Charting the Economic Course in a World of Change

Issued by
The Honourable Don Mazankowski
Minister of Finance

April 1993

Canada

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Department of Finance Canada
Ministère des Finances Canada

Ce document est également disponible en français.

Preface: Changing Times

In these times of extraordinary change, the number one concern of Canadians is the economy. Charting a course for Canada's economic future is vital if our economy is to achieve strong growth, create jobs, generate wealth and give Canadians a prosperous and secure standard of living.

Canada's economic future has been very much on my mind as I have met with representatives of small and large business, labour, social and many other groups from every region of the country in my pre-budget consultations. I have also benefited from the views of Canadians from across the country who responded to the opportunity to write or phone in regarding the budget.

They told me what Canadians from every walk of life have been saying: They have been coping with the pressures of a rapidly changing economy for many years. In the workplace or in the home, they are adapting to change as best they can and they want governments to do their part in facing up to the economic and fiscal reality of the 1990s.

Most agreed that we need to continue strengthening the abilities of Canadian workers and companies to adapt to the reality of global competitiveness and change. That is the only way we can produce economic growth, better our incomes and create more jobs.

Today, no challenge is more important to our economic future and prospects, or more urgent, than solving the problem of deficits and debt.

In all of my pre-budget consultations with Canadians, deficit and debt reduction was the dominant issue. By far the majority of the groups told me we must work to eliminate the deficit, and we must do it through spending cuts and the streamlining of government, not through tax increases.

They also recognized that deficits and growing debt are not just a federal problem, but a problem facing all levels of government. They called on federal and provincial governments to work together to achieve a national solution.

It is important for Canadians to recognize that reducing deficits and the debt is not an end in itself. It is an essential step we must take to successfully achieve our broader economic goals.

As every consumer knows, paying interest on your credit card balance is money you don't have available to spend on priorities like home repairs or your children's education. And the only way to stop paying more and more interest is to stop borrowing.

That is why, in my upcoming budget, I will be concentrating on actions that ensure we continue to make real progress in controlling spending and reducing the deficit.

The changing economic world will continue to test our ingenuity and our ability to take advantage of new opportunities. There are a number of areas where we must persist in our efforts to ensure economic progress.

- We must encourage private initiative and enterprise as the basis for productive economic activity.
- We must ensure Canadians can acquire the skills, training and education they need to succeed.
- We must open up markets, here in Canada as well as around the globe, for Canadians to do business and trade.
- We must ensure that government operates in step with the marketplace and takes necessary measures to reduce the cost of government. This means reducing the regulatory burden, streamlining and harmonizing operations, privatizing government enterprises, and ensuring that services are provided in the most efficient way.
- We must sustain the efforts to reduce the burden on the taxpayer caused by interest charges on government debt. This requires cutting deficits and ultimately the debt itself.

The government, led by Prime Minister Brian Mulroney, spelled out these challenges in 1984 when it came to office and set out a comprehensive plan to build renewed foundations for economic success. Since then, considerable progress has been made in meeting all of them.

Today, Canadians can be encouraged by the fact that the economic recovery is gaining momentum. We are increasingly seeing positive signs of renewed economic growth. Exports are up strongly. We're more competitive and more productive. Inflation is being held in check. Interest rates were down to a 20-year low. By taking action now to bring our fiscal problems under control, we will ensure that our potential to grow and create jobs will continue to expand.

The budget I will be presenting shortly will help sustain Canada's economic progress. In preparing the budget, and looking ahead to our economic future, I believe it is important that Canadians understand the government's overall economic approach, our economic objectives, what has been accomplished since 1984 and the results these have delivered.

This booklet is intended to provide that important information.

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Chapter 1: Canada's Economic Policy in a World of Change

During the 1993 pre-budget consultations, many participants emphasized the reality of the new world economic order that affects us all. In this environment, it is the ability of the private sector to compete effectively – not government programs or trade barriers – that creates jobs and improves our standard of living.

Canadians live in a global economy marked by fast-evolving opportunities for growth and new jobs.

