been able to use these transfers according to their particular priorities, rather than in the more restricted fashion required by the previous cost-sharing arrangements. EPF transfers are the largest single form of federal assistance to provinces, and have grown from $14.5 billion in 1984-85 to about $20 billion in 1989-90, an average annual growth rate of more than 6 per cent.

In addition to Established Programs Financing, the federal government also provides substantial additional assistance to the lower income provinces to help them provide public services including health care and post-secondary education through the equalization program. Equalization transfers have grown strongly in recent years, from over $5 billion in 1984-85 to close to $8 billion in 1989-90. For example, they now exceed EPF as the largest form of federal support in the Atlantic provinces.

For 1990-91 and 1991-92, the per capita EPF transfer will be held to the 1989-90 level. This means it will grow with the population increase of each province, or about 1 per cent nationally. Federal cash expenditures will be reduced by about $870 million in 1990-91 and $1,540 million in 1991-92. In 1992-93, EPF growth will resume at the rate of growth of GNP less three percentage points, consistent with the announcement in the April 1989 budget. The growth of the total EPF transfer, beginning 1992-93, will not fall below the rate of inflation.

This change to EPF represents less than 1.0 per cent of total provincial revenues in 1990-91 and just over 1.0 per cent in 1991-92.

Equalization transfers to the lower-income provinces are not affected by the budget. They are expected to increase about 6 to 7 per cent annually over the next two years, roughly in line with the nominal growth of the economy. EPF and equalization transfers together are expected to amount to over $27 billion in 1990-91.

Public Utilities Income Tax Transfer

The *Public Utilities Income Tax Transfer Act* provides for the transfer to the provinces of 95 per cent of the federal income tax collected from certain privately owned electric and gas utilities.

Transfers will be frozen for two years at the 1989-90 levels, reducing projected expenditures under the Act by $16 million in 1990-91 and $34 million in 1991-92.

CBC Capital Budget

The government provides about $1 billion a year to the CBC to pursue its mandate of providing a national broadcast service for all Canadians. In 1990-91, the CBC is expected to raise an additional amount of over $400 million in commercial and miscellaneous revenues.

The 1989 budget reduced CBC funding by $140 million over four years. As a further contribution to expenditure control, funds provided for purchases of capital equipment will be frozen, for the next two years, at earlier planned levels. Recently approved increases of $5 million in 1990-91 and $15 million in 1991-92 will be cancelled. The capital budget in 1990-91 will stay at about the same level as in 1989-90.

Telefilm Canada (Canadian Film Development Corporation)

Telefilm Canada assists the Canadian film and television industry to finance the production and distribution of Canadian films and television programs. Funding of Telefilm Canada is $145.6 million for 1989-90.

Payments to Telefilm Canada will be frozen at the 1989-90 level for the next two years. Savings will be $6.4 million in 1990-91 and $7.4 million in 1991-92.

Export Development Corporation

The Export Development Corporation provides insurance, loans and guarantees to support Canadian exports. In addition to its corporate activities, the Corporation administers export insurance and financing for the Canadian government to support export transactions considered to be in the national interest, but involving credit risks or interest rate concessions the Corporation would not normally undertake.

The Corporation's budgetary reference level will be frozen at its 1989-90 level of $185 million for two years. This will yield savings of $25 million in 1990-91 and $50 million in 1991-92.

Marine Atlantic

Marine Atlantic provides ferry services in Atlantic Canada. Its annual cash operating expenses are about $190 million, of which about $70 million – or 37 per cent – are recovered from users. An operating subsidy from Transport Canada funds the remainder.

Since its creation in 1979, Marine Atlantic has considerably increased the efficiency of its operations. However, further measures are necessary to improve cost recovery. Accordingly, the company's operating subsidy will be frozen at its 1989-90 level of $120 million for the next two fiscal years. This will save $4 million in 1990-91 and $5 million in 1991-92.

Legal Aid Cost-Sharing Arrangements

Under legal aid agreements, the federal government transfers funds to the provinces and territories to help them provide legal aid to individuals involved in criminal cases. Transfers in 1989-90 are expected to total about $86 million.

The existing agreements come up for review at the end of March 1990. The federal government has decided to maintain its contribution at the 1989-90 level for two years.

C. Programs Reduced

Secretary of State and Multiculturalism and Citizenship

The Departments of the Secretary of State and Multiculturalism and Citizenship Canada have grants and contributions budgets to assist groups and organizations active in the areas of citizenship development and multiculturalism.

These budgets will be reduced by $23 million annually from planned levels in 1990-91 and 1991-92. The Secretary of State and Minister of State for Multiculturalism and Citizenship will provide further information on the implementation of these reductions.

National Health and Welfare

The Department of National Health and Welfare supports organizations and projects through various grants and contributions under the health services and promotion program and the social services program.

These expenditures will be reduced by $12.2 million a year. The Minister of National Health and Welfare will provide further information on the implementation of these reductions.

Small Craft Harbours

The Small Craft Harbours program funds the development, operation, and maintenance of federally owned fishing and recreational harbours.

Expenditures under this program will be reduced to $99 million through a reduction in the scale of new projects in 1990-91. In subsequent years, the government intends to implement alternative management and operational policies for existing harbours. This will involve local management of recreational harbours that will make the operation of these facilities more responsive to the needs of users. The savings realized through these measures will be $4 million in 1990-91 and $5 million in 1991-92, and will total $29 million over five years.

Social Housing

On behalf of the federal government, Canada Mortgage and Housing Corporation provides funds to provinces and territories, under a variety of cost-sharing arrangements, to assist Canadians who have difficulty finding affordable housing. In 1989-90 federal expenditures on social housing programs total $1.7 billion and provide assistance to approximately 600,000 households. Funding for social housing has grown substantially over the last five years, from $1,123 million in the 1984-85 Main Estimates to $1,695 million in 1989-90.

Over the next two years, funding for new commitments will total $90 million in 1990-91 and $86 million in 1991-92. This will assist approximately 36,000 more households each year. This funding is 15 per cent less than planned, yielding savings of $16 million in 1990-91 and $35 million in 1991-92.

D. Programs/Projects Eliminated

Canadian Exploration Incentives Program

The Canadian Exploration Incentives Program (CEIP) provides a contribution of 30 per cent of the cost of mineral and oil and gas exploration financed with flow-through share arrangements. It was introduced in 1988 following the sharp decline in the stock markets and the subsequent difficulty in raising capital. It is the only remaining subsidy to business that is demand-driven and open-ended. Program costs in 1989-90 are expected to exceed $160 million.

The program is being cancelled, effective midnight February 19, 1990. Except as noted, expenses incurred after February 19, will no longer be eligible under the program. Expenses will only continue to qualify if they are in respect of a written agreement entered into before February 20, 1990. Such an agreement must be either:

(a) a flow-through share agreement between an exploration company and a flow-through share investor; or

(b) a subscription agreement entered into between an investor and a Fund pursuant to a prospectus that has been filed with a securities commission in Canada.

In any event, expenses incurred after February 28, 1991 will not qualify. The termination and grandfathering rules will be implemented through amendments to the CEIP Act and Regulations after consultation with the industry. Termination is expected to result in savings of $50 million in 1990-91 and $125 million in 1991-92.

OSLO

The OSLO (Other Six Leases Operations) project is a proposal to develop further the oil sands deposits of Northeastern Alberta. It would be the third major oil sands project in the region. In the fall of 1988, the federal government and the government of Alberta entered into an agreement in principle with the project's sponsors to provide financial assistance for the project.

Given the present and foreseeable fiscal environment, the government has reviewed this initiative and has decided not to proceed with the offer of financial assistance for the construction and operating phases of the project. The government is prepared to provide its share of funding for the engineering phase, which is to be completed by July 1991. Once the engineering studies are completed, the sponsors will be in a position to proceed with the project, when the economics justify such a decision. This initiative will make an important contribution to expenditure control and deficit reduction, resulting in savings of the $650 million in assistance that had been projected for the construction phase of the project.

Polar 8 Icebreaker Project

In light of the overall expenditure control program, the government has decided to terminate the Polar 8 Icebreaker Project due to significant increases in the estimated costs and changes in the international environment. This decision will generate direct fiscal savings of $84 million in 1990-91 and $62 million in 1991-92.

The cost of the Polar 8 is currently estimated to be in excess of $680 million. This is 20 per cent higher than the original estimate of $565 million. The revised estimate already incorporates a number of design changes made since 1986 which were intended to reduce construction costs.

The decision to construct the Polar 8 was taken in a significantly different international context. In 1988, the government signed the Canada-U.S. Arctic Cooperation Agreement. Under this proven and workable agreement, the United States has agreed to provide advance notice and seek the prior consent of Canada for all U.S. icebreaker voyages in Canadian Arctic waters.

E. Management Measures

Contributions to Business

The federal government will be adopting a more businesslike approach to assistance to business. In particular, the government is instituting a policy that will, with limited exceptions, eliminate grants to business for applications received after February 19, 1990. Financial contributions from the federal government providing assistance to business will be repayable on more rigorous terms, rather than being straight grants or subsidies.

The President of the Treasury Board will be responsible for developing the procedures to implement this policy. This initiative is intended to reinforce the government's efforts to further orient its business assistance programming towards investing in economic development rather than the subsidization of the private sector.

Crown Corporations and Agencies: Privatization, Rationalization and Management

Since 1984, the government's privatization objective has been to sell investments where government ownership is no longer required and to rely on market forces to spur Canada's competitiveness.

The government has decided, in keeping with this goal, to sell its shareholding in Telesat Canada. It has also decided to proceed with the sale of Nordion International Inc. and Theratronics International Ltd. (for which enabling legislation received Royal Assent on January 30, 1990). Proceeds from these sales will contribute to deficit reduction in 1990-91 and 1991-92.

The government is also continuing efforts to reduce the number of Crown corporations and agencies. Organizations that will be wound up and whose functions will be transferred to other entities include Canada Harbour Place Corporation, Canadian Patents and Development Ltd. and the Canadian Livestock Feed Board. The government will proceed with the necessary legislation at an early date and windups will take place in an orderly fashion.

The government has also decided not to re-introduce legislation to create a Postal Services Review Board. The interim Postal Services Review Committee will be discontinued.

Profitable Crown corporations have been asked to return more of their income to the government as shareholder. These corporations are therefore establishing dividend policies to encourage management to function in a more commercial way. Over the next two years, new dividend initiatives are expected to yield over $150 million.

Ports Canada will contribute towards deficit reduction through its cash management. The Ports Canada system is made up of Canada Ports Corporation and seven local Port Corporations. They are financially self-sufficient and pay annual dividends to the government totalling $13 million. In most cases, the ports have cash reserves exceeding their short-term capital investment needs. Accordingly, Ports Canada will make additional cash payments of $100 million for deficit reduction in 1990-91.

Management Initiatives

In December 1989, the President of the Treasury Board announced a number of initiatives designed to reduce the costs of government and improve management efficiency. The measures announced included, among others, restraints on the growth of the public service, a freeze on major construction projects in the National Capital Region, reductions in international travel, the sale of two Challenger aircraft and a number of administrative changes to improve cash and asset management. This package of initiatives is expected to contribute $2.8 billion in savings over the next five years. A number of further initiatives are contained in this budget.

The Department of National Revenue, Taxation has taken measures to improve management practices and to improve the collection of revenue outstanding and owing to the government. Outstanding revenue which is not subject to dispute has increased by half a billion dollars over the last two years. As well, resources have been allocated to National Revenue, Taxation to maintain the level of its compliance effort. These measures are consistent with the recommendations of the Auditor General. As a result of these initiatives, there will be an improvement in the government's fiscal position by about $160 million in 1990-91, increasing to about $230 million by 1991-92.

As part of the ongoing efforts to improve the management of government operations and public resources, the Bank of Canada will accelerate its remittance of net revenue to the federal government. This will result in a one-time fiscal saving of $400 million in 1990-91.

The Department of Veterans Affairs will update board and lodging charges for veterans in long-term care and apply them uniformly. These measures will save $17.3 million over the next two years. As well, the services provided veterans by the Veterans Independence Program will be streamlined slightly to save an estimated $18 million over the next two years.

The government has implemented stringent limits on the growth of non-salary expenditures by all departments. This policy has allowed the government to constrain the growth of aggregate non-salary operating and maintenance budgets to no more than 2 per cent a year since 1986-87. In December, the President of the Treasury Board announced an extension of the 2-per-cent cap to 1992-93. It will be extended again to 1994-95, saving about $450 million over the two years.

Since the government came to power in 1984, federal wage compensation settlements have been fiscally responsible and have contributed to reducing inflation pressures. Federal public service wage settlements have been lower than those in other sectors and below the rate of inflation.

The Government of Canada will continue its leadership in wage restraint. It recognizes the right of most public service employees to take part in collective bargaining to determine pay and other terms and conditions of employment. The government will continue to bargain in good faith, but bargain hard in accordance with its responsibility to taxpayers and its obligation to play a leading role in reducing inflation.

4. Canada's Fiscal Performance and Prospects

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Overview

In 1984, the government was facing a critical fiscal situation. The budgetary deficit had tripled to over $38 billion in just four years. Public debt was growing by more than 20 per cent per year, and public debt charges were consuming a rapidly increasing proportion of federal revenues. Government spending was expanding rapidly and outstripped, by a wide margin, the growth of the economy. The revenue yield – government revenues as a percentage of economic output – was falling.

Given the size and severity of the fiscal problem in 1984, no quick fix was available. Canada's fiscal problem, which took ten years to develop and was compounded by the impact of the worst recession in the postwar period, could not be solved overnight. What was needed was a consistent and comprehensive medium-term approach to fiscal consolidation. The government acted quickly in the fall of 1984 to establish *The Agenda for Economic Renewal*, in effect a planning framework to restore control over the fiscal situation and to implement complementary structural policies to increase Canada's economic potential.

Since then, the government has steadily pursued this plan. Reducing government spending, eliminating waste and inefficiency in government operations, reforming the tax system to provide a more secure tax base and less distorting revenue source, and improving the growth potential of the Canadian economy by structural reforms are all integral parts of the government's 1984 plan to ensure sustained, non-inflationary growth, productive jobs and rising living standards for Canadians.

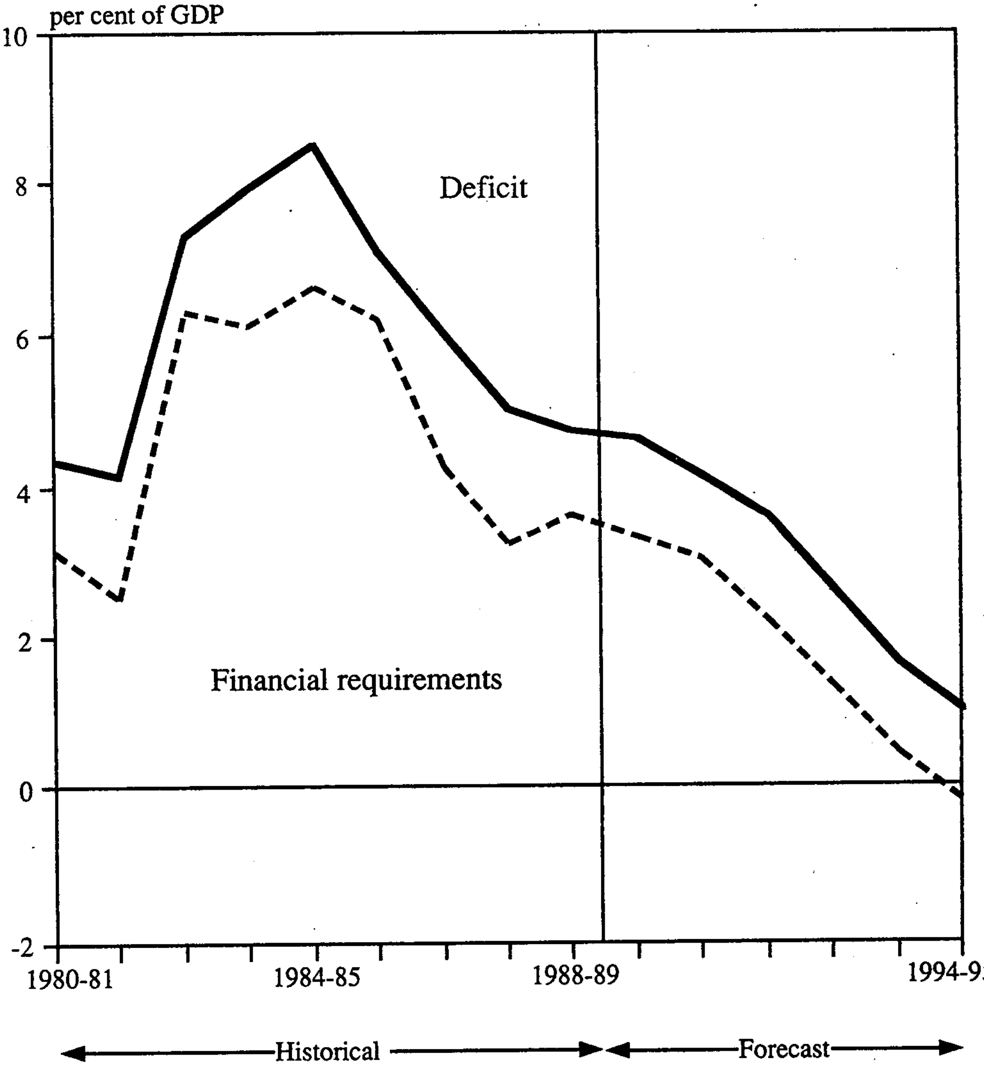
The record shows that significant progress has been made. Government spending has been greatly restrained since 1984. Transfers to the energy sector under the National Energy Program were eliminated. The growth of transfers to the provinces was reduced. Subsidies to Crown corporations were cut and 18 Crown corporations were sold and 8 other entities were dissolved. Transportation subsidies and subsidies to business were significantly scaled back. Growth in defence spending and Official Development Assistance (ODA) was reduced. Spending on the cost of other government operations, basically the cost of running the government, is lower now than in 1984-85, reflecting personnel reductions and tight control of overhead and operating budgets. As a result of these actions, program spending has grown by less than the average rate of inflation since 1984. Relative to the size of the economy, or gross domestic product (GDP), program expenditures declined 3 1/2 percentage points since 1984 and, at 16.0 per cent of GDP, are at their lowest level in almost 20 years.

Rapid expenditure growth prior to 1984 was not the only source of the fiscal problem. A decade of ad hoc tax expenditures had seriously eroded the tax yield.

This problem was compounded by structural flaws in the manufacturers sales tax. Moreover, the lingering impacts of the 1981-1982 recession, in particular the large corporate loss carry-overs, further eroded tax revenues. Since 1984, the government has taken comprehensive actions to close loopholes, reduce tax expenditures, reform the income tax system and, with the proposed sales tax reform, move to a more secure sales tax base. The impact of these measures is to restore the tax yield to about the average level that prevailed in the 1970s.

Chart 1

The Deficit and Financial Requirements*
1980-81 to 1994-95



* Excluding foreign exchange transactions.

Overall, as a result of these expenditure actions and revenue measures, the deficit in 1989-90 has declined almost $8 billion from its 1984-85 peak of $38.3 billion. This represents a reduction of 45 per cent in the deficit-to-GDP ratio, from 8.6 per cent in 1984-85 to 4.7 per cent in 1989-90 (Chart 1). Crucial to future prosperity, the growth of the debt has slowed dramatically and is now roughly in line with the growth of the economy's output of goods and services. But behind these improvements in the government's deficit are even more significant changes in the ongoing structure of the government's spending and revenues.

The government now has an operating surplus – the costs of government programs are more than completely financed by ongoing government revenues. This was not the case five years ago, when program spending exceeded revenues by $16 billion. By 1989-90, the government had acted to convert this $16 billion operating deficit to a $9 billion operating surplus – a swing of $25 billion in just five years. Relative to GDP, 70 per cent of this improvement in the operating balance has been achieved by expenditure restraint (Table 1).

Although substantial progress has been made, the task is not yet complete. The enormous build-up of debt over the last 15 years means that we are on a treadmill dominated by growth in public debt and debt servicing costs. With an annual deficit of $30 billion, debt interest costs increase $3 billion each year just to service the annual build-up in debt. This means that the operating surplus has to improve by $3 billion each year just to keep the overall deficit from rising. This problem is compounded by the vulnerability of the government's fiscal situation to increases in interest rates.

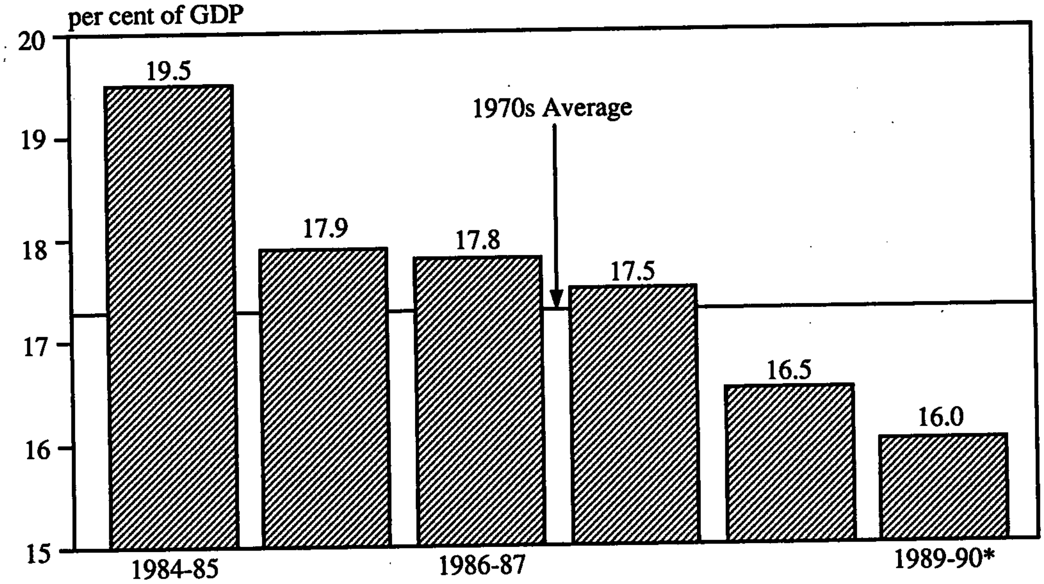
This exposure to interest rate developments was dramatically illustrated in late 1988 and through 1989. With the economy at capacity and inflation pressures mounting, higher-than-anticipated interest rates added about $6 1/2 billion to public debt charges in 1989-90 relative to the fiscal framework projected in the February 1988 budget. In response, the April 1989 budget introduced substantial expenditure reductions and revenue measures. With the actions in that budget, the government was able to set out a fiscal framework which was designed to deal with Canada's fiscal problems. In particular, the April 1989 budget fiscal framework projected:

- the deficit being cut in half to $15 billion by 1993-94;
- financial requirements all but being eliminated by 1993-94;
- the debt-to-GDP ratio stabilizing over the 1990-91 to 1991-92 period, and then falling over the medium term; and
- expenditure control and revenues both contributing to deficit reduction.

Since the April 1989 budget, inflation pressures have proved to be more strongly entrenched than was expected, and this has resulted in interest rates remaining higher than expected. Further fiscal action is required to hold to the fiscal framework set out in the April 1989 budget. Through the Expenditure Control Plan, the substantial expenditure actions taken in this budget reinforce the momentum of earlier measures and help to ensure that the goals of the

Chart 2

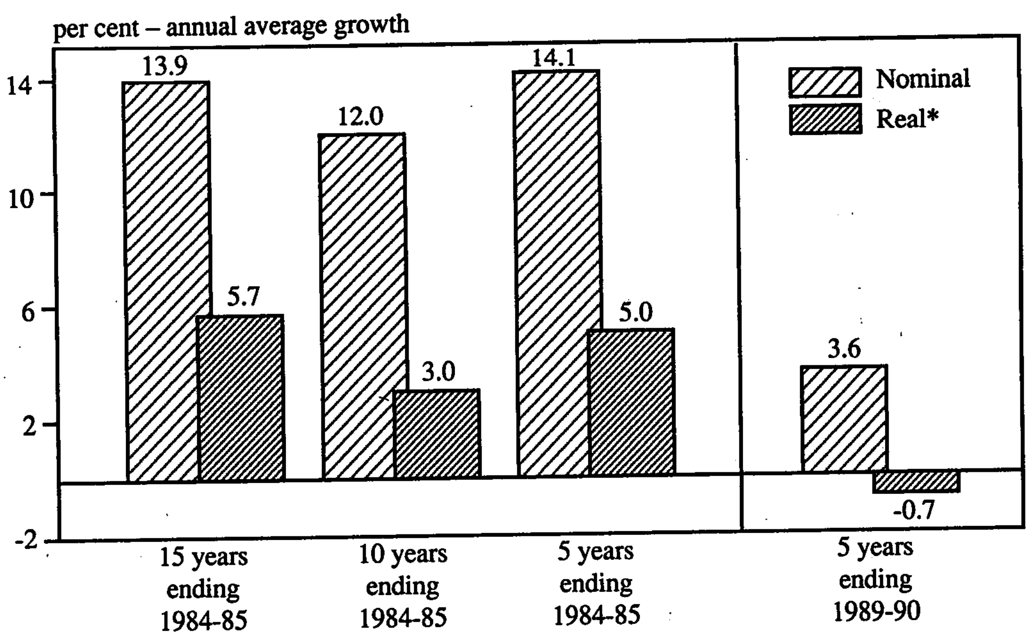
Program Expenditures



* Estimate.

