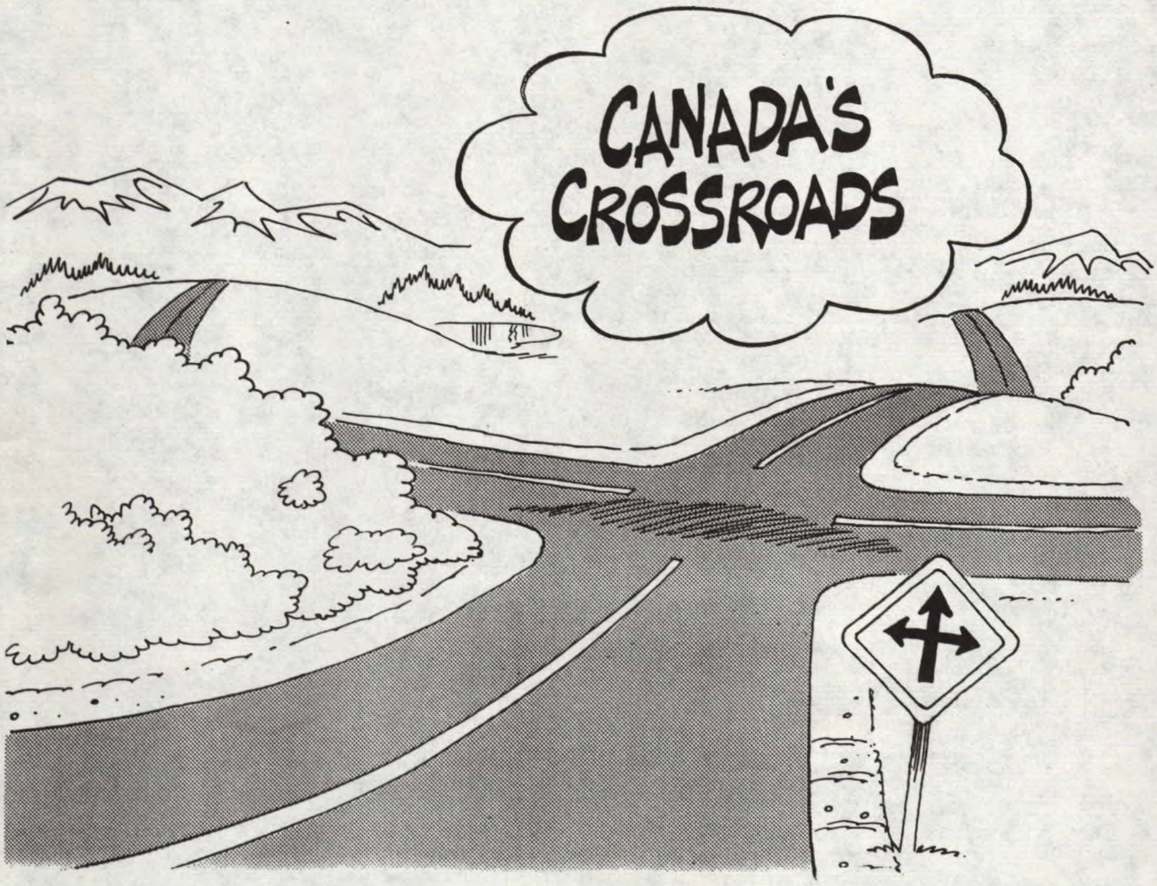
Canada's Economy: What Path? What Future?



Written and produced by:
THE CANADIAN FOUNDATION FOR ECONOMIC EDUCATION

An opportunity for Canadians to propose solutions to Canada's deficit/debt challenges and to send them to the Minister of Finance.

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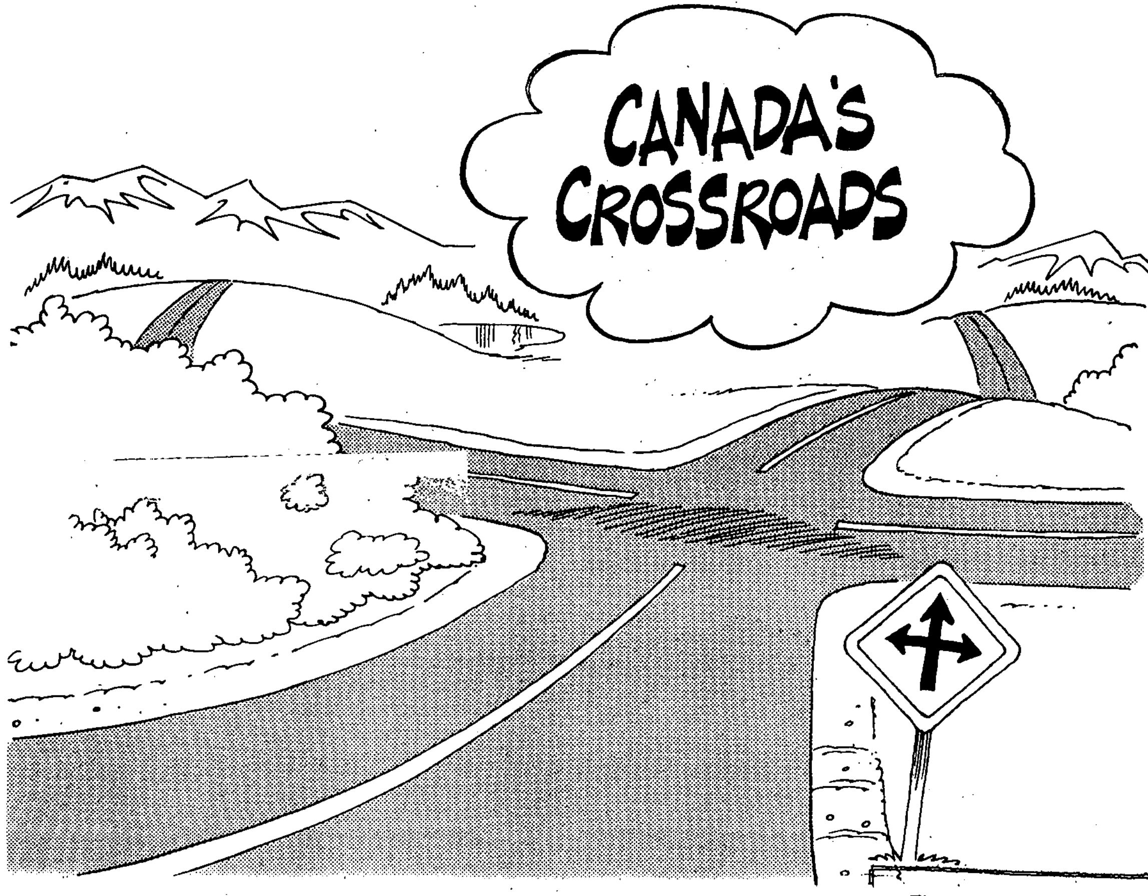

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An opportunity for Canadians to propose solutions to Canada's deficit/debt challenges and to send them to the Minister of Finance.

This document has been written by Gary Rabbior, President
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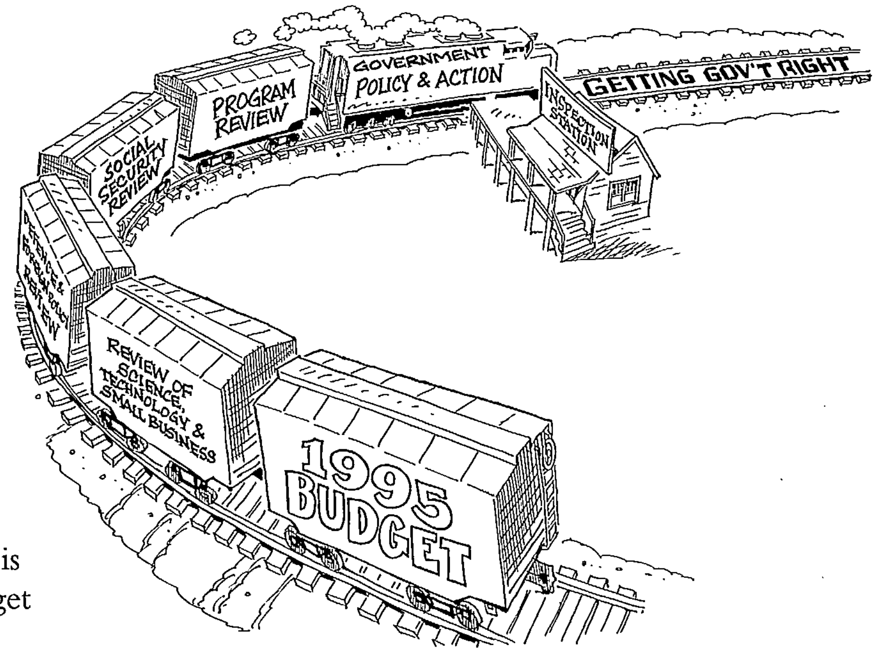
Produced with the technical participation of the Department of Finance Canada.