International trade – especially in advanced manufactured goods – has become a major engine for national prosperity. Small businesses produce most new jobs. And in both manufacturing and services, innovation and skilled know-how are emerging as the fundamental tools for personal and business success.

Improving our potential for growth

In 1984, the government established an economic plan to address underlying problems facing our economy and position us for a world of change. This framework was dedicated to improving our national potential for long-term growth and new job creation within an interdependent world economy. This policy framework also recognizes that the only way to maintain Canada's social safety net is to reverse the spiral of government deficits and debt.

These principles were first spelled out in the 1984 policy paper *A New Direction for Canada: An Agenda for Economic Renewal.* Since then, the government has been implementing that plan by taking wide-ranging actions to increase Canada's global competitiveness; to encourage market responsiveness and flexibility; to enhance investment in R&D and skills upgrading; and to reduce the burden of government and improve fiscal performance.

The government also created a Ministerial Task Force on program review – the Nielsen Task Force – with members from business and the federal and provincial governments. Its objective was to suggest ways of improving the efficiency of government and its services to the public.

This task force identified $7.5 billion of potential savings that could be realized over a five-year period. These included revenue measures – such as tax changes, asset sales and cost recovery action – as well as reductions in program spending. However, the overall fiscal actions actually undertaken by the government since 1984 have **exceeded** the Task Force's recommendations by a wide measure.

A decade of reforms

Canada has come a long way in improving the underlying performance of its economy in the past nine years.

In 1984, the country was at an economic crossroads. The previous decade had been marked by great changes: oil price shocks, globalization, slowing productivity growth. And Canada had not responded well. Real growth had slowed and inflation and unemployment had risen.

Unfortunately, government actions had more often been a hindrance than a help: excessive intervention in the economy, over-regulation, too much reliance on taxes that distorted economic decision-making, and failure to control inflation and fiscal deficits. The cost of all these problems was reflected in the poor economic performance of the country.

New direction was needed

Clearly, a new policy direction was needed to remedy the shortcomings of the previous decade. The government in 1984 adopted a comprehensive medium-term approach, shifting from quick-fix responses to policies aimed at improving underlying economic performance.

First, the government had to adopt policies to improve the broad economic environment. The Canadian economy would not function well with rising inflation and surging fiscal deficits. But this was only part of the solution.

Policies were also required to create the right economic climate where business would invest and create jobs. This meant undertaking tax reform; ensuring our access to export markets; reforming financial sector regulation; improving assistance for labour-market adjustment; and improving support for science and technology.

Governments must pay their own way

The government also realized that the public sector, as well as the private sector, had to become more efficient. That is, government had an obligation to operate and provide services to the public in the most frugal and effective way possible. It had to lower operating costs, reduce the burden of regulations on the private sector, and increase its own efficiency.

■ *Seeing the results*

This policy environment helped Canada achieve very strong economic performance during the second half of the 1980s.

Between 1984 and 1989, we enjoyed the second highest rate of growth among the seven large industrialized countries constituting the G-7. And our rate of job creation during that period was the highest in the G-7.

But our economic growth began to outstrip the economy's capacity to produce. By the late 1980s, this resulted in growing cost and price pressures that were seriously undercutting Canada's ability to compete.

The federal government and businesses did respond. Monetary conditions were oriented to counter inflationary pressures and fiscal policy was tightened. Firms began to take vigourous actions to control costs.

Regaining our competitive edge

We are now beginning to see the benefits from this difficult restructuring, and can look forward to durable economic expansion as we regain our competitive edge.

- Productivity is up sharply; Canadian business is more competitive.
- Exports have surged. Aided by the Free Trade Agreement, our exports to the U.S. are at record levels.
- Inflation is down to its lowest level in 30 years. As a result, interest rates have fallen dramatically.
- Despite the impact of the recession, the fiscal deficit is lower as a proportion of GDP than it was in 1984-85.
- Employment is rising again.