Chart 3

Nominal and Real Growth in Program Expenditures



* Excluding the effects of inflation as measured by the change in the consumer price index.

April 1989 budget will be reached. What could only be aimed at in the medium term five years ago is increasingly within reach.

For next year, the deficit will be reduced to $28.5 billion. In 1991-92, the deficit falls further to $26.8 billion. Thereafter, as a result of the ongoing impacts on government spending and revenues of the measures introduced in this and previous budgets, the operating surplus grows quickly. This provides the basis for substantial declines in the deficit and the elimination of financial requirements over the medium term.

The deficit will be cut by more than half, to $14 billion in 1993-94. The following year it is projected to fall to $10 billion, or about 1 per cent of GDP (Chart 1), the lowest level in 25 years. Financial requirements will be in surplus by 1994-95, allowing the government to begin paying back the debt it previously borrowed on capital markets. The burden of the debt will be falling: the debt-to-GDP ratio stabilizes in 1991-92 and declines thereafter, the first decline since 1974-75. In short, the fiscal environment required for sustained, non-inflationary economic growth will be firmly in place.

The Fiscal Record: 1984-85 to 1989-90

In the early 1980s, the fiscal situation in Canada was deteriorating rapidly. There was a fundamental fiscal imbalance as a result of a decade of rapid expenditure growth and a falling revenue yield. This potentially unstable situation was leading to ever-larger deficits and rapid growth in public debt. The deficit reached a peak of 8.6 per cent of GDP in 1984-85. Growth in public debt had averaged 22 1/2 per cent per year over the five years ending in 1984-85. The challenge was to regain control over the government's finances.

Since 1984, much has been achieved. A consistent multi-year fiscal and economic plan is firmly in place. This plan will restore health to the nation's finances and create the conditions for strong non-inflationary growth in the 1990s.

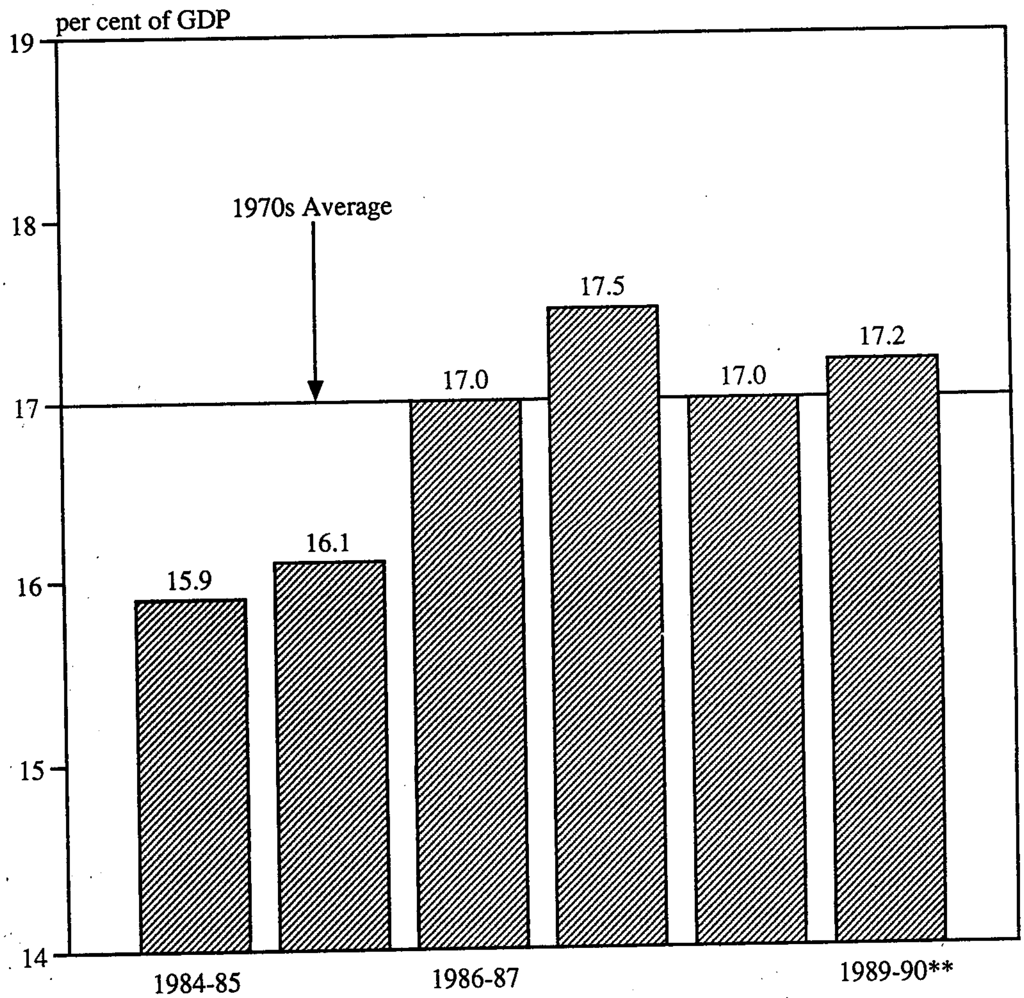
Restraining the growth in program spending has been the cornerstone of fiscal consolidation. After peaking at 19.5 per cent of GDP in 1984-85, program expenditures declined to 16.0 per cent in 1989-90 (Chart 2). Over the five-year period ending in 1989-90, the average annual growth in program spending was held to 3.6 per cent. This was less than half the growth in the economy and 0.7 per cent per year less than the rate of inflation. By comparison, average annual growth of program expenditures exceeded 12 per cent per year in the previous ten years. The decline in real program spending since 1984 stands in sharp contrast to the substantial real growth in the 1970s and in the first half of the 1980s (Chart 3). Details on the government's record of expenditure restraint are contained in Chapter 3.

The revenue yield had been declining in the late 1970s and into the early 1980s and was part of the fiscal problem. The revenue yield fell from a peak of 19.2 per cent in 1974-75 to 15.9 per cent in 1984-85. This reflected the proliferation of selective tax expenditures, ad hoc tax cuts, the endemic flaws in the manufacturers sales tax and the direct and indirect impacts of the 1981-1982 recession. With the measures introduced since November 1984, the revenue yield has increased to 17.2 per cent by 1989-90, about the revenue yield that prevailed, on average, in the 1970s (Chart 4).

The strength of the fiscal actions taken is apparent. From 1984-85, the deficit has been reduced from its peak of $38.3 billion to $30.5 billion in 1989-90, a decline

Chart 4

The Revenue Yield: Budgetary Revenues*



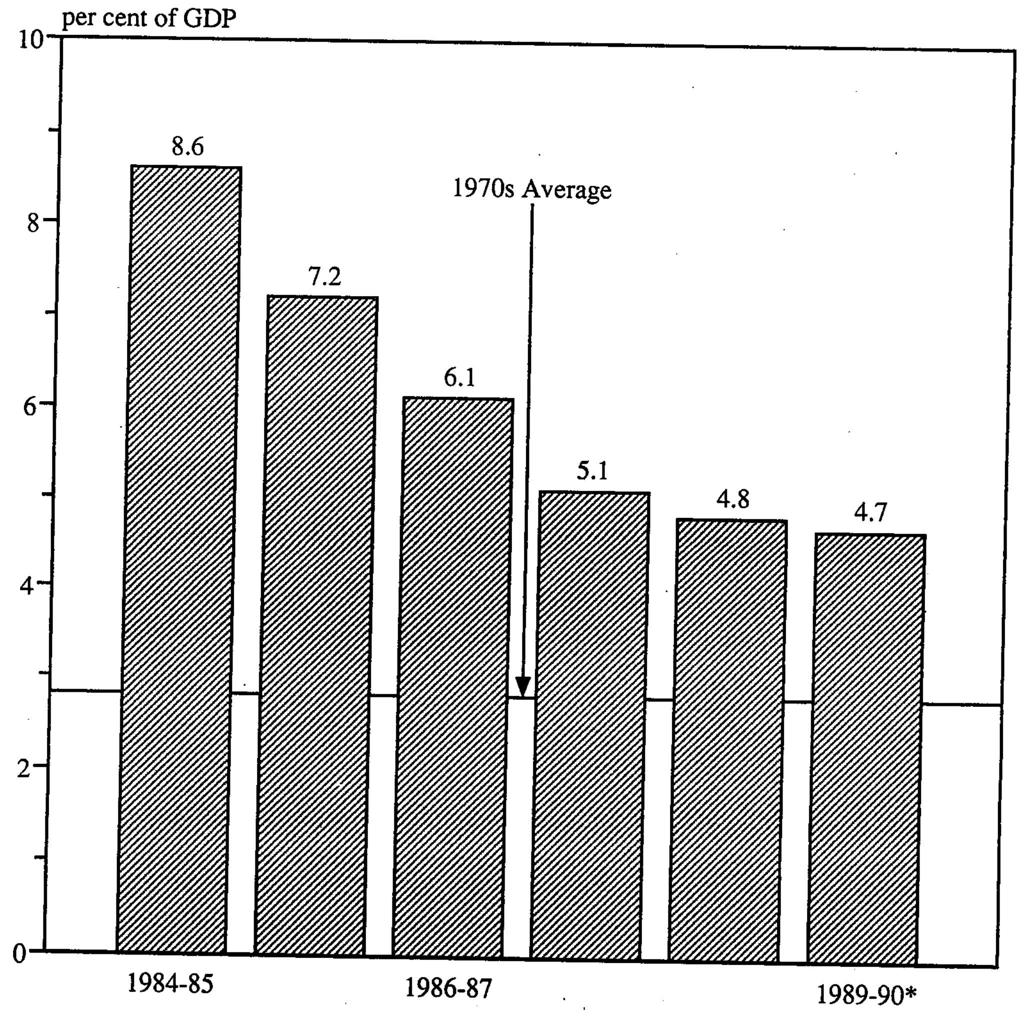
* Excludes the impact of cash management initiatives affecting the timing of remittances of personal and corporate income, sales and excise taxes.

** Estimate.

of almost $8 billion. Relative to the size of the economy, the deficit has declined almost 4 percentage points to 4.7 per cent of GDP in 1989-90 (Chart 5), a drop of 45 per cent. Financial requirements – the direct borrowings of the federal government in capital markets – are also down almost $8 billion since 1984-85. On a national accounts basis, the deficit declined to 3.5 per cent of GDP in 1989-90 and is now much more in line with those of other major industrialized countries (Annex 1 contains further details on the national accounts deficit and Annex 3 gives an international perspective on Canada's fiscal situation).

Chart 5

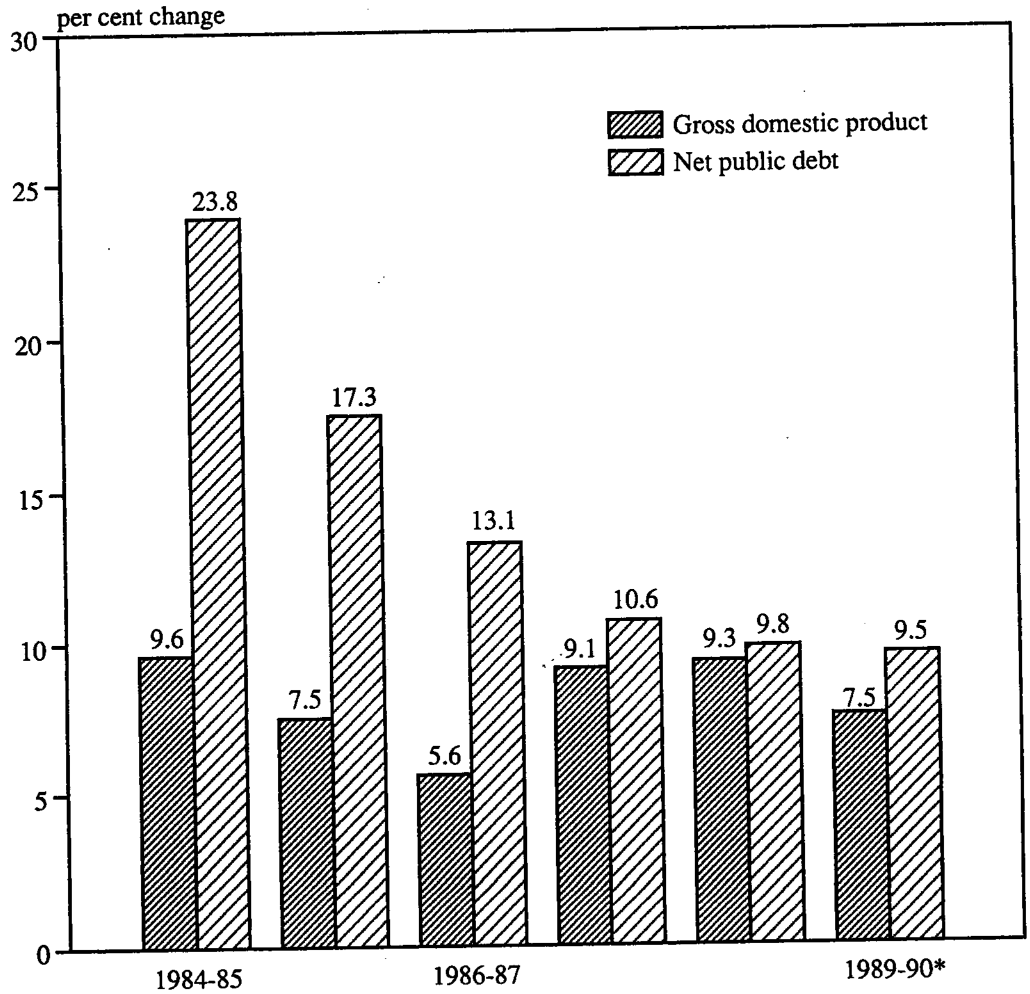
The Budgetary Deficit



* Estimate.

Chart 6

Gross Domestic Product and Net Public Debt



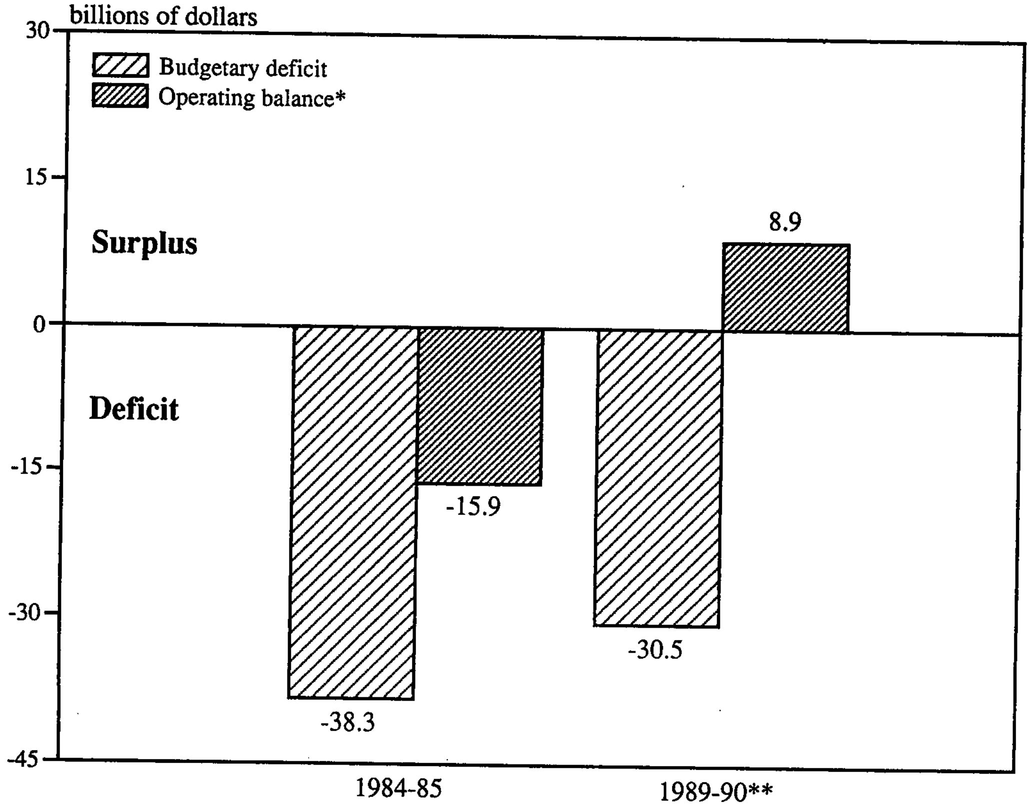
* Estimate.

In concert with the reduction in the annual deficit, the growth in the public debt has been brought roughly into line with the growth in the economy. From growth of almost 24 per cent in 1984-85, growth in the public debt has declined steadily. It was held below 10 per cent in each of the last two years, close to the growth of GDP. Five years ago, growth of the debt outpaced GDP growth by 14 percentage points (Chart 6).

The extent of the progress that has been achieved is best illustrated by the improvement in the operating balance. In 1984-85, the operating balance was in deficit: ongoing program expenditures were about $16 billion higher than ongoing revenues. Reflecting mainly the actions taken to restrain program spending since

Chart 7

Budgetary Deficit and Operating Balance 1984-85 to 1989-90



* The operating balance equals the budgetary deficit excluding public debt charges. It is the difference between ongoing program expenditures and government revenues.
** Estimate.

1984, the operating balance is now in a surplus with program spending $9 billion less than revenues (Chart 7). Relative to GDP, this swing of $25 billion in the operating balance results in an improvement from a deficit of 3.6 per cent in 1984-85 to a surplus of 1.4 per cent in 1989-90 (Table 1). Of this 5-percentage-point improvement in the operating balance, 3.5 percentage points, or 70 per cent, is due to program expenditure restraint. Revenue increases account for the remaining 1.5 percentage points, or 30 per cent of the improvement.

Reflecting the dangerous dynamics of deficits and debt, debt charges have grown rapidly despite fiscal restraint, and have hampered the efforts to reduce the deficit and slow the build-up of debt. Of the $25 billion improvement in the operating balance from 1984-85 to 1989-90, about $17 billion was required simply to pay increased interest charges on the public debt, with only $8 billion available to reduce the deficit. When the government took office in 1984, the level of the public debt was about $200 billion. Since 1984-85, the compound interest on that $200 billion stock of debt has totalled $120 billion, accounting for 80 per cent of the $150 billion increase in the debt since 1984-85.

Table 1

Key Fiscal Indicators: The 1984-85 to 1989-90 Record

	1984-85	1989-90	Change	Relative contribution
	(per cent of GDP)			(per cent)
1. Operating balance				
Budgetary revenue	15.9	17.4	1.5	30
Program expenditures	19.5	16.0	-3.5	70
Operating surplus/deficit (-)	−3.6	1.4	5.0	100
2. Budgetary deficit				
Public debt charges	5.0	6.1	1.1	
Budgetary deficit	−8.6	−4.7	3.9	

The Fiscal Challenge

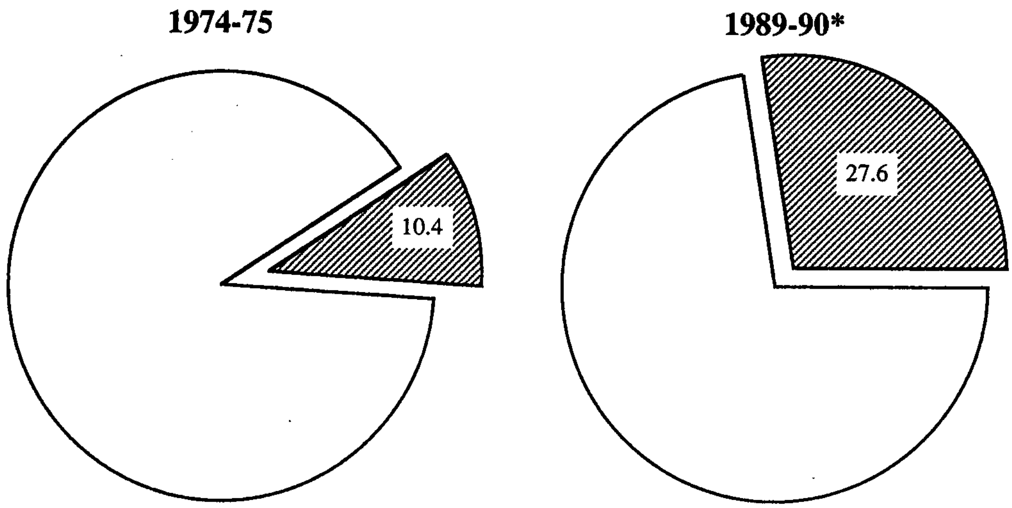
In the April 1989 budget, the government set out a five-year fiscal plan to cut the deficit in half by 1993-94, to eliminate government borrowings in capital markets after 1993-94 and to stabilize the debt-to-GDP ratio over the 1990-91 to 1991-92 period, with declines thereafter. In order to sustain and strengthen the economic expansion through the 1990s, these fiscal objectives must be met.

Economic developments over the past six to nine months have put the achievement of the April 1989 budget objectives at risk. Inflation pressures have proved to be more entrenched than anticipated. In the face of these strong inflation pressures, monetary policy has remained restrictive. This has meant higher-than-anticipated interest rates, leading to substantial increases in public debt charges, principally in 1990-91 and 1991-92. The fiscal challenge is to get over the hurdle posed by these significant upward pressures on the short-term deficit track, and still achieve the medium-term economic and fiscal objectives set out in the April 1989 budget.

The Expenditure Control Plan proposed in this budget, together with the spending reductions announced in December 1989 and the April 1989 budget measures, will achieve two goals. First, they will put the deficit back on a downward track. This will free up domestic savings to help finance needed investment, diminish our

Chart 8

Public Debt Charges as a Per Cent of Budgetary Expenditures



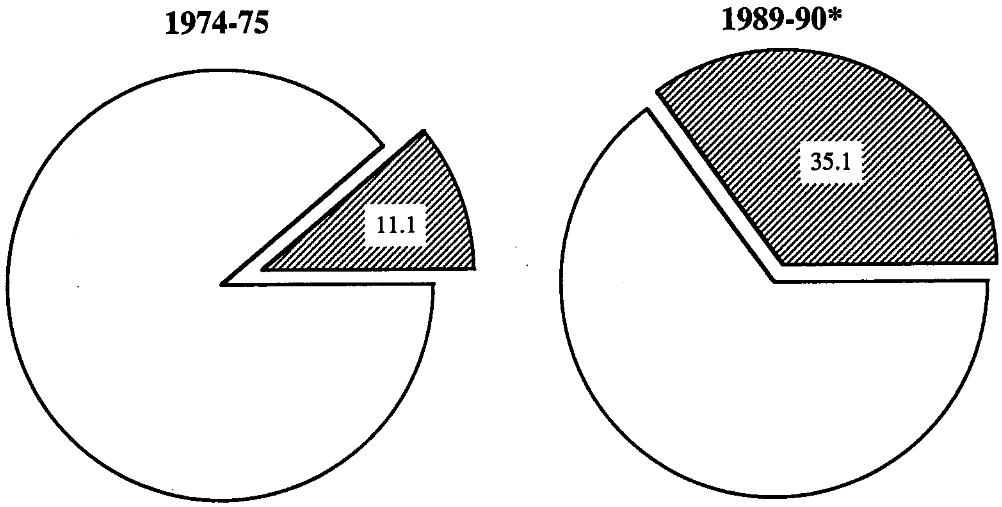
* Estimate.

reliance on foreign savings and reduce the debt burden on future generations. Second, they will contribute to lower inflation. By so doing, the budget measures will ease the burden on monetary policy and increase the scope for interest rates to come down. With the forecast slowing in growth, the expected reduction in inflation, and a better balance in macroeconomic policy, significant and sustainable declines in interest rates can occur. Lower interest rates, in turn, will contribute to further reductions in the deficit. The stage will then be set for the economy to make the transition to strong, sustained growth over the medium term.

A declining deficit track is urgently needed – attempting to live with $30 billion deficits is not a viable option. Annual deficits in the $30 billion range add $3 billion annually to debt service charges. Thus, just to keep the deficit constant at $30 billion, requires $3 billion in expenditure reductions or revenue increases each year to offset the rising public debt charges. Meanwhile, the rising debt service charges consume ever-growing portions of government expenditures (Chart 8) and revenues. Over 35 cents of every revenue dollar now goes to service the debt (Chart 9); fifteen years ago only 11 cents were required. Failure to get

Chart 9

Public Debt Charges as a Per Cent of Budgetary Revenues



* Estimate.

off the treadmill of $30 billion deficits will increasingly undermine the government's ability to meet the priorities of Canadians.