PREAMBLE

The Canadian economy is at a crossroads. Without effective action, the successes Canadians have achieved are at risk.



The federal government has laid out a number of steps that it wants to take. There is a general review of all government programs, as well as specific reviews of Social Policy, Defence, Foreign Policy, and Science and Technology and Small Business.

Another important part of the process will be the 1995 budget, which will lay out actions having an effect for years to come. In preparation for this budget, the government is anxious to involve Canadians in budget deliberations and decision making.

To help get the discussion going, the government released two documents about the Canadian economy — where it is and where it's headed. These documents are titled *Agenda: Jobs and Growth — A New Framework for Economic Policy* and *Creating a Healthy Fiscal Climate.* But these documents alone may not provide all Canadians with the information they need to play a part in the debate about our budget choices. And so, the government has commissioned the Canadian Foundation for Economic Education to produce this workbook.

The Canadian Foundation for Economic Education is a national, non-partisan, non-profit organization with a history of efforts to promote economic understanding among Canadians. Founded in 1974, the Foundation has worked with provincial ministries of education, and educators across Canada, to improve economic understanding. We have also collaborated with organizations such as the Bank of Canada, the Economic Council of Canada, and the Canadian Labour Congress to produce publications for the general public.

Our goal as a Foundation and, in particular, with this workbook is not to advocate any particular point of view or action. Our goal is to provide you with background information that might be useful as you consider the issues and options that face Canada. We have also tried to clarify the government's views so that you can decide whether you agree or disagree with the government. So be aware that we are going to try to clarify the government's perspective and priorities.

There are other points of view and we encourage you to seek them out and see how they compare with the government's position.

The book will highlight key questions people may want to ask the government. It will ask readers to consider for themselves some of the tougher choices that have to be made. Throughout, there are areas for you to make notes for yourself, and there's a questionnaire at the end entitled "What Do You Think?" Please fill it out and send it in, with or without your name attached. Express your support for other views and perspectives if you think they have merit or should be considered by the government. Tell the government what you think it should do.

- Will the Minister of Finance personally review your response? He can't read them all, but he will read a representative sample. He will also read a summary report based on the responses received.
- Your response will be read by a team of officials in the Department of Finance. They have promised to do that, and have also agreed to provide the Minister with those that are exceptional or unique in some way along with the summary of the responses noted above.
- Will your response have an impact? The more Canadians who take the time to express their views, the more significant the impact. However, even a single voice can make a difference if you are able to propose a truly innovative idea or suggestion. So please be imaginative, and encourage others to play a part.
- Will you benefit from the exercise? We hope so. Whether or not you believe you can have an impact on policy, we hope that you will engage in the discussion and that this document will help you establish your own views.

Between November and January, meetings and discussion groups will take place in many cities across Canada. You, or an organization you are a member of, may want to hold a meeting to discuss the issues raised in this publication. We hope this workbook will help you to prepare for these opportunities and encourage you to participate. In addition, the House of Commons Standing Committee on Finance will be holding meetings in Ottawa and across the country to solicit opinions and recommendations from Canadians. The Committee will report to the House of Commons.

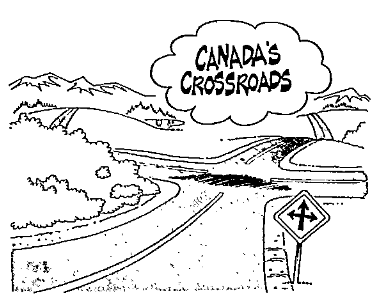
Send completed recommendations to:
(Note: no postage is necessary.)

Workbook '95
c/o The Honourable Paul Martin
Room 515-S, Centre Block
House of Commons
Ottawa, Ontario K1A 0A6

Section I

Where Are We? Where Are We Headed?

An Economic Future in the Making



Many Canadians find that just making ends meet these days can be a real preoccupation. There is often little time to try to understand the broader issues and challenges facing our nation. At the same time, many Canadians want to be more informed and play a larger role in the nation's business. The goal of this workbook is to help in that regard. Let's begin with a look at our economy. Just how are things anyway?

There's good news, and there's bad news. First, the good news.

The Good News

Canada has a history of economic success, and our nation is the envy of many throughout the world. When we look around the world and ask "Is there any other place I'd rather be?", most Canadians would likely choose to stay where they are.

Certainly there are Canadians who are not as well off as others, and too many are unemployed and experiencing real hardship. But, overall, our economy has done well.

Fact: Canada has one of the highest standards of living in the world as measured by GDP per capita.

Definition: GDP (Gross Domestic Product) — this statistic measures the value of goods and services produced in a country in one year.

GDP/capita — the value of goods and services produced **per person** in a country in one year.

Fact: Canada was recently ranked by the UN as the number one country in the world in which to live.

Fact: Canada currently has the fastest growing economy of any of the G-7 nations (G-7 nations include the United States, France, United Kingdom, Germany, Italy, Japan, and Canada).

Fact: Canada is currently setting records for this nation in export sales to other countries.

Fact: Canada's unemployment rate, although still high, has started to come down, falling from 11.2 per cent in September 1993 to 10.1 per cent in September 1994. This is the lowest unemployment rate since January 1991.

Your Thoughts: Your Notes

Is there something you admire about another nation? If so, what and in which country?

Could this be realized in Canada? If so, how? What would it take?

Things are definitely looking up for our economy compared with the last few years. But the last few years have been very difficult ones, and the question arises — can we keep the improvement going? Things may be better for a while, but is our economy positioned to embark on a long-term, sustained path of growth and more jobs?

That brings us to the bad news or, at least, the not-so-good news.

THE BAD NEWS

A. THE CHALLENGE OF JOB CREATION

In the 1950s and 1960s, when Canada's economy came out of a slump, it was very successful at creating jobs. Most people who wanted a job could find one. Of course, there were always people unemployed due to seasonal factors or because they were moving from one job to another.

Definition: The "core rate of unemployment" — the percentage of Canadians who want to work but remain unemployed even at the peak of economic expansion.

Up until the 1960s, the "core rate" was 5 per cent or less. But today, the core rate has risen to roughly 8 per cent. Even as the economy recovers, jobs aren't being created at a fast enough rate. That means that even as our economy moves toward the next peak in its cycle, over one million Canadians will likely remain without work.

How about you?

What do you think are the major factors behind Canada's relatively high unemployment rate?

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What could be done to improve the situation?

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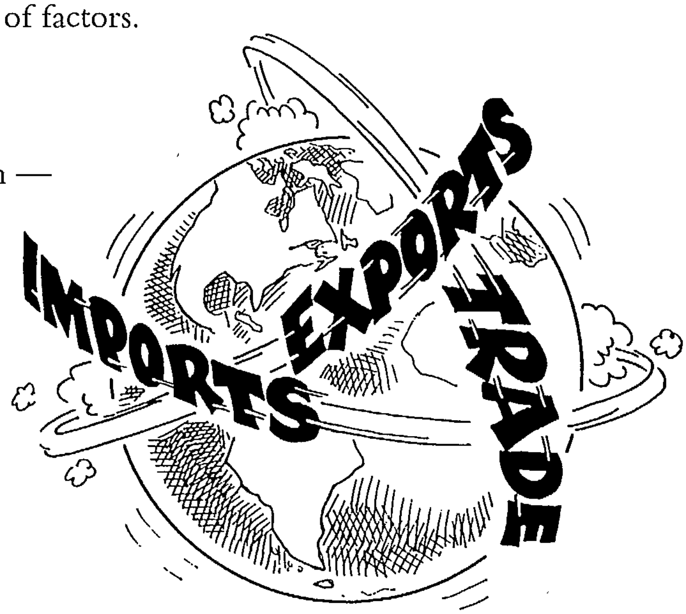
Why has the "core rate" risen? There are a number of factors.

(a) Global Challenges



- Canadian producers are facing stiffer competition — within Canada and in global markets.
- If we lose sales to the competition, it is harder to create jobs.
- Our competitiveness will be affected by how productive we are.