Forecasts see Canada as economic leader

In its 1992 survey of Canada, the 24-country Organization for Economic Co-operation and Development (OECD) says that "The Government's accomplishments in the field of structural reform in recent years will enhance the economy's growth potential." And in its most recent global outlook (December 1992), the OECD forecast that Canada will be the leader among the world's seven largest economies – the G-7 – in growth in both 1993 and 1994.

Canada's positive outlook has also been confirmed by another major economic agency, the International Monetary Fund (IMF). "A solid foundation for a strong economic performance seems to be in place" for Canada, said the IMF's October 1992 *World Economic Outlook*. The latest IMF forecast has Canada second only to the U.S. in growth in 1993.

Chapter 2: Restoring Foundations for Canadian Growth

In the cross-country pre-budget consultation sessions, participants discussed the issues of debt control and low inflation in relation to the goals of economic growth and job creation. Canada's postwar history shows that fiscal responsibility and price stability are foundations for – not obstacles to – national success.

When the government took office in 1984, the country's economic problems had been accumulating.

Canada was falling behind . . .

At a time when international industrial competition was growing, Canada was falling behind. Productivity had slowed significantly. Inflationary expectations were deeply entrenched, pushing up interest rates and business costs. Unemployment had risen markedly.

. . . quick fixes weren't working

Many of these problems can be traced back to actions which focused on short-term goals at the expense of medium-term performance. Instead of dealing with the root causes of these growing challenges, Canadians and their governments too often emphasized a band-aid approach that tried to insulate us from a changing world.

- The government intervened heavily in the economy, characterized by the *Foreign Investment Review Act*, the National Energy Program, expanded regulation of transportation and communications, and a proliferation of Crown corporations.
- Some design features of Canada's social programs – for example, the emphasis on passive income support under unemployment insurance – were hampering the economy and reducing incentives to work. Labour markets were not adjusting quickly enough to meet competitive challenges.
- Tax incentives to achieve short-term priorities led to narrow tax bases and high tax rates. In the end, this distorted investment, production, distribution and consumption decisions as businesses acted more on tax calculations than on economic fundamentals.
- At the same time, government spending kept rising even though new tax incentives and loopholes meant that tax revenues were falling as a proportion of GDP.

This meant the government had stopped paying its own way. By 1984-85, for every dollar of tax revenue, the government was spending $1.33 on programs. And the rising government deficits drained the economy of private savings that could have been used for productive investment in the private sector. In turn, foreign indebtedness consequently increased, and more and more of the income produced in Canada went to pay interest income outside the country.

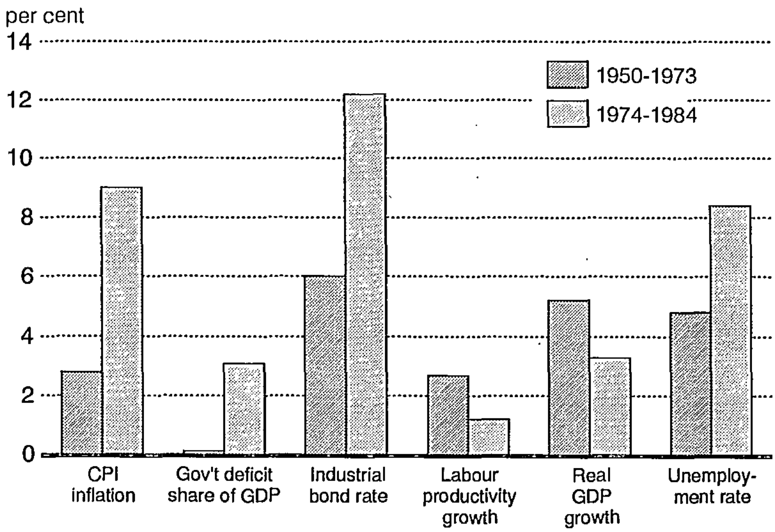
Canada has done, and can do, better

But the situation in Canada had not always been like this. The decade from 1974 to 1984 stands in sharp contrast to the period from 1950 to the mid-1970s, when Canada's economic performance was exceptional. (Chart 1)

This was a time when our economy grew rapidly, productivity growth was strong and unemployment was low. And it is no accident that Canadians also enjoyed low inflation and interest rates, aided by governments that paid their way through strict fiscal control.