The large fiscal deficits of recent years are also reflected in Canada's widening current account deficit, and the rising level of Canada's net foreign indebtedness. In an economy that is operating at high levels of capacity, government deficits increase our liabilities to foreigners and lower our prospective domestic standard of living. Large government deficits further threaten the well-being of future generations of Canadians by imposing on them a large and unjust debt burden. This debt burden will ultimately have to be financed by future generations, either through higher taxes or lower program expenditures.

The Short-Term Fiscal Outlook: 1989-90 to 1991-92

Table 2 summarizes the short-term fiscal outlook to 1991-92. These projections are based on the economic assumptions described in Chapter 2 and reflect the impacts of the proposed Expenditure Control Plan as set out in Chapter 3. With the fiscal actions contained in the Expenditure Control Plan:

- The deficit falls to $28.5 billion in 1990-91 and to $26.8 billion in 1991-92: a decline of $3.7 billion from the 1989-90 deficit of $30.5 billion.
- The deficit, as a per cent of GDP, falls to 4.2 per cent in 1990-91 and 3.7 per cent the next year: by 1991-92 a decline of 1.0 percentage point from 1989-90 and almost 5.0 percentage points from 1984-85.
- Program spending growth is restrained over the next two years to an annual average increase of only 3.7 per cent, well below the projected rate of inflation.
- Budgetary revenues are projected to stabilize at about 17.4 per cent of GDP in both 1990-91 and 1991-92: an unchanged revenue yield relative to 1989-90.
- The operating surplus – the difference between budgetary revenues and program spending – increases from $8.9 billion in 1989-90 to $14.7 billion in 1991-92, in sharp contrast to the operating deficit of nearly $16 billion in 1984-85.
- Financial requirements excluding foreign exchange transactions – a comprehensive measure of the government's borrowing in credit markets – fall from $22 billion in 1989-90 to $17 billion in 1991-92, down sharply from financial requirements of nearly $30 billion in 1984-85.
- Growth in the public debt relative to GDP is halted at 56.2 per cent in 1991-92 – the first time its upward trend has been arrested since 1974-75 – and it declines thereafter.

The extent of the deficit decline in both 1990-91 and 1991-92 is limited by certain transitional costs associated with the implementation of the proposed Goods and Services Tax (GST). As set out in the December 19, 1989 GST Technical Paper, the government will begin paying the GST credit in December 1990 in advance of collection of the 7-per-cent GST; it will refund the manufacturers sales tax paid on existing inventories; and, it will provide a transitional grant of up to $1,000 to small businesses. These two-year transitional costs amount to roughly $1.8 billion in 1990-91 and $2.0 billion in 1991-92. Excluding these non-recurring fiscal costs, the underlying deficit in 1990-91 is $26.7 billion and it falls to $24.8 billion in 1991-92. Continuing improvements in the operating surplus and a forecast rebound in the economy and declines in interest rates lead to sharp declines in the deficit in 1992-93 and beyond.

Table 2

Summary Statement of Transactions

	1989-90	1990-91	1991-92
	(billions of dollars)		
Budgetary transactions			
Budgetary revenues	112.4	119.3	125.9
Program spending	–103.5	–106.6	–111.2
Operating surplus	8.9	12.6	14.7
Public debt charges	–39.4	–41.2	–41.5
Budgetary deficit	–30.5	–28.5	–26.8
Non-budgetary transactions	8.5	7.5	9.9
Financial requirements[1]	–22.0	–21.0	–17.0
Net public debt	351.4	379.9	406.8
	(per cent of GDP)		
Budgetary revenues	17.4	17.5	17.4
Program spending	16.0	15.7	15.4
Operating surplus	1.4	1.9	2.0
Public debt charges	6.1	6.1	5.7
Budgetary deficit	4.7	4.2	3.7
Financial requirements [1]	3.4	3.1	2.3
Net public debt	54.4	55.9	56.2

Note: Figures may not add due to rounding.
(1) Excludes foreign exchange transactions.
(–) indicates a net requirement for funds.
(+) indicates a net source of funds.

The Expenditure Plan to 1991-92

This section provides an overview of the government's expenditure plan to 1991-92. Details of budgetary expenditures are set out by type of payment in Table 3. The expenditure projections include the impacts of the proposed Expenditure Control Plan and the program reductions announced by the President of the Treasury Board in December 1989 (Chapter 3 gives details).

Total budgetary expenditures are projected to increase 3.4 per cent in 1990-91 and in 1991-92, considerably less than the projected rate of inflation. The growth in public debt charges is expected to slow noticeably over the next two fiscal years, in sharp contrast to the double-digit increases witnessed in each of the last two fiscal years. This reflects both the significant slowdown in the growth of public

Table 3

Budgetary Expenditures

	1989-90	1990-91	1991-92
	(millions of dollars)		
A. Major transfers to persons	32,380	34,965	37,255
B. Major transfers to other levels of government(1)	24,645(1)	23,985(1)	24,475(1)
C. Major subsidies/other major transfers	10,465	9,890	9,935
D. Payments to major Crown corporations	5,410	4,745	4,650
E. Defence	11,310	11,870	12,460
F. Official Development Assistance	2,445	2,565	2,695
G. Other government operations	16,845	17,330	18,105
H. Reserves net of lapse	–	1,275	1,675
I. Program spending	103,500	106,625	111,250
J. Public debt charges	39,400	41,150	41,500
K. Total budgetary expenditures	142,900	147,775	152,750
	(per cent change from previous year)		
A. Total budgetary expenditures	7.7	3.4	3.4
B. Public debt charges	18.7	4.4	0.9
C. Program spending	4.0	3.0	4.3
D. Consumer price index (CPI)	5.0	4.7	5.1
CPI excluding one-time impact of 7% GST	5.0	4.7	3.9
E. Gross domestic product (value)	7.5	5.2	6.4

(1) Certain transfers to other levels of government are made as a combination of cash and a transfer of tax points. Program spending includes only the cash transfer component as well as adjustments to program entitlements for prior years. Total transfer entitlements, including cash and tax transfers but excluding prior-year adjustments, are as follows:

	1989-90	1990-91	1991-92
	(millions of dollars)		
Cash and tax transfer entitlements to other levels of government	35,050	36,100	37,150

debt and the expected easing of inflationary pressures, which should allow short-term interest rates to decline.

With the proposed Expenditure Control Plan, program expenditures will be strictly controlled over the next two fiscal years. Program spending is projected to increase at an average annual growth of 3.7 per cent over the 1990-91 to 1991-92 period. This pace of growth is substantially less than the average inflation rate expected over this period.

Not all programs will be included in the Expenditure Control Plan. Major federal direct transfers to persons – old age security payments, guaranteed income supplement, spouses allowances, family allowances, veterans pensions and allowances and unemployment insurance benefits – are exempt. Certain major federal transfers to provinces – equalization and Canada Assistance Plan payments to equalization-receiving provinces – are also exempt. In addition, a limited number of other programs such as federal transfers to the non-equalization-receiving provinces under the Canada Assistance Plan, science and technology, native programs, Official Development Assistance, and defence will be allowed to increase, but will have their growth limited to 5 per cent per year over the next two fiscal years.

As Table 4 indicates, all of the increase in program spending over the next two years is attributable to the limited number of programs identified above, which under the Expenditure Control Plan are either exempt or allowed to grow by no more than 5 per cent per year over the next two years. All other program spending, which in 1989-90 accounted for 40 per cent of government spending on programs, will decline in 1990-91 and will continue to be less in 1991-92 than it is in 1989-90.

Table 4

Program Spending

	1989-90	1990-91	1991-92	Change from 1989-90 to 1991-92
	(billions of dollars)			
A. Exempt programs	42.3	45.3	48.5	6.2
B. Programs constrained to no more than 5% per year	19.5	20.5	21.5	2.0
C. All other program spending	41.7	40.9	41.3	−0.4
D. Total program spending	103.5	106.6	111.2	7.7

Note: Figures may not add due to rounding.

Total entitlement transfers to other levels of government, including both tax and cash transfers, are projected to increase, on average, 3.0 per cent per year between 1989-90 and 1991-92 (Table 3). However, the impact of the proposed Expenditure Control Plan measure affecting Established Programs Financing (EPF) and prior-year adjustments result in cash transfers to other levels of government declining slightly in 1990-91 and then increasing 2.1 per cent in

1991-92. The restraint in cash transfers to the provinces largely reflects the freezing of per capita transfers under EPF at 1989-90 levels. As the value of tax transfers is unaffected by this measure, this restraint measure impacts only on cash transfers. The equalization program is exempt from the Expenditure Control Plan, and its underlying rate of growth in both 1990-91 and 1991-92 reflects the growth in the economy. Cost-sharing expenditures under the Canada Assistance Plan for provinces not receiving equalization are being capped at a maximum of 5 per cent growth in each of the next two years.

The measures in the proposed Expenditure Control Plan account for most of the restraint in the major subsidies and other major transfers component. Restraint measures announced in this budget, as well as in previous budgets, explain the declines in transfers to major Crown corporations.

The cost of other government operations – basically the cost of running the government – is expected to increase, on average, by only 3.7 per cent per year in 1990-91 and 1991-92. This reflects the capping of operating and maintenance costs and strict controls over person-year growth. In December 1989, the President of the Treasury Board announced that the 2-per-cent cap on non-salary operating and maintenance costs would be extended to 1992-93. This initiative was first announced in the February 1986 budget for the period 1986-87 to 1990-91. Person-year growth will continue to be restrained.

Federal public service wage settlements have been lower than those in other sectors, and below the rate of inflation, since 1984. The government will continue its leadership in this regard, bargaining fairly with the public service unions but recognizing the continuing need for fiscal responsibility and its obligation to contribute to reducing inflation.

The reserves-net-of-lapse component is the difference between the reserves built into the framework to handle contingencies and new priorities, and the anticipated lapsing of appropriated funds. Reserves are necessary to provide a margin for changed economic circumstances, to deal with contingencies, and to address policy priorities. They provide a measure of flexibility throughout the year. They are not allocated until their ultimate use has been determined.

The Revenue Outlook to 1991-92

The projections set out in Table 5 provide an overview of the revenue outlook to 1991-92. The projections are based on the economic forecast set out in Chapter 2, which sees slow economic growth continuing in 1990. In this environment, the average growth in budgetary revenues is expected to slow to under 6 per cent per year over the next two years.

Personal income tax revenues are estimated to increase by 11.3 per cent in 1989-90. Growth is expected to remain strong in 1990-91, largely reflecting the dampening impact on personal income tax collections in 1989-90 of refunds relating to personal income tax reform. Slowing employment growth and the impact of the enhanced GST credit affect growth in 1991-92.

Table 5

Budgetary Revenue Projections

	1989-90	1990-91	1991-92
		(millions of dollars)	
Personal income tax	51,210	55,880	59,485
Corporate income tax	12,700	12,400	13,640
Unemployment insurance contributions	10,735	12,620	13,340
Sales taxes	16,985	16,240	17,980
Excise taxes and duties	11,565	11,915	12,165
Other revenues	9,205	10,195	9,290
Total budgetary revenues	112,400	119,250	125,900
		(percentage change from previous year)	
Personal income tax	11.3	9.1	6.5
Corporate income tax	8.3	–2.4	10.0
Unemployment insurance contributions	–4.7	17.6	5.7
Sales taxes	8.6	–4.4	10.7
Excise taxes and duties	14.2	3.0	2.1
Other revenues	0.2	10.8	–8.9
Total budgetary revenues	8.1	6.1	5.6
Revenues as a percentage of GDP	17.4	17.5	17.4

The slowing of growth in 1989 has had its most pronounced fiscal effect on corporate profits. Rising labour costs and weakening demand have squeezed profit margins; corporate profits declined in 1989 and are expected to be relatively flat in 1990. As a result, corporate income tax collections are expected to decline in 1990-91. The rebound in economic activity in late 1990, and the base-broadening measures announced in previous budgets, account for the increase in collections in 1991-92.

Proposed changes to the Unemployment Insurance Act to restructure the financing of the unemployment insurance program, effective in 1990, are the major factors underlying the 17.6 per cent increase in unemployment insurance contributions in 1990-91. With the premium rate for employees set at $2.25 per $100 of insurable earnings, contributions growth in 1991-92 reflects increases in maximum insurable earnings and employment. The major factor impacting on the sales tax revenue projections in both 1990-91 and 1991-92 is the one-time costs of the transition to the proposed GST, due to the refunding of the manufacturers sales tax paid on inventories and the transitional grant to small businesses. In addition, sales tax revenues are dampened in 1990-91 due to cash flow impacts relating to the timing of GST revenues.

The main components in the category of excise taxes and duties are customs import duties, motive fuel excise taxes and excise levies on tobacco and alcohol products. Growth in this component is expected to be restrained over the next two years, primarily reflecting the loss in customs import duties associated with the phase-in of the Canada-United States Free Trade Agreement.

The category, other revenues, is composed of non-resident withholding taxes, miscellaneous indirect taxes, return on investments and other non-tax revenues. The increase in 1990-91 primarily reflects several of the management initiatives included in the proposed Expenditure Control Plan.

Reconciliation with the April 1989 Budget

The deficit outlook for 1989-90, at $30.5 billion, remains unchanged from the April 1989 budget forecast. Both budgetary revenues and expenditures are unchanged, although there are offsetting differences within each of the major components (Table 6). Within budgetary revenue, personal income tax collections are expected to be somewhat greater than forecast in the April 1989 budget, owing to the stronger-than-expected increases in employment and incomes in 1989. These incremental revenues will be offset, however, by lower corporate tax collections, reflecting the weakness in corporate profits. Although short-term interest rates were higher at the end of 1989 than forecast in the April 1989 budget, average short-term rates over 1989-90 should be only marginally higher and long-term rates are now lower than projected in the April 1989 budget. Taken together, these developments suggest that public debt charges will be in line with the April 1989 budget forecast for 1989-90. So will program spending.

The deficit outlook for 1990-91 is now projected at $28.5 billion, $0.5 billion higher than in the April 1989 budget. As shown in Annex 5, the one-time transitional costs of sales tax reform – refunding of the manufacturers sales tax paid on inventories and the prepayment of the GST credit – lowers the level of revenues in 1990-91.

The changed economic environment since the April 1989 budget has resulted in the deficit increasing by $1.7 billion in 1990-91. The fiscal deterioration from the changed economic environment results from lower corporate income tax collections and higher public debt charges. The decline in corporate income tax collections reflects the weakness in corporate profits. Although interest rates are expected to decline in 1990, short-term interest rates are now expected to average about 120 basis points above the April 1989 budget levels and this increases 1990-91 public debt charges by $1.6 billion.

Partially offsetting the impact of these factors on the deficit are higher personal income tax and other revenues. Although the rate of expansion of the Canadian economy slowed in 1989, and this will continue into 1990, the strength in final domestic demand has resulted in higher levels of employment and personal income, and thus, higher personal income tax receipts than were forecast in the April 1989 budget for 1989-90 and 1990-91. The impact of this stronger-than-projected growth in employment and average earnings on unemployment insurance contributions, along with higher-than-expected income from foreign

Table 6

Changes to the Deficit Since the April 1989 Budget

	1989-90	1990-91
	(billions of dollars)	
April 1989 budget deficit	30.5	28.0
Changes due to transitional costs of GST*		1.8
Changes due to economic and other factors		
Personal income tax	−0.8	−1.3
Corporate income tax	1.0	2.4
Other revenues	−0.2	−0.2
Program spending		−0.7
Public debt charges		1.6
Sub-total	–	1.7
Changes due to expenditure restraint measures		
Expenditure Control Plan	–	−2.8
December 1989 expenditure reductions	–	−0.2
Total changes	–	0.5
February 1990 budget deficit	30.5	28.5

Note: Figures may not add due to rounding.
(−) denotes a reduction in the deficit.
(+) denotes an increase in the deficit.
* See Annex 5 for details.

exchange reserves, is the source of most of the increase in other revenues. The stronger growth in the value of tax transfers under Established Programs Financing results in lower direct cash transfers and contributes importantly to the decline in program spending.

The proposed Expenditure Control Plan produces fiscal savings of $2.8 billion in 1990-91. In addition, the President of the Treasury Board, on December 15, 1989, announced expenditure reductions and management initiatives amounting to $0.2 billion in 1990-91, rising to $0.7 billion per year by 1992-93.

Factors Affecting Financial Requirements

The government's net financial requirements reflect not only budgetary revenues and expenditures, but also non-budgetary transactions. These include loans, investments and advances, specified purpose accounts, and other non-budgetary transactions. Total non-budgetary transactions have normally provided the government with a net source of funds, lessening the extent to which the government has had to borrow on financial markets.

The underlying principle of classification between budgetary and non-budgetary transactions is that transactions changing the net indebtedness of the government are classified as budgetary, while transactions involving the receipt of offsetting financial assets or the creation of liabilities are classified as non-budgetary. In addition, the government maintains a number of trust accounts that are held for third parties, such as the pension accounts of federal government employees. Other non-budgetary transactions include accounting adjustments to convert certain budgetary transactions that are recorded on an accrual basis to a cash basis. These include interest accounts, accounts payable, cash-in-transit and outstanding cheques.

Funds generated by non-budgetary transactions are estimated at $8.5 billion in 1989-90 (Table 7). They are expected to decline in 1990-91, to about $7.5 billion. Most of this decline reflects the extraordinary impact in 1989-90 of the sale of the outstanding Air Canada shares. In 1991-92, the net source of funds is projected to increase to $9.9 billion.

Table 7

Non-Budgetary Transactions

	1989-90	1990-91	1991-92
		(billions of dollars)	
Loans, investments and advances	1.2	0.3	0.4
Specified purpose accounts	7.0	7.3	8.1
Other transactions	0.3	−0.1	1.4
Non-budgetary transactions	8.5	7.5	9.9

Note: Figures may not add due to rounding.

Financial Requirements and Borrowing Authority

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

For 1990-91, the government will be seeking borrowing authority in the amount of $25.5 billion to cover projected financial requirements of $21.0 billion, Exchange Fund earnings of $1.5 billion, and a $3 billion contingency to manage foreign exchange transactions (Table 8). The request for borrowing authority to cover Exchange Fund earnings reflects the fact that, although these earnings are reported as budgetary revenues, they remain in the Exchange Fund Account and are not available to finance ongoing operations of government.

Table 8

Borrowing Requirements

	1990-91
	(billions of dollars)
Financial requirements (excluding foreign exchange transactions)	21.0
Exchange Fund earnings	1.5
Reserve for contingencies	3.0
Total borrowing authority requested	25.5

The Medium-Term Fiscal Outlook

The medium-term fiscal projection to 1994-95 is presented in Table 9. Significant momentum toward a fundamental rebalancing in the government's fiscal situation has been established by the actions taken in previous budgets. These actions are substantially reinforced by the Expenditure Control Plan proposed in this budget.

The medium-term projections also incorporate the impacts of the proposed GST. The GST contributes to achieving the government's medium-term fiscal objectives by providing greater assurance that the revenues needed to meet the government's fiscal targets will be forthcoming. In particular, by minimizing tax avoidance and evasion, it secures the $2 billion in additional sales tax revenues announced in the April 1989 budget. The GST will also improve Canada's medium-term economic performance, and thereby will lead to a lower medium-term deficit than would have been the case in the absence of reform.

The fiscal plan in this budget takes the country a long way toward healthier public finances:

- Financial requirements will be in surplus by 1994-95 the first time since 1969-70 (Chart 10). At that time, the government will be reducing its outstanding debt in the form of Treasury bills, Canada Savings Bonds and other debt instruments held by the general public.

- The budgetary deficit will fall to about $10 billion in 1994-95 from its peak of $38.3 billion in 1984-85. Excluding the transitional costs of the GST, the deficit declines to $26.7 billion in 1990-91, $1.3 billion less than projected in April 1989, and falls to $24.8 billion in 1991-92. By 1993-94, the deficit drops to $14 billion, $1 billion less than in the April 1989 budget (Chart 11).

- Relative to GDP, the deficit will fall steadily to approximately 1 per cent in 1994-95, the lowest deficit-to-GDP ratio in 25 years. This fiscal track is achieved primarily through program expenditure restraint: program expenditures will fall to 14.2 per cent of GDP in 1994-95, the lowest level since 1966-67 and over 3 percentage points below the level that prevailed on average in the 1970s (Chart 12). Total budgetary expenditures decline to 18.9 per cent of GDP in 1994-95, the lowest ratio since 1971-72. Revenues remain relatively stable, well below the peak of the 1970s (Chart 13).

- A fiscal structure has been put in place which will generate increasing operating surpluses. By 1994-95, the operating surplus will be $31 billion, or 3 1/2 per cent of GDP, an improvement of $22 billion from 1989-90 and $47 billion relative to 1984-85 (Chart 14).

- The national accounts deficit will decline steadily over the medium term and move into surplus in 1994-95. This reduction in government dissaving will lessen Canada's reliance on foreign savings.

Table 9

Key Fiscal Indicators Over the Medium Term

	1989-90[1]	1990-91[2]	1991-92[2]	1992-93[2]	1993-94[2]	1994-95[2]
			(billions of dollars)			
Budgetary revenues	112.4	119.3	125.9	137	146	155
Program expenditures	103.5	106.6	111.2	117	120	125
Operating surplus	8.9	12.6	14.7	20	25	31
Public debt charges	39.4	41.2	41.5	40	40	41
Budgetary expenditures	142.9	147.8	152.7	157	160	165
Budgetary deficit	30.5	28.5	26.8	21	14	10
Financial requirements/source(–)[3]	22.0	21.0	17.0	11	4	–1
Net public debt	351	380	407	428	442	452
National accounts deficit/surplus(–)	22.6	19.0	16.2	9	2	–2
			(per cent of GDP)			
Budgetary revenues	17.4	17.5	17.4	17.7	17.7	17.8
Program expenditures	16.0	15.7	15.4	15.2	14.6	14.2
Operating surplus	1.4	1.9	2.0	2.5	3.1	3.5
Public debt charges	6.1	6.1	5.7	5.2	4.8	4.7
Budgetary expenditures	22.1	21.7	21.1	20.4	19.4	18.9
Budgetary deficit	4.7	4.2	3.7	2.7	1.7	1.1
Financial requirements/source(–)[3]	3.4	3.1	2.3	1.4	0.5	–0.1
Net public debt	54.4	55.9	56.2	55.5	53.7	51.6
National accounts deficit/surplus(–)	3.5	2.8	2.2	1.2	0.3	–0.2

Note: Figures may not add due to rounding.

(1) Estimate.

(2) Forecast.

(3) Excluding foreign exchange transactions.