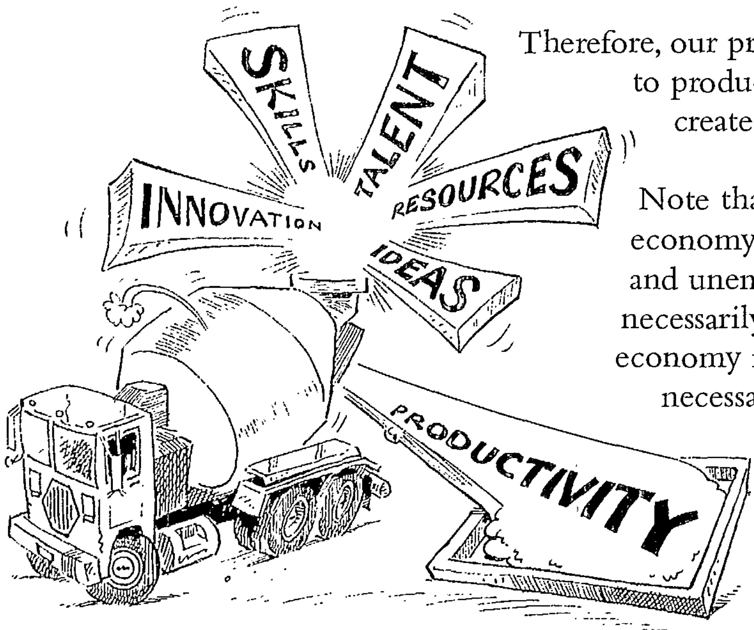
Fact: Global competition is intensifying rapidly.

(b) Lack of Productivity Growth

Definition: Productivity is a way in which we measure how well ideas, workers, resources, and investment are brought together to produce products and services.

- The smarter we are at producing goods and services, the lower our production costs will be and the better quality we can produce.

- The lower our production costs, the more competitive we can be.
- The lower our production costs, the higher the income that can be earned from selling our goods and services.



Productivity is a way in which we measure how well ideas, workers, resources, and investment are brought together to produce products and services.

Therefore, our productivity performance will affect our ability to produce goods and services, sell goods and services, create jobs, and increase incomes.

Note that growth is different from productivity. The economy can grow by re-employing idle resources and unemployed workers. Therefore, growth doesn't necessarily mean that our productivity is rising. The economy may be using more resources — and not necessarily improving the way it uses and combines available resources.

Fact: Canada was the second most productive economy (behind the U.S.) for decades.

Fact: Canada's productivity growth has been stalled for 20 years.

Fact: Other nations such as Japan, Germany, France, Singapore, Taiwan, and so on are catching up to and, in some cases, passing Canada in terms of productivity growth and performance.

Our productivity level affects our competitiveness.

But many people see a quest for higher productivity as exploitation. Get people to do more for less — work harder for less — help *me* make more money from *your* hard work.

Yes, one way to increase productivity is to make people work harder to try to accomplish more in the same amount of time. But to what extent? As any smart employer will tell you, if you try to increase productivity simply by pushing people who are already working hard to work harder, any gains will be short-lived. Workers won't be happy. Stress levels rise. Performance declines. Turnover increases. People get sick. Loyalty and dedication erode.

Your Thoughts: Your Notes

What factors hinder **your** productivity?

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What makes you better at what you do?

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Working harder can bring rewards, but long-term success usually requires working smarter as well.

There is another face to productivity. Long-term benefits from productivity come from working smarter, not just harder — finding new ways, better ways; employing people more effectively; making better use of people's talent; developing new technology; making improvements through "brain power," not only "brawn power."

The goal for Canadians is to determine how we can work smarter to create jobs at a fast enough rate to lower the core rate of unemployment and put more Canadians back to work.

But, in addition to helping to create jobs, productivity improvements can also benefit those who are working. Productivity improvements can lead to more production, lower cost per unit, increased sales, and, as a result, the potential for higher incomes.

Fact: "Real income" growth for Canadians has been stalled, or has decreased for some, over the last 20 years.

Definition: Real income refers to your purchasing power to acquire goods and services, not just whether you've received a higher disposable (after-tax) income. For example, if your income rises by 3 per cent, but the prices you pay rise by 5 per cent, you are actually worse off than you were. Your purchasing power has declined.

That is, if you take out the effects of inflation and the income needed to cover higher prices, the growth in real income that Canadians have taken home has been flat or declining for a long time. Without improved productivity, it is very difficult to raise real incomes.

How about you?

Over the last five years, do you believe your real income has:

Increased ☐ Decreased ☐ Stayed the same ☐

(c) Expansion of Our Labour Force

Over the last two decades, Canada's economy has actually led G-7 nations in job creation. But, at the same time, with population growth, the "baby boom" entering the labour market, more women participating in the workforce, and more people coming to Canada, the labour force has grown more quickly than the number of new jobs.

Therefore, even though we've created more jobs than most other nations, our unemployment rate, and the number of Canadian unemployed, has been rising.

Fact: The country's economy has done a good job at creating jobs, but it has to do better.

How about you?

What is the best idea you have for improving job creation?

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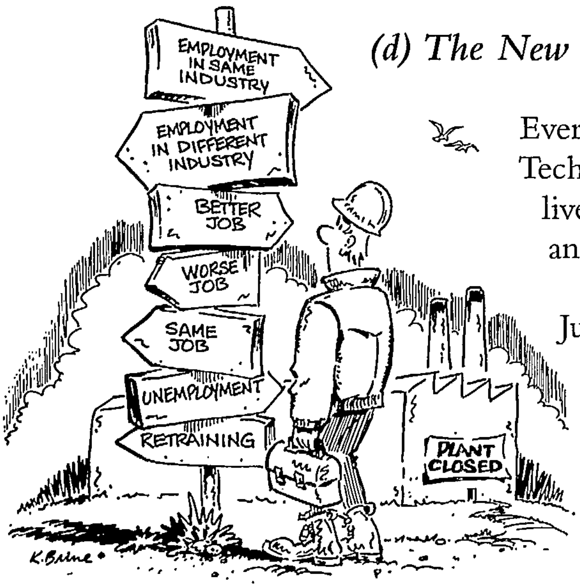
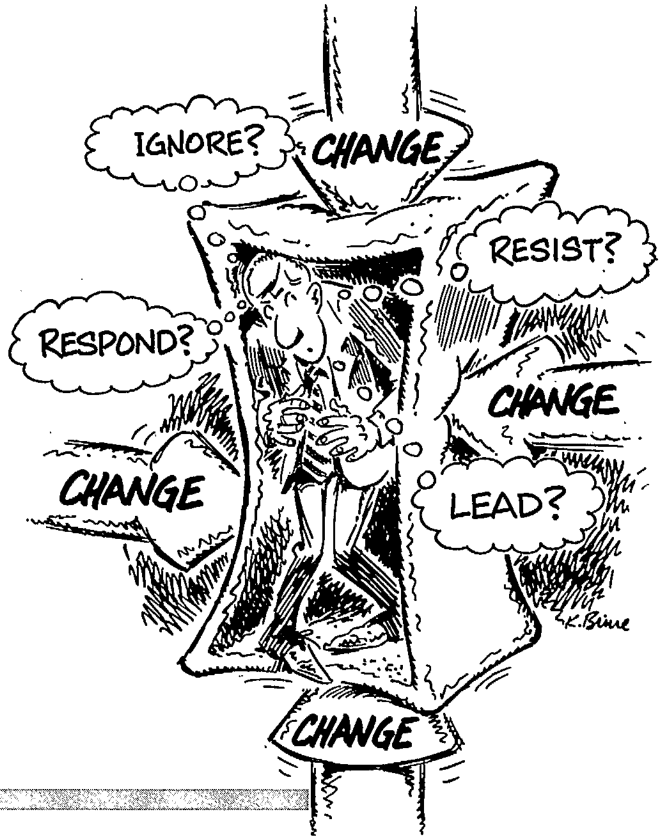


(d) The New Economy

Everyone knows that we are in a period of dramatic change. Technology is evolving rapidly and affecting many aspects of our lives. This poses challenges to businesses as they try to adjust to and adopt the new technologies.

Just as businesses have to adjust, workers have to adjust. And it isn't easy. Some people will lose their job because of the transitions generated by new technology. Our economy may benefit. The business may benefit. But that's little consolation to a person who loses a job. That person, like the business, will have to adjust to change to obtain a new position.

This type of "structural unemployment" can lengthen the time of unemployment. The need for workers to adjust to the new economy, and the time it takes to adjust, are other factors affecting our ability to create jobs and get more Canadians back to work.



Definition: Structural unemployment — those who are unemployed because (a) their skills do not match those needed for the jobs available or (b) they live in areas different from where available jobs are located.

How about you?

What do you think could be done to help Canadians keep up with technology and innovation?

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To summarize, a key challenge we face is to improve the level of job creation in the economy so that the unemployment rate can continue its decline. The following, then, have contributed to a rise in Canada's core unemployment rate in recent years:

- global changes and challenges,
- flat productivity growth,
- an expanding labour force, and
- the efforts needed to adapt to and transfer new technology more effectively.

B. THE CHALLENGE OF THE DEBT

As we work at creating more jobs by improving our productivity and achieving growth, there is a major obstacle in the way — our debt and deficit. The ability and capacity of the government to act, to lead, to complement, to assist, to support, or to do whatever is judged to be most important is being eroded. It is being eroded by the failure of government in the past to put its financial house in order. It is being eroded by the debt and continued deficits.

Definition: Deficit — the amount by which spending exceeds revenues in one year.

Debt — the total outstanding amount owing resulting from the deficits and/or surpluses experienced over the years since Confederation.