Chart 1

Economic performance declined sharply during 1974-1984



Sources: Statistics Canada and Bank of Canada.

This was also a time when Canada aggressively pursued more open trade with the rest of the world; for example, through the Canada-U.S. Auto Pact, and under the General Agreement on Tariffs and Trade (GATT).

Not surprisingly, Canadians realized growing prosperity thanks to these positive forces. Real incomes grew at an average annual rate of 4.3 per cent from 1950 to 1973. That was double the 2.1 per cent yearly rate of the next, troubled decade.

It is these common-sense lessons from the past that are the foundations for the government's 1984 Agenda and for its policy actions today.

Chapter 3: Fiscal Responsibility: A Continuing Commitment

The overwhelming majority of participants during the pre-budget consultations said that the federal government must continue to focus on reducing deficits and the public debt. They saw this as an essential step in bringing interest rates down further, reducing the national tax burden, and encouraging business to invest and create new jobs.

Deficit and debt control is a vital foundation for economic growth and new jobs.

- Fiscal responsibility eases inflationary pressures.
- It ensures savings are available for productive, job-creating investment.
- Lower borrowing holds down the share of federal revenues that must go to pay interest on the debt. As a result, fiscal responsibility ensures that funds are available for the important national programs and services Canadians want today and for our children tomorrow.
- Just as important, by avoiding excessive government borrowing, Canada preserves its sovereignty – because we are less vulnerable to the concerns of foreign bankers and bond holders.

Fiscal progress starts with spending control

At the start of its mandate, the government recognized the structural nature of the fiscal problem it had inherited and identified spending control as a key priority for action.

Because program spending exceeded revenues, deficits were rising rapidly every year and adding to the debt. We were borrowing against our children's future.

The resulting debt grew to a point where, by 1984-85, interest costs became the largest and fastest-growing budgetary item. This further compounded the deficit problem.

The government could no longer count on revenues growing faster than interest payments to reduce the deficit without pain. The reverse was happening. The deficit had taken on a life of its own. The government was caught on a treadmill of deficits, debt and interest payments.

This vicious circle, left unchecked, would have devastated the economy.

Acting on the problem, the government has made controlling expenditures its top fiscal priority. Between 1984-85 and 1991-92, it cut the growth of program spending – all spending except interest payments on the debt – to a yearly average of just 4.1 per cent. That was a drop of **two-thirds** from 13.8 per cent yearly growth during the previous 15 years.

Legislation sets strict limits on spending growth

This discipline was reinforced in 1992 when the government passed the *Spending Control Act* with its strict limits on future spending increases. And despite the impact of the recession and slow recovery, government spending remains on the disciplined track set out by the Act.

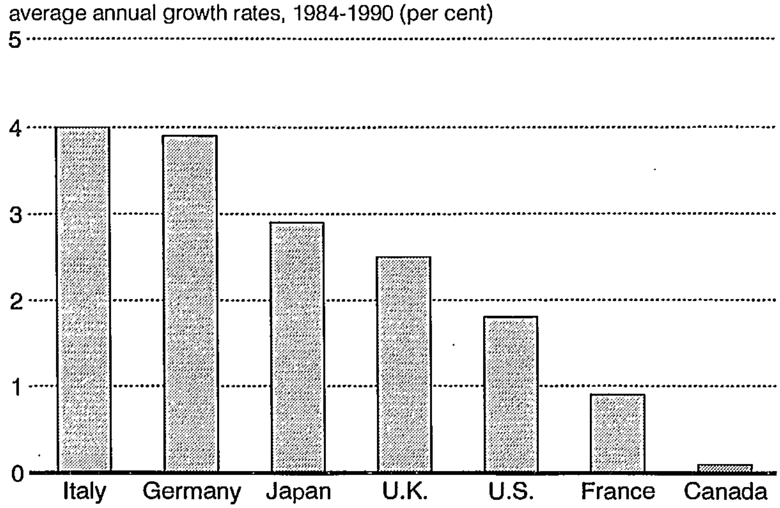
An important companion initiative was to establish the *Debt Servicing and Reduction Account*, which ensures that revenues from the GST are used only to pay interest on the debt and, over time, pay down the debt itself.

The government's commitment to fiscal responsibility has begun to deliver results.

- Spending on programs and operations as a proportion of GDP have rapidly declined. According to OECD figures, Canada had the lowest growth of real program expenditures of any central government among the G-7 countries during 1984-1990. (Chart 2)
- The government has turned around the revenue/program spending relationship. In 1984-85, the government was spending $16 billion more on its programs and services than it received in taxes. For 1991-92, however, revenues exceeded program spending by $6.6 billion. That's a turnaround of $22.6 billion. (Chart 3)
- For the last five years, the government has run a cumulative operating surplus – when revenues exceed program spending. This means that since 1984-85, the cumulative operating surplus has been $20 billion, compared to a cumulative deficit of $66.3 billion over the preceding ten years.
- Overall, the deficit has been cut from 8.7 per cent of GDP in 1984-85 to 5.1 per cent in 1991-92.

Chart 2

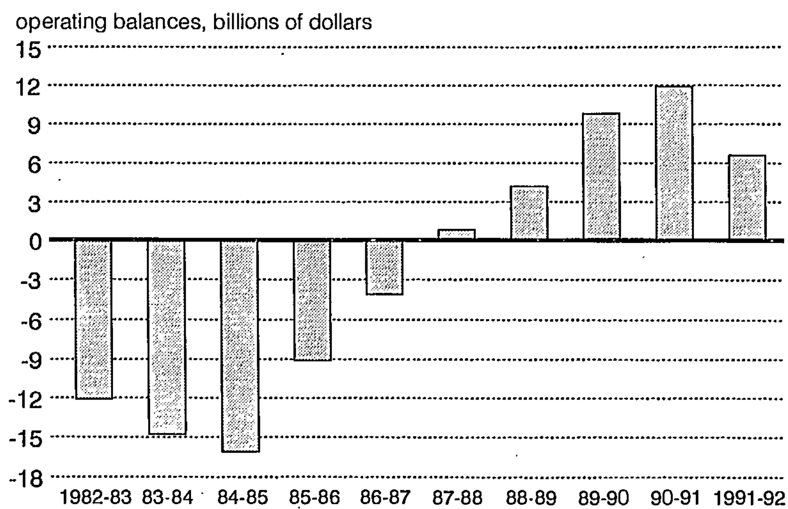
Growth in central government real program expenditures is lowest in the G-7



Source: OECD.

Chart 3

The federal operating balance has been turned from a deficit into a surplus



Source: Department of Finance.

- The 24-nation OECD says that, among its larger members, Canada has made the greatest progress in recent years in reducing its structural deficit.
- Without the government's actions to control its spending, the deficit would have reached $82.5 billion by 1991-92 – close to *two-and-a-half times* the actual level – and the debt would have reached $645 billion, or 95 per cent of GDP.

Inherited debt slows down fiscal progress

Despite these achievements, the effects of the fiscal imbalances of the 1970s and the early 1980s linger on. The rapid growth of debt charges has absorbed much of the gains from program spending restraint. Net public debt more than doubled between 1984-85 and 1991-92, reaching $423.1 billion.

The entire increase in the debt is due to the compounding of the interest on the debt already owed in 1984-85 – a debt that had increased 11-fold since 1967-68. In essence, the bills are coming due for services already provided. This is why the government has consistently taken action to get this situation under control, including in its December 1992 *Economic and Fiscal Statement*, when spending plans were cut by a further $8 billion.

Chapter 4: Keeping Inflation Down

As in previous years, both business and consumer representatives at the 1993 pre-budget consultations underscored the importance of low interest rates to encourage investment and boost economic confidence. This is why it is vital that Canadians and their government co-operate to keep inflation low – the only way for interest rates to come down and stay down (because it allows lenders to cut the risk premium they charge to borrowers).

Low inflation means savings for everyone

Low inflation means better and more equitable standards of living for all Canadians. For example, the purchasing power of an individual on a fixed annual income of $10,000 would be worth only $1,220 after 20 years of inflation at 10 per cent, but worth $8,180 after 20 years of inflation at 1 per cent.

In the 1970s and early 1980s, inflation became a major problem for the Canadian economy, averaging 8.8 per cent, and trending upwards. The consequences were severe.

- Inflation combined with low productivity growth was cutting the cost competitiveness of Canadian industry, particularly its manufacturing sector.
- It was creating uncertainty for business decision-makers and lenders. This contributed to pushing interest rates higher, reducing business' ability to make productive investments, such as in new technology, and imposing higher mortgage costs on home buyers.
- And it was punishing those Canadians most vulnerable to soaring consumer costs: the poor, and the elderly on fixed incomes.

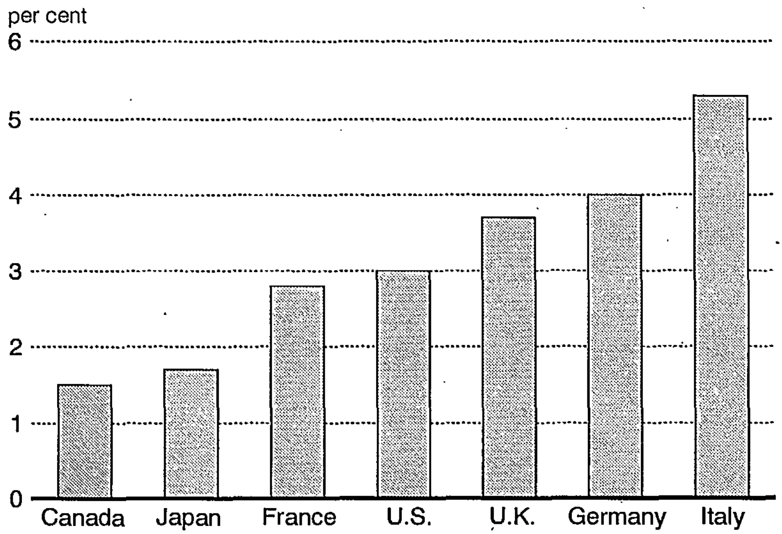
Today, however, the Canadian economy is better positioned for sustained growth than it was following the 1981-1982 recession. Over the last nine years, inflation has grown at an average annual rate of 4.2 per cent – less than half the yearly rate in the decade earlier. And for 1992, inflation was down to just 1.5 per cent, the lowest level in 30 years (and sharply down from the 4.4-per-cent rate in 1984) and the lowest among the G-7 countries. (Chart 4)

Government took strong, visible action

Helping to achieve the current low level of inflation has been the strong, visible action taken by government. Clear public targets to get inflation down were established, and a freeze on parliamentary and public service wages was implemented. (Chart 5)

Chart 4

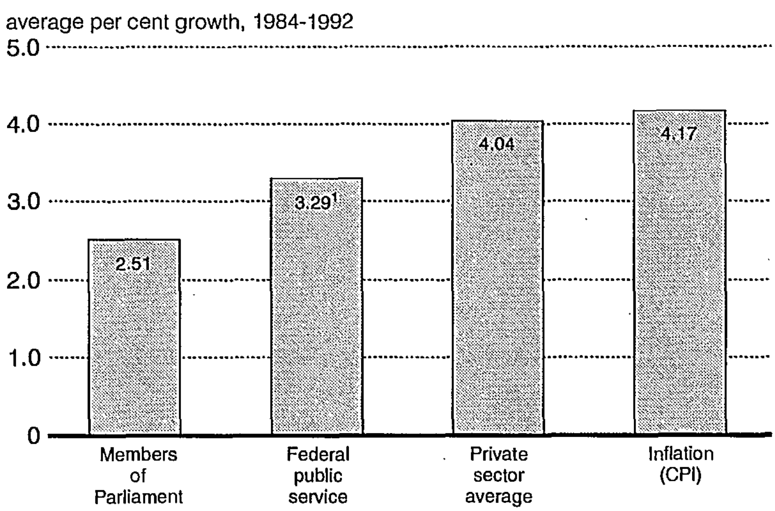
Canadian CPI inflation in 1992 was the lowest in the G-7



Sources: DRI and Statistics Canada.

Chart 5

Spending control restrained salaries on Members of Parliament and the public service



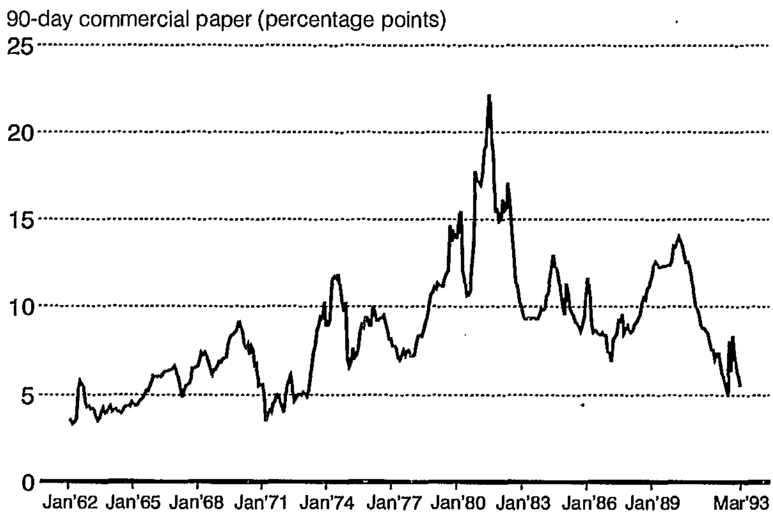
[1]Estimated.

In turn, Canadian interest rates have fallen to levels not seen since the early 1970s. This is providing a real payoff for businesses, consumers, homeowners and governments.(Chart 6)

- In September 1984, five-year mortgage rates were 14 per cent. But this spring, they are below 9 per cent. This represents a saving in carrying costs of over $4,000 a year on a 25-year mortgage of $100,000.
- The prime rate in April was down to 6 per cent – *less than half* what the rate was in September 1984 (13 per cent). This means a small business was saving nearly $4,400 a year on a $100,000 loan amortized over ten years.

Chart 6

As inflation came down, interest rates also declined



Source: Bank of Canada.

Chapter 5: A Fairer, More Efficient Tax System

An important issue for the Canadian economy identified at pre-budget consultations is the burden imposed by taxation at all levels of government. Concerns include not only the rate of taxation – which is higher than many of our competitors, such as the U.S. – but also the need to ensure that the structure of the tax system (the way we are taxed) is fair and supports effective, market-oriented decision-making.

Changes to the tax system have been a critical element of the new framework policies pursued by the government. The goal of these reforms has been to make the system fairer and more conducive to an efficient economy – while ensuring a stable source of revenue to support national programs and slow the growth of the public debt.

To help restore economic growth following the recession, the government has also acted to reduce the federal tax burden in order to support Canadian competitiveness and encourage renewed economic confidence.

■ *Tax reform*

Closing loopholes – cutting tax rates

Fundamental changes to the income and sales tax systems have broadened the tax base, and eliminated many loopholes and special preferences which distorted business and investment decisions and often favoured high-income Canadians.

In turn, by reducing the ways to avoid tax, the government could afford to also undertake a general lowering of tax rates. This helped keep our rates in line with our key trading partners, while still providing the stable revenue base needed to deal with the growing debt challenge.

■ *Personal income tax*

Under tax reform, many special provisions were eliminated and personal exemptions were converted into tax credits (an approach that provides taxpayers with equal levels of tax savings, instead of providing disproportionate benefits to wealthier Canadians).

As well, a new system of three tax rates replaced the old ten tax brackets, with the top marginal rate dropping to 29 per cent, down from 34 per cent. And a new alternative minimum tax helped ensure that high-income individuals would pay their fair share.

Reforms meant needy, elderly paid less or no tax

These reforms had real effects. Some 850