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1989

Where Your Tax Dollars Go

Canada

Printed in Canada

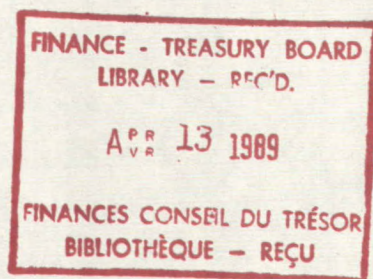
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Department of Finance
Canada

Ministère des Finances
Canada

Preface

Most Canadians appreciate the need to bring government spending more closely in line with government revenues. They recognize that expenditure restraint is an essential part of the effort to reduce deficits and bring the public debt under control.

Through a disciplined approach to the management of government and its finances, we have substantially reduced the rate of growth in program spending in the past four years. It has not been easy or painless.

The result is that program spending has been brought under control. We are now spending less on programs than we receive in revenues.

Despite this solid progress, rising interest rates have dramatically increased interest payments on the large and growing national debt and threatened to undermine the expenditure restraint program. These developments clearly show how important it is to get the debt under control so that we will be less vulnerable to interest rate changes in the future.

By taking action to control the debt, we will be better able to maintain social programs important to all Canadians while ensuring that we do not leave our children the prospect of narrower opportunities and a lower standard of living than we enjoy.

This booklet addresses basic questions about government spending that I believe are important for Canadians to know. Where does the taxpayers' money go? Where has the government made progress in controlling spending in the past four years?

The answers to these questions are fundamental to understanding the challenge we face, not just as a government but as a society. That challenge is to bring the public debt under control so that we can preserve our ability to pay for services vital to the well-being of Canadians in every part of the country.

A handwritten signature in dark ink, reading "Michael H. Wilson". The signature is fluid and cursive, with the first name "Michael" and last name "Wilson" clearly distinguishable.

Michael H. Wilson
Minister of Finance

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A. Where the Money is Spent

Over the 12 months ending March 31, 1989, the federal government spent about \$133 billion.⁽¹⁾

This works out to about \$5,600 for each man, woman and child in Canada.

This is roughly one-quarter of all spending by individual Canadians, by businesses and by all levels of government in the Canadian economy.

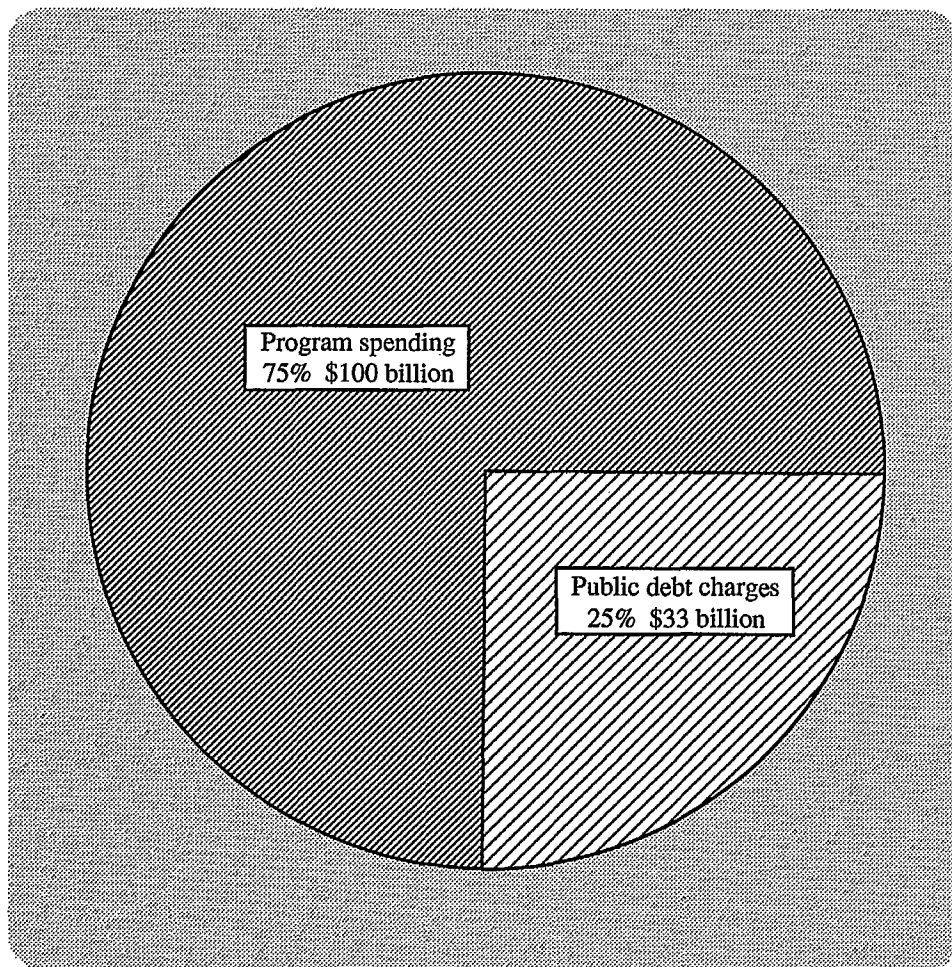
Federal government spending is in two broad categories:

- spending on programs designed to help the government meet social, economic and international policy objectives; and
- the interest the government must pay on its debt.

(1) The numbers referred to in this document are estimates for the fiscal year which began April 1, 1988 and ended March 31, 1989.

Chart 1

The Structure of Federal Government Spending 1988-89



- In 1988-89, the federal government spent almost \$133 billion.
- Out of every dollar spent, 25 cents went to paying interest on government debt.

Interest Payments on the Public Debt

These payments are made to the holders of Government of Canada securities, such as Canada Savings Bonds, other bonds, and Treasury bills.

Debt is the sum of annual shortfalls between what the government spends and what the government takes in, commonly known as the deficit.

Since Confederation, the sum of all the annual deficits have resulted in a current stock of debt totalling about \$320 billion.

In 1972-73, the debt was only \$21.5 billion. In just 15 years, it has increased by about \$300 billion.

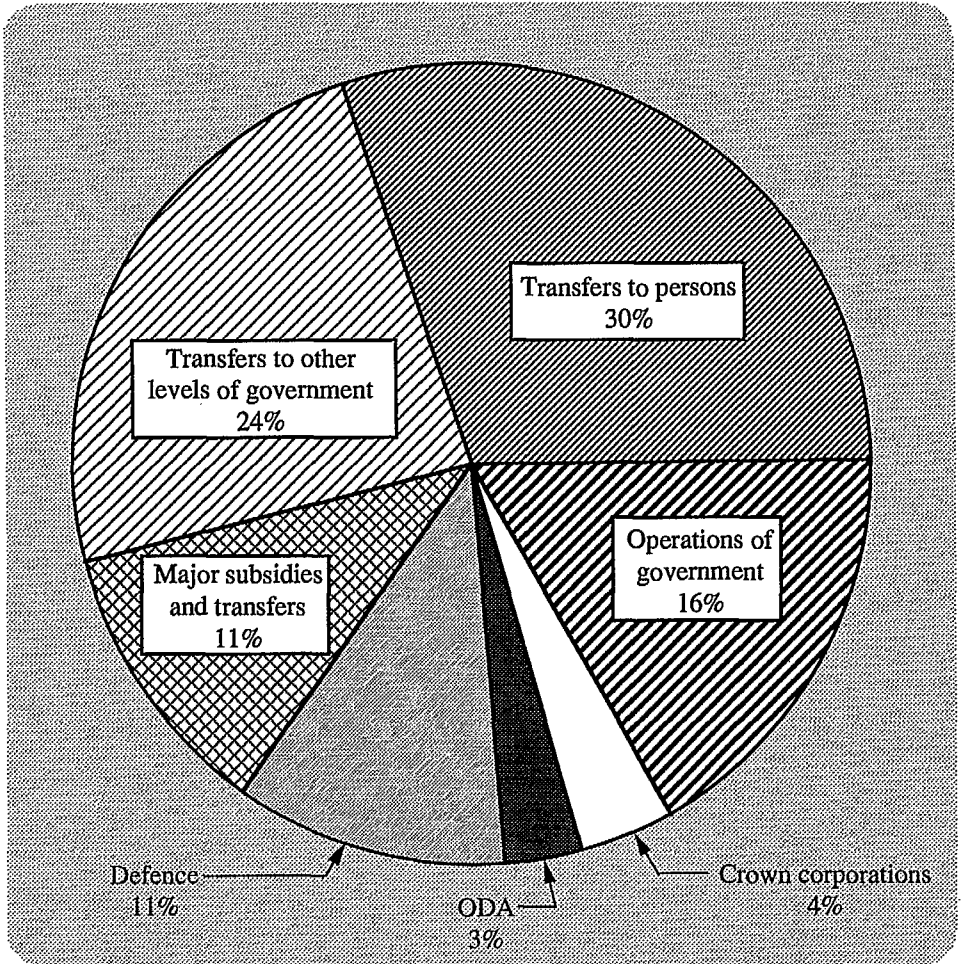
This past year, the government paid about \$33 billion in interest alone.

That is 25 cents out of each dollar it spent. Fifteen years ago, interest payments took only 11 cents of each dollar.

Interest payments on the debt last year were twice as much as the government spent on assistance to the elderly, 12 times more than the total value of family allowance cheques and 3 times the defence budget.

Chart 2

The Structure of Program Expenditures 1988-89



- The government spent about \$100 billion on programs.
- More than half of this was in the form of financial support to individual Canadians and to provincial governments.

Program Spending

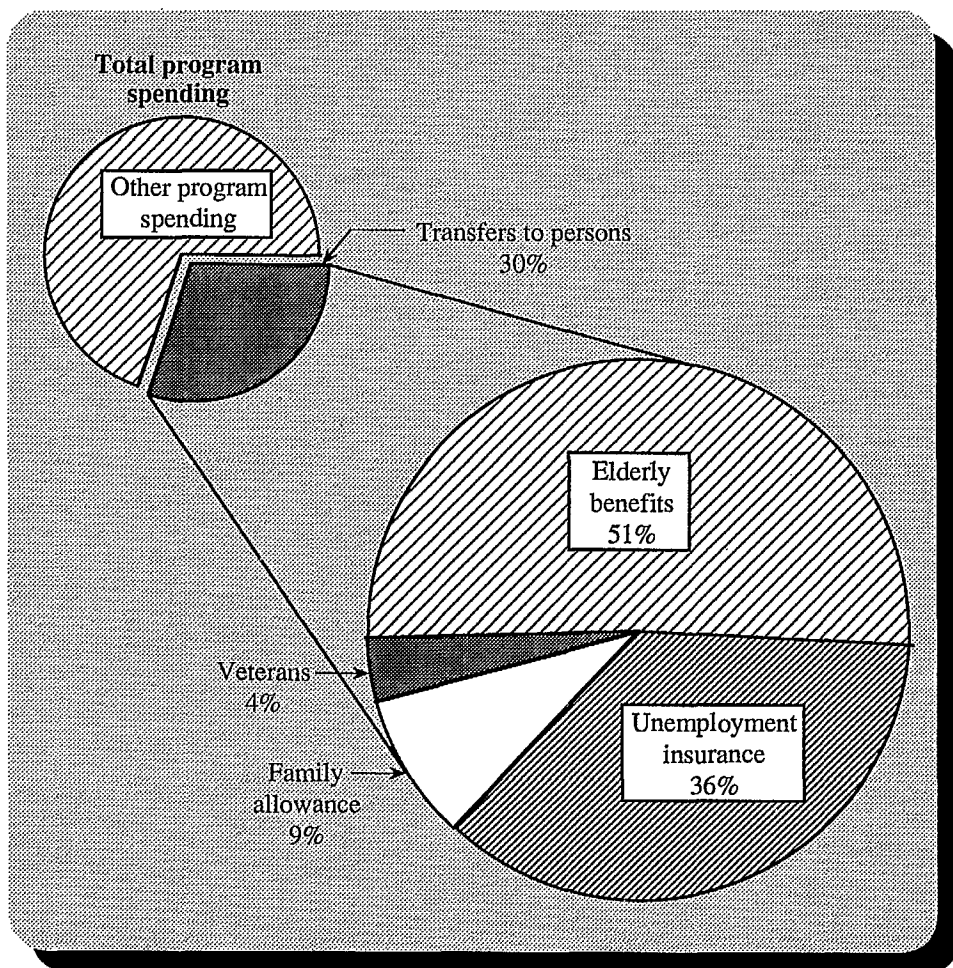
There are seven major categories of programs on which the government spends money:

- transfers to persons,
- transfers to other levels of government,
- major subsidies and transfers,
- payments to Crown corporations,
- defence,
- foreign aid (Official Development Assistance), and
- operation of government.

Chart 3

Transfers to Persons 1988-89

	(billions of dollars)
Elderly benefits system	15.4
Old age security	11.1
Guaranteed income supplement	3.8
Spouse's allowances	0.5
Unemployment insurance benefits	10.8
Family allowances	2.6
Veterans' pensions and allowances	1.2
Total transfers to persons	30.0



Transfers to Persons

The government spends more – \$30 billion in 1988-89 – on direct income support to individual Canadians than on any other program.

Half of this assistance is directed to older Canadians through the elderly benefit system. About 2.9 million elderly persons are presently receiving benefits under this program.

The elderly benefit system consists of the old age security, guaranteed income supplement and spouse's allowances. Cheques are mailed monthly and benefits are increased four times a year to reflect changes in the consumer price index. Old age security goes to all persons over the age of 65 who meet the residence requirements. The guaranteed income supplement provides additional income to those elderly Canadians most in need. Spouse's allowances are available to needy persons between the ages of 60 and 65 provided they meet certain requirements.

Unemployment insurance benefits account for over one-third of direct payments to individuals. Most recipients are persons who have been laid off or are absent from work due to maternity or adoption leave. Individuals who are on government-sponsored work-sharing programs or other job creation and training programs may also receive unemployment insurance. The duration of benefits normally depends upon the number of weeks the person was employed and on the unemployment rate in the region in which the person lives.

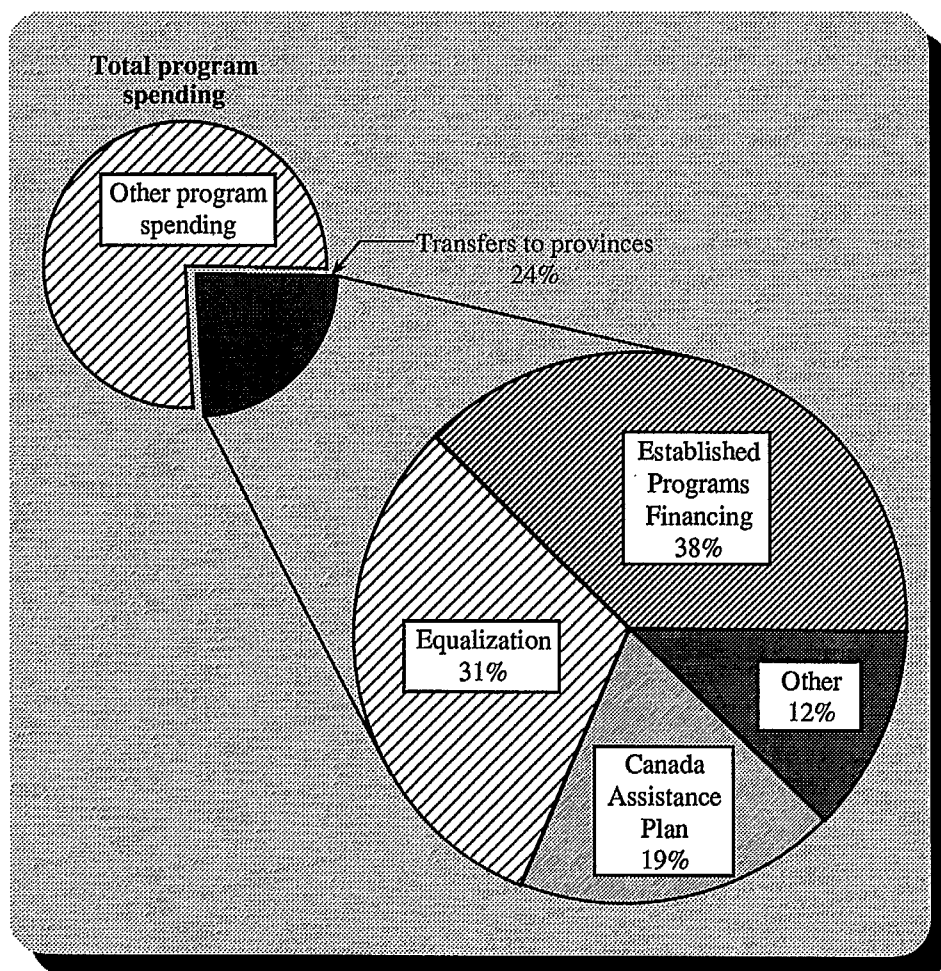
Family allowance benefits are available to all families with dependent children under the age of 18. About 3.6 million households are currently receiving family allowance cheques. Benefits are increased annually in line with changes in the consumer price index in excess of 3 percentage points.

In recognizing the unique contribution made by veterans and certain civilians to Canada's war and peacekeeping efforts, various pension, income-support and health programs have been established for veterans and these civilians, their dependants and survivors. Benefits are increased with the cost of living.

Chart 4

Transfers to Other Levels of Government 1988-89

	(billions of dollars)
Established Programs Financing	9.1
Equalization	7.5
Canada Assistance Plan	4.6
Other	<u>3.1</u>
Total transfers to other levels of government	24.3



Transfers to Other Levels of Government

Providing financial assistance to the provinces is the second largest component of federal government spending.

This past year, the government transferred about \$24 billion directly to the provinces, territories and municipal governments.

More than 70 per cent of these transfers were under the Established Programs Financing (EPF) and equalization programs.

Under EPF, the federal government provides unconditional support to the provinces and territories in the financing of insured health care, extended health care and post-secondary education. Federal support is provided to each province on an equal per capita basis.

Direct cash payments to the provinces under EPF were \$9.1 billion last year. An additional \$9.3 billion in support to provinces was provided through the tax system for a total of \$18.4 billion.

The purpose of the equalization program is to ensure that the lower-income provinces have sufficient revenues to be able to provide their residents with levels of public services that are comparable to those provided in other provinces. The total value of the equalization cheques was estimated at \$7.5 billion in 1988-89.

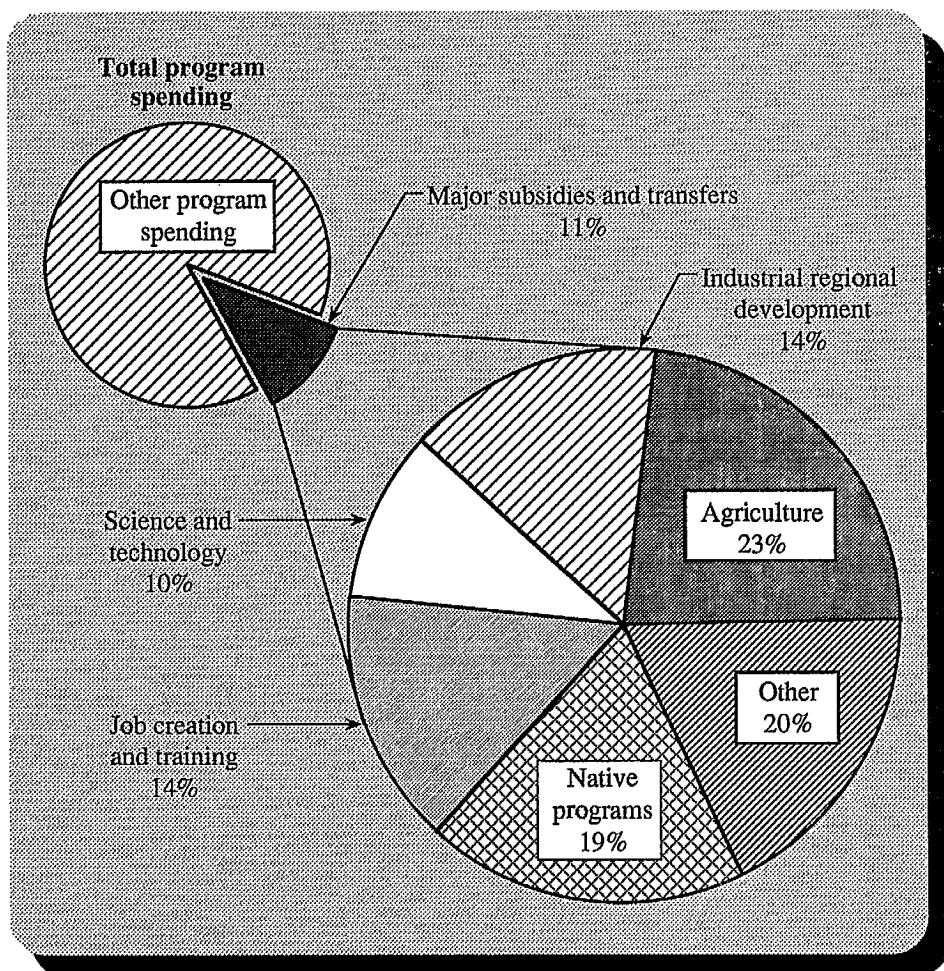
Under the Canada Assistance Plan, the federal government reimburses the provinces and municipalities for up to 50 per cent of their eligible expenditures for assistance payments to persons in need, and for certain welfare and health services.

The federal government is also involved in a number of cost-sharing arrangements with the provinces in such areas as legal services, agriculture and official languages.

Chart 5

Major Subsidies and Transfers 1988-89

	(billions of dollars)
Agriculture	2.6
Science and technology	1.2
Industrial/regional development	1.6
Job creation and training	1.7
Native programs	2.2
Other	1.9
Total major subsidies and transfers	11.2



Major Subsidies and Transfers

The government provides funds to individuals, businesses, associations, and universities, to stabilize and protect farm incomes, to encourage regional development, to foster job skills development, to support research, development and exploration and to provide social assistance to native communities. A total of \$11.2 billion went to such subsidies in 1988-89.

About 25 per cent of this money was directed to the agricultural sector. Half of it went to grain farmers affected by the international grain subsidy war and by the drought. This assistance was provided primarily through the Western Grain Stabilization Act, which is a program designed to protect farm incomes, and through the Canadian Grains Assistance Program.

Financial support is provided for industrial and regional development through the Atlantic Canada Opportunities Agency, the Western Diversification Office, Economic and Regional Development Assistance grants, and other programs administered by the Department of Industry, Science and Technology.

The government provides funding for job training to individuals and employment creation initiatives through the Canadian Jobs Strategy.

Funding to assist research and development is provided through the Medical Research Council, the National Research Council, the Natural Sciences and Engineering Council, as well as through other special programs.

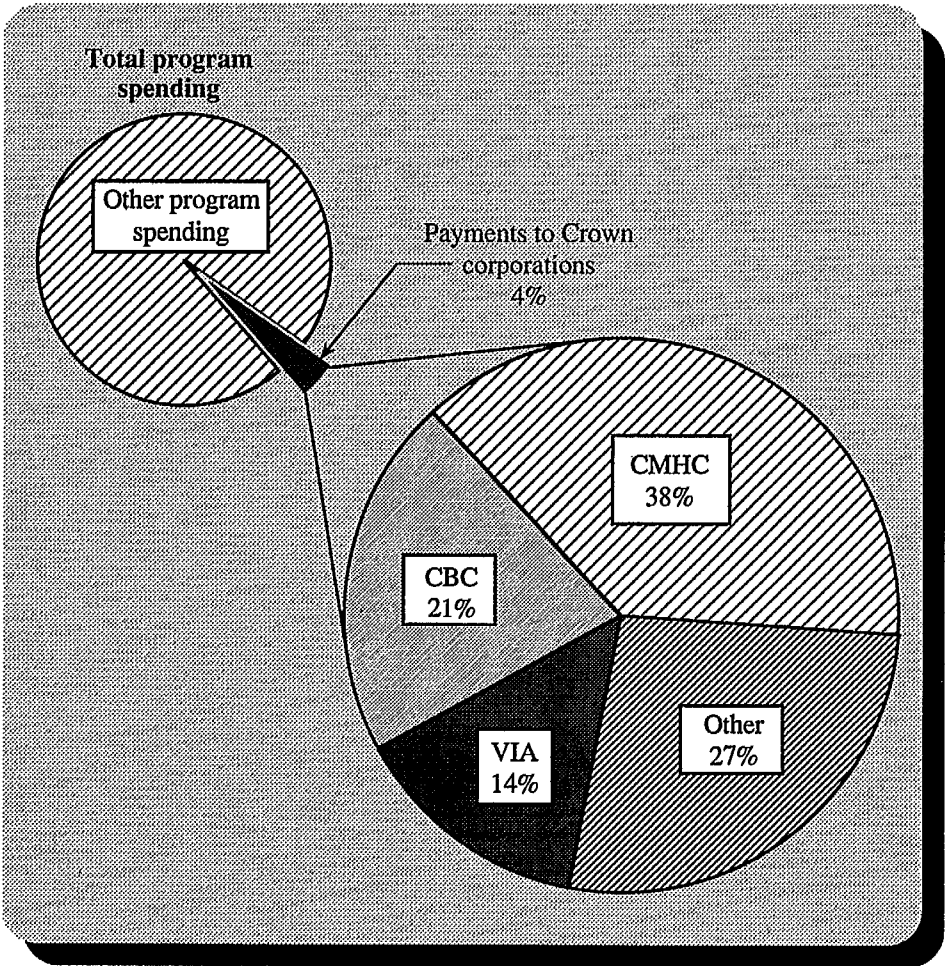
The government provides for basic services, including education, social assistance, housing and infrastructure, to status Indian and Inuit communities.

Subsidies are also paid to the railways for the transportation of western grain, to the oil, gas and mining industries to help stimulate exploration and development, and to qualified post-secondary students in the form of guaranteed loans and subsidized interest payments.

Chart 6

**Payments to Crown Corporations
1988-89**

	(billions of dollars)
CMHC	1.7
CBC	0.9
VIA	0.6
Other	1.2
Total payments to Crown corporations	<u>4.4</u>



Payments to Crown Corporations

Direct payments are made to a number of Crown corporations to allow them to carry out their mandates.

Of the \$4.4 billion spent on Crown corporations, nearly 40 per cent went to the Canada Mortgage and Housing Corporation, primarily to assist families in need to obtain suitable and adequate shelter.

Payments totalling nearly \$1 billion were paid to the Canadian Broadcasting Corporation in assisting the corporation to provide a national broadcasting service in both official languages.

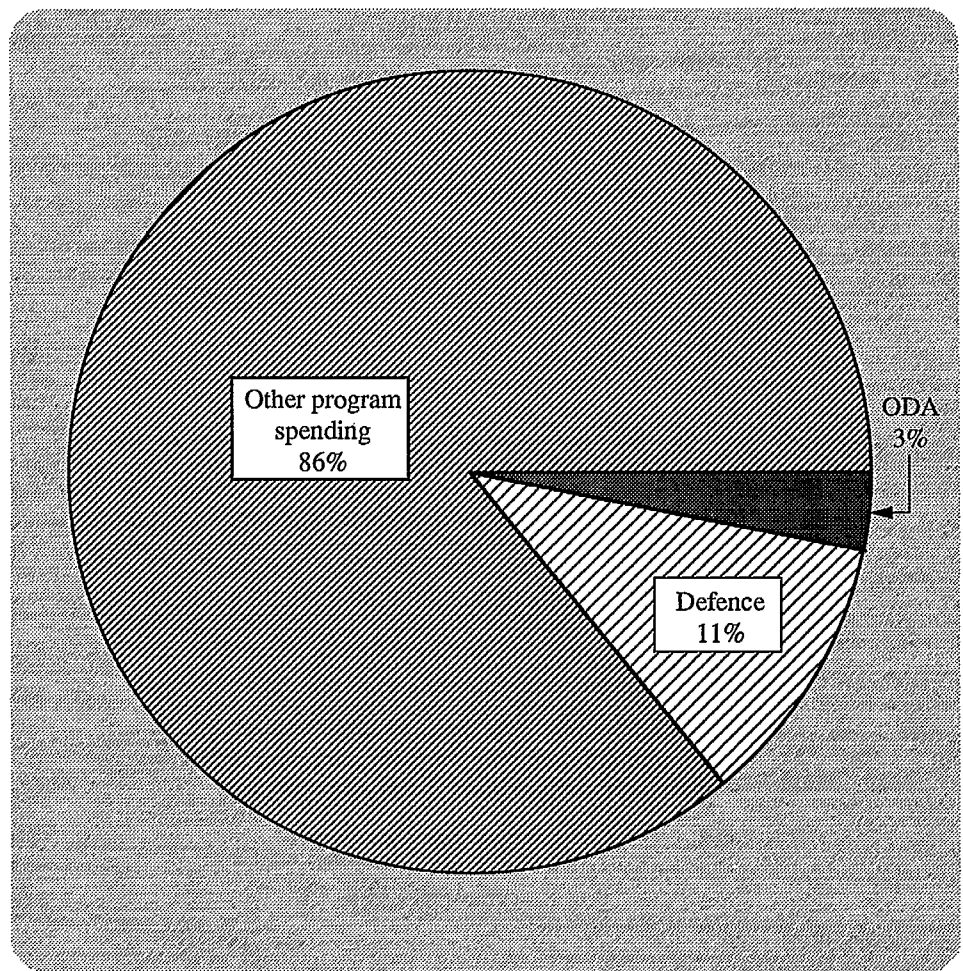
Subsidies were also provided to VIA Rail for the maintenance of passenger railway service and to Marine Atlantic for ferry service.

The government actively supports the cultural community through various payments to the Canada Council, the Canadian Film Development Corporation and the National Arts Centre. Payments are also made to the Canada Post Corporation to offset some of the costs of mailing cultural magazines and newspapers.

Chart 7

**Defence and Official Development Assistance
1988-89**

	(billions of dollars)
Defence	11.1
ODA	<u>2.8</u>
Total defence and ODA	13.9



Defence and Official Development Assistance

About 11 per cent of program spending was allocated to defence, and an additional 3 per cent went to providing assistance to developing countries under Official Development Assistance in 1988-89.

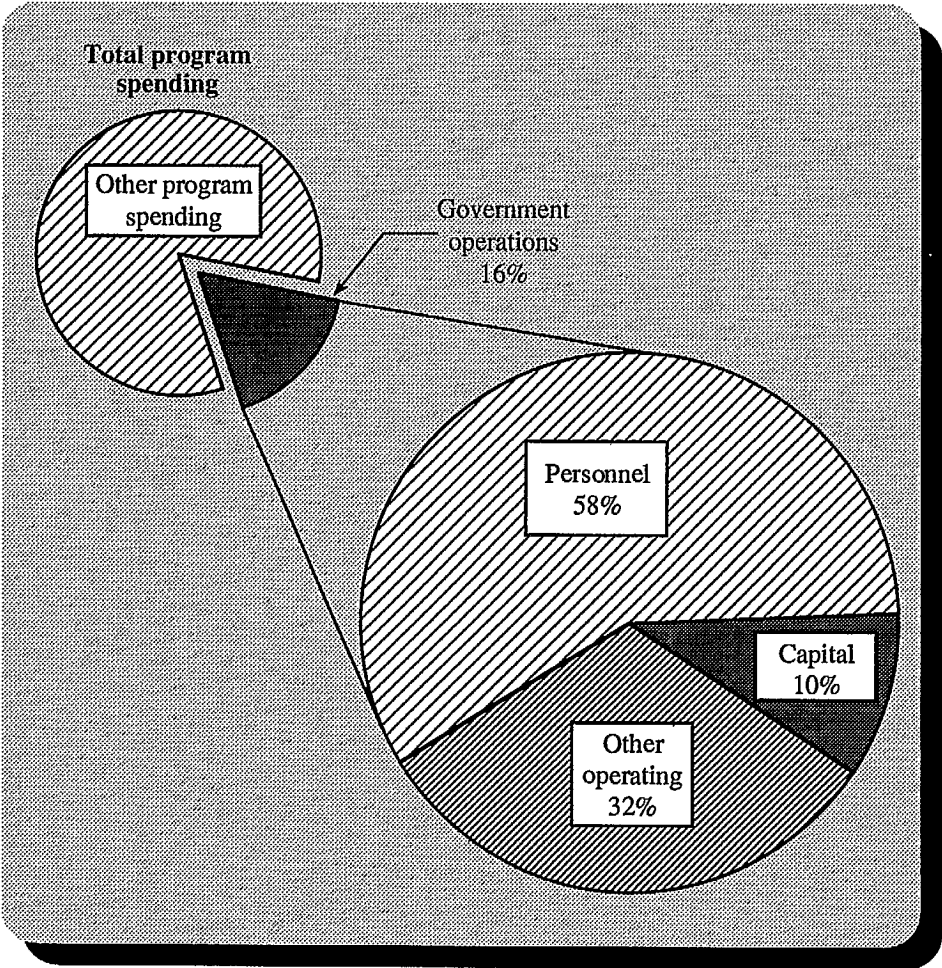
About 30 per cent of defence spending was allocated to capital acquisitions, such as tanks, aircraft and the frigates, while the remainder is primarily for personnel costs, the operation of bases and for supplies.

The funds spent under Official Development Assistance are used for bilateral and multilateral aid purposes, food assistance, special development assistance and international emergency relief.

Chart 8

**Operations of Government
1988-89**

	(billions of dollars)
Personnel	9.4
Other operating	5.2
Capital	<u>1.6</u>
Total operations of government	16.2



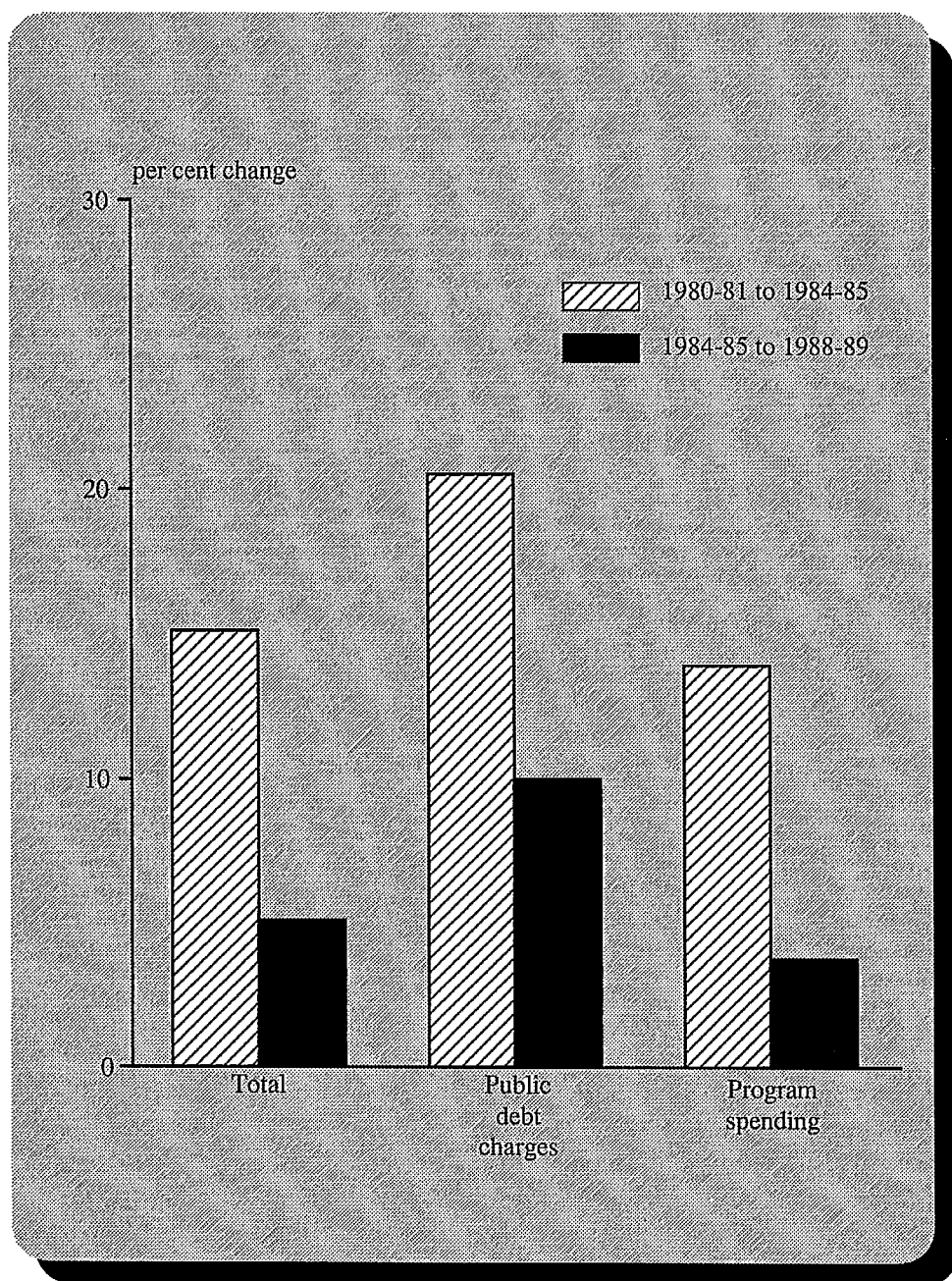
Operations of Government

The final component of government spending is the costs of running the government. This amounted to about 16 per cent of total program spending in 1988-89.

This spending on government operations includes the personnel costs of the public servants administering all the government programs, as well as the costs of utilities, materials and supplies, repair and maintenance, rentals, transportation, communications, and capital expenditures.

Chart 9

Growth in Federal Spending



B. Restraining the Growth of Program Spending

In the late 1970s and early 1980s, rapid increases in federal government spending were the major factor contributing to the rise in the annual deficit and the explosive growth of public debt.

This growth reflected the impact of both new policy initiatives and the economic events at that time.

Double-digit inflation in the early 1980s resulted in large increases in spending on indexed programs such as elderly benefits, family allowances, defence and Official Development Assistance.

The recession in 1981 and 1982 resulted in a substantial increase in the number of unemployed and therefore a rise in unemployment insurance benefits.

In the four years ending in 1984-85, program spending rose at an average annual rate of 13.9 per cent.

One of the first objectives of the government in the fall of 1984 was to regain control over spending.

Since November 1984, fiscal actions have been taken which strongly restrained the growth in program spending.

Programs have been eliminated or reduced and a more business-like approach to government management has been adopted in order to reduce costs and waste and to increase efficiency.

In the first full year of the government's mandate (1985-86), program spending declined by 1.1 per cent and over the period 1984-85 to 1988-89, program spending increased at an average annual rate of only 3.6 per cent.

This was less than one-half the growth in the economy and also less than the rate of inflation over the four-year period.

Chart 10

**Growth in Program Spending
1984-85 to 1988-89**

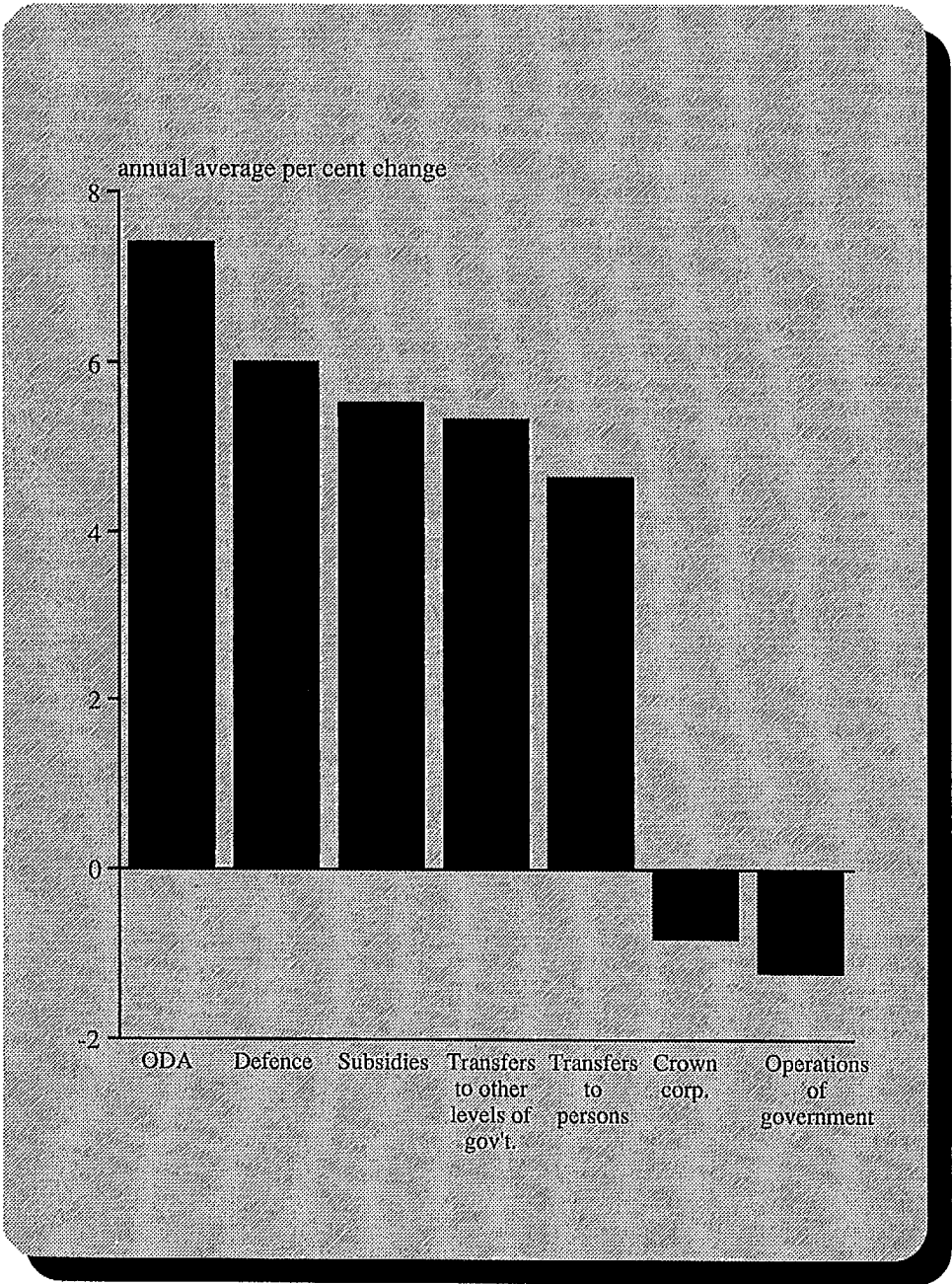


Table 1

Program Spending

	1984-85	1988-89	Absolute change	Annual average growth
	(billions of dollars)			(per cent)
Transfers to persons	25.1	30.0	4.9	4.6
Transfers to other levels of government	19.7	24.3	4.5	5.3
Major subsidies/transfers	9.0	11.2	2.1	5.5
Payments to Crown corporations	4.6	4.4	-0.2	-0.8
Defence	8.8	11.1	2.3	6.0
Official Development Assistance	2.1	2.8	0.7	7.4
Operations of government	17.5	16.2	-1.3	-1.9
Program spending	86.8	100.0	13.2	3.6
Public debt charge	22.5	33.0	10.5	10.1
Total spending	109.2	133.0	23.8	5.0

Note: Details may not add due to rounding.

Cutting the Costs of Operating the Government

Program spending is estimated to have increased by \$13.2 billion between 1984-85 and 1988-89.

Among the seven major components of program spending, two of them – operations of government and payments to Crown corporations – recorded absolute declines in spending.

The reduction of personnel and overhead costs was a major factor in bringing the costs of running the government to a lower level in 1988-89 than four years earlier.

Since November 1984, measures have been put in place to reduce the size of the public service by 2 per cent in 1986-87 and by a further 1 per cent per year thereafter to 1990-91. Between 1984-85 and 1988-89, public service reductions totalled 10,375 person-years, from 241,539 to 231,164.

In the May 1985 budget, a general cut in operations and maintenance of 2 per cent was introduced for 1986-87. From this lower base, rates of growth in operations and maintenance have been restricted to below the rate of inflation in each year thereafter.

Capital spending has also been reduced significantly.

Table 2

The Operations of Government

	1984-85	1988-89	Annual average change
	(billions of dollars)		(per cent)
Personnel	9.8	9.4	-1.0
Other operations and maintenance	5.5	5.2	-1.4
Capital	2.2	1.6	-7.6
Total	17.5	16.2	-1.9

Crown Corporations

The decline in payments to Crown corporations was largely due to the actions undertaken to make the Canada Post Corporation self-sufficient.

The closing of the heavy water plants in Cape Breton and cut-backs in funding to Atomic Energy of Canada also contributed to this decline.

Table 3
Payments to Crown Corporations

	1984-85	1988-89	Annual average change
	(billions of dollars)		(per cent)
CMHC	1.5	1.7	3.5
CBC	0.9	0.9	-
VIA	0.5	0.6	4.0
Canada Post Corporation	0.6	0.2	-18.9
Atomic Energy of Canada	0.3	0.2	-21.5
Other	0.8	0.8	-
Total	4.6	4.4	-0.8

Transfers to Persons

Nearly all of the increase in major transfers to persons over the last four years was due to higher payments to the elderly. This reflects not only the increase in the number of people eligible for benefits, but also the increases in average benefits which are indexed to keep pace with inflation.

Declines in the number of unemployed have restrained the growth in unemployment insurance benefits, but much of this improvement has been offset by higher average benefits.

The limiting of indexation of benefits, introduced in the May 1985 budget, along with a smaller population base, has slowed the growth in family allowance payments.

Table 4

Transfers to Persons

	1984-85	1988-89	Annual average change
	(billions of dollars)		
Elderly benefits	11.4	15.4	7.5
Unemployment insurance benefits	10.1	10.8	1.9
Family allowances	2.4	2.6	1.9
Veterans' pensions and allowances	1.2	1.2	-
Total	25.1	30.0	4.6

Transfers to Other Levels of Government

Major transfers to other levels of government rose at an average annual rate of 5.3 per cent over the last four years.

Most of this increase reflects higher equalization payments to the lower-income provinces, reflecting the impact of the strong economic growth in the province of Ontario on the equalization formula.

Although total entitlements under EPF advanced by over 6 per cent per year over this period, the overall strength in the economy resulted in a sharp rise in the value of the tax transfer,⁽¹⁾ thereby limiting the increase in direct cash payments. In addition, the modification to the EPF escalator, introduced in the May 1985 budget, also contributed to the slowing in direct cash transfers.

Table 5

Transfers to Other Levels of Government

	1984-85	1988-89	Annual average change
	(billions of dollars)		(per cent)
Established Programs Financing	8.6	9.1	1.5
Equalization	5.4	7.5	8.4
Canada Assistance Plan	3.7	4.6	5.3
Other	2.0	3.1	11.6
Total	19.7	24.3	5.3

(1) EPF is paid as a combination of cash and a transfer of tax points to the provinces. The value of the tax points grows with the economy. Therefore, the cash portion is the difference between the total entitlements and the value of the tax point transfer.

Total entitlements for 1988-89 \$18.4 billion

of which:

Value of tax transfer \$9.3 billion

Cash payments \$9.1 billion

Major Subsidies and Transfers

Major subsidies advanced at an average annual rate of 5.5 per cent, but with significant differences among the components.

Most of the increase was concentrated in payments to the agricultural sector as the government provided additional assistance to those farmers most severely hurt by the drop in incomes resulting from the international grain price war and the drought.

The establishment of the Atlantic Canada Opportunities Agency and the Western Diversification Office largely accounted for the increase in industrial/regional development funding.

In contrast, energy subsidies recorded a significant decline, reflecting the elimination of the Petroleum Incentives Program, as specified under the Western Energy Accord.

Table 6

Major Subsidies and Transfers

	1984-85	1988-89	Annual average change
	(billions of dollars)		(per cent)
Agriculture	0.7	2.6	37.7
Industrial/regional development	0.8	1.6	17.0
Native programs	1.5	2.2	9.7
Energy	2.2	0.7	-24.1
Other	3.8	4.1	2.0
Total	9.0	11.2	5.5

Defence and Official Development Assistance

The increase in defence funding reflects the government's commitment to increase defence spending by at least 2 per cent per year in real terms. Incremental funding was also provided in 1988-89 in order to undertake new initiatives outlined in the White Paper on Defence.

Likewise, the assistance to developing countries has risen significantly, in line with the government's policy of maintaining the growth in its commitments consistent with the growth in the economy.

Table 7

Defence and Official Development Assistance

	1984-85	1988-89	Annual average change
	(billions of dollars)		(per cent)
Defence	8.8	11.1	6.0
Official Development Assistance	2.1	2.8	7.4

Chart 11

Program Expenditures Relative to the Size of the Economy

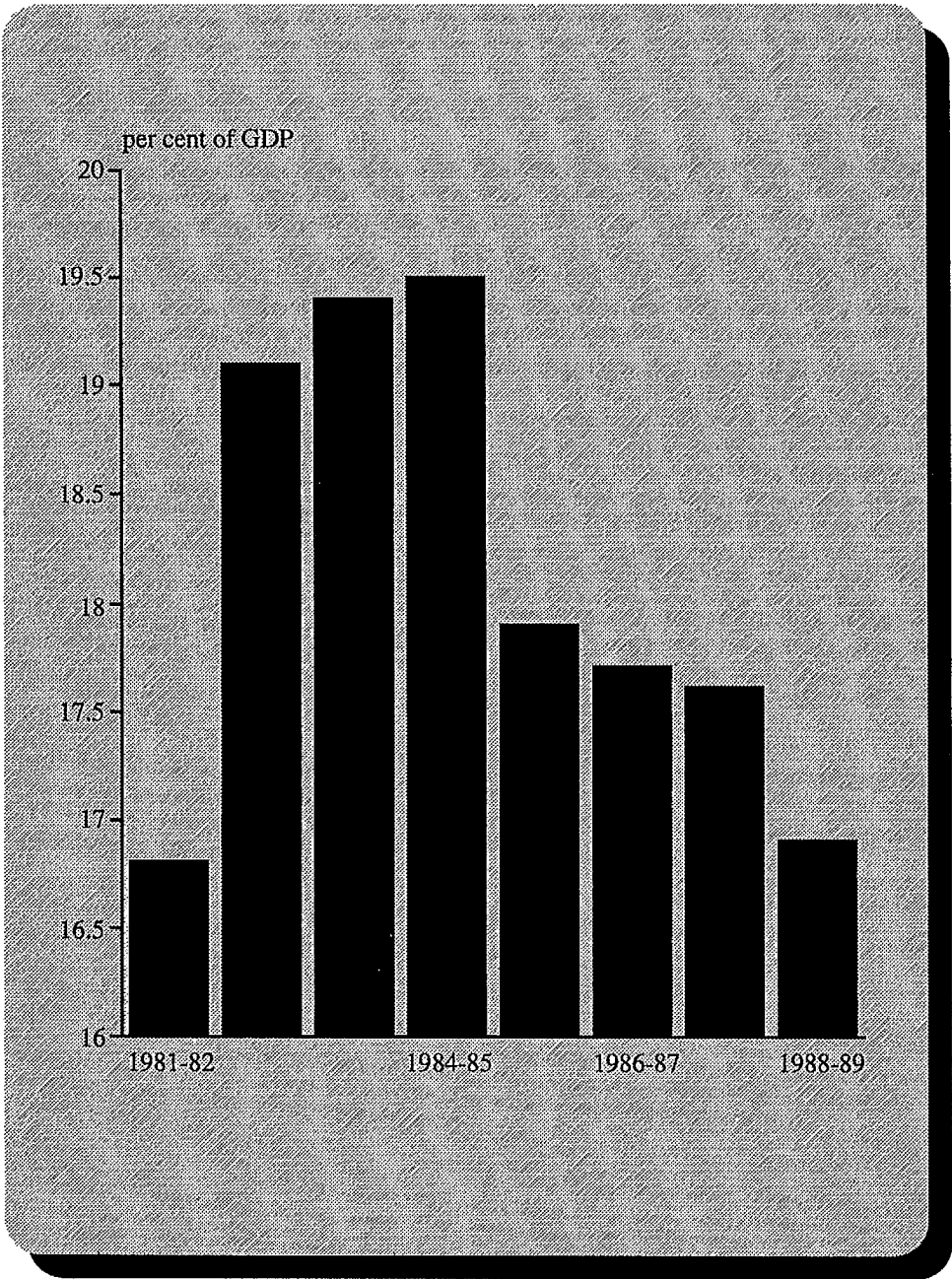
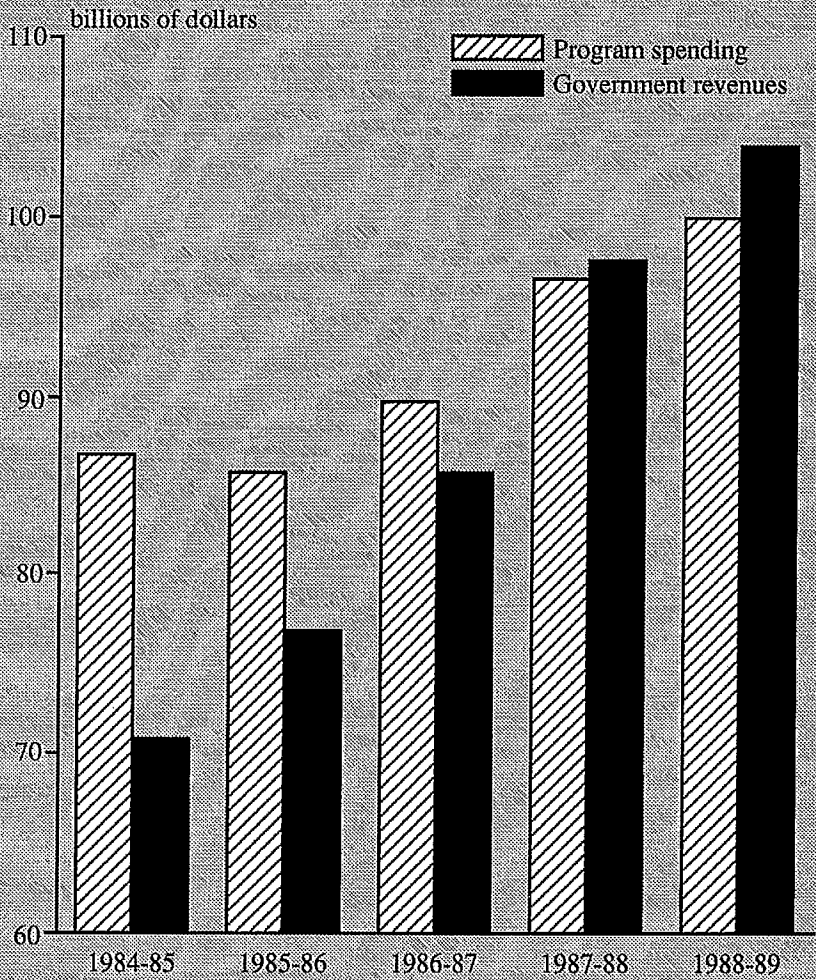


Chart 12

Program Spending and Government Revenues



Summary

The initiatives undertaken in the last four years have resulted in a substantial reduction in the rate of growth in program spending.

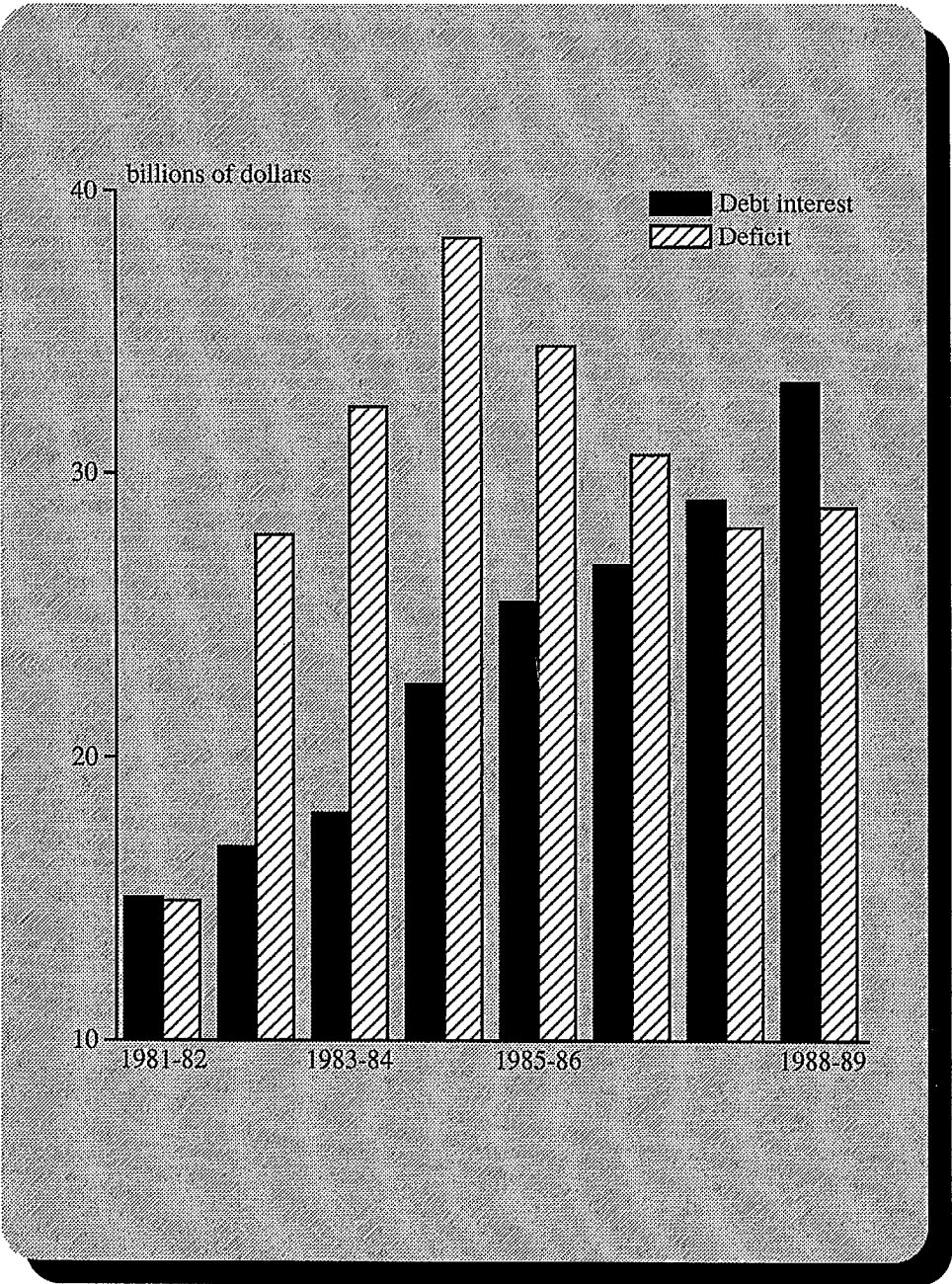
By rising less than the growth in the economy, federal government program spending fell from over 19 per cent of gross domestic product in 1984-85 to 17 per cent in 1988-89, back to the rates in evidence prior to the 1981-1982 recession.

The measures undertaken since November 1984 have resulted in a restructuring and better targeting of government programs.

In 1984-85, spending on government programs greatly exceeded revenues. The level of program spending is now below the level of total revenues.

Chart 13

Debt Interest and the Deficit



C. The Rise in Debt Interest

Although solid progress has been made in restraining program expenditure growth, rising debt interest payments have frustrated efforts to reduce the deficit.

Debt interest has risen to \$33 billion and has reached the point that debt interest is larger than the entire federal deficit itself.

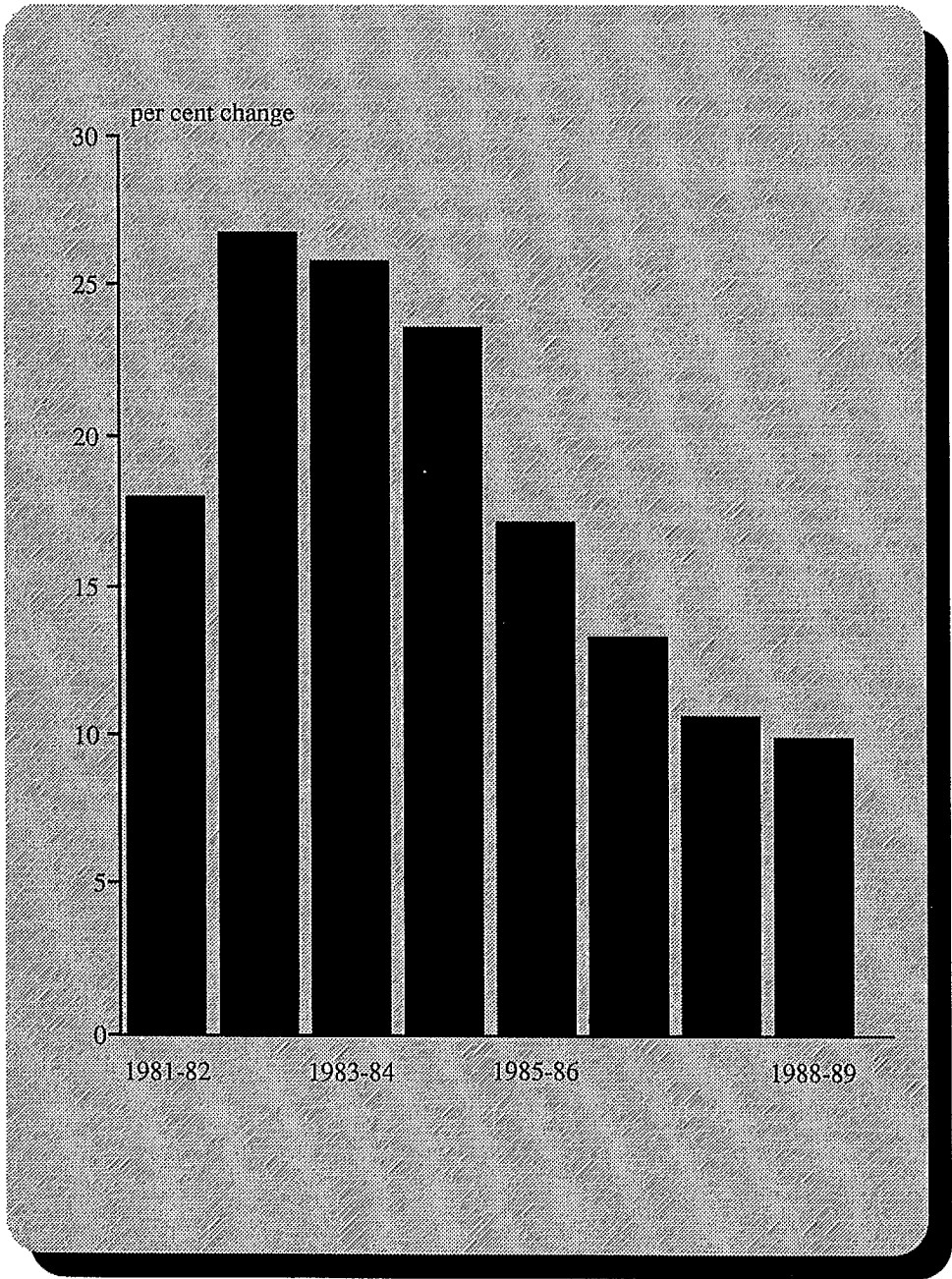
Debt charges rose by \$10 billion from 1984-85 to 1988-89. To meet this cost as well as to reduce the deficit by \$10 billion over the same period required an improvement of \$20 billion in the balance between program expenditures and revenues.

The most important reason for rising debt interest payments is the large and growing stock of debt.

And with the large stock of debt, the costs of servicing the debt becomes very sensitive to changes in interest rates.

Each time interest rates rise by one percentage point, the debt servicing costs increase by \$1.5 billion in the first year, rising to approximately \$3.5 billion after four years.

Chart 14
Growth in the Public Debt



Growth in the Public Debt

With annual reductions in the government's deficit since 1984, the growth of the public debt has slowed sharply.

After growing on average close to 24 per cent per year during the four years ending in 1984-85, the growth of debt slowed to less than 10 per cent in 1988-89.

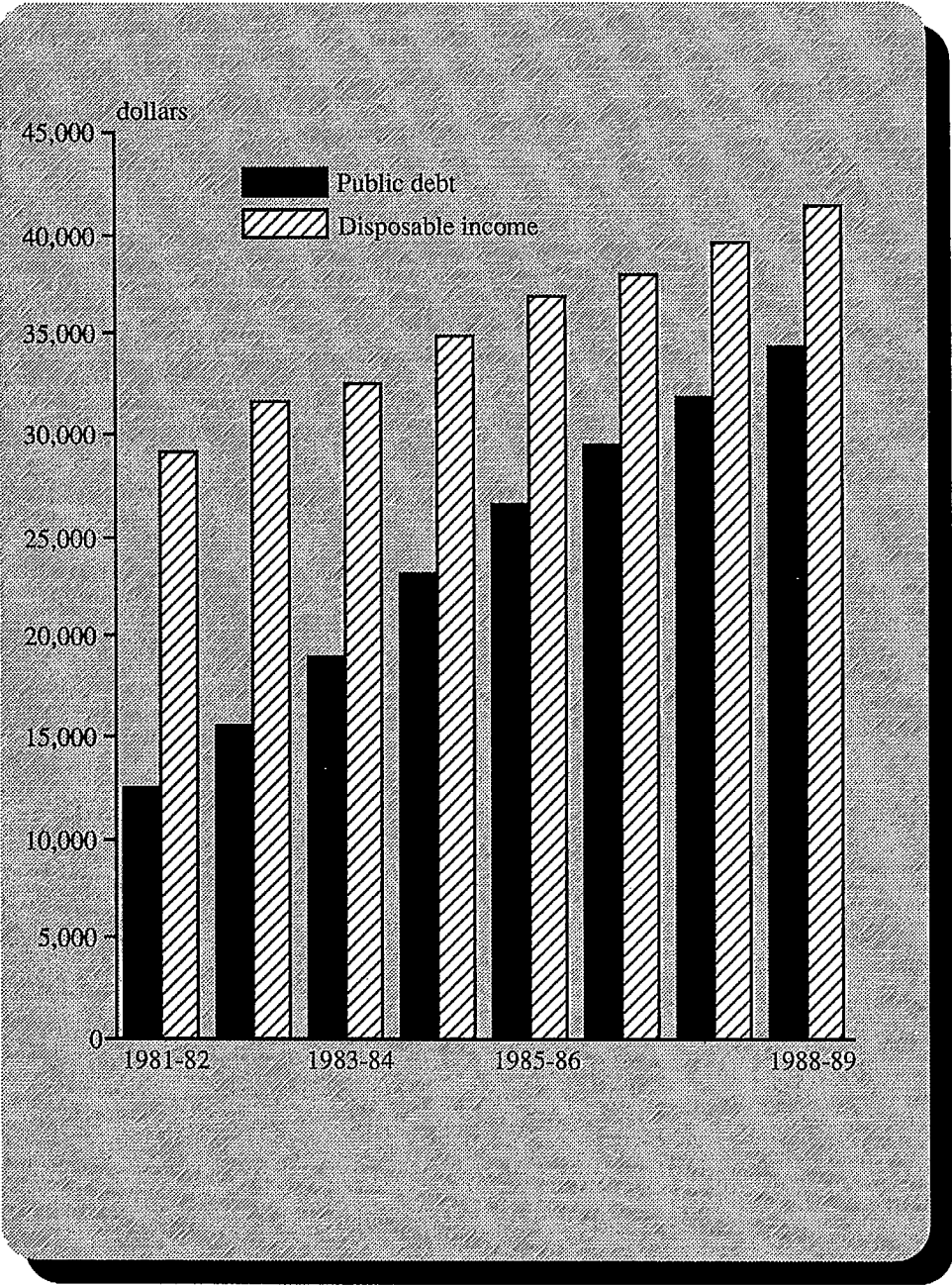
The Increasing Level of Public Debt

In spite of the slowing in the growth of public debt, however, the annual deficits have added considerably to the public debt.

The public debt rose from approximately \$200 billion in 1984-85 to \$320 billion in 1988-89.

Chart 15

**The Burden of Public Debt: Debt per Household
Versus Disposable Income per Household**



The Burden of Public Debt

The amount owed by the Government of Canada per household has risen dramatically over the past eight years. In 1981, the debt stood at \$12,300 per household; deficits incurred since have raised this to \$34,200 per household in 1988-89.

In other words, federal government debt per household has grown almost 16 per cent per year. In contrast, disposable income per household has grown only 5 per cent per year.

There are two ways to control this growing burden of debt:

- fiscal policies to ensure lower deficits; and
- economic policies to ensure lower interest rates and sustained, non-inflationary growth.

D. Conclusion

The expenditure restraint actions taken by the government have held the growth of program spending to less than the rate of inflation during the past four years.

Financial management has been improved and a cost-conscious climate established throughout government. The government has succeeded in reducing its spending on programs to less than it receives in revenues.

Even with this progress, the public debt continues to grow. As a result, the government now spends more money in interest payments on the debt than it spends on any other government program. Rising debt interest payments threaten to undo the solid progress already made in controlling program spending.

The only way to slow the growth of the debt and reduce the size of debt interest payments is to take the actions necessary to keep the government's deficit falling year after year and to bring about lower rates of inflation and lower rates of interest. That challenge must and can be met so that Canada can continue to afford the social programs that are the best expression of our nationhood.