Fact: The federal and provincial governments collectively owe approximately $700 billion.

Fact: This combined debt is equivalent to $24,000 for every man, woman, and child in Canada.

Fact: Our debt is growing at a faster rate than our economy. That is, our nation's debt is growing faster than our nation's total income (our GDP).

Fact: Our GDP in 1992 was $688.4 billion and in 1993 was $711.7 billion. Thus, the economy grew 3.4 per cent between 1992 and 1993.

Fact: Total government debt (federal and provincial) stood at $630.2 billion on March 31, 1993, the end of the 1992-93 fiscal year. By March 31, 1994, it had increased 10.4 per cent to $695.7 billion (compared with the 3.4 per cent growth in the economy).

Why does our level of debt and deficit matter? Let's now explore, in detail, the issue of the debt and deficit.

CHECKING YOUR PULSE

After reading this section, check the boxes that most describe the way you are feeling or your personal reactions:

- ☐ I knew that
- ☐ Surprise
- ☐ Confusion
- ☐ Optimism
- ☐ Challenged
- ☐ Inspired
- ☐ Frustrated
- ☐ More informed
- ☐ Keen to read more
- ☐ Pessimistic
- ☐ Anxious to discuss
- ☐ Seems to be on the right track
- ☐ Seems to be on the wrong track

Activity:

Indicate the priority you would assign to each of the following. Indicate the highest priority with #1, second highest with a #2, and so on.

	Rank
• Assisting/supporting those negatively affected by the changes under way in our economy.	________
• Maintaining a low rate of inflation to help maintain the value of money and keep interest rates down.	________
• Avoiding any increase in taxes.	________
• Reducing government spending.	________
• Enhancing the skills of Canadian workers.	________
• Encouraging entrepreneurs and creating a positive environment for entrepreneurs.	________
• Encouraging research and the development of new technology in Canada.	________
• Expanding export opportunities for Canadian companies.	________
• Other: ______________________________	________

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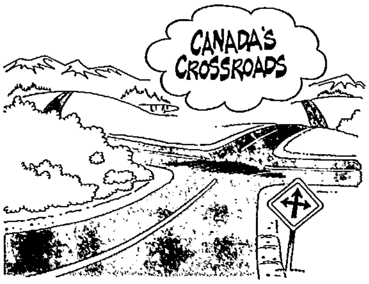
Section II

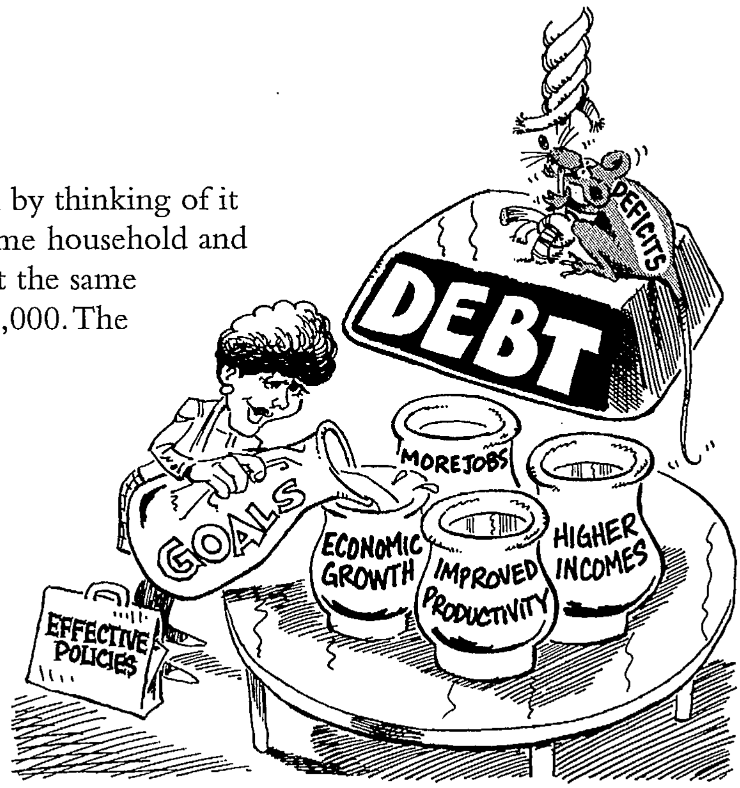
Canada's Debt and the Deficit:

A Roadblock to Our Future



Let's examine our nation's debt and deficit situation by thinking of it on a personal level. Suppose you live in a two-income household and that, together, the two incomes bring in $50,000. At the same time, suppose the household incurs expenses of $55,000. The financial picture of this household is as follows:

Total Revenues:	$50,000	
Total Expenses:	$55,000	
Operating Deficit:	$ 5,000	Debt: $5,000
Debt as a Portion of Income:	10%	[5,000/50,000]



Our debt and deficit problem poses a threat to our goals for the economy.

If this is the household's first year of operating, the debt at the end of year one would be $5,000.

Now, suppose the next year is exactly the same, that is, no wage increase and no extra expenses, except one — the interest cost on outstanding debt. [Note: We will assume an interest rate of 8 per cent on outstanding debt.]

Total Revenues:	$50,000	
Total Expenses:	$55,000	
Operating Deficit:	$ 5,000	
Interest on Last Year's Debt:	400	[8% of $5,000]
Total Deficit for the Year:	$ 5,400	
Previous Debt:	$ 5,000	
		Accumulated Debt: $10,400
Debt as a Portion of Income:	Approximately 21%	

Therefore, the "operation" of the household contributed $5,000 to the deficit. The interest payment on the debt contributed $400 to the deficit. This brings the total deficit for the year to $5,400. Combined with the deficit from the previous year, the total debt is now $10,400.

Let's add one more year and assume the same revenues and household operation expenses.

Total Revenues:	$50,000	
Total Expenses:	$55,000	
Operating Deficit:	$ 5,000	
Interest on Accumulated Debt:	832	[8% of $10,400]
Total Deficit for the Year:	$ 5,832	
Previous Debt:	$10,400	
		Accumulated Debt: $16,232
Debt as a Portion of Income:	32%	

Note how the debt, as a portion of income, has increased from 10 per cent in the first year to over 30 per cent by the third year.

The household's income represents its ability to carry debt. The higher the level of debt in relation to income, the harder it is for the household to meet the debt payments and carry the debt. Furthermore, the household will have to use more and more of its income to carry the debt and so it will have less available for other things such as food, shelter, entertainment, transportation, and so on.

Suppose the household continued in this way to the point where the debt it had incurred was now equal to its income — both equal $50,000. Maybe some item such as a second car or a cottage was purchased. Let's look at the next year's situation.

Total Revenues:	$50,000	
Total Expenses:	$55,000	
Operating Deficit:	$ 5,000	
Interest on Accumulated Debt:	$ 4,000	[8% of $50,000]
Total Deficit for the Year:	$ 9,000	
Previous Debt:	$50,000	
		Accumulated Debt: $59,000
Debt as a Portion of Income:	118%	

Now, suppose the household decides action must be taken and it cuts expenses by $3,000. Think for a moment. If you had to cut your spending by 5 per cent, what would be the first things you would cut? In household spending, the first cuts are usually the least painful. In this case, maybe the household sold the second car.

Suppose further that revenues increase by $2,000 (perhaps someone picked up some part-time work, or was promoted, or managed to get a higher paying job). What happens to the household's situation with the reduced spending and higher income?

Total Revenues:	$52,000	
Total Expenses:	$52,000	
Operating Deficit:	0	
Interest on Accumulated Debt:	$ 4,720	[8% of $59,000]
Total Deficit for the Year:	$ 4,720	
Previous Debt:	$59,000	
		Accumulated Debt: $63,720
Debt as a Portion of Income:	122%	

Even with more income and reduced expenses, the household debt is still rising. Why? Because of interest payments. The debt grew more quickly than income, and the financial situation continues to worsen.

The entire cause of this household's deficit in the last year was the interest payments on the accumulated debt.

The growth in income helped, and the reduced spending helped, but together they weren't enough. The growth in this household's income will need to be accompanied by additional reductions in expenses. **Together, they must reach a point where the operating surplus exceeds the interest payments on the accumulated debt.** Then, the debt stops rising, and further efforts could start to reduce it.

Definition: Operating surplus — when the income in one year exceeds expenses related to operating the household. It does not include the expenses related to carrying debt accumulated in the past.

Operating deficit — when operating expenses exceed income in one year.

The situation described above is more than hypothetical. It describes the "household" of Canada. Canada has run a series of 23 years of annual deficits. How bad has the situation become? In the last section, we presented some "facts." Here are some more.

Fact: Total federal government debt as of the end of 1993-94 was $508 billion, which represents a debt/national income ratio of 71.4 per cent.