Chart 10

Financial Requirements

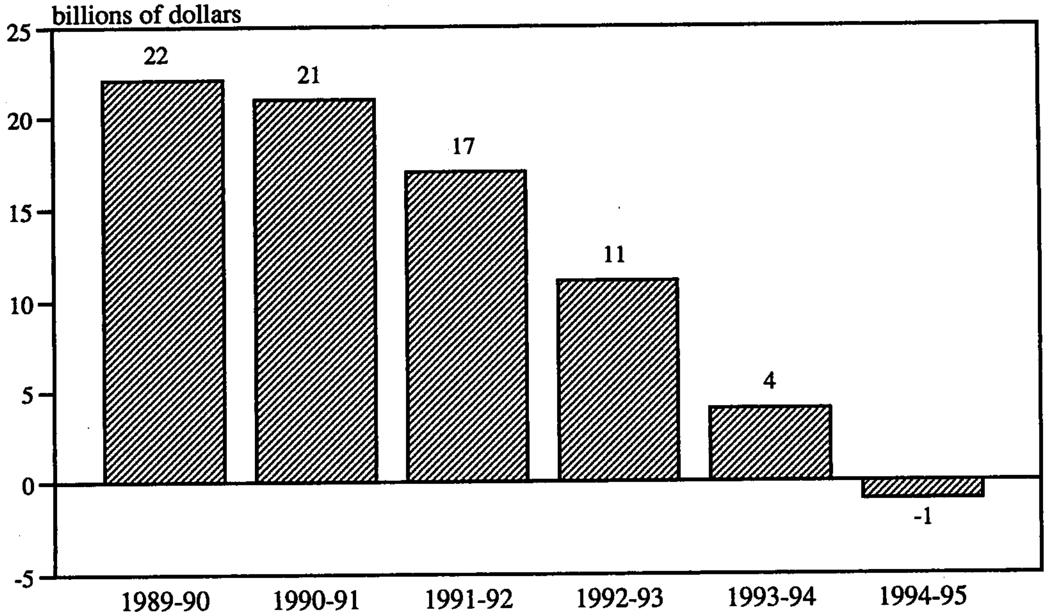


Chart 11

The Budgetary Deficit

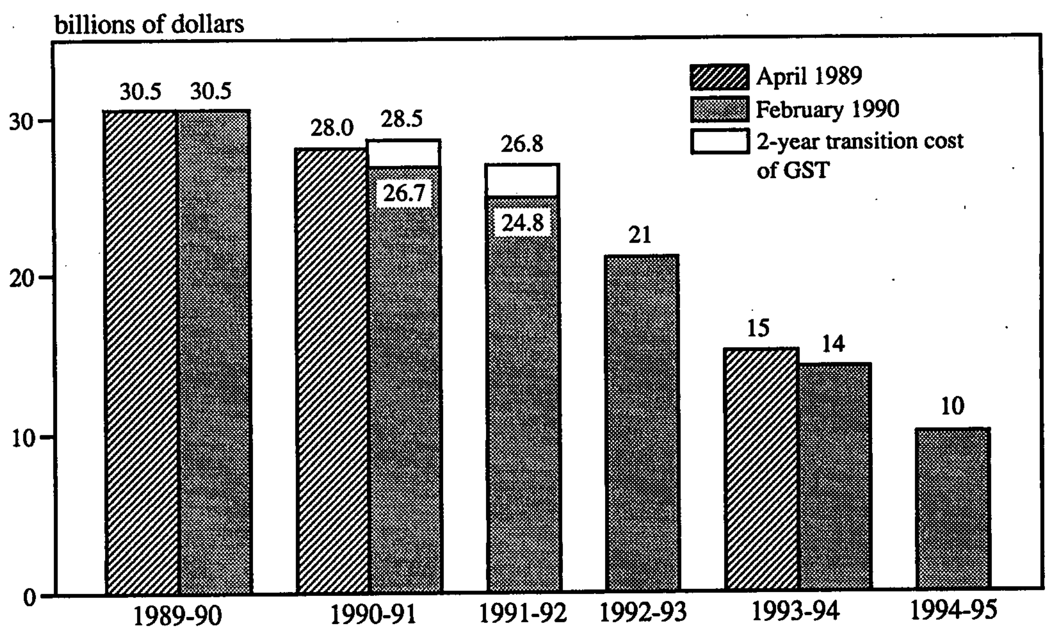
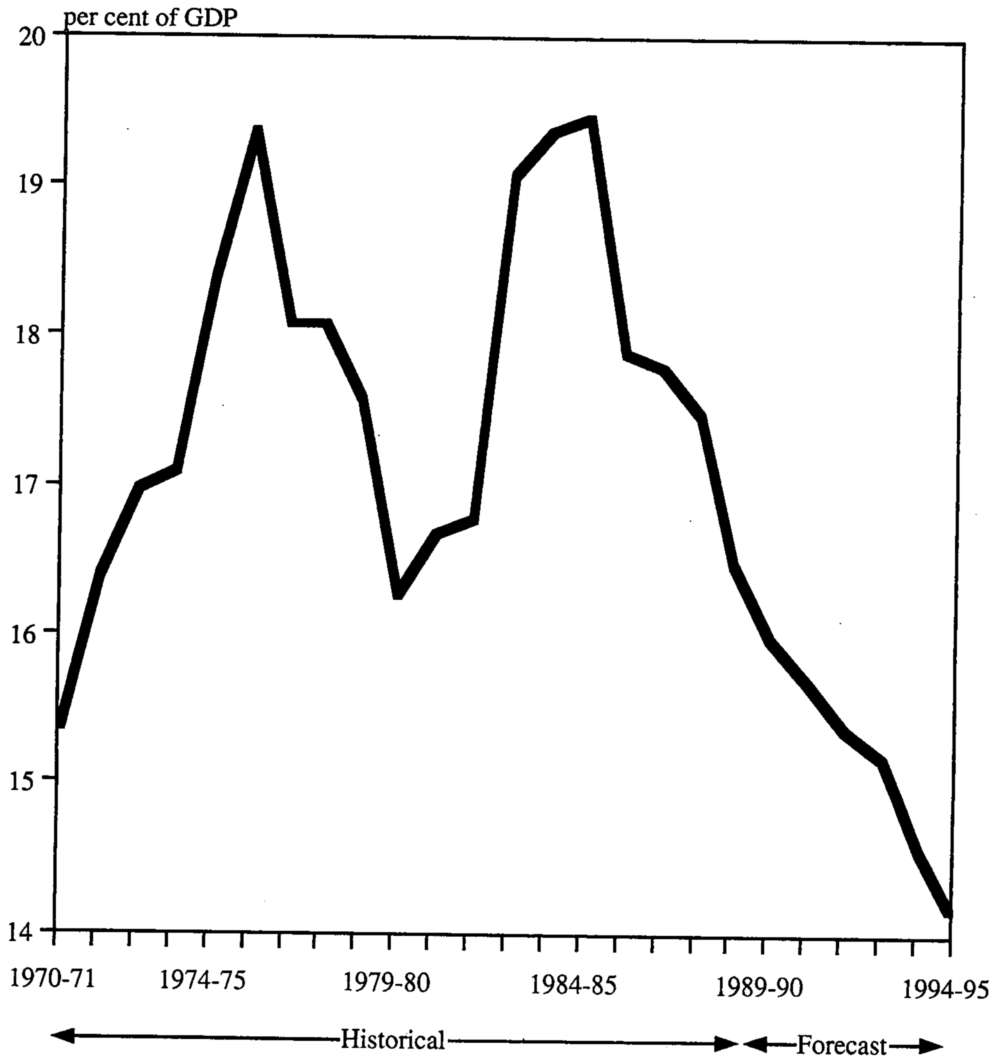


Chart 12

Program Expenditures

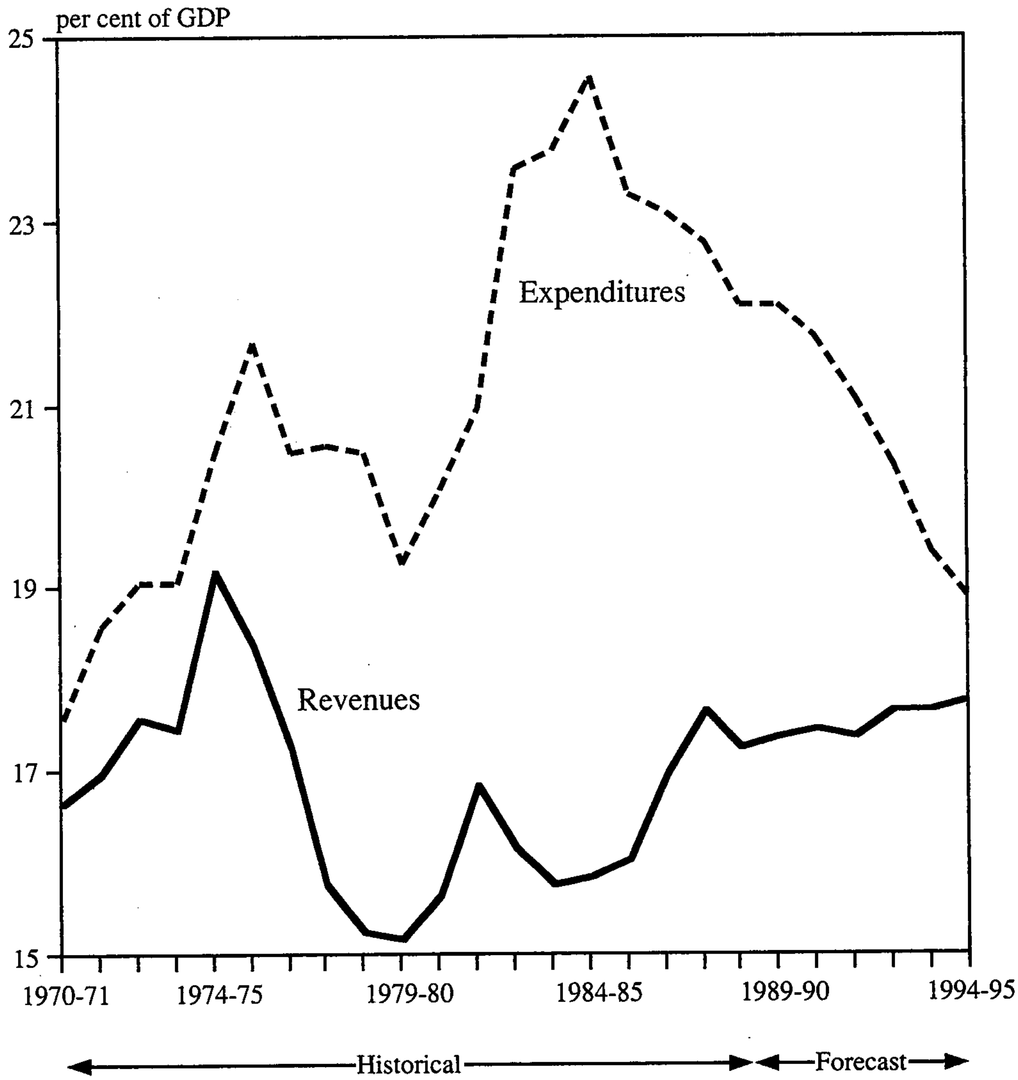


- The goal of stabilizing the debt-to-GDP ratio, the key medium-term objective of fiscal policy since 1984, will be achieved in 1991-92 and thereafter the ratio will decline (Chart 15). This means a reduced burden of debt for future generations. It also means reduced vulnerability of the fiscal framework to interest rate fluctuations.

- Public debt charges will consume an ever-smaller portion of each revenue dollar, declining to about 26 cents in 1994-95 from their peak of just over 35 cents in 1989-90 (Chart 16). This will help restore the government's flexibility to respond to future economic developments and to changing policy priorities.

Chart 13

Budgetary Revenues and Budgetary Expenditures 1970-71 to 1994-95

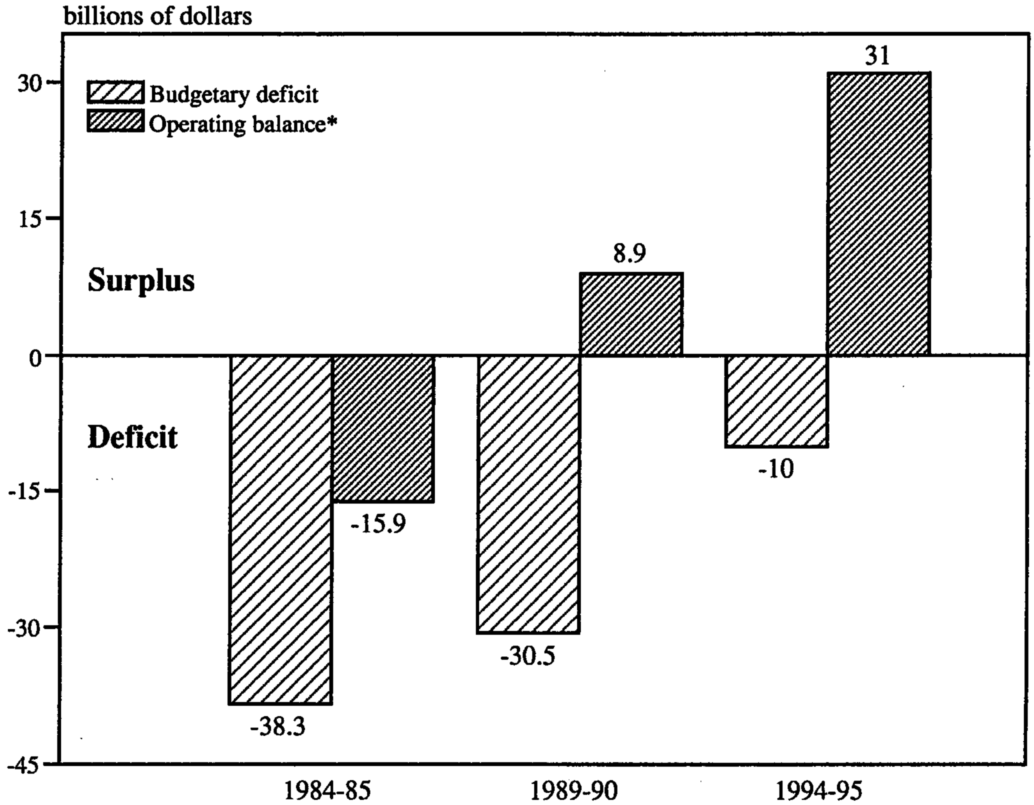


The Fiscal and Economic Goals Are Met

The actions in this budget sustain the momentum toward realizing the medium-term fiscal objectives set out in the April 1989 budget. While there are risks inherent in any medium-term planning projection, the fiscal and economic projections presented here are realistic. The short-term economic forecast embodies a period of slow economic growth, an easing of inflation pressures and an accompanying decline in interest rates – a view shared by the consensus of

Chart 14

Budgetary Deficit and Operating Balance 1984-85 to 1994-95



* The operating balance equals the budgetary deficit excluding public debt charges. It is the difference between ongoing program expenditures and government revenues.

private sector forecasters.[1] Over the medium term, increased potential output growth, which results from the structural initiatives introduced since 1984 (Chapter 2 gives details), and a further decline in inflation are forecast. The fiscal actions taken in this and previous budgets, together with anti-inflationary monetary policy, will help ensure the realization of lower inflation. Nominal interest rates are projected to decline in line with forecast reductions in inflation, but real interest rates over the medium term are expected to remain well above historical averages.

Since coming to office in 1984 the government has worked consistently to regain control over the fiscal situation in order to ensure the capacity of the economy to grow, and of the government to meet the priorities of Canadians. The fiscal framework in this budget, together with the structural initiatives taken by the government since 1984, will generate an environment for sustained, non-inflationary growth.

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[1] Chapter 2 contains a description of the economic forecast. An assessment of the Department of Finance's forecasting record is contained in the *Quarterly Economic Review*, Finance Canada, December 1989.

Chart 15

The Debt-to-GDP Ratio: 1980-81 to 1994-95

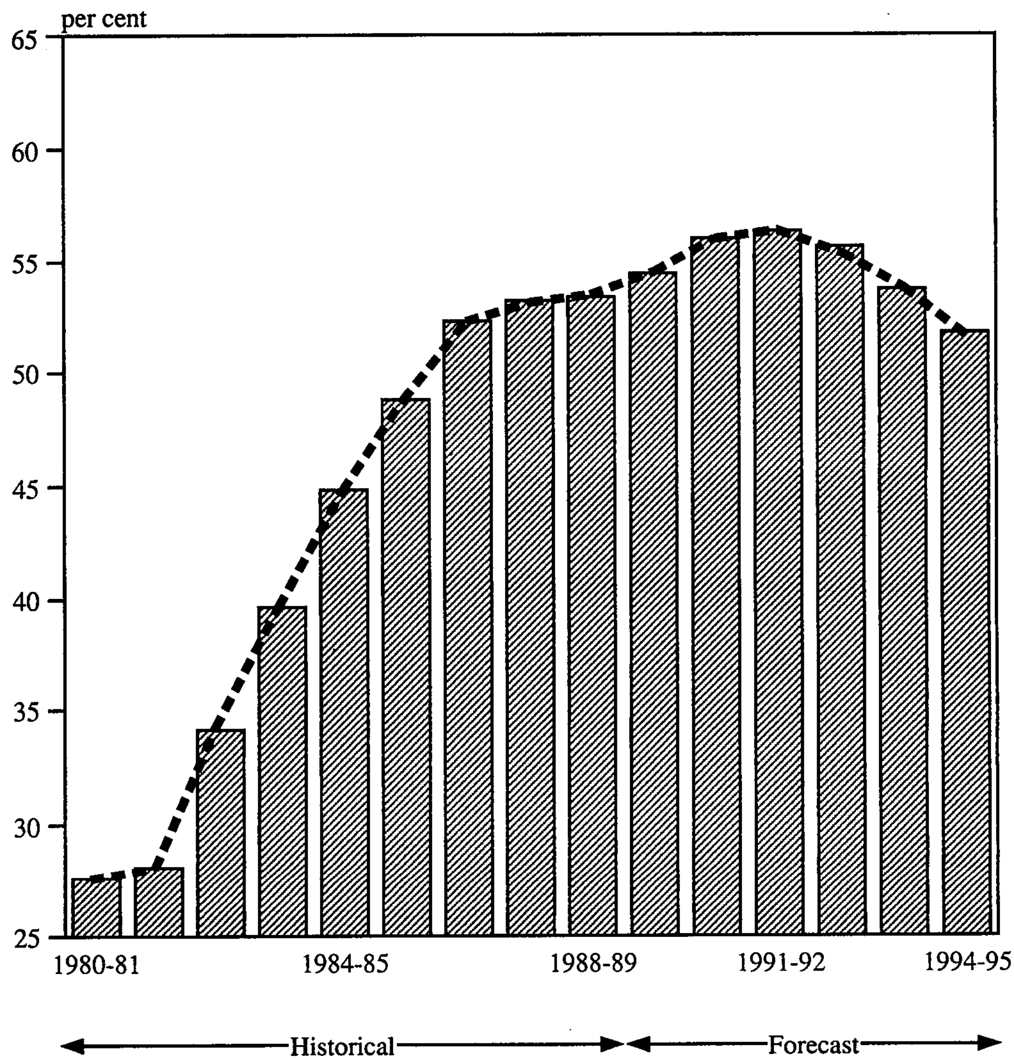
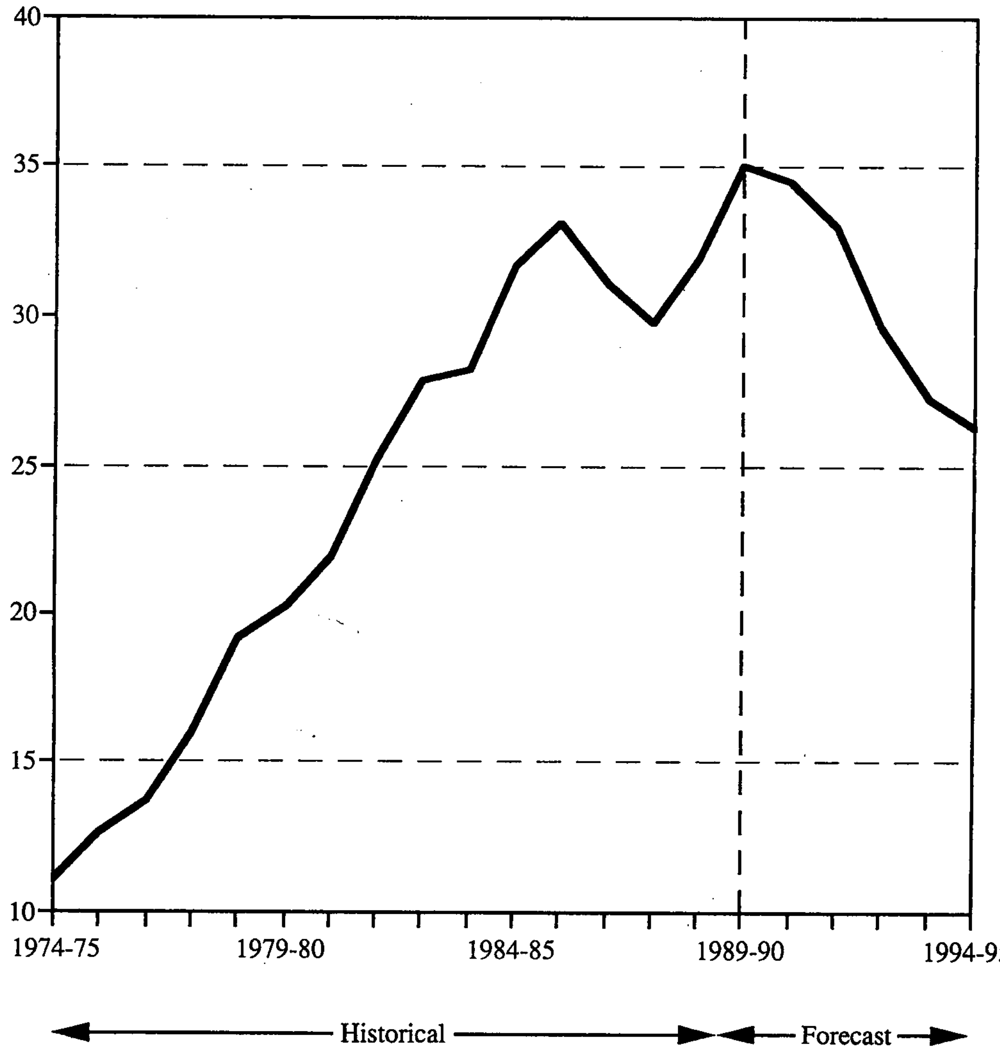


Chart 16

Debt Charges as a Per Cent of Budgetary Revenues



Annex 1

The Fiscal Projections on a National Accounts Basis

There are three basic measures of the federal fiscal position – the public accounts deficit, financial requirements, and the national accounts deficit. The first two have been discussed at length in previous sections. The third measure – the national accounts deficit – is presented in this section.

Differences between the various measures arise because the accounting frameworks are designed for different purposes. The public accounts conventions have been adopted to facilitate parliamentary control over the flows of cash into and out of the Consolidated Revenue Fund. Financial requirements show the net direct impact of the federal government's activities on the credit markets. The primary objective of the national accounts is to measure current economic production, and thus the government sector is treated on the same basis as other sectors of the economy, such as the personal, business and foreign sectors. National accounts are typically used for international comparisons: under the auspices of the United Nations and the Organization for Economic Co-operation and Development, government budget balances of member countries are brought together within the framework of the United Nations' national accounts system on which Canada's national accounts are based.

With these differences in objectives between the public accounts and the national accounts, there are significant differences in the level of the public accounts deficit and the national accounts deficit. The national accounts deficit is lower than the public accounts deficit; in 1989-90, the national accounts deficit is estimated to be $8 billion lower. Although the levels are different, the trends are similar (Chart A.1.1). The level of the national accounts deficit is much more comparable to that of financial requirements, excluding foreign exchange requirements, given that the net position of the federal government employees' pension funds are common to both but excluded from the computation of the public accounts deficit (Chart A.1.1).

There are a number of other less significant differences in the determination of the public accounts and national accounts deficits. These include:

- more extensive use of accrual accounting principles in the national accounts; and

- the exclusion of the sale of capital assets from the national accounts.

Table A.1.1 sets out the federal government's revenues, expenditures and deficit on a national accounts basis.

Chart A.1.1

Alternative Measures of the Federal Balance 1982-83 to 1994-95 (Fiscal Years)

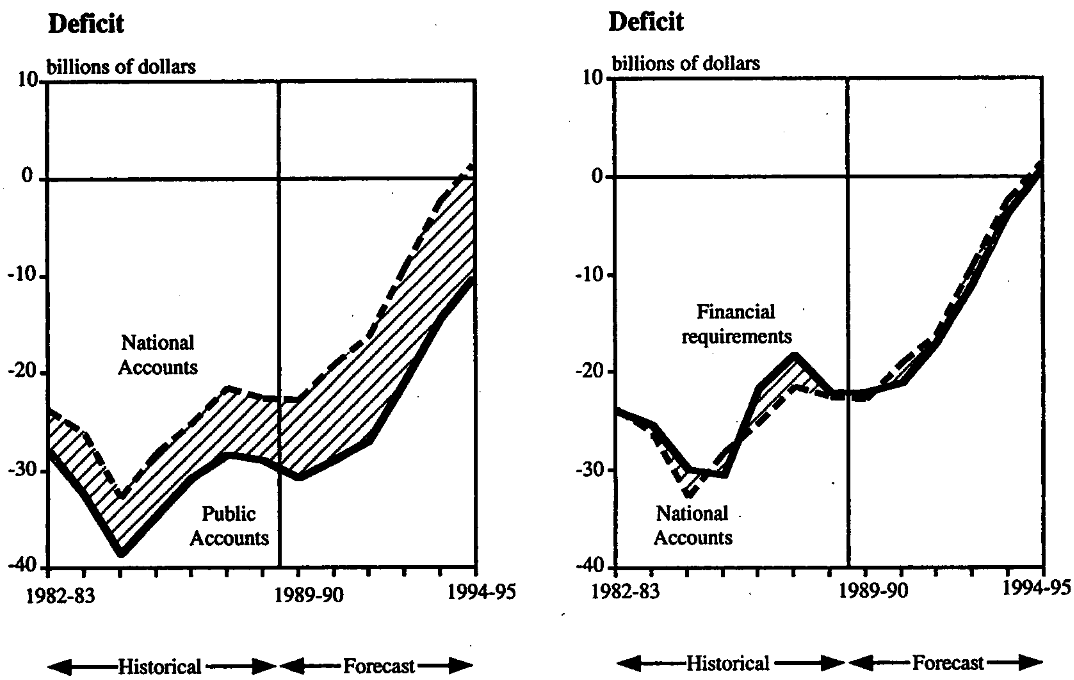


Table A.1.1

Government of Canada Revenues and Expenditures
National Accounts Basis

	1989-90	1990-91	1991-92
		(millions of dollars)	
Revenues			
Direct taxes			
– persons	64,225	70,990	75,495
– corporations	11,410	12,690	14,060
– non-residents	1,405	1,610	1,690
Indirect taxes	29,555	30,500	32,415
Other current transfers from persons	25	30	30
Investment income	12,240	12,920	13,270
Current revenues	118,860	128,740	136,960
Capital consumption allowances	1,500	1,555	1,605
Total revenues	120,360	130,295	138,565
Expenditures			
Current goods and services			
– capital consumption allowances	1,500	1,555	1,605
– other	25,345	27,015	28,190
Transfer payments to persons	38,665	42,520	45,190
Transfers to other levels of government	25,945	25,795	26,450
Current transfers to non-residents	2,220	2,430	2,545
Subsidies	5,605	5,150	5,635
Capital assistance	2,240	1,860	1,810
Public debt interest	39,125	40,855	41,205
Current expenditures	140,645	147,180	152,630
Gross capital formation	2,320	2,080	2,130
Total expenditures	142,965	149,260	154,760
Current balance	–21,785	–18,440	–15,670
Total deficit	–22,605	–18,965	–16,195

Annex 2

Total Government Sector Fiscal Trends

Introduction

This annex examines the evolution of the fiscal situation of the total government sector in Canada over the past decade and over the medium-term forecast period. The total government sector includes the federal government, provincial and local administrations including hospitals (PLH), and the Canada and Quebec Pension Plans (C/QPP). The focus is on the evolution of government sector deficits and debt and comparative federal-provincial government debt service costs, program expenditure growth, and wage settlements.

Deficits and Debt

Since 1984, after a decade of large deficits and rapid growth in debt, there has been a pronounced decline in collective government deficits. This reflects the effects of discretionary measures to restrain expenditures and raise revenues, along with strong economic growth.

The total government sector deficit reached 6 1/2 per cent of GDP in 1984, on a national accounts, calendar year basis. From 1984 to 1989, it declined almost 3 percentage points. The federal deficit peaked at 6.8 per cent in 1984 and was down to 3.7 per cent in 1989 (Chart A.2.1). PLH deficits, which have generally remained low, rose in 1985 and 1986, following largely from the fiscal impact on western provinces of declines in energy and grain prices. Corrective fiscal action was taken by affected provinces, however, and by 1989, the PLH sector was in budgetary balance.

With the Expenditure Control Plan in this budget, the federal government is projected to be in a small surplus by 1994 on a national accounts basis. The PLH sector is projected to be in budgetary balance by 1994. The total sector debt-to-GDP ratio stabilizes in 1991 and it declines through the medium term. By 1994, the federal debt-to-GDP ratio is projected to be down to 35 per cent; the debt ratio for the PLH sector is projected to remain fairly stable at about 6 per cent of GDP (Chart A.2.2).

The C/QPP sector shows a history of surpluses. Reflecting increased contribution rates, the surplus-to-GDP ratio has stabilized in recent years; continued small surpluses are projected for the medium term.

Chart A.2.1

Government Sector Budget Balances
Deficit (+) / Surplus (–)
as a Per Cent of GDP

(National Accounts Basis)

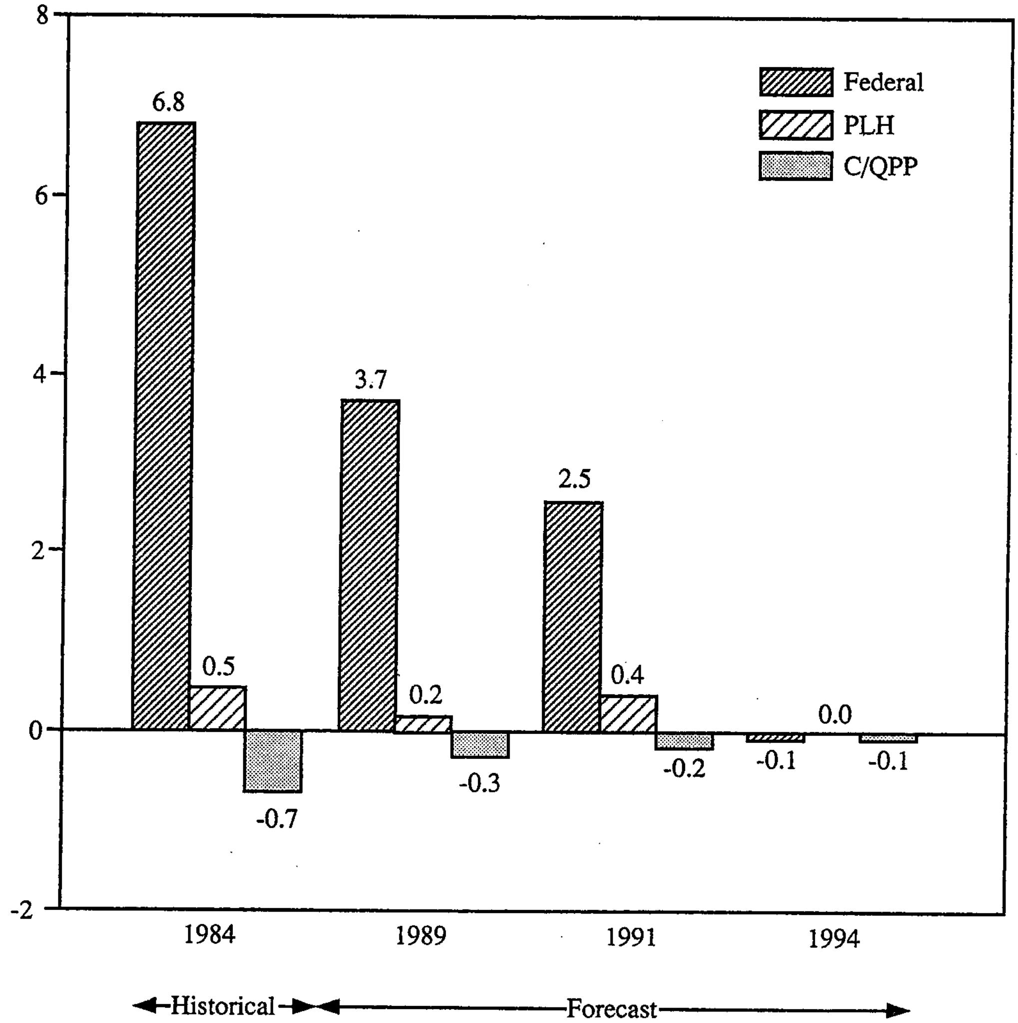
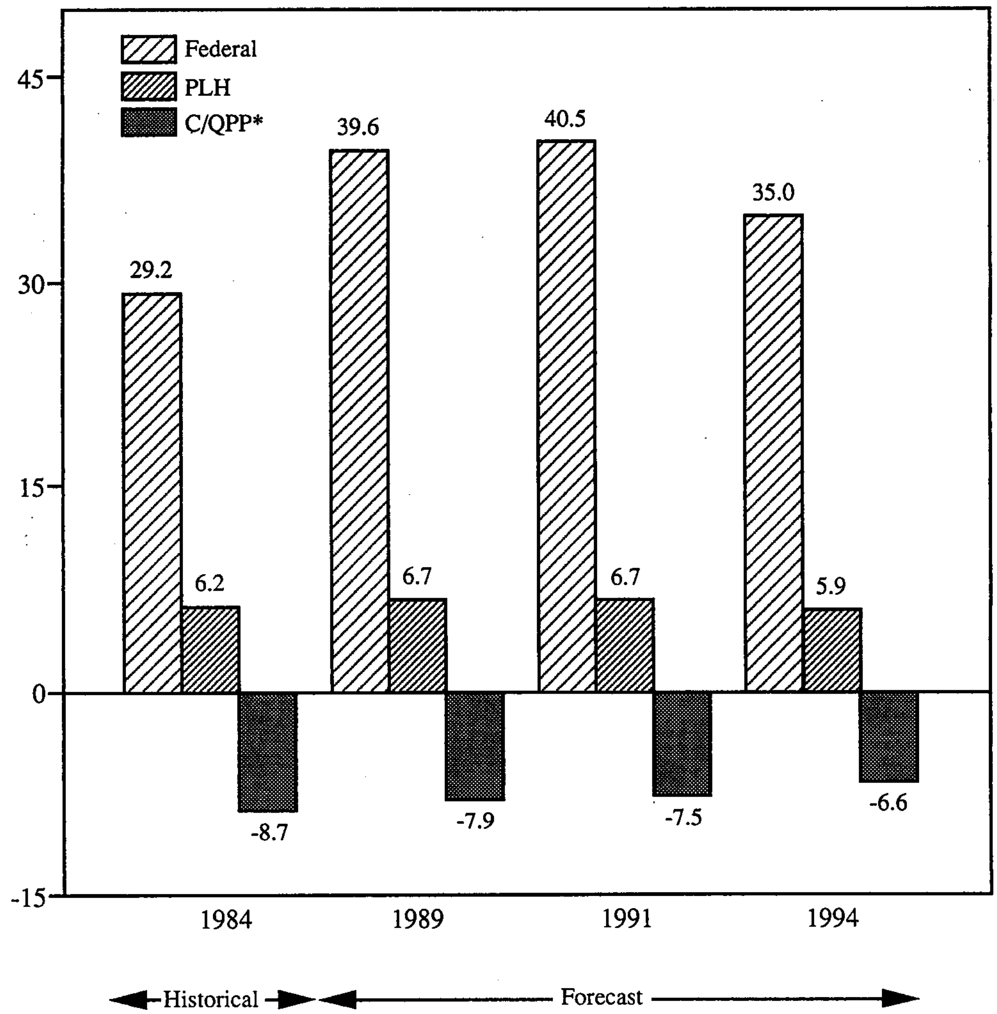


Chart A.2.2

Government Sector Net Debt as a Per Cent of GDP

(National Accounts Basis)



* Negative sign denotes net assets.

Comparative Federal-Provincial Debt Service Costs

Reflecting the comparative levels of indebtedness, while 35 cents of every federal revenue dollar went to service the public debt in 1989-90, for provinces the corresponding average figure was 12 cents (Chart A.2.3). Although debt service costs vary greatly from province to province, federal debt service costs are well above those of every province.

Comparative Federal-Provincial Program Expenditure Growth and Wage Settlements

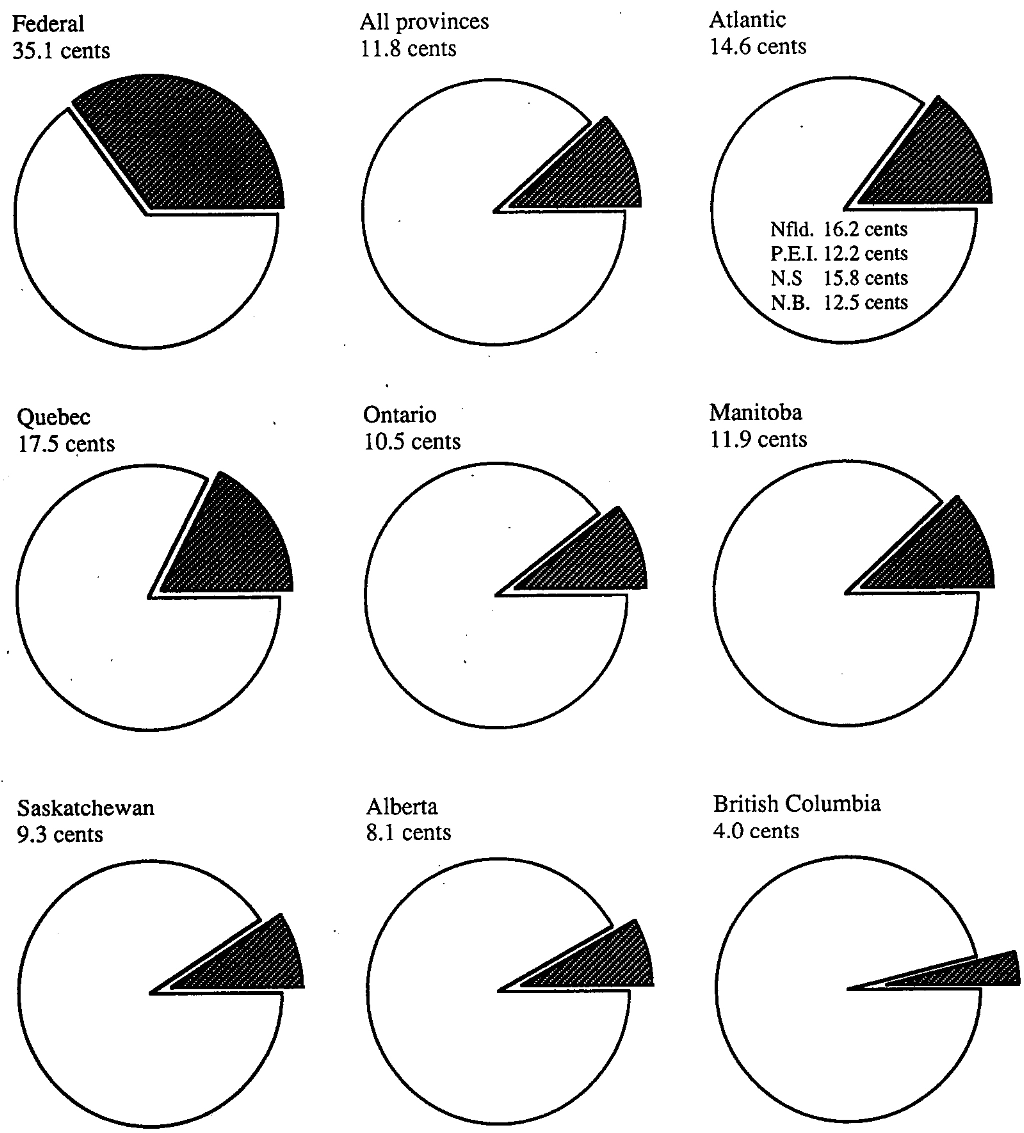
From 1984-85 to 1989-90, program expenditures rose, on average, 6.4 per cent per year for the provinces compared to only 3.6 per cent for the federal government. Average program expenditure growth in the provinces ranged from a high of 9.5 per cent in Ontario to a low of 3.9 per cent in Alberta (Chart A.2.4). With inflation averaging 4.3 per cent per year over this period, only the federal government and the governments of Alberta, Quebec and Saskatchewan have shown real declines in program spending since 1984.

An important component of program spending, particularly for provinces, is wages. Public sector wage settlements averaged 5.2 per cent in the first three quarters of 1989, up substantially from average settlements of 3.9 per cent in 1988. Settlements in 1989 have risen in all provinces. Federal wage settlements have remained below those in the provinces and below the rate of inflation (Chart A.2.5).

Chart A.2.3

Federal and Provincial Government Debt Charges

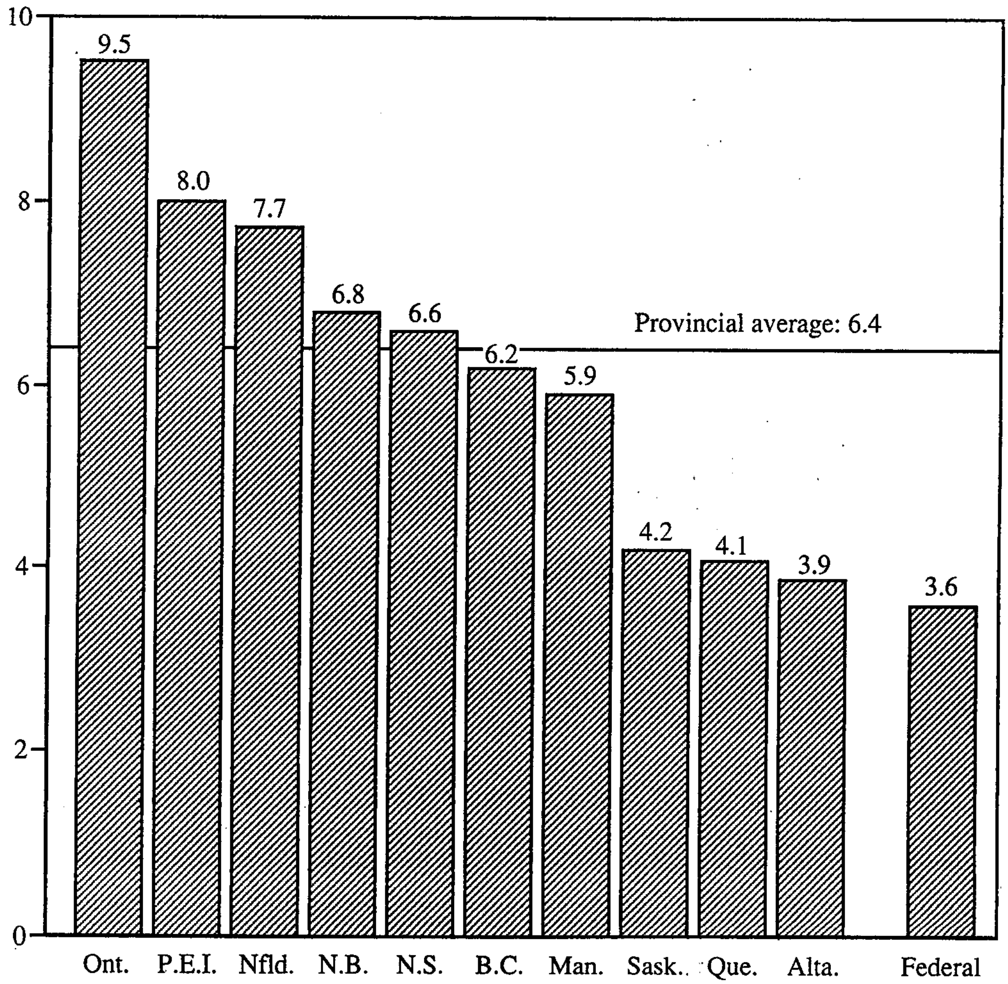
Number of Cents in Each Revenue Dollar Going to Cover Debt Charges in 1989-90*



*Based on most recent public accounts estimates published by the government concerned. It should be noted that government universes differ as do accounting conventions, and hence, data are not strictly comparable.

Chart A.2.4

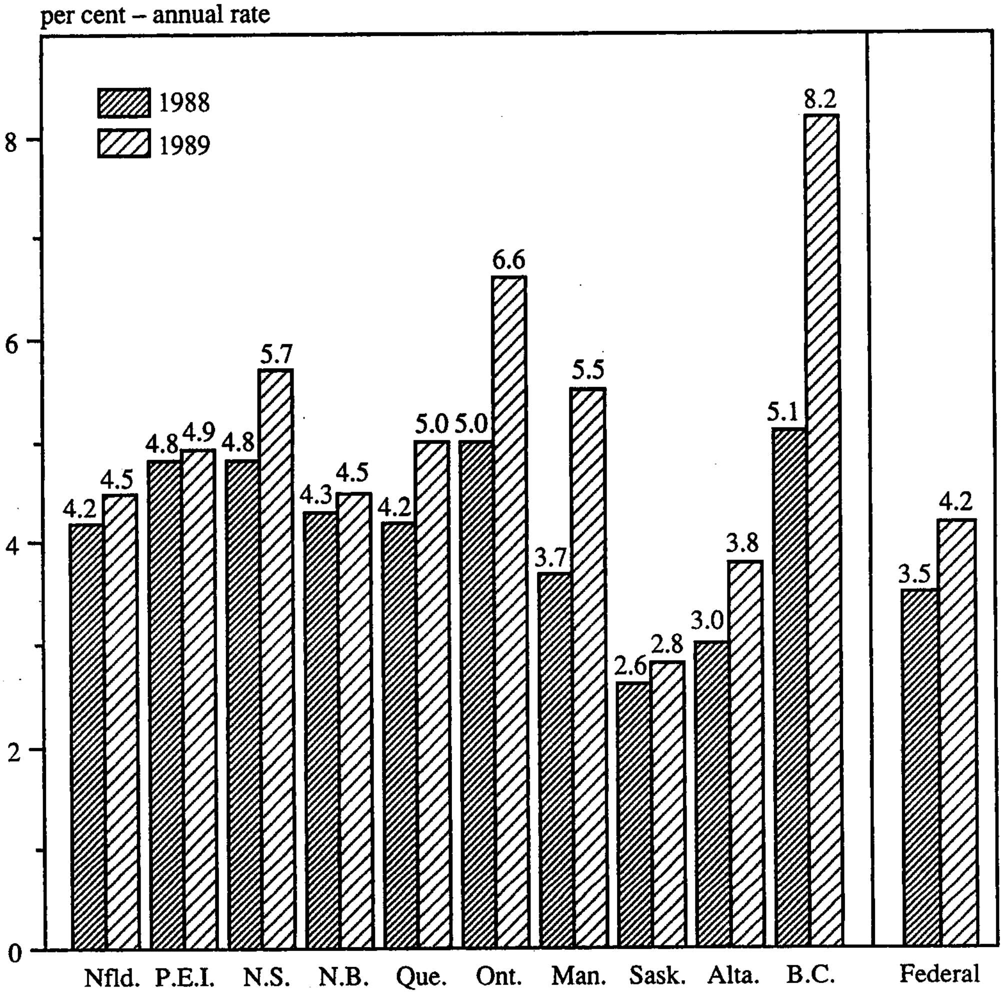
Average Annual Percentage Increase in Program Expenditures* 1984-85 to 1989-90



* Based on most recent public accounts estimates.

Chart A.2.5

Public Sector Wage Settlements 1988 and 1989*



* First three quarters.

Annex 3

International Fiscal Comparisons

International comparisons of fiscal positions are difficult to make since differences between countries in accounting procedures and the definitions of government universes can introduce inconsistencies into the data. The comparisons given below are made using, for the most part, national accounts data produced on an internationally consistent basis by the Organization for Economic Co-operation and Development (OECD).

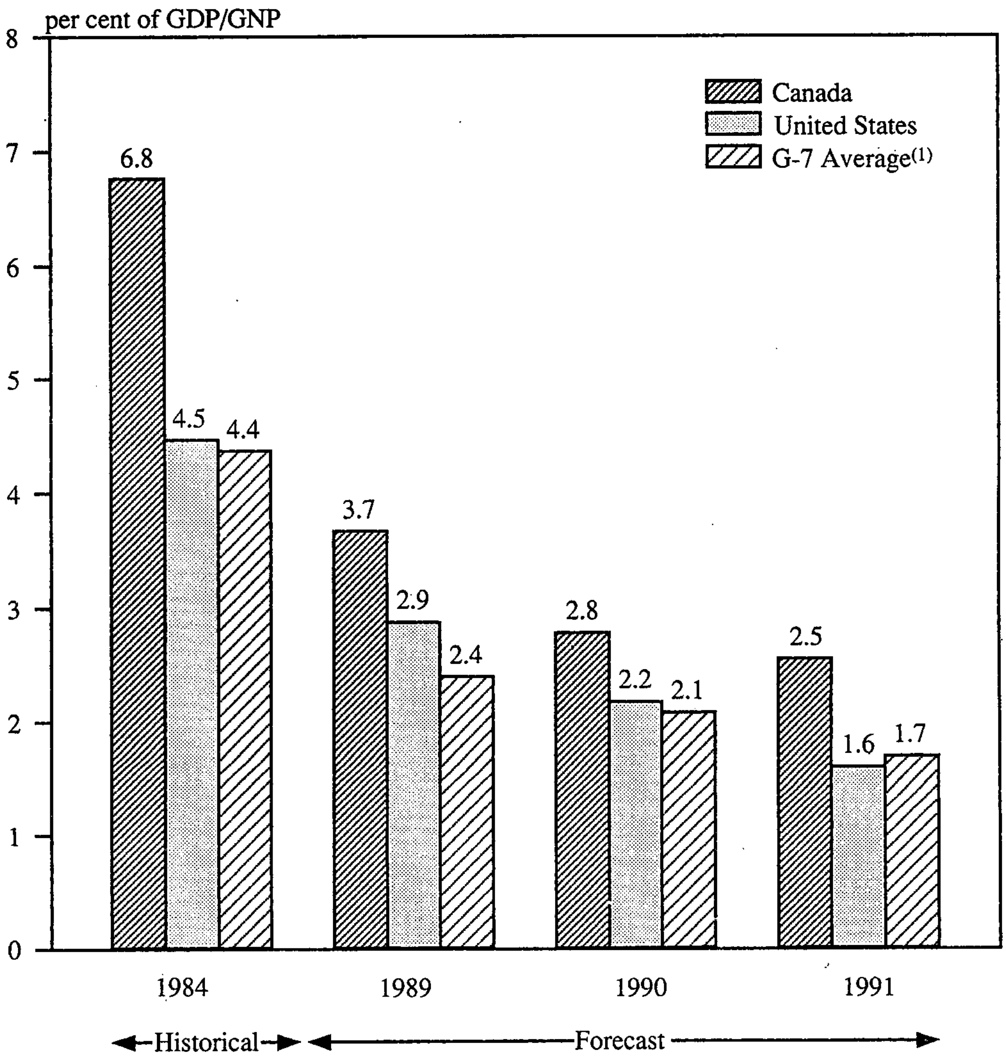
Over the past five years, discretionary fiscal actions, in conjunction with strong economic performances, have resulted in solid progress in reducing budget deficits in the G-7 countries, particularly in Canada. In 1984, Canada's federal government deficit on a national accounts basis was 6.8 per cent of GDP, 2.4 percentage points of GDP/GNP higher than the G-7 average (Chart A.3.1). Between 1984 and 1989, the federal government deficit in Canada declined 3.1 percentage points of GDP while the central government deficit in the G-7 declined by 2 percentage points. Firm action taken in this budget ensures continued progress in this regard. By 1991, the federal government deficit in Canada is expected to decline to 2.5 per cent of GDP, less than one percentage point of GDP/GNP higher than the G-7 average.

Actions to reduce the deficit in Canada have resulted in considerable restraint in program expenditures. Expenditure restraint in Canada exceeds that achieved in the United States and matches that achieved in the United Kingdom (Table A.3.1). From their peaks in the 1980s through 1989-90, on a public accounts basis as a per cent of GDP, program expenditures declined 18 per cent in Canada compared to declines of 13 per cent in the United States and 17 per cent in the United Kingdom (Chart A.3.2).

Chart A.3.1

International Comparisons of Central Government Budget Deficits 1984 to 1991

(National Accounts Basis)



(1) 1980-1981 GDP/GNP weights in U.S. dollars.

Sources: OECD, *Economic Outlook,* December 1989; Data Resources Incorporated; and Department of Finance.

Chart A.3.2

Comparison of Declines in Program Expenditures (as a per cent of GDP/GNP) From Their 1980s Peaks: Canada, United Kingdom, and the United States

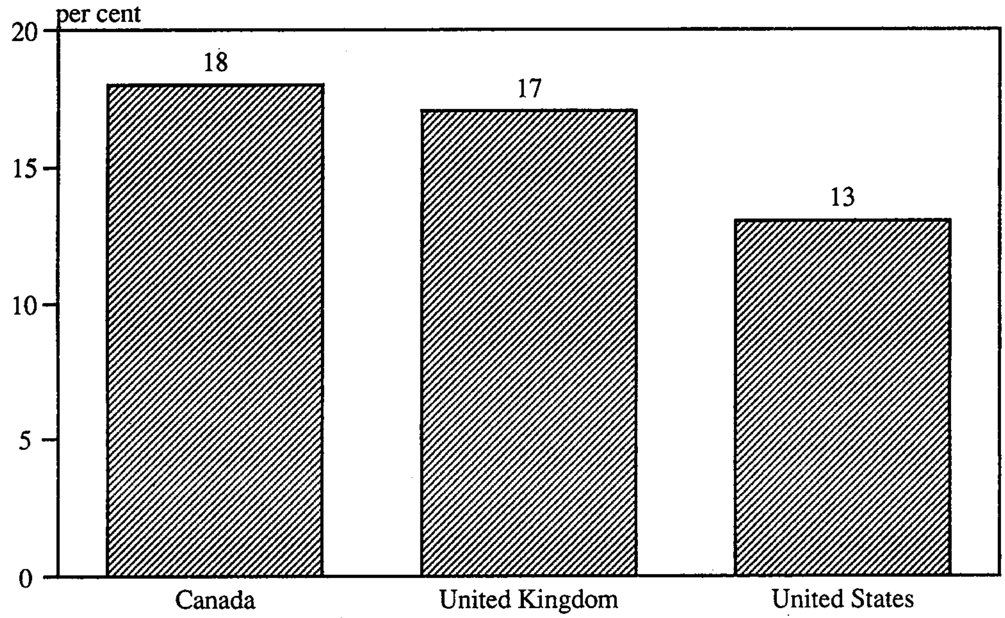


Table A.3.1

Canada-U.S.-U.K. Comparisons of Program Expenditures

			United Kingdom[2]	
Fiscal Year[1]	Canada	United States	Asset sales[3] netted against expenditures	Asset sales[3] as revenue
		(per cent of GDP/GNP)		
1980-81	16.7	19.3	41.9	42.2
1981-82	16.8	20.3	42.0	42.2
1982-83	19.1	21.2	42.7	42.9
1983-84	19.4	21.4	41.5	41.9
1984-85	19.5	19.9	41.4	42.2
1985-86	17.9	20.6	39.5	40.2
1986-87	17.8	20.4	38.7	39.9
1987-88	17.5	19.3	36.9	38.2
1988-89	16.5	18.8	34.7	36.2
1989-90	16.0	18.7	34.8	35.8

(1) The Canadian and U.K. fiscal years ending March 31 are compared with the U.S. fiscal year ending September 30 of the previous year.

(2) The United Kingdom is a non-federal country and therefore the figures are at the total government level.

(3) In the United Kingdom, revenues from asset sales are netted against expenditures in their financial statements. In Canada, the public accounts include receipts from asset sales as revenues. To conform to the convention in Canada, the receipts from asset sales are also recorded as revenues.

Sources: Budget of the United States Government, FY 1991, Office of Management and Budget, January 29, 1990; *Financial Statement and Budget Report*, London, Her Majesty's Stationery Office, March 1989; *Public Expenditure White Paper*, London, Her Majesty's Treasury, January 1988; and Department of Finance.

Annex 4

Fiscal Sensitivity Analysis

Fiscal projections are sensitive to economic developments. Estimates of the sensitivity of the main fiscal aggregates to changed assumptions about the level of real output and interest rates are presented in Table A.4.1. A 1-per-cent increase in the level of real output reduces the deficit by about $1 1/4 billion in the first year rising to approximately $1 3/4 billion after four years. A 100-basis-point decline in all interest rates would reduce the deficit about $1 3/4 billion in the first year and $3 1/2 billion after four years. The fiscal impacts of the opposite changes in these two variables are broadly symmetric.

Table A.4.1

Fiscal Sensitivity Analysis

	Estimated changes to fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
1-per-cent increase in output (level)[1]				
Budgetary transactions				
Revenue increases	1.1	1.3	1.4	1.5
Expenditure reductions	0.1	0.2	0.2	0.2
Deficit reductions	1.2	1.5	1.6	1.7
100-basis-point lower interest rates				
Budgetary transactions				
Revenue reductions	0.1	0.2	0.2	0.2
Expenditure reductions	1.8	2.8	3.3	3.7
Deficit reductions	1.7	2.6	3.1	3.5

Note: Figures may not add due to rounding.

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

Annex 5

Direct Fiscal Impact of Sales Tax Reform

The fiscal projections presented in Chapter 4 incorporate the impact of replacing the existing federal manufacturers sales tax (FST) with the Goods and Services Tax (GST). The FST is an increasingly unreliable source of federal revenues. As such, the tax is an impediment to sound fiscal planning and a threat to the government's strategy for getting the deficit under control.

The proposed GST will contribute to the federal government's deficit reduction effort in two ways:

- First, because it will minimize tax avoidance and evasion activities, the GST will provide greater assurance that the revenues required to meet the government's deficit targets will, in fact, be forthcoming. In particular, it will secure the $2 billion in additional sales tax revenues announced in the April 1989 budget.

- Second, by improving Canadian economic performance, the GST will lead to a lower deficit than would have been the case in the absence of reform.

In this annex, the direct fiscal impact of sales tax reform is examined in detail. Panel A of Table A.5.1 presents the direct revenue impact of replacing the FST with the 7-per-cent GST. Differences will arise from year to year as the tax bases are not identical and the rates of growth in the various components of the bases differ.

- the GST replaces the FST and a number of miscellaneous excise taxes, including the cable programming services tax. These taxes would have yielded projected net revenues of almost $19 billion in 1991-92.

- In 1991-92, the first full year of implementation, the GST is projected to yield $20.8 billion in net revenues. This figure includes the impact of the adjustments to the excise taxes on alcoholic beverages and tobacco products to maintain the federal tax burden on these products at their pre-reform levels.

- In addition, the figure of $20.8 billion is net of the GST rebates to hospitals, school boards, municipalities, colleges, universities, charities, non-profit organizations, and libraries. It is also net of the housing rebate. In total, these rebates represent about $2 billion per annum in foregone GST revenues.

- To ensure that lower- and modest-income Canadians are better off under the new system, the existing refundable FST credit will be replaced by the new GST credit. The amount of the credit will be based on the previous year's income and family status. In the fall of 1990, Revenue Canada will advise all applicants about their eligibility and the amount of their GST credit. The new credit will be paid in four equal instalments during the year. The current

Table A.5.1

Direct Fiscal Impact of Sales Tax Reform

	1990-91	1991-92	Mature system 1992-93
		(millions of dollars)	
A. Sales and excise taxes			
Net GST revenues*	2,700	20,755	21,935
Elimination of existing FST and miscellaneous excise taxes	–3,110	–18,970	–20,430
Enhanced GST credit		–1,270	–1,290
Net sales and excise tax revenues	–410	515	215
B. Consequential impacts/related fiscal actions			
Indexation impact	0	–295	–685
Administration costs	–260	–365	–380
Expenditure reductions	246	450	700
Increase in high-income surtax	35	160	190
Increase in large corporations tax	15	155	160
Total consequential impact/related fiscal actions	36	105	–15
C. Transitional impacts			
Prepayment of GST credit	–600		
FST inventory rebates	–1,200	–1,100	
Small business transitional grants		–900	
Total transitional costs	–1,800	–2,000	

(+) represents a net source of funds.
(–) represents a net requirement for funds.

* Net of rebates to public sector institutions, charities, non-profit organizations, and libraries. It is also net of the housing rebate.

FST credit is paid only once a year at the time of tax filing. The total value of the GST credit will amount to $2.4 billion per year, representing an increase of about $1.3 billion over the current FST credit.

Panel B presents the consequential impacts of sales tax reform and the fiscal actions that the government undertook to achieve a fiscally balanced GST at the 7-per-cent rate. These are:

- the effect of the one-time increase in the price level on the indexation of the personal income tax brackets and credits and of payments under various indexed programs – elderly benefits, veterans' pensions and allowances, family allowances, etc.;

- the administrative and collection costs of the new program;
- a number of expenditure reduction and management initiative measures, which were announced by the President of the Treasury Board in December 1989. Once fully implemented, these measures are expected to generate annual savings of $0.7 billion;
- an increase in the high-income surtax; and
- an increase in the large corporations tax.

Panel C shows the one-time transitional costs of sales tax reform. These include:

- the prepayment of the GST credit in December 1990;
- the transitional grant to small businesses; and
- the rebate of FST paid on inventories, held on December 31, 1990, of new and unused goods.

These one-time transitional costs are estimated to lower budgetary revenues by $1.8 billion in 1990-91 and by $2.0 billion in 1991-92. As these costs are not ongoing, the design of the GST did not recover them on an ongoing basis.

Annex 6

Fiscal Reference Tables

Table I

Fiscal Transactions

	Budgetary revenues	Budgetary expenditures	Budgetary surplus or deficit(−)	Non-budgetary transactions	Financial requirements (excl. foreign exchange transactions)
			(millions of dollars)		
1926-27	372	−330	42	−38	4
1931-32	303	−417	−114	−104	−218
1936-37	420	−498	−78	10	−68
1941-42	1,487	−1,839	−352	−269	−621
1946-47	3,034	−2,604	430	−896	−466
1951-52	4,101	−3,745	356	64	420
1956-57	5,582	−5,257	325	130	455
1957-58	5,456	−5,652	−196	−150	−346
1958-59	5,159	−6,036	−877	−601	−1,478
1959-60	5,896	−6,496	−600	116	−484
1960-61	6,322	−6,851	−529	205	−324
1961-62	6,468	−7,416	−948	95	−853
1962-63	6,662	−7,495	−833	−106	−939
1963-64	7,099	−8,268	−1,169	910	−259
1964-65	8,220	−8,535	−315	399	84
1965-66	8,955	−8,652	303	−205	98
1966-67	9,752	−9,939	−187	−473	−660
1967-68	10,637	−11,348	−711	−667	−1,378
1968-69	11,939	−12,339	−400	−411	−811
1969-70	14,291	−13,959	332	−98	234
1970-71	14,874	−15,654	−780	−248	−1,028
1971-72	16,511	−18,053	−1,542	176	−1,366
1972-73	19,097	−20,772	−1,675	367	−1,308
1973-74	22,322	−24,321	−1,999	482	−1,517
1974-75	29,143	−31,152	−2,009	−130	−2,139
1975-76	31,549	−37,286	−5,737	963	−4,774
1976-77	34,300	−40,597	−6,297	749	−5,548
1977-78	34,518	−44,944	−10,426	1,977	−8,449
1978-79	36,866	−49,483	−12,617	1,405	−11,212
1979-80	41,921	−53,422	−11,501	1,369	−10,132
1980-81	48,775	−62,297	−13,522	3,628	−9,894
1981-82	60,001	−74,873	−14,872	5,626	−9,246
1982-83	60,705	−88,521	−27,816	4,014	−23,802
1983-84	64,216	−96,615	−32,399	7,198	−25,201
1984-85	70,898	−109,222	−38,324	8,516	−29,808
1985-86	76,833	−111,237	−34,404	4,134	−30,270
1986-87	85,784	−116,389	−30,605	9,038	−21,567
1987-88	97,452	−125,535	−28,083	9,930	−18,153
1988-89	103,981	−132,715	−28,734	6,762	−21,972

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table II

Fiscal Transactions

	Budgetary revenues	Budgetary expenditures	Budgetary surplus or deficit(−)	Non-budgetary transactions	Financial requirements (excl. foreign exchange transactions)
			(percentage of GDP)*		
1926-27	7.2	−6.4	0.8	−0.7	0.1
1931-32	6.5	−8.9	−2.4	−2.2	−4.6
1936-37	9.1	−10.7	−1.7	0.2	−1.5
1941-42	18.0	−22.2	−4.3	−3.2	−7.5
1946-47	25.5	−21.9	3.6	−7.5	−3.9
1951-52	19.0	−17.3	1.6	0.3	1.9
1956-57	17.4	−16.4	1.0	0.4	1.4
1957-58	16.3	−16.9	−0.6	−0.4	−1.0
1958-59	14.8	−17.4	−2.5	−1.7	−4.2
1959-60	16.4	−18.1	−1.7	0.3	−1.4
1960-61	16.5	−17.9	−1.4	0.5	−0.8
1961-62	15.8	−18.1	−2.3	0.2	−2.1
1962-63	15.0	−16.9	−1.9	−0.2	−2.1
1963-64	14.9	−17.3	−2.5	1.9	−0.5
1964-65	15.7	−16.4	−0.6	0.8	0.2
1965-66	15.6	−15.0	0.5	−0.4	0.2
1966-67	15.1	−15.4	−0.3	−0.7	−1.0
1967-68	15.4	−16.4	−1.0	−1.0	−2.0
1968-69	15.8	−16.4	−0.5	−0.5	−1.1
1969-70	17.2	−16.8	0.4	−0.1	0.3
1970-71	16.7	−17.6	−0.9	−0.3	−1.2
1971-72	17.0	−18.6	−1.6	0.2	−1.4
1972-73	17.6	−19.1	−1.5	0.3	−1.2
1973-74	17.5	−19.1	−1.6	0.4	−1.2
1974-75	19.2	−20.5	−1.3	−0.1	−1.4
1975-76	18.4	−21.7	−3.3	0.6	−2.8
1976-77	17.3	−20.5	−3.2	0.4	−2.8
1977-78	15.8	−20.6	−4.8	0.9	−3.9
1978-79	15.3	−20.5	−5.2	0.6	−4.6
1979-80	15.2	−19.3	−4.2	0.5	−3.7
1980-81	15.7	−20.1	−4.4	1.2	−3.2
1981-82	16.9	−21.0	−4.2	1.6	−2.6
1982-83	16.2	−23.6	−7.4	1.1	−6.4
1983-84	15.8	−23.8	−8.0	1.8	−6.2
1984-85	15.9	−24.6	−8.6	1.9	−6.7
1985-86	16.1	−23.3	−7.2	0.9	−6.3
1986-87	17.0	−23.1	−6.1	1.8	−4.3
1987-88	17.7	−22.8	−5.1	1.8	−3.3
1988-89	17.3	−22.1	−4.8	1.1	−3.7

* For 1926-27 to 1960-61 inclusive, figures are expressed as a percentage of GNP.

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table III

Budgetary Revenues

	Personal income tax	Corporate income tax	Sales and excise taxes	Unemployment insurance contributions	Other tax revenues	Non-tax revenues	Total budgetary revenues
				(millions of dollars)			
1961-62	2,052	1,302	2,204	278	197	435	6,468
1962-63	2,018	1,298	2,395	285	216	450	6,662
1963-64	2,168	1,375	2,525	296	216	519	7,099
1964-65	2,535	1,669	2,890	310	233	583	8,220
1965-66	2,637	1,759	3,344	327	278	610	8,955
1966-67	3,050	1,743	3,628	343	305	683	9,752
1967-68	3,650	1,821	3,718	346	323	779	10,637
1968-69	4,334	2,213	3,747	432	318	895	11,939
1969-70	5,588	2,839	4,009	490	349	1,016	14,291
1970-71	6,395	2,426	4,060	493	378	1,122	14,874
1971-72	7,227	2,396	4,637	569	420	1,262	16,511
1972-73	8,378	2,920	5,272	745	353	1,429	19,097
1973-74	9,226	3,710	6,068	1,001	625	1,692	22,322
1974-75	11,710	4,836	6,837	1,585	2,103	2,072	29,143
1975-76	12,709	5,748	6,655	2,039	1,981	2,417	31,549
1976-77	14,634	5,363	7,376	2,470	1,782	2,675	34,300
1977-78	13,988	5,280	8,093	2,537	1,599	3,021	34,518
1978-79	14,656	5,654	8,853	2,783	1,489	3,431	36,866
1979-80	16,808	6,951	9,044	2,778	2,054	4,286	41,921
1980-81	19,837	8,106	10,152	3,303	2,475	4,902	48,775
1981-82	24,046	8,118	11,322	4,753	5,659	6,103	60,001
1982-83	26,330	7,139	10,629	4,900	6,277	5,430	60,705
1983-84	26,967	7,286	12,047	7,259	5,202	5,455	64,216
1984-85	29,254	9,379	13,698	7,553	5,607	5,407	70,898
1985-86	33,008	9,210	16,143	8,719	4,527	5,226	76,833
1986-87	37,878	9,885	19,084	9,558	3,464	5,915	85,784
1987-88	45,125	10,878	20,338	10,425	3,972	6,714	97,452
1988-89	46,026	11,730	23,125	11,268	4,489	7,343	103,981

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table IV

Budgetary Revenues

	Personal income tax	Corporate income tax	Sales and excise taxes	Unemployment insurance contributions	Other tax revenues	Non-tax revenues	Total budgetary revenues
				(percentage of GDP)			
1961-62	5.0	3.2	5.4	0.7	0.5	1.1	15.8
1962-63	4.5	2.9	5.4	0.6	0.5	1.0	15.0
1963-64	4.5	2.9	5.3	0.6	0.5	1.1	14.9
1964-65	4.9	3.2	5.5	0.6	0.4	1.1	15.7
1965-66	4.6	3.1	5.8	0.6	0.5	1.1	15.6
1966-67	4.7	2.7	5.6	0.5	0.5	1.1	15.1
1967-68	5.3	2.6	5.4	0.5	0.5	1.1	15.4
1968-69	5.7	2.9	5.0	0.6	0.4	1.2	15.8
1969-70	6.7	3.4	4.8	0.6	0.4	1.2	17.2
1970-71	7.2	2.7	4.6	0.6	0.4	1.3	16.7
1971-72	7.4	2.5	4.8	0.6	0.4	1.3	17.0
1972-73	7.7	2.7	4.9	0.7	0.3	1.3	17.6
1973-74	7.2	2.9	4.8	0.8	0.5	1.3	17.5
1974-75	7.7	3.2	4.5	1.0	1.4	1.4	19.2
1975-76	7.4	3.4	3.9	1.2	1.2	1.4	18.4
1976-77	7.4	2.7	3.7	1.2	0.9	1.4	17.3
1977-78	6.4	2.4	3.7	1.2	0.7	1.4	15.8
1978-79	6.1	2.3	3.7	1.2	0.6	1.4	15.3
1979-80	6.1	2.5	3.3	1.0	0.7	1.6	15.2
1980-81	6.4	2.6	3.3	1.1	0.8	1.6	15.7
1981-82	6.8	2.3	3.2	1.3	1.6	1.7	16.9
1982-83	7.0	1.9	2.8	1.3	1.7	1.5	16.2
1983-84	6.6	1.8	3.0	1.8	1.3	1.3	15.8
1984-85	6.6	2.1	3.1	1.7	1.3	1.2	15.9
1985-86	6.9	1.9	3.4	1.8	0.9	1.1	16.1
1986-87	7.5	2.0	3.8	1.9	0.7	1.2	17.0
1987-88	8.2	2.0	3.7	1.9	0.7	1.2	17.7
1988-89	7.7	2.0	3.8	1.9	0.7	1.2	17.3

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table V

Budgetary Revenues

	Personal income tax	Corporate income tax	Sales and excise taxes	Unemployment insurance contributions	Other tax revenues	Non-tax revenues	Total budgetary revenues
				(percentage of total)			
1961-62	31.7	20.1	34.1	4.3	3.0	6.7	100.0
1962-63	30.3	19.5	36.0	4.3	3.2	6.8	100.0
1963-64	30.5	19.4	35.6	4.2	3.0	7.3	100.0
1964-65	30.8	20.3	35.2	3.8	2.8	7.1	100.0
1965-66	29.4	19.6	37.3	3.7	3.1	6.8	100.0
1966-67	31.3	17.9	37.2	3.5	3.1	7.0	100.0
1967-68	34.3	17.1	35.0	3.3	3.0	7.3	100.0
1968-69	36.3	18.5	31.4	3.6	2.7	7.5	100.0
1969-70	39.1	19.9	28.1	3.4	2.4	7.1	100.0
1970-71	43.0	16.3	27.3	3.3	2.5	7.5	100.0
1971-72	43.8	14.5	28.1	3.4	2.5	7.6	100.0
1972-73	43.9	15.3	27.6	3.9	1.8	7.5	100.0
1973-74	41.3	16.6	27.2	4.5	2.8	7.6	100.0
1974-75	40.2	16.6	23.5	5.4	7.2	7.1	100.0
1975-76	40.3	18.2	21.1	6.5	6.3	7.7	100.0
1976-77	42.7	15.6	21.5	7.2	5.2	7.8	100.0
1977-78	40.5	15.3	23.4	7.3	4.6	8.8	100.0
1978-79	39.8	15.3	24.0	7.5	4.0	9.3	100.0
1979-80	40.1	16.6	21.6	6.6	4.9	10.2	100.0
1980-81	40.7	16.6	20.8	6.8	5.1	10.1	100.0
1981-82	40.1	13.5	18.9	7.9	9.4	10.2	100.0
1982-83	43.4	11.8	17.5	8.1	10.3	8.9	100.0
1983-84	42.0	11.3	18.8	11.3	8.1	8.5	100.0
1984-85	41.3	13.2	19.3	10.7	7.9	7.6	100.0
1985-86	43.0	12.0	21.0	11.3	5.9	6.8	100.0
1986-87	44.2	11.5	22.2	11.1	4.0	6.9	100.0
1987-88	46.3	11.2	20.9	10.7	4.1	6.9	100.0
1988-89	44.3	11.3	22.2	10.8	4.3	7.1	100.0

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table VI

Budgetary Expenditures

	Major transfers to persons	Major transfers to governments	National defence	Other	Program expenditures	Public debt charges	Total budgetary expenditures
				(millions of dollars)			
1961-62	1,860	667	1,626	2,431	6,584	832	7,416
1962-63	1,933	766	1,575	2,306	6,580	915	7,495
1963-64	1,977	829	1,684	2,785	7,275	993	8,268
1964-65	2,076	954	1,536	2,919	7,485	1,050	8,535
1965-66	2,120	878	1,548	2,996	7,542	1,110	8,652
1966-67	2,291	1,054	1,640	3,772	8,757	1,182	9,939
1967-68	2,698	1,504	1,754	4,106	10,062	1,286	11,348
1968-69	2,941	1,856	1,761	4,317	10,875	1,464	12,339
1969-70	3,210	2,286	1,789	4,980	12,265	1,694	13,959
1970-71	3,595	3,008	1,818	5,346	13,767	1,887	15,654
1971-72	4,263	3,667	1,862	6,151	15,943	2,110	18,053
1972-73	5,493	4,196	1,937	6,846	18,472	2,300	20,772
1973-74	6,457	4,650	2,224	8,425	21,756	2,565	24,321
1974-75	8,099	5,956	2,526	11,333	27,914	3,238	31,152
1975-76	9,766	6,953	2,966	13,631	33,316	3,970	37,286
1976-77	10,466	8,492	3,373	13,558	35,889	4,708	40,597
1977-78	11,743	8,635	3,776	15,259	39,413	5,531	44,944
1978-79	12,735	9,688	4,096	15,940	42,459	7,024	49,483
1979-80	12,711	10,735	4,377	17,105	44,928	8,494	53,422
1980-81	14,594	11,734	5,063	20,248	51,639	10,658	62,297
1981-82	16,955	13,740	5,989	23,075	59,759	15,114	74,873
1982-83	22,712	14,617	6,938	27,351	71,618	16,903	88,521
1983-84	23,615	17,488	7,843	29,592	78,538	18,077	96,615
1984-85	25,120	19,740	8,762	33,145	86,767	22,455	109,222
1985-86	26,380	20,175	9,094	30,147	85,796	25,441	111,237
1986-87	27,695	20,745	9,993	31,298	89,731	26,658	116,389
1987-88	28,770	21,520	10,769	35,448	96,507	29,028	125,535
1988-89	30,300	23,665	11,025	34,542	99,532	33,183	132,715

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table VII

Budgetary Expenditures

	Major transfers to persons	Major transfers to govts.	National defence	Other	Program expenditures	Public debt charges	Total budgetary expenditures
				(percentage of GDP)			
1961-62	4.5	1.6	4.0	5.9	16.1	2.0	18.1
1962-63	4.4	1.7	3.5	5.2	14.8	2.1	16.9
1963-64	4.1	1.7	3.5	5.8	15.3	2.1	17.3
1964-65	4.0	1.8	2.9	5.6	14.3	2.0	16.4
1965-66	3.7	1.5	2.7	5.2	13.1	1.9	15.0
1966-67	3.6	1.6	2.5	5.9	13.6	1.8	15.4
1967-68	3.9	2.2	2.5	5.9	14.6	1.9	16.4
1968-69	3.9	2.5	2.3	5.7	14.4	1.9	16.4
1969-70	3.9	2.8	2.2	6.0	14.8	2.0	16.8
1970-71	4.0	3.4	2.0	6.0	15.4	2.1	17.6
1971-72	4.4	3.8	1.9	6.3	16.4	2.2	18.6
1972-73	5.1	3.9	1.8	6.3	17.0	2.1	19.1
1973-74	5.1	3.7	1.7	6.6	17.1	2.0	19.1
1974-75	5.3	3.9	1.7	7.5	18.4	2.1	20.5
1975-76	5.7	4.1	1.7	7.9	19.4	2.3	21.7
1976-77	5.3	4.3	1.7	6.9	18.1	2.4	20.5
1977-78	5.4	4.0	1.7	7.0	18.1	2.5	20.6
1978-79	5.3	4.0	1.7	6.6	17.6	2.9	20.5
1979-80	4.6	3.9	1.6	6.2	16.3	3.1	19.3
1980-81	4.7	3.8	1.6	6.5	16.7	3.4	20.1
1981-82	4.8	3.9	1.7	6.5	16.8	4.2	21.0
1982-83	6.1	3.9	1.9	7.3	19.1	4.5	23.6
1983-84	5.8	4.3	1.9	7.3	19.4	4.5	23.8
1984-85	5.6	4.4	2.0	7.5	19.5	5.0	24.6
1985-86	5.5	4.2	1.9	6.3	17.9	5.3	23.3
1986-87	5.5	4.1	2.0	6.2	17.8	5.3	23.1
1987-88	5.2	3.9	2.0	6.4	17.5	5.3	22.8
1988-89	5.0	3.9	1.8	5.7	16.5	5.5	22.1

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table VIII

Budgetary Expenditures

	Major transfers to persons	Major transfers to govts.	National defence	Other	Program expenditures	Public debt charges	Total budgetary expenditures
				(percentage of total)			
1961-62	25.1	9.0	21.9	32.8	88.8	11.2	100.0
1962-63	25.8	10.2	21.0	30.8	87.8	12.2	100.0
1963-64	23.9	10.0	20.4	33.7	88.0	12.0	100.0
1964-65	24.3	11.2	18.0	34.2	87.7	12.3	100.0
1965-66	24.5	10.1	17.9	34.6	87.2	12.8	100.0
1966-67	23.1	10.6	16.5	38.0	88.1	11.9	100.0
1967-68	23.8	13.3	15.5	36.2	88.7	11.3	100.0
1968-69	23.8	15.0	14.3	35.0	88.1	11.9	100.0
1969-70	23.0	16.4	12.8	35.7	87.9	12.1	100.0
1970-71	23.0	19.2	11.6	34.2	87.9	12.1	100.0
1971-72	23.6	20.3	10.3	34.1	88.3	11.7	100.0
1972-73	26.4	20.2	9.3	33.0	88.9	11.1	100.0
1973-74	26.5	19.1	9.1	34.6	89.5	10.5	100.0
1974-75	26.0	19.1	8.1	36.4	89.6	10.4	100.0
1975-76	26.2	18.6	8.0	36.6	89.4	10.6	100.0
1976-77	25.8	20.9	8.3	33.4	88.4	11.6	100.0
1977-78	26.1	19.2	8.4	34.0	87.7	12.3	100.0
1978-79	25.7	19.6	8.3	32.2	85.8	14.2	100.0
1979-80	23.8	20.1	8.2	32.0	84.1	15.9	100.0
1980-81	23.4	18.8	8.1	32.5	82.9	17.1	100.0
1981-82	22.6	18.4	8.0	30.8	79.8	20.2	100.0
1982-83	25.7	16.5	7.8	30.9	80.9	19.1	100.0
1983-84	24.4	18.1	8.1	30.6	81.3	18.7	100.0
1984-85	23.0	18.1	8.0	30.3	79.4	20.6	100.0
1985-86	23.7	18.1	8.2	27.1	77.1	22.9	100.0
1986-87	23.8	17.8	8.6	26.9	77.1	22.9	100.0
1987-88	22.9	17.1	8.6	28.2	76.9	23.1	100.0
1988-89	22.8	17.8	8.3	26.0	75.0	25.0	100.0

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table IX

Public Debt Charges

	Gross public debt charges	Return on investments	Net public debt charges	Ratio of gross public debt charges to gross debt	Ratio of net public debt charges to net debt
		(millions of dollars)		(per cent)	
1926-27	130	9	121	4.8	5.2
1931-32	121	9	112	4.3	4.7
1936-37	137	11	126	3.9	4.1
1941-42	172	22	150	2.6	3.7
1946-47	469	69	400	2.8	3.2
1951-52	512	118	394	3.2	3.8
1956-57	508	207	301	3.1	2.6
1957-58	543	227	316	3.2	2.7
1958-59	636	247	389	3.4	3.1
1959-60	776	265	511	4.0	3.9
1960-61	788	287	501	3.9	3.7
1961-62	832	308	524	3.8	3.6
1962-63	915	312	603	3.9	3.9
1963-64	993	366	627	4.0	3.8
1964-65	1,050	423	627	4.0	3.7
1965-66	1,110	438	672	4.1	4.0
1966-67	1,182	519	663	4.2	3.9
1967-68	1,286	612	674	4.3	3.8
1968-69	1,464	695	769	4.6	4.3
1969-70	1,694	860	834	5.1	4.7
1970-71	1,887	1,000	887	5.1	4.8
1971-72	2,110	1,133	977	5.1	4.9
1972-73	2,300	1,265	1,035	5.1	4.8
1973-74	2,565	1,461	1,104	5.4	4.7
1974-75	3,238	1,802	1,436	6.1	5.6
1975-76	3,970	2,083	1,887	6.7	6.0
1976-77	4,708	2,410	2,298	7.0	6.1
1977-78	5,531	2,592	2,939	6.9	6.1
1978-79	7,024	3,059	3,965	7.2	6.5
1979-80	8,494	3,646	4,848	8.1	6.7
1980-81	10,658	4,315	6,343	8.8	7.4
1981-82	15,114	5,064	10,050	11.0	10.0
1982-83	16,903	4,616	12,287	10.2	9.6
1983-84	18,077	4,372	13,705	9.1	8.5
1984-85	22,455	4,252	18,203	9.5	9.1
1985-86	25,441	3,739	21,702	9.4	9.3
1986-87	26,658	4,234	22,424	8.8	8.5
1987-88	29,028	4,548	24,480	8.7	8.3
1988-89	33,183	5,509	27,674	9.1	8.6

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table X

Public Debt Charges in Comparative Terms

	Gross public debt charges as a percentage of			Net public debt charges as a percentage of		
	GDP*	Budgetary revenues	Budgetary expenditures	GDP*	Budgetary revenues	Budgetary expenditures
1926-27	2.5	34.9	39.4	2.4	32.5	36.7
1931-32	2.6	39.9	29.0	2.4	37.0	26.9
1936-37	3.0	32.6	27.5	2.7	30.0	25.3
1941-42	2.1	11.6	9.4	1.8	10.1	8.2
1946-47	3.9	15.5	18.0	3.4	13.2	15.4
1951-52	2.4	12.5	13.7	1.8	9.6	10.5
1956-57	1.6	9.1	9.7	0.9	5.4	5.7
1957-58	1.6	10.0	9.6	0.9	5.8	5.6
1958-59	1.8	12.3	10.5	1.1	7.5	6.4
1959-60	2.1	13.2	11.9	1.4	8.7	7.9
1960-61	2.1	12.5	11.5	1.3	7.9	7.3
1961-62	2.0	12.9	11.2	1.3	8.1	7.1
1962-63	2.1	13.7	12.2	1.4	9.1	8.0
1963-64	2.1	14.0	12.0	1.3	8.8	7.6
1964-65	2.0	12.8	12.3	1.2	7.6	7.3
1965-66	1.9	12.4	12.8	1.2	7.5	7.8
1966-67	1.8	12.1	11.9	1.0	6.8	6.7
1967-68	1.9	12.1	11.3	1.0	6.3	5.9
1968-69	1.9	12.3	11.9	1.0	6.4	6.2
1969-70	2.0	11.9	12.1	1.0	5.8	6.0
1970-71	2.1	12.7	12.1	1.0	6.0	5.7
1971-72	2.2	12.8	11.7	1.0	5.9	5.4
1972-73	2.1	12.0	11.1	1.0	5.4	5.0
1973-74	2.0	11.5	10.5	0.9	4.9	4.5
1974-75	2.1	11.1	10.4	0.9	4.9	4.6
1975-76	2.3	12.6	10.6	1.1	6.0	5.1
1976-77	2.4	13.7	11.6	1.2	6.7	5.7
1977-78	2.5	16.0	12.3	1.3	8.5	6.5
1978-79	2.9	19.1	14.2	1.6	10.8	8.0
1979-80	3.1	20.3	15.9	1.8	11.6	9.1
1980-81	3.4	21.9	17.1	2.0	13.0	10.2
1981-82	4.2	25.2	20.2	2.8	16.7	13.4
1982-83	4.5	27.8	19.1	3.3	20.2	13.9
1983-84	4.5	28.2	18.7	3.4	21.3	14.2
1984-85	5.0	31.7	20.6	4.1	25.7	16.7
1985-86	5.3	33.1	22.9	4.5	28.2	19.5
1986-87	5.3	31.1	22.9	4.4	26.1	19.3
1987-88	5.3	29.8	23.1	4.5	25.1	19.5
1988-89	5.5	31.9	25.0	4.6	26.6	20.9

* For 1926-27 to 1960-61 inclusive, figures are expressed as a percentage of GNP.

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table XI
Public Debt

	Gross public debt	Net recorded assets	Net public debt		GDP*
	(millions of dollars)		(millions of dollars)	(percentage of GDP*)	(millions of dollars)
1926-27	2,726	378	2,348	45.6	5,145
1931-32	2,827	451	2,376	50.6	4,693
1936-37	3,542	458	3,084	66.6	4,634
1941-42	6,563	2,562	4,001	48.3	8,282
1946-47	16,849	4,180	12,669	106.6	11,885
1951-52	15,940	5,544	10,396	48.0	21,640
1956-57	16,491	5,045	11,446	35.7	32,058
1957-58	16,805	5,163	11,642	34.7	33,513
1958-59	18,681	6,162	12,519	36.0	34,777
1959-60	19,409	6,290	13,119	35.6	36,846
1960-61	20,120	6,472	13,648	35.6	38,359
1961-62	21,906	7,310	14,596	35.7	40,886
1962-63	23,321	7,892	15,429	34.7	44,408
1963-64	25,127	8,529	16,598	34.8	47,678
1964-65	26,204	9,291	16,913	32.4	52,191
1965-66	26,802	10,192	16,610	28.9	57,523
1966-67	28,225	11,428	16,797	26.1	64,388
1967-68	29,810	12,302	17,508	25.4	69,064
1968-69	32,020	14,112	17,908	23.7	75,418
1969-70	33,260	15,684	17,576	21.2	83,026
1970-71	37,114	18,758	18,356	20.6	89,116
1971-72	41,169	21,271	19,898	20.5	97,290
1972-73	44,693	23,120	21,573	19.9	108,629
1973-74	47,542	23,970	23,572	18.5	127,372
1974-75	52,866	27,285	25,581	16.8	152,111
1975-76	59,612	28,294	31,318	18.3	171,540
1976-77	67,323	29,708	37,615	19.0	197,924
1977-78	79,879	31,838	48,041	22.0	217,879
1978-79	96,957	36,299	60,658	25.1	241,604
1979-80	104,862	32,703	72,159	26.1	276,096
1980-81	120,446	34,765	85,681	27.6	309,891
1981-82	137,573	37,020	100,553	28.2	355,994
1982-83	166,203	37,834	128,369	34.3	374,442
1983-84	199,497	38,729	160,768	39.6	405,717
1984-85	237,112	38,020	199,092	44.8	444,735
1985-86	269,286	35,790	233,496	48.8	477,988
1986-87	302,744	38,643	264,101	52.3	504,631
1987-88	333,521	41,337	292,184	53.1	550,334
1988-89	363,855	42,937	320,918	53.4	601,508

* For 1926-27 to 1960-61 inclusive, figures are expressed as a percentage of GNP.
Note: Figures for GNP and GDP relate to the corresponding calendar year.
Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table XII

Total Borrowing

	Financial requirements			Total borrowing		
	Excluding foreign exchange transactions	Including foreign exchange transactions	Change in cash position	Domestic borrowing	Foreign borrowing	Total borrowing
			(millions of dollars)			
1961-62	−853	−662	416	1,078	0	1,078
1962-63	−939	−1,234	−400	834	281	1,115
1963-64	−259	−330	451	781	−35	746
1964-65	84	−377	−145	232	0	232
1965-66	98	−63	−46	17	−5	12
1966-67	−660	−417	181	598	−5	593
1967-68	−1,378	−752	203	955	−205	750
1968-69	−811	−1,571	−415	1,156	282	1,438
1969-70	234	−154	236	390	5	395
1970-71	−1,028	−2,423	431	2,854	−110	2,744
1971-72	−1,366	−2,038	322	2,360	−2	2,358
1972-73	−1,308	−1,383	399	1,782	−2	1,780
1973-74	−1,517	−1,386	−1,189	197	−76	121
1974-75	−2,139	−1,546	2,394	3,940	−50	3,890
1975-76	−4,774	−4,779	−152	4,627	−28	4,599
1976-77	−5,548	−4,267	545	4,812	−2	4,810
1977-78	−8,449	−7,263	909	8,172	855	9,027
1978-79	−11,212	−6,851	1,927	8,778	6,186	14,964
1979-80	−10,132	−10,575	−2,695	7,880	−2,516	5,364
1980-81	−9,894	−8,967	2,193	11,160	−66	11,094
1981-82	−9,246	−8,688	689	9,377	634	10,011
1982-83	−23,802	−24,442	−2,041	22,401	977	23,378
1983-84	−25,201	−24,787	1,833	26,620	−299	26,321
1984-85	−29,808	−27,385	−554	26,831	2,971	29,802
1985-86	−30,270	−24,644	−1,114	23,530	4,740	28,270
1986-87	−21,567	−27,957	−126	27,831	−1,800	26,031
1987-88	−18,153	−25,302	−3,085	22,217	−715	21,502
1988-89	−21,972	−27,702	300	28,002	−2,962	25,040

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table XIII

Gross Public Debt

	Unmatured debt – held by outside parties										
	Marketable bonds*										
	Domestic	Foreign	Total	Treasury bills	Canada Savings Bonds*	Less: government's own holdings	Total	Superannuation accounts	Interest and debt accounts	Other liabilities	Gross public debt
	(millions of dollars)										
1961-62	10,838	287	11,125	1,885	4,055	−95	16,970	2,291	275	2,370	21,906
1962-63	10,802	568	11,370	2,165	4,582	−32	18,085	2,562	293	2,381	23,321
1964-65	10,899	533	11,432	2,140	5,552	−61	19,063	4,150	339	2,652	26,204
1965-66	10,745	528	11,273	2,150	5,733	−81	19,075	4,489	391	2,847	26,802
1966-67	10,018	523	11,541	2,310	6,017	−200	19,668	4,890	427	3,240	28,225
1967-68	11,573	318	11,891	2,480	6,096	−49	20,418	5,350	499	3,543	29,810
1968-69	12,294	600	12,894	2,840	6,169	−47	21,856	5,883	581	3,700	32,020
1969-70	12,279	605	12,884	2,895	6,579	−107	22,251	6,503	600	3,906	33,260
1970-71	13,021	495	13,516	3,735	7,804	−60	24,995	7,200	839	4,080	37,114
1971-72	13,385	493	13,878	3,830	9,712	−67	27,353	7,934	1,158	4,724	41,169
1972-73	13,423	491	13,914	4,290	10,989	−60	29,133	8,792	1,506	5,262	44,693
1973-74	13,592	415	14,007	4,905	10,406	−64	29,254	9,794	1,801	6,693	47,542
1974-75	14,311	365	14,676	5,630	12,915	−77	33,144	11,054	2,257	6,411	52,866
1975-76	15,281	337	15,618	6,495	15,517	−87	37,543	12,557	2,923	6,589	59,612
1976-77	17,748	335	18,083	8,255	16,304	−89	42,553	14,212	3,619	6,939	67,323
1977-78	21,182	1,190	22,372	11,295	18,011	−98	51,580	16,101	4,523	7,675	79,879
1978-79	26,532	7,376	33,908	13,535	19,247	−146	66,544	18,056	4,014	8,343	96,957
1979-80	32,947	4,860	37,807	16,325	18,081	−305	71,908	20,022	3,976	8,956	104,862
1980-81	40,849	4,794	45,643	21,770	15,812	−223	83,002	22,329	4,162	10,953	120,446
1981-82	43,493	5,428	48,921	19,375	24,978	−261	93,013	25,343	6,095	13,122	137,573
1982-83	48,377	6,405	54,782	29,125	32,641	−157	116,391	28,826	7,710	13,276	166,203
1983-84	57,036	6,106	63,142	41,700	38,204	−334	142,712	32,688	8,622	15,475	199,497
1984-85	69,438	9,077	78,515	52,300	41,960	−261	172,514	36,990	9,418	18,190	237,112
1985-86	81,067	13,810	94,877	61,950	44,245	−288	200,784	41,670	9,084	17,748	269,286
1986-87	94,426	12,010	106,436	76,950	44,309	−880	226,815	46,665	9,065	20,199	302,744
1987-88	103,898	11,295	115,193	81,050	53,323	−1,249	248,317	52,088	9,600	23,516	333,521
1988-89	115,748	8,415	124,163	102,700	47,756	−1,262	273,357	57,913	7,123	25,462	363,855

* Including government's holdings of its own debt.

Source: Public Accounts of Canada adjusted to reflect accounting changes.

Table XIV

Government Revenues, Expenditures and Surpluses or Deficits, 1961-1988
National Accounts Basis

	Total government[1]			Federal government			Provincial-local-hospital		
	Revenues	Expenditures	Surplus or deficit(−)	Revenues	Expenditures	Surplus or deficit(−)	Revenues	Expenditures	Surplus or deficit(−)
					(billions of dollars)				
1961	11.3	12.2	−0.9	6.8	7.2	−0.4	5.7	6.1	−0.5
1962	12.4	13.2	−0.8	7.0	7.5	−0.5	6.6	6.8	−0.2
1963	13.3	13.9	−0.7	7.3	7.6	−0.3	7.1	7.5	−0.4
1964	15.0	14.9	0.0	8.4	8.0	0.3	7.9	8.1	−0.3
1965	16.7	16.5	0.2	9.1	8.6	0.5	9.0	9.4	−0.4
1966	19.4	19.1	0.4	10.0	9.8	0.2	10.4	10.9	−0.5
1967	21.9	21.8	0.0	10.9	11.0	−0.1	12.0	12.8	−0.7
1968	24.9	24.5	0.3	12.2	12.3	—	13.9	14.6	−0.6
1969	29.0	27.2	1.8	14.5	13.5	1.0	16.0	16.4	−0.3
1970	31.8	31.1	0.7	15.5	15.3	0.2	18.3	19.1	−0.7
1971	35.2	35.2	0.0	17.3	17.4	−0.1	20.8	21.9	−1.1
1972	39.7	39.8	0.0	19.6	20.1	−0.5	23.0	23.9	−0.9
1973	46.1	45.0	1.1	22.8	22.4	0.4	26.3	27.0	−0.8
1974	58.6	55.8	2.9	30.0	28.7	1.3	32.5	32.7	−0.2
1975	64.2	68.5	−4.3	31.8	35.6	−3.8	37.2	39.7	−2.5
1976	73.4	77.0	−3.5	35.5	38.8	−3.3	43.2	45.6	−2.4
1977	81.4	86.9	−5.5	36.7	44.0	−7.3	51.0	51.4	−0.4
1978	89.3	96.9	−7.6	38.3	49.1	−10.9	57.7	56.9	0.8
1979	101.5	107.0	−5.5	43.4	52.8	−9.4	64.9	63.8	1.1
1980	116.3	124.9	−8.6	50.7	61.3	−10.7	72.8	73.8	−1.0
1981	141.6	146.9	−5.2	65.0	72.3	−7.3	84.2	85.3	−1.2
1982	151.3	173.5	−22.2	66.1	86.4	−20.3	93.3	98.9	−5.7
1983	162.1	190.2	−28.0	69.6	94.6	−25.0	102.1	108.3	−6.2
1984	177.9	206.7	−28.8	76.5	106.5	−30.0	112.3	114.3	−2.1
1985	191.0	223.6	−32.5	83.2	114.7	−31.4	119.6	123.9	−4.3
1986	205.6	233.6	−28.0	91.3	115.3	−24.0	124.7	131.8	−7.1
1987	224.2	248.5	−24.3	99.1	122.0	−22.9	136.0	139.6	−3.7
1988	249.2	265.1	−15.9	110.1	130.6	−20.5	150.8	148.2	2.5

(1) Including the Canada and Quebec Pension Plans.
Numbers may not add due to rounding.
Source: Statistics Canada, *National Income and Expenditure Accounts*, quarterly, cat. 13−001.

Table XV

Government Revenues, Expenditures and Surpluses or Deficits, 1961-1988
National Accounts Basis

	Total government[1]			Federal government			Provincial-local-hospital		
	Revenues	Expenditures	Surplus or deficit(−)	Revenues	Expenditures	Surplus or deficit(−)	Revenues	Expenditures	Surplus or deficit(−)
					(percentage of GDP)				
1961	27.7	29.8	−2.1	16.6	17.6	−1.0	13.9	15.0	−1.1
1962	28.0	29.7	−1.7	15.7	16.9	−1.2	14.9	15.4	−0.5
1963	27.8	29.2	−1.4	15.4	16.0	−0.6	14.9	15.7	−0.8
1964	28.7	28.6	0.1	16.0	15.4	0.6	15.0	15.6	−0.6
1965	29.0	28.7	0.3	15.8	14.9	0.9	15.7	16.3	−0.6
1966	30.2	29.6	0.6	15.5	15.2	0.3	16.1	17.0	−0.9
1967	31.7	31.6	0.1	15.8	16.0	−0.2	17.4	18.5	−1.1
1968	33.0	32.5	0.4	16.2	16.3	0.0	18.5	19.3	−0.8
1969	34.9	32.8	2.1	17.5	16.3	1.2	19.3	19.7	−0.4
1970	35.7	34.9	0.8	17.4	17.2	0.3	20.6	21.4	−0.8
1971	36.2	36.2	0.0	17.8	17.9	−0.1	21.4	22.5	−1.1
1972	36.6	36.6	0.0	18.0	18.5	−0.5	21.2	22.0	−0.8
1973	36.2	35.3	0.9	17.9	17.6	0.3	20.6	21.2	−0.6
1974	38.5	36.7	1.9	19.7	18.9	0.8	21.4	21.5	−0.1
1975	37.4	39.9	−2.5	18.5	20.8	−2.2	21.7	23.1	−1.4
1976	37.1	38.9	−1.8	17.9	19.6	−1.7	21.8	23.0	−1.2
1977	37.4	39.9	−2.5	16.8	20.2	−3.4	23.4	23.6	−0.2
1978	37.0	40.1	−3.2	15.8	20.3	−4.5	23.9	23.5	0.3
1979	36.7	38.8	−2.0	15.7	19.1	−3.4	23.5	23.1	0.4
1980	37.5	40.3	−2.8	16.3	19.8	−3.4	23.5	23.8	−0.3
1981	39.8	41.3	−1.5	18.3	20.3	−2.1	23.6	24.0	−0.3
1982	40.4	46.3	−5.9	17.7	23.1	−5.4	24.9	26.4	−1.5
1983	40.0	46.9	−6.9	17.2	23.3	−6.2	25.2	26.7	−1.5
1984	40.0	46.5	−6.5	17.2	24.0	−6.8	25.2	25.7	−0.5
1985	40.0	46.8	−6.8	17.4	24.0	−6.6	25.0	25.9	−0.9
1986	40.8	46.3	−5.5	18.1	22.8	−4.8	24.7	26.1	−1.4
1987	40.7	45.1	−4.4	18.0	22.2	−4.2	24.7	25.4	−0.7
1988	41.4	44.1	−2.6	18.3	21.7	−3.4	25.1	24.6	0.4

[1] Including the Canada and Quebec Pension Plans.
Numbers may not add due to rounding.
Source: Statistics Canada, *National Income and Expenditure Accounts*, quarterly, cat. 13–001.

Table XVI

Federal Government Assets and Liabilities, 1961-1988
National Accounts Basis

	Financial			Non-financial assets	Assets less liabilities	Financial			Non-financial assets	Assets less liabilities
	Liabilities	Assets	Net debt			Liabilities	Assets	Net debt		
	(billions of dollars)					(percentage of GDP)				
1961	19.0	11.4	7.6	4.0	−3.6	46.5	27.9	18.7	9.8	−8.8
1962	20.0	12.1	8.0	4.2	−3.8	45.1	27.1	18.0	9.4	−8.6
1963	21.1	12.8	8.4	4.4	−4.0	44.3	26.8	17.6	9.2	−8.4
1964	21.6	13.6	8.1	4.5	−3.6	41.5	26.0	15.5	8.7	−6.8
1965	21.8	14.3	7.5	4.9	−2.6	37.8	24.8	13.0	8.6	−4.4
1966	22.5	15.3	7.2	5.5	−1.8	35.0	23.8	11.2	8.5	−2.7
1967	23.8	16.5	7.4	6.0	−1.3	34.5	23.9	10.6	8.7	−1.9
1968	25.6	18.2	7.4	6.4	−1.0	33.9	24.1	9.9	8.5	−1.4
1969	26.0	19.6	6.4	7.0	0.6	31.4	23.6	7.7	8.4	0.7
1970	28.3	21.9	6.4	7.5	1.1	31.8	24.6	7.2	8.4	1.2
1971	31.4	24.9	6.6	8.4	1.8	32.3	25.5	6.8	8.6	1.9
1972	33.9	26.8	7.0	9.2	2.1	31.2	24.7	6.5	8.4	2.0
1973	34.0	27.7	6.4	10.5	4.1	26.7	21.7	5.0	8.2	3.2
1974	39.4	33.6	5.8	13.3	7.5	25.9	22.1	3.8	8.7	4.9
1975	44.0	34.6	9.3	15.4	6.1	25.6	20.2	5.4	9.0	3.5
1976	48.3	35.2	13.0	16.7	3.6	24.4	17.8	6.6	8.4	1.8
1977	56.9	38.3	18.6	18.0	−0.5	26.1	17.6	8.5	8.3	−0.2
1978	71.8	43.1	28.7	19.6	−9.2	29.7	17.8	11.9	8.1	−3.8
1979	78.7	41.4	37.3	21.3	−16.0	28.5	15.0	13.5	7.7	−5.8
1980	93.5	46.8	46.7	23.5	−23.2	30.2	15.1	15.1	7.6	−7.5
1981	107.0	52.9	54.1	26.1	−28.0	30.1	14.8	15.2	7.3	−7.9
1982	126.6	51.2	75.3	28.2	−47.1	33.8	13.7	20.1	7.5	−12.6
1983	156.5	54.8	101.7	29.0	−72.6	38.6	13.5	25.1	7.2	−17.9
1984	183.2	53.2	130.1	30.9	−99.1	41.2	12.0	29.1	7.0	−22.3
1985	220.5	57.7	162.8	32.7	−130.1	46.1	12.1	34.1	6.8	−27.2
1986	244.2	55.2	189.0	33.9	−155.0	48.4	10.9	37.4	6.7	−30.7
1987	271.6	61.9	209.8	34.9	−174.9	49.4	11.2	38.1	6.3	−31.8
1988	302.4	70.2	232.2	37.1	−195.2	50.3	11.7	38.6	6.2	−32.4

Numbers may not add due to rounding.

Source: Statistics Canada, *National Balance Sheet Accounts*, annual, cat. 13-214.

Table XVII

Provincial-Local-Hospital Government Assets and Liabilities, 1961-1988
National Accounts Basis

	Financial			Non-financial	Assets less	Financial			Non-financial	Assets less
	Liabilities	Assets	Net debt	assets	liabilities	Liabilities	Assets	Net debt	assets	liabilities
	(billions of dollars)					(percentage of GDP)				
1961	10.8	7.6	3.2	16.4	13.2	26.4	18.6	7.8	40.0	32.2
1962	11.7	8.2	3.5	17.9	14.4	26.3	18.5	7.8	40.3	32.5
1963	12.6	8.7	3.9	19.9	16.0	26.5	18.3	8.3	41.8	33.6
1964	13.8	9.4	4.4	21.8	17.3	26.4	17.9	8.5	41.7	33.2
1965	15.1	10.2	4.9	25.2	20.3	26.3	17.7	8.5	43.8	35.3
1966	17.3	11.5	5.8	28.8	22.9	26.9	17.8	9.0	44.7	35.6
1967	19.8	12.6	7.2	31.2	24.0	28.7	18.3	10.4	45.2	34.8
1968	22.1	14.2	7.9	33.2	25.3	29.3	18.8	10.5	44.0	33.5
1969	24.4	16.4	7.9	36.8	28.9	29.3	19.8	9.5	44.3	34.8
1970	27.0	18.3	8.8	40.7	31.9	30.4	20.5	9.9	45.7	35.8
1971	29.9	19.9	10.0	46.2	36.2	30.7	20.5	10.3	47.5	37.2
1972	32.9	21.6	11.3	51.3	39.9	30.3	19.9	10.4	47.2	36.8
1973	36.3	24.5	11.8	59.9	48.1	28.5	19.3	9.2	47.0	37.8
1974	41.1	28.5	12.6	76.9	64.3	27.0	18.7	8.3	50.6	42.3
1975	47.6	31.3	16.3	89.4	73.1	27.7	18.2	9.5	52.1	42.6
1976	53.9	35.3	18.5	98.0	79.4	27.2	17.9	9.4	49.5	40.1
1977	62.1	41.7	20.3	107.8	87.5	28.5	19.2	9.3	49.5	40.2
1978	70.6	51.6	19.0	119.1	100.1	29.2	21.4	7.9	49.3	41.4
1979	76.7	58.2	18.5	133.8	115.3	27.8	21.1	6.7	48.5	41.8
1980	84.9	68.1	16.9	153.6	136.7	27.4	22.0	5.4	49.6	44.1
1981	98.7	86.6	12.1	179.1	166.9	27.7	24.3	3.4	50.3	46.9
1982	113.7	94.6	19.1	197.8	178.7	30.4	25.3	5.1	52.8	47.7
1983	127.3	100.4	26.9	209.4	182.4	31.4	24.7	6.6	51.6	45.0
1984	140.5	112.9	27.6	219.7	192.1	31.6	25.4	6.2	49.4	43.2
1985	155.7	118.9	36.8	232.1	195.2	32.6	24.9	7.7	48.6	40.8
1986	173.0	130.2	42.8	238.2	195.3	34.3	25.8	8.5	47.2	38.7
1987	187.4	138.0	49.4	245.8	196.4	34.1	25.1	9.0	44.7	35.7
1988	197.5	153.7	43.8	257.2	213.4	32.8	25.5	7.3	42.8	35.5

Numbers may not add due to rounding.

Source: Statistics Canada, *National Balance Sheet Accounts*, annual, cat. 13-214.

Table XVIII

Canada and Quebec Pension Plans Assets and Liabilities, 1966-1988
National Accounts Basis

	Financial			Non-financial assets	Assets less liabilities	Financial			Non-financial assets	Assets less liabilities
	Liabilities	Assets	Net debt			Liabilities	Assets	Net debt		
	(billions of dollars)					(percentage of GDP)				
1966	–	0.7	–0.7	–	0.7	–	1.1	–1.1	–	1.1
1967	–	1.6	–1.6	–	1.6	–	2.3	–2.3	–	2.3
1968	–	2.6	–2.6	–	2.6	–	3.4	–3.4	–	3.4
1969	–	3.7	–3.7	–	3.7	–	4.5	–4.5	–	4.5
1970	–	4.9	–4.9	–	4.9	–	5.5	–5.5	–	5.5
1971	–	6.2	–6.2	–	6.2	–	6.4	–6.4	–	6.4
1972	–	7.6	–7.6	–	7.6	–	7.0	–7.0	–	7.0
1973	–	9.0	–9.0	–	9.0	–	7.1	–7.1	–	7.1
1974	–	10.8	–10.8	–	10.8	–	7.1	–7.1	–	7.1
1975	–	12.8	–12.8	–	12.8	–	7.5	–7.5	–	7.5
1976	–	15.0	–15.0	–	15.0	–	7.6	–7.6	–	7.6
1977	–	17.2	–17.2	–	17.2	–	7.9	–7.9	–	7.9
1978	–	19.7	–19.7	–	19.7	–	8.1	–8.1	–	8.1
1979	–	22.4	–22.4	–	22.4	–	8.1	–8.1	–	8.1
1980	–	25.4	–25.4	–	25.4	–	8.2	–8.2	–	8.2
1981	–	28.6	–28.6	–	28.6	–	8.0	–8.0	–	8.0
1982	–	32.4	–32.4	–	32.4	–	8.7	–8.7	–	8.7
1983	–	35.6	–35.6	–	35.6	–	8.8	–8.8	–	8.8
1984	–	38.9	–38.9	–	38.9	–	8.7	–8.7	–	8.7
1985	–	42.0	–42.0	–	42.0	–	8.8	–8.8	–	8.8
1986	–	45.3	–45.3	–	45.3	–	9.0	–9.0	–	9.0
1987	–	47.6	–47.6	–	47.6	–	8.7	–8.7	–	8.7
1988	–	49.7	–49.7	–	49.7	–	8.3	–8.3	–	8.3

Numbers may not add due to rounding.

Source: Statistics Canada, *National Balance Sheet Accounts*, annual, cat. 13-214.

5. Notices of Ways and Means Motions and Supplementary Information

Notice of Ways and Means Motion to Amend the Income Tax Act

Notice of Ways and Means Motion to Amend the Income Tax Act

That it is expedient to amend the *Income Tax Act* to provide among other things:

Cultural Property

(1) That the value of certified cultural property donated after February 20, 1990 to a designated Canadian institution or public authority be determined by the Canadian Cultural Property Export Review Board for the purposes of determining the amount of any tax credit or deduction available under the Act to the donor in respect of the donation.

Mutual Fund Trusts and Corporations

(2) That a trust or corporation not qualify for the purposes of the Act as a mutual fund trust or mutual fund corporation at any time after February 20, 1990 where it is reasonable to consider that the trust or corporation was established or maintained primarily for the benefit of non-resident persons, unless

(a) throughout the period from February 21, 1990 to that time, all or substantially all of the property of the trust or corporation consists of property other than real property situated in Canada, options in respect thereof and property referred to in subparagraphs 115(1)(b)(iii) to (ix) of the Act, or

(b) the trust or corporation has not issued a unit or share after February 20, 1990 to a person that, after reasonable inquiry, it had any reason to believe was a non-resident, other than a trust unit issued in satisfaction of that person's right to income under the trust, a share issued as a stock dividend or a trust unit or a share issued pursuant to an agreement in writing entered into before February 21, 1990.

Registered Education Savings Plans

(3) That

(a) the total contributions made after February 20, 1990 to registered education savings plans in respect of a beneficiary be limited to the lesser of $1,500 per year and the amount by which $31,500 exceeds the total contributions made to all such plans in respect of that beneficiary for all preceding years,

(b) a penalty be imposed on plans in respect of contributions in excess of the limit described in (a) equal to 1% per month on the excess amount,

(c) educational assistance payments from such plans entered into after February 20, 1990 may be made in a taxation year only to individuals who are full-time students enrolled in qualifying educational programs at designated educational institutions in the year,

(d) for the 1990 and subsequent taxation years, a plan that has been in existence for more than 21 years cease to be a registered plan,

(e) a promoter not be required to file a prospectus with a securities commission to obtain registration under the Act of such a plan where the promoter is otherwise exempted under applicable securities law, and

(f) contributions to a registered education savings plan be required to be held in trust by a corporation licensed or authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee.

Child Tax Credit

(4) That the family income threshold used for the purposes of determining an individual's eligibility for prepayment of the refundable child tax credit in respect of three or more eligible children be increased for the 1990 and subsequent taxation years from 2/3 to the full amount of the family income threshold used for the purposes of determining the amount of the credit for the year.

Part VI Tax — Life Insurance

(5) That,

(a) after February 20, 1990, each corporation carrying on a life insurance business in Canada in a taxation year be subject to tax under Part VI of the Act in respect of the amount by which the corporation's taxable capital employed in Canada for the year (computed in accordance with Part I.3 of the Act without reference to paragraph 181.3(1)(a) thereof) exceeds its capital deduction under Part VI for the year,

(b) the tax so payable for a taxation year by each such corporation be creditable against its tax payable under Part I of the Act for the year or any of its three preceding or seven subsequent taxation years that is attributable to the period after February 20, 1990, and

(c) such tax be required to be paid by monthly instalments except that no such tax or instalment be required to be remitted by a corporation before July, 1990.

Foreign Property Limit

(6) That Part XI of the Act be amended to increase the maximum percentage of foreign property that may be held by pension and other deferred income plans, without incurring tax under that Part, to 12%, 14%, 16% and 18% for 1990, 1991, 1992 and 1993, respectively, and to 20% after 1993.

Dispositions by Non-Residents

(7) That,

(a) in respect of a non-resident person's business income derived from the disposition after February 20, 1990 of real property situated in Canada, Canadian resource property, timber resource property or an option in respect of such property, the non-resident person be deemed to be carrying on business in Canada, and

(b) the certification and withholding procedures set out in subsections 116(5.2) and (5.3) of the Act apply to dispositions of such property after February 20, 1990 from which a non-resident person derived business income.

Notice of Ways and Means Motion to Amend the Cultural Property Export and Import Act

Notice of Ways and Means Motion to Amend the Cultural Property Export and Import Act

That it is expedient to amend the *Cultural Property Export and Import Act* to provide among other things that the provisions of the Act relating to donations of certified cultural property be amended to give effect to the changes proposed in the Notice of Ways and Means Motion to amend the *Income Tax Act* tabled in the House of Commons on February 20, 1990 in respect of such donations.

Supplementary Information

Supplementary Information

Tax Measures

The following supplementary notes set out six tax changes. Largely housekeeping in nature, they are aimed at protecting the revenue base of the federal government, improving the management of the income tax system, or increasing flexibility for taxpayers. The proposals have little or no impact on forecast revenues, although one measure (to relax the existing rules for prepayment of the child tax credit) will advance the cash outflow of about $30 million by one fiscal year.

Cultural Property

The Canadian Cultural Property Export Review Board is responsible, under the *Cultural Property Export and Import Act*, for certifying that an object is of outstanding significance and of such national importance that its loss to Canada would significantly diminish the national heritage. Where an object so certified is donated to certain designated Canadian institutions or public authorities, the donor is deemed not to have realized a taxable capital gain that might otherwise have arisen and is eligible for a tax credit or deduction based upon the fair market value of the object. As well, for these purposes, the amount of a gift taken into account in any particular year is not limited to 20 per cent of the donor's income, as are most other charitable donations.

In addition to determining whether an object is Canadian cultural property, the Board provides an estimate of the value of the object for income tax purposes. In view of the expertise of the Board and its impartiality in determining such valuations, a more formal legislative base is proposed for the Board's role. The Board will be given the legislative responsibility for determining the fair market value of objects that it certifies to be Canadian cultural property. While this measure has no revenue implications, it will ensure a fair and streamlined administration of the rules governing gifts of certified Canadian cultural property. It is proposed that this measure be effective in respect of gifts made after February 20, 1990.

Dispositions of Real Property by Non-Residents

Traders in Real Estate

A non-resident carrying on business in Canada is subject to tax in Canada on profit from the business. Where the business involves the buying and selling of Canadian real estate, the non-resident would normally be regarded as carrying on business in Canada.

To make it clear that such transactions are subject to tax, it is proposed to amend the *Income Tax Act* to specifically provide that a non-resident trader in Canadian real estate is considered to be carrying on business in Canada. It is also proposed that the same rule apply in respect of non-resident traders in resource property.

These rules are to apply after February 20, 1990.

Investors in Mutual Funds

Non-residents who invest directly in Canadian real estate are subject to tax in Canada in respect of capital gains arising on the disposition of such property. If Canadian real estate is held in a mutual fund in which non-residents hold units or shares, however, special rules in the *Income Tax Act* permit capital gains of mutual fund corporations and trusts to be distributed to non-resident investors tax free. These special rules are appropriate where the capital gain arises on the disposition of property that, if the property were held directly by the non-resident, would not be subject to tax in Canada: for example, shares in widely held public corporations. The rules are not appropriate, however, where the gains arise on dispositions of Canadian real estate and other taxable Canadian property — such as shares of private corporations, units in certain partnerships and trusts — held by the mutual fund.

It is proposed to restrict the use of mutual fund trusts and corporations for the benefit of non-residents for the purposes of holding Canadian real estate and other taxable Canadian property. Effective February 20, 1990, a trust or corporation will not qualify as a mutual fund trust or corporation if it is established or maintained primarily for the benefit of non-residents. This rule will not apply where all or substantially all of the property owned by the mutual funds consists of property other than Canadian real property, options in respect thereof, and other taxable Canadian property referred to in paragraph 115(1)(b) of the *Income Tax Act*. Existing mutual fund trusts and corporations will not be affected by this rule unless new units or new shares are issued to non-residents after February 20, 1990.

Registered Education Savings Plans

Registered education savings plans were specifically recognized under the *Income Tax Act* in 1974. Under arrangements that were being marketed at that time, individuals contributed sums into trusts at regular intervals to generate income that would be used to finance the post-secondary education costs of the trust beneficiaries. Contributions to registered education savings plans are not deductible from the income of the contributor and may be returned to the contributor tax free. The income generated by the contributions is tax-sheltered until it is paid out to named beneficiaries, when it is taxed in the beneficiaries' hands.

Current rules set an administrative limit on total contributions that may be made to any single plan (approximately $32,000 in 1989), but no limit on the number of individuals who may hold plans for the same beneficiary. Further, a beneficiary is not required to attend school full time.

To ensure that the amount of tax-assisted savings available under a registered education savings plan bears a reasonable relationship to the costs of post-secondary education, it is proposed that total contributions to registered education savings plans be limited to $1,500 per beneficiary a year. The table below illustrates the annual payouts available in constant 1990 dollars from contributions of $1,500 a year over varying periods.

Annual Payouts for Four Years Resulting from Annual Contributions of $1,500 for Varying Contribution Periods

Contribution period	Annual payouts*
(years)	(dollars)
5	1950
10	4250
15	7000

* In 1990 dollars. Assumes rate of interest 3 1/2 percentage points above the inflation rate.

For existing registered education savings plans it is proposed that no further contributions may be made for a beneficiary if total contributions for that beneficiary exceed $31,500. This amount is the maximum that can be contributed to registered education savings plans for one beneficiary over the life of a plan ($1,500 per year for 21 years) and is in keeping with the current administrative limit. A penalty of 1 per cent a month will be imposed on the amount of any contributions made after February 20, 1990 in excess of these limits.

To ensure that these limits are effective, the *Income Tax Regulations* will be amended to require that an Information Return be filed by each promoter of a registered education savings plan, providing the name and social insurance number of each beneficiary, as well as the amount contributed in the year and the aggregate amount contributed for that beneficiary.

Changes to the rules governing registered education savings plans will also be made to ensure that they operate more effectively. For plans entered into after February 20, 1990, it is proposed that payments to beneficiaries may be made only if they are full-time students enrolled in qualifying educational programs at designated educational institutions, as defined for the purposes of the education tax credit. Each registered education savings plan will be limited to a 21-year life span. The requirement that a promoter file a prospectus will be modified to exempt promoters who are not otherwise required to file prospectuses under applicable securities law. Finally, as currently required by administrative practice, the rules will ensure that contributions to registered education savings plans are held by a licensed trustee.

These changes are designed to improve control over the tax assistance provided through the special treatment accorded to registered education savings plans. They will have no significant impact on federal revenues.

Child Tax Credit

The prepayment of the child tax credit is equal to two-thirds of the maximum credit and is paid in November to families with incomes up to two-thirds of the maximum credit threshold. No special provision is made for larger families with incomes above the prepayment income threshold, even though they may need it more. It is proposed that families with three or more children will now be entitled to the prepayment ($383 per child in 1990) provided their incomes do not exceed the maximum child tax credit threshold ($24,769 in 1990). For the current year, the proposal is summarized as follows:

Number of children	Payment per child	Current threshold	Proposed threshold
	(dollars)	(dollars)	(dollars)
1 or 2	383	16,513	16,513
3 or more	383	16,513	24,769

This measure will allow 70,000 additional families with a total of 236,000 children to receive the prepayment in 1990. It is expected that about 730,000 families will now qualify for the prepayment. This measure will shift $30 million forward from the 1991-92 fiscal year to the 1990-91 fiscal year.

Part VI Tax

A basic objective of income tax reform was to levy a fair level of income tax across competing financial institutions. Because some financial institutions would not pay tax until existing after-tax financing instruments matured, the current Part VI tax was imposed on large banks and trust companies. It is fully creditable against regular income tax. This tax effectively brought forward payments of tax to the early years of tax reform.

Some large life insurance companies have not yet begun to pay the level of income tax anticipated under tax reform. In order to ensure that insurance companies are treated in a manner consistent with the objectives of tax reform, the government proposes that the existing Part VI tax be extended to large life insurance companies carrying on business in Canada. The Part VI tax will now apply to large banks, trust companies and life insurance companies with Canadian financial capital in excess of $200 million.

The Part VI tax will apply to the financial capital of life insurance companies in a manner consistent with the application of the existing tax to banks and trust companies.

The extension of the Part VI tax to life insurers is to apply after February 20, 1990. For a taxation year commencing before that day, the amount of tax payable will be prorated according to the portion of the taxation year remaining after budget day. A similar proration will be used to determine the amount of Part I tax against which the Part VI tax may be credited.

The tax will be payable in monthly instalments based on a corporation's Part VI tax liability for the current year and immediately preceding year. Instalments for the first two months of a year may be based on the corporation's Part VI tax liability for the second preceding year. To compute a life insurance corporation's instalment liability, the tax payable under Part VI of the Act for taxation years beginning before February 21, 1990 will be deemed to be the amount that would have been payable if Part VI had applied to the corporation throughout that year. Payment of any balance of tax owing at the end of a year will be due two months after the end of the corporation's taxation year.

No payments of tax or instalments will be required before July, 1990, when amounts otherwise payable from February 21, 1990 to the end of June will become payable.

Foreign Property Limit for Pension Investments

Deferred income trusts and other similar registered retirement vehicles are subject to a special tax if the book value of their foreign property holdings exceeds 10 per cent of the book value of total assets. The tax is levied at a rate of 1 per cent a month on foreign property holdings in excess of the allowable 10 per cent. The limit has constrained investment choice, and therefore the potential benefits associated with increased diversification.

Most industrialized countries, recognizing the advantages to pension beneficiaries and plan sponsors from increased diversification, have enhanced their pension plans' access to international investment opportunities. In keeping with these developments, the budget proposes a gradual increase in the foreign property limit for pension investments. Starting in 1990, the foreign property limit will be increased over five years by 2 percentage points a year to a new overall limit of 20 per cent. The change will have no impact on government revenues.