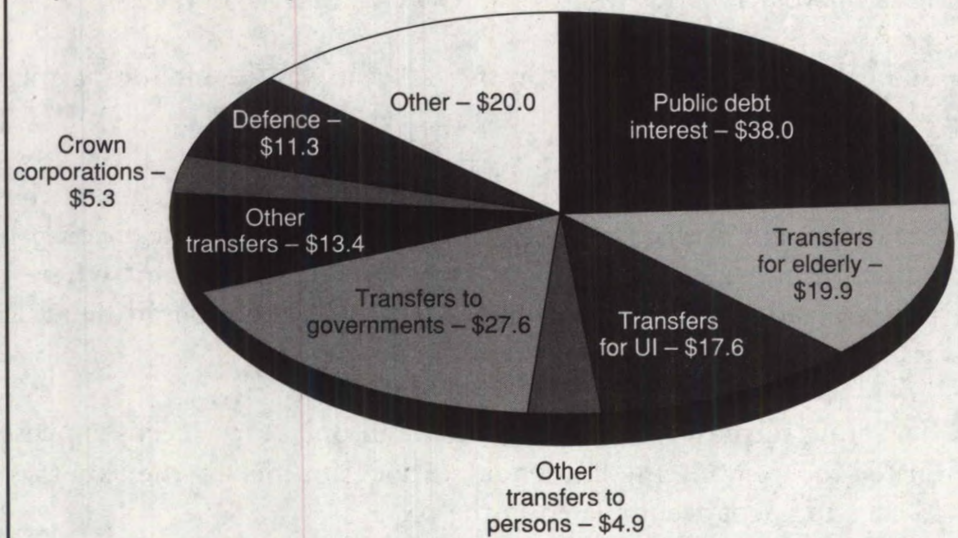
Fact: Canada's federal deficit in 1993-94 was $42 billion. This was made up of a $4 billion operating deficit and $38 billion in interest payments on our debt for the year.

Fact: The federal government's total revenues in 1993-94 were $116 billion, and, of that, 33¢ of every tax dollar was used to pay interest.

Fact: Interest payments on our debt represent the single largest area of federal government spending.

It may surprise many Canadians to find out that last year more Canadian tax dollars were used to pay interest on the debt than were spent on any other area — more than was spent on health care, welfare, or programs for seniors — far more than was spent to run the entire federal government.

Where Government Spends[1]
(billions of dollars)



[1] Spending during the 1993-94 fiscal year, which ended March 31, 1994.

Note: A complete list of where government spends is found on page 41.

Fact: As mentioned before, our total federal and provincial debt is approximately $700 billion. This results in a ratio of our total debt to our total national income (GDP) of approximately 100 per cent.

How can people relate to a figure such as $700 billion in debt? It's not easy.

To put it in perspective, consider the following facts.

Fact: If we wanted to pay off all of our debt (federal and provincial) today, we would need more than $24,000 from every man, woman, and child in Canada.

Fact: As it is, we need the equivalent of $2,000 a year from every Canadian just to pay the interest on our total federal and provincial debt.

Fact: The interest costs on our **federal** debt alone are rising by $85,000 per minute, 24 hours a day. For example, if it has taken you seven minutes to read this far, the interest on our debt would have increased by $595,000 in that time.

We have another problem as well. Our need for borrowing is now such that we need to borrow from sources outside of Canada. Consider 1993. Total private savings (funds saved by private citizens or private companies) in Canada in 1993 was $131 billion, private borrowing (by citizens or companies) was $109 billion, and public borrowing (by governments) was $50 billion. That results in total borrowing of $159 billion and available savings of only $131 billion. Canada was unable to generate enough savings to cover its borrowing needs. As a result, Canada needed to borrow $28 billion from foreign sources.

Fact: Canada's combined private and public sector borrowing from foreign lenders now amounts to $313 billion.

Fact: Our foreign borrowing represents 44 per cent of our total national income (GDP).

How does this compare with other countries? Well, the next highest borrower of foreign funds among the G-7 countries is Italy, which borrows only 12 per cent from foreign sources.

Let's return to our household example for a moment.

For what reasons might a household incur such deficits?

(a) for items that bring long-term benefits, such as a car, home, or education, or an investment for which the expected return will be greater than the borrowing cost and expected inflation,

(b) for short-term benefits, such as a vacation, or for other products and services that will be used for current enjoyment (and for which one is willing to give up spending as the debts are repaid),

(c) in the belief (hope) that incomes will rise faster than debt in the future, or

(d) due to neglect, indifference, or a lack of desire to weigh the present against the future.

Governments also incur deficits for many reasons — investments in the future, current consumption priorities, hopes for future income, waste, or a lack of willingness to deal with the future.

In 1993-94, our deficit was virtually all interest payments — $38 billion of a $42 billion deficit was for interest payments. In 1994-95, this current fiscal year, our entire deficit will be due to interest payments on the debt. If things persist, we will leave the next generation, and future generations, an extraordinary burden — a burden that would likely guarantee they experience a lower standard of living than those who preceded them and incurred the debt. It will be like leaving a mortgage still to be paid but no house to show for it.

If we don't change course, our financial situation will continue to worsen because of compounding interest (borrowing to make interest payments results in this year's interest payment being added to next year's debt). Furthermore, in the future, there would be increased pressures for higher taxes, a need for greater cuts to programs, and more upward pressure on our interest rates.

Your Thought: Your Notes

In what ways, if any, do you think our high government debt and deficits are affecting you or your household situation?

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There are four things that can help to turn things around:

- total revenues for the government can rise as a result of economic growth and growth in sales and incomes (generating more tax revenue),
- total expenses can go down as a result of economic growth (for example, fewer people collecting benefits such as welfare and unemployment insurance),
- total revenues can potentially rise through changes in tax policy — increase tax rates, broaden what is taxed (that is, apply taxes to more products, services, and so on), or allow fewer deductions/tax credits,
- total expenses can be reduced by cutting government spending.

The interest on our debt is increasing our debt burden faster than growth in the economy is working to reduce it. Result: the debt burden on Canada's economy is increasing.

As the household example illustrated, once you reach a high level of debt, it is unrealistic and risky to count just on economic growth (growth in our nation's income) to halt and reverse our debt's course. It would take unprecedented growth to achieve that, and there is no forecast for the economy, done by any organization, that sees growth in the years ahead that would be strong enough on its own to solve the debt problem. Our interest payments are simply too high.

We will also need spending cuts and/or tax measures to go along with the growth we can achieve. In recent years, government has slowed down the rate of increases in program spending. Last year, federal government spending on programs actually declined — on total spending other than the interest payments. It was the first year of decline in program spending since the 1984-85 to 1985-86 period.

How about you?

Have you seen evidence of reduced government spending on programs? If so, where and with what effects?

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____

But our better growth, increases in tax revenues, and reduced program spending have not yet done enough to stop our debt from rising. More will have to be done if we are going to change our course.

What about further cuts to government spending?

As with the household, the first cuts that were made in spending were the least painful. Further cuts will hurt more — and that makes the cutting more difficult.

- How do you decide who will be hurt?

- Who will share the pain?

- What's fair?

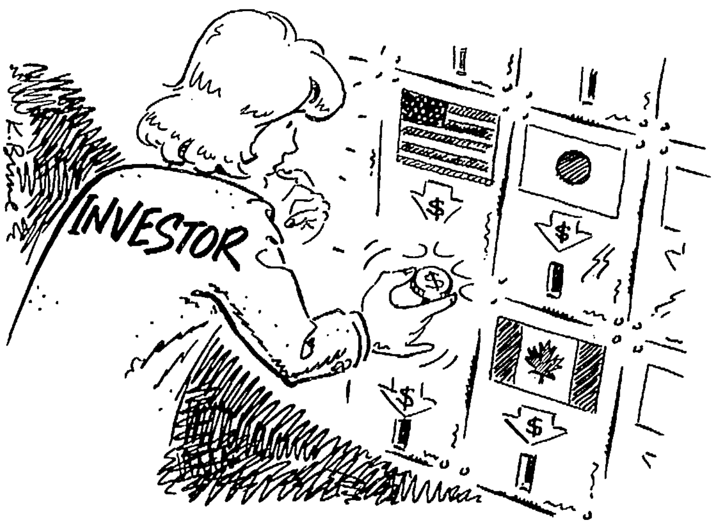
What about trying to raise more revenues from taxes? Most Canadians would likely react negatively to that prospect — but it is an option.

Some Canadians, while arguing that they, themselves, don't want to pay any more taxes, believe there are some that should be taxed more, particularly wealthy Canadians and corporations.

There are a couple of points to make here.

Many people feel that wealthy Canadians should be paying more tax and that this can solve our deficit problem. On the basis of fairness, there is no question that wealthier Canadians should be providing their fair share of revenue to the government. There may well be additional steps that could be taken to insure all high income earners pay a greater share of taxes. But when it comes to the debt and deficit, the numbers tell the story. Even if taxes were increased dramatically for all Canadians earning $100,000 or more, the fact is it would help, but by itself it wouldn't yield enough revenue to make a major impact on the deficit.

Corporations should also pay their fair share of taxes. But in deciding what should be a fair share, you should consider a few things. Corporations view taxes as a cost of doing business and will try to pass them on to whoever buys their product or service. If the costs can't be passed on, the impact of higher taxes will be felt by the owners (the shareholders) through reduced profits (dividends). Profits of shareholders are already taxed as income. Therefore, corporate taxes tend to be paid by one (or both) of two groups — consumers or shareholders.



When dividends to shareholders are taxed at too high a rate, the shareholders will avoid making those investments. Canadian and foreign investors may look outside the country to places where tax rates are lower. Lost investment would reduce growth in our economy and cost jobs. Companies, too, can move to places where tax rates are lower. Also, many of the major shareholders of Canadian corporations today are pension funds and mutual funds, which are investing the savings of individual Canadians.

Now, let's examine what large debts and deficits do to the economy.

- High deficits and debts lead to higher taxes as governments need more revenue to pay interest on the debt.
- Furthermore, the demand by governments for borrowing forces up interest rates. High rates dampen investment, spending, entrepreneurial activity, growth, and job creation.
- High debts and deficits have led to a reliance on foreign borrowing. This means we lose some control over our own policy and decision making.

- Our high debt also results in the need for a "risk premium," a higher interest rate offered to compensate the lender for what is seen as a more risky lending environment. This again pushes up interest rates.
- High levels of deficits and debts will eventually need to be repaid — if not today, then by future generations.
- High levels of debt mean the government has less funding available for other programs.
- High levels of deficits and debts today, if left on their current course, will lead to the need for higher taxes and for more program cuts in the future. Furthermore, as the debt load continues to grow, it reduces the contribution that economic growth can make to helping us solve the problem.

These are the problems arising from our debt situation. Some people think we can "grow" our way out of our debt problem. Economic growth certainly helps. But, as we've noted, because our problem is so large, it isn't enough. We'll need spending cuts and/or tax increases to reduce the deficit — the first step in halting the growth of our debt.

How does the government plan to address our debt situation? That is what we will review in the next section.

Activity:

The following is provided for you to make reference notes on your thoughts. This is not part of the worksheet section to submit to the government. But if you feel strongly about something, you may wish to include it in your comments to the Minister in the back of the book. So make notes if you find it helpful.

1. What role(s), if any, do you think the federal government currently assumes that it should abandon? Why? Are there services you think the government should cut back or eliminate? Why?

Who would be affected negatively by these changes?

2. What factors do you believe have contributed most to the build up of debt in Canada?

3. Do you agree with the government in terms of the seriousness of our debt and deficit problem?

Agree ☐ Disagree ☐

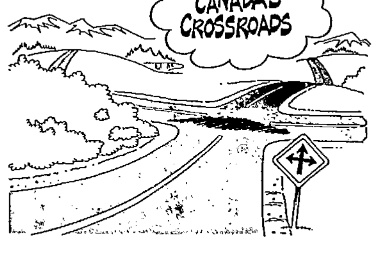
If you disagree, why?

4. If steps are taken to address our debt and deficit situation, what concerns would you have related to the consequences arising from these steps?

Section III

Charting a Course for the Future:

The Government's Perspective and Priorities



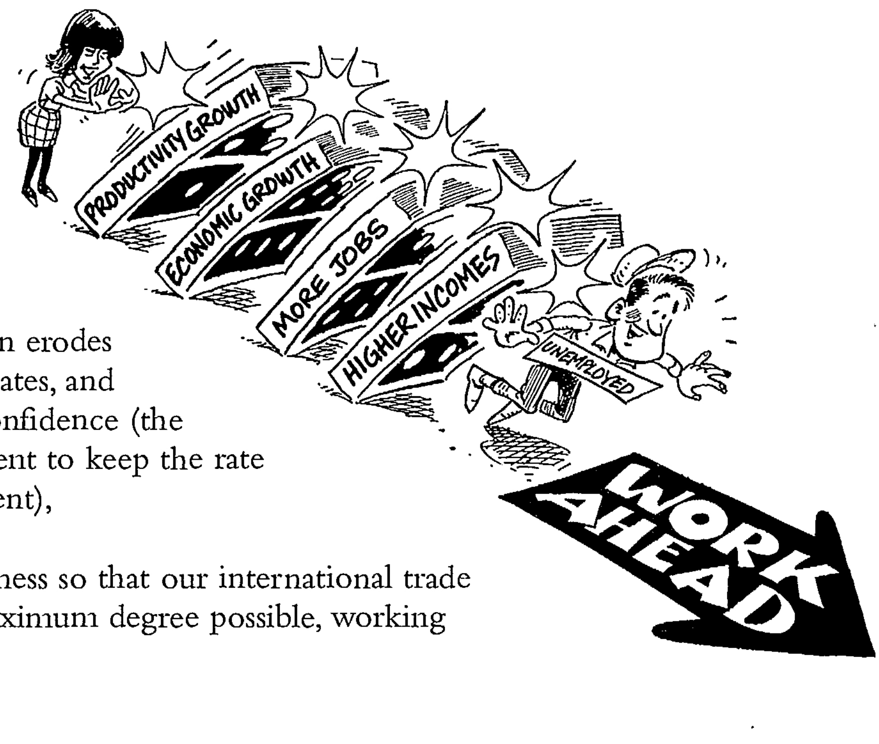
We have spent some time reviewing the state of the economy and some of the key challenges that confront us. Each of us, in our own way, will have to respond to how these changes and challenges affect our lives or those of family members. But what is the government going to do?

In this section, we will summarize for you the current thinking of the government and the direction in which it is heading. We encourage you to reflect back on Sections I and II and decide whether or not you believe that the government's thinking is on track and is heading in the right direction. Then use the What Do You Think? section to share your opinions with the government.

Let's examine the government's views. First, what goals and objectives have been identified?

THE GOVERNMENT'S ULTIMATE GOAL: IMPROVED JOB CREATION

The government believes that to achieve this ultimate goal, it will also be necessary to:



- increase and sustain economic growth,
- improve productivity growth,
- bring our debt and deficit under control,
- maintain stable prices since inflation erodes the value of money, raises interest rates, and can stifle consumer and investor confidence (the government has stated a commitment to keep the rate of inflation between 1 and 3 per cent),
- maintain international competitiveness so that our international trade and financial situation is, to the maximum degree possible, working to Canada's benefit, and

- assign high priority to achieving fairness to ensure benefits, as well as costs and hardship, are distributed fairly among all Canadians — today's Canadians and future generations.

To achieve these goals, the government has identified some guiding principles and key priority areas.

The Government's Guiding Principles

The government has established five principles to guide the choices it will make. These are specified in government documents and are stated as follows:

- *Deficit reduction and debt control are essential parts of a strategy to create jobs through economic growth.*
- *Budgetary actions should weigh toward reductions in expenditures.*
- *Fairness is paramount. Expenditure reduction must not be an excuse to abandon those Canadians in greatest need.*
- *Deficit reduction is fundamentally an exercise in setting priorities and making reasoned choices.*
- *It is essential that government make prudent assumptions to guide its economic and fiscal projections.*

How about you?

What do you think of these guiding principles? Are there any others you would add? Are there any you would delete?

Review these principles and keep them in mind when you review the government's priority areas and the measures the government is considering.

What are the priority areas the government has identified? They are as follows:

The Government's Priorities for Improving the Economy and Creating Jobs

1. ***Helping Canadians to acquire skills,*** *by better preparing people through training and upgrading of skills for new job opportunities.*

2. ***Encouraging Canadians to adapt to new opportunities,*** *by improving the capacity of individuals and businesses to adjust quickly and confidently to new economic conditions and opportunities.*

3. ***Getting government right,*** *by refocusing government so as to ensure that its actions are appropriate to the nation's strategic needs and are carried out with maximum cost effectiveness.*

4. ***Providing leadership in the economy,*** *by taking the initiative in those areas where federal government action is both necessary and effective in support of private sector activity.*

5. ***Creating a healthy fiscal and monetary climate,*** *by establishing and meeting prudent fiscal and monetary policy targets, these being prerequisites for the success of all of the government's other growth and job creation objectives.*

How about you?

What do you think of these priorities? Is there anything you would add? Is there anything you would delete?

Clearly, the government believes that addressing the debt problem is an essential step toward achieving a better economic environment for growth and job creation.

The Government's Approach to the Debt Problem

But, where to begin? The government believes that the first key step is to achieve a situation in which our debt is no longer growing at a faster rate than the economy. If that target can be reached, then our capacity as a nation (just like the household) to deal with our debt will improve. In short, to slow the growth of our debt, the deficit will have to be dramatically reduced.

The government has specified a deficit/GDP ratio of 3 per cent as the point at which the growth in the debt would no longer exceed the growth rate of the economy. (Deficit/GDP ratio is currently 6 per cent.) To reach this point by 1996-97, the government has identified deficit targets for 1994-95 through to 1996-97. These targets are as follows:

1994-95: $39.7 billion
1995-96: $32.7 billion
1996-97: Approximately $25 billion

How have these targets been determined? If the ratio of the deficit to GDP is to be 3 per cent, assumptions must be made about what GDP will be. Once growth estimates have been determined, you can determine what the deficit will have to be in order to achieve the 3 per cent ratio.

The government has made the following estimates for real growth in the economy based on the average of a number of private sector forecasts. They forecast our economy will grow:

1994: 4.0%
1995: 3.8%
1996: 3.8%

This enables the government to set the deficit targets identified above.

The next question, then, is, if government spending and revenues remain on their present course, will the deficit targets and the 3 per cent target, be achieved?

The government has stated that these targets will not be achieved if government spending and revenues stay on their present course. There is going to be a "gap" — a potential deficit higher than the target level — that will need to be closed by spending cuts, revenue increases, or a combination of both in the two years ahead.

What are the estimated gaps that will have to be closed to reach the deficit targets?

To estimate the gaps is an important step. The size of the gap will determine the actions the government will look to take to close the gaps and reach its targets. The gaps will determine the extent of spending reduction and/or revenue increases.

To estimate the gaps, there are some other estimates that have to be made. Specifically, estimates have to be made for those variables that will influence government revenue and spending. What variables are those? Some of the key ones are:

- real growth in the economy (because it affects tax revenues and program costs),

- inflation (which affects the growth in income and, therefore, government revenues and costs),

- nominal income growth (which roughly represents the government's tax revenue base), and

- changes in interest rates (which affect the interest payable on our debt — as well as influencing growth).

The assumptions made about these variables are very important. If estimates of interest rates are too low, interest payments will be higher than expected — and the targets will be missed. If estimates of nominal income growth are too high, revenues will fall short — and the targets will be missed. And so on.

With the situation we are in, the price of being wrong would be too high. If targets are missed, even tougher actions will be needed in the future. Furthermore, most Canadians have heard governments set targets in the past. They have then watched as those targets were frequently missed. The government knows this and realizes there is a job to do to restore government credibility.

To ensure that it meets its objectives, the government has tried to avoid being too optimistic in its forecasts and estimates.

How is it doing this? The government has reviewed the estimates of private sector forecasts. It has calculated an average estimate for the key variables such as economic growth, interest rates, and so on. It has then forecast a more "prudent" scenario. That is, it has set forecasts for interest rates 1/2 per cent higher than the private sector average.

Taking this approach, the government has estimated the gaps that will need to be closed to hit the deficit targets. These are:

Gap for 1995-96: $3.1 billion
Gap for 1996-97: $6.3 billion

Thinkabout

Do you think the government should close the $3.1 billion gap for next year?

How about the gap of $6.3 billion in 1996-97?

Would you support assumptions of a bigger gap and a need to do more? Or a smaller gap and a need to do less?

Therefore, the government believes that, to hit the estimated targets, action must be taken on spending reductions and/or revenue increases to eliminate those gaps. The government has clearly stated a preference for spending reductions over tax measures.

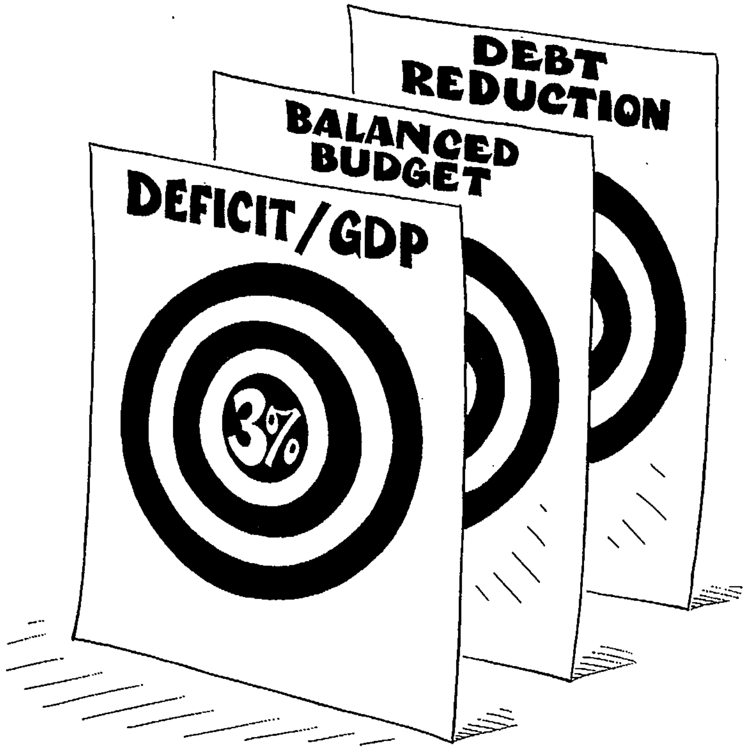
Check Point: Agree ☐ Disagree ☐

The government has also made it clear that it is committed to the 3 per cent target and will take whatever steps are necessary to achieve that goal. Although you may differ with the government's position, the government has made it clear that it will not waver from the 3 per cent target. On the other hand, how the gap will be closed through spending cuts and/or revenue increases is a key issue and one on which you should express an opinion in the What Do You Think? section.

Thinkabout

Do you support the pace the government is setting for deficit reduction? Would you want to see faster/more significant reductions in the deficit targets? Slower/smaller reductions?

It's Going to Hurt



Further spending reductions by the federal government are going to result in hardship. But why? Because program cuts and reductions have been under way for a while now. Program cuts will affect those Canadians who currently benefit from the programs and services. To have the greatest impact, you may want to keep in mind that the focus should be on cutting or reducing **programs**. Any reduction or elimination of government programs will result in lower government operating costs and fewer civil servants.

Although focusing primarily on spending cuts to reach the targets, the government also believes that there are significant "tax expenditures" that should be reviewed.

Definition: A tax expenditure is when the government allows certain deductions or tax credits and, therefore, forgoes tax revenue.

There is a section in the What Do You Think? part of this workbook for you to offer your opinions on these tax expenditures.

The government is anxious for Canadians to understand that it does not see hitting the 3 per cent target (deficit/GDP ratio) as the end of the job. The next stage is the government's intention to move toward a balanced budget. That will be the ultimate target. For now, though, the key for the government is to hit the 3 per cent target to establish credibility and demonstrate real steps are being taken toward achieving a balanced budget in the future.

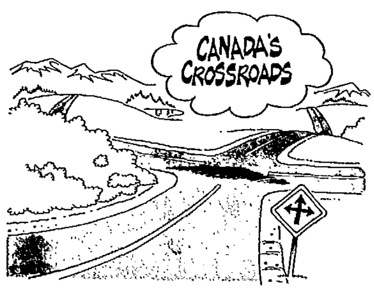
Why has the government set targets? Establishing targets achieves a number of things. One, it charts the government's course for dealing with the debt problem. Two, it establishes guidelines for the actions the government will have to take. And three, it provides a means for holding the government accountable. People will be able to tell clearly whether or not the government upheld its commitments and achieved its objectives.

The government believes that if the targets it has established can be achieved, the country can turn the corner on its debt problem. If the deficit/GDP ratio is 3 per cent by 1996-97, and other estimates are correct, the growth in our country's income should begin to exceed the growth in the debt.

That's what the government is thinking. Now it's your turn. We hope the information provided in this workbook has helped you to formulate your opinions and priorities, provoked some thought, and motivated you to participate in discussion.

We now encourage you to complete the questionnaire that follows.

What Do You Think?



The Canadian Foundation for Economic Education encourages you to complete this questionnaire and send it to the Minister of Finance at the address shown below. You can work on the questionnaire on your own, or complete it after you have participated in a group discussion, debate, or workshop.

Make an effort to seek out alternative opinions and perspectives. See how they compare with the government's position. There are some, for example, who advocate that interest rates should be lowered to stimulate growth to deal with the debt. What do you think? Decide where you stand and let the Minister know.

At the same time, if you have any innovative ideas, offer your suggestions. Tell the government what you think! As we said, we have been assured that all responses will be read, and a selection will be read by the Minister along with a report that will summarize the main ideas and opinions put forth by Canadians.

It's a new government with a new Minister trying some new things. Only you can decide whether or not you think this effort is worth the investment of your time. We hope you do. We think this effort deserves a chance, and that is why CFEE has agreed to be involved. It's up to you.

Send your completed form to:

Workbook '95
c/o The Honourable Paul Martin
Room 515-S, Centre Block
House of Commons
Ottawa, Ontario
K1A 0A6

Note: If the above address is used, no postage is necessary.

1. How strongly do you agree with each of the government's guiding principles, which are listed below. Use a scale of 1-10 where 1 means you don't agree and 10 means you agree very strongly.

   Guiding Principles

   - Deficit reduction and debt reduction are essential parts of a strategy to create jobs through growth. ________
   - Fairness is paramount. Expenditure reduction must not be an excuse to abandon those Canadians in greatest need. ________
   - Deficit reduction is fundamentally an exercise in setting priorities and making reasoned choices. ________
   - Budgetary actions should weigh toward reductions in expenditures. ________
   - It is essential that the government make prudent assumptions to guide its economic and fiscal projections. ________

2. Everyone wants to see government (a) alleviate distress and (b) promote opportunity. If you had to decide how much of $100,000 you would spend on each, what would you decide?

   Alleviate distress: $__________   Promote opportunity: $__________

3. **Try your hand at being the Minister of Finance.**

   If cuts in spending are to be made, where should they occur? Should cuts be across the board, or should some program areas be cut more than others? Should some areas be increased? Should some areas of spending be eliminated altogether? These are difficult questions. If you were Minister of Finance, what would you do? We're going to give you a chance to think about that.

   This section has two parts. In the first part, we'd like you to review the current expenditures of the government. We'll start with an imaginary $100,000 and show you, first, how the government's current spending would allocate it. (Note that figures have been rounded.) Then, we'll ask you how you would split up the $100,000 among the various categories of spending.

   Next, we want you to do a second allocation. This time we're only going to give you $75,000. We want you to indicate how you would cut $25,000 from your original spending. This is a large reduction, but it will result in a clear indication of your priorities.

The exercise is designed to help you express your feelings of priority to the government — the areas you feel are most important and the areas you feel should be the ones considered for reductions. Before you begin, what comes to mind as spending areas you would want to see maintained — maybe even increased? What areas come to mind that you would want to cut?

4. Government Spending: What Would You Do?

The following exercise may require a significant investment of time if you work through the numbers. If you don't have the time, simply complete the last column. In the case of the last column, indicate for each area of spending whether you recommend it be reduced (R), eliminated (E), increased (I) or left alone (M). Of course, you could do both exercises if you wish.

Program Area	Federal Government's 1993-94 distribution of $100,000	How would you distribute $100,000?	How would you distribute $75,000?	Recommended action
1. Transfers to Individuals				
Elderly Benefits[1]	$16,600	________	________	________
Unemployment Insurance	14,600	________	________	________
Veterans Pensions and Allowances	1,500	________	________	________
Indians and Inuit	2,500			
	$35,200	________	________	________
2. Transfers to Other Levels of Government				
Health Care	$ 6,000	________	________	________
Post-secondary Education	2,000	________	________	________
Equalization Payments to less wealthy provinces[2]	6,500	________	________	________
Transfers to Territories[3]	1,000	________	________	________
Canada Assistance Plan[4]	6,000	________	________	________
Other	1,600			
	$23,100	________	________	________

Program Area	Federal Government's 1993-94 distribution of $100,000	How would you distribute $100,000?	How would you distribute $75,000?	Recommended action
3. Subsidies and Other Transfers				
Transfers and Subsidies to Business				
• Industry Canada				
Regional Development	500			
Industrial Subsidies	500			
Science and Technology	800			
• Natural Resources	300			
• Transport	400			
Subtotal	$ 2,500			
International Development Assistance	2,000			
Other				
Agriculture	1,000			
Fisheries and Oceans	300			
National Transportation Agency	900			
Human Resources Development	1,900			
Health (minus operating funds for Indian health programs	500			
Other	1,900			
Subtotal	6,500			
	$11,000			
4. National Defence	$ 9,500			
5. Crown Corporations				
Canada Mortgage and Housing Corporation	$ 1,500			
CBC	1,000			
Other	2,000			
	$ 4,500			

Program Area	Federal Government's 1993-94 distribution of $100,000	How would you distribute $100,000?	How would you distribute $75,000?	Recommended action
6. Government Operations (all salaries of civil servants and direct operations expenses for the government)	$ 16,700			
TOTAL	$100,000	$100,000	$75,000	

1 Includes Old Age Security, Guaranteed Income Supplement, Spouse's Allowances.

2 Aims to ensure all provinces provide reasonably comparable public services at comparable tax levels.

3 To assist territories with providing public services.

4 Federal contribution toward provincially provided social assistance (for example, welfare).

5. Taxes and Tax Expenditures: What Would You Do?

Changes to tax revenues are also possible as a means to deal with our deficit and debt. Below are the major sources of income for the federal government as forecast for 1995-96. Please indicate your recommendation regarding the level that you think should come from each.

As you consider tax measures, you might want to keep some things in mind. Changes to personal income taxes influence how much income people have to spend on goods and services and how much people have to save. Spending on goods and services boosts production and can influence jobs. Savings are important for investment and helping our economy to improve and expand. Tax levels also affect people's incentives to work.

Corporate taxes, as we mentioned, tend to get passed on to consumers in the prices of goods and services. If the taxes can't be passed on, or are too high, they can have a negative effect on a business and result in production cutbacks or closures. This would affect jobs. Furthermore, if taxes are relatively high and can't be passed on, companies may consider moving to where taxes are lower.

Sales taxes affect consumer decisions and can influence the level of sales, production, and jobs. UI premiums increase employee costs and can provide disincentives to hiring and job creation. These are just some things to consider as you review possible tax measures

Category	Estimated 1995-96 Tax Revenue ($ billions)	Recommended Level ($ billions)
1. Personal Income Tax	63.8	________
2. Corporate Income Tax	13.3	________
3. Sales and Excise Tax	10.0	________
4. Goods and Services Tax	17.1	________
5. Unemployment Insurance Premiums	20.0	________
6. Other	8.7	________
TOTAL	132.9	________

6. Tax Expenditures

Definition: A tax expenditure is when the government allows certain deductions or tax credits and, therefore, forgoes tax revenue.

Information available on the final implications for government revenues from tax expenditures lags somewhat. The following lists the largest tax expenditures and the estimated tax revenue that was forgone in 1991.

Indicate your recommendation for changes to any of the following tax expenditures. [Note: Reducing a tax expenditure increases tax revenue.]

- reduce (R) the tax deduction/credit,
- eliminate (E) the tax deduction/credit,
- increase (I) the tax deduction/credit, or
- maintain the status quo (M).

Current Tax Expenditures	1991 Revenue Tax Forgone ($ millions)	Recommended Action (R, E, I, or M)
• Non-taxation of lottery and gambling winnings	860	____________
• Education and tuition fee credits	314	____________
• Married credit	1,100	____________
• Equivalent to married credit(1)	565	____________
• Partial inclusion of capital gains(2)	1,080	____________
• Non-taxation of employer-paid premiums(3) for group private health plans	830	____________
• Non-taxation of worker's compensation payments	695	____________
• Age and pension income credits(4)	1,600	____________
• Tax assistance for retirement savings		
Registered Pension Plans (RPPs)	9,380	____________
Registered Retirement Savings Plans (RRSPs)	5,535	____________

Current Tax Expenditures	1991 Revenue Tax Forgone ($ millions)	Recommended Action (R, E, I, or M)
• $500,000 lifetime capital gains exemption on small business shares[5]	585	___________
• Charitable donations credit[6]	845	___________
• Low tax rate for small businesses[7]	2,037	___________
• Low tax rate for manufacturing and processing[8]	353	___________
• R&D investment tax credit	543	___________
• Accelerated write-off for exploration and development[9]	465	___________
TOTAL	_______	___________

1 An "equivalent-to-married" tax credit may be claimed by single parents for a dependent child.

2 Not all capital gains are taxable. Two-thirds of net capital gains realized since 1972 were included in income in 1989, and this rate was increased to three quarters effective 1990. A capital gain is when an asset is purchased at one price and sold for a higher price.

3 Employer-paid premiums for group term life insurance coverage of up to $25,000 per employee are not taxable.

4 Individual taxpayers aged 65 or over were entitled to claim a tax credit of 17 per cent of $3,272 in 1989, $3,327 in 1990 and $3,387 in 1991.

5 A $500,000 lifetime capital gains exemption is available for capital gains achieved through selling qualified small business shares.

6 A tax credit is available for donations to registered charities of up to 20 per cent of net income.

7 Corporations that are Canadian-controlled private companies are eligible for a small business tax rate reduction that provides a preferential tax rate on the first $200,000 of active business income.

8 A tax reduction is provided on Canadian manufacturing and processing profits not subject to the small business deductions.

9 All Canadian oil and gas development expenditures are classified as Canadian Development Expenses, and a portion are written off.

7. Open Forum: Letter to the Minister of Finance

Send a message directly to the Minister of Finance. What are the most important points that you would like to make?

Dear Minister

From: [The following information is optional. If you complete it, your submission will be acknowledged.]

Name: ____________________

Address: ____________________

____

Telephone: ____________________ Fax: ____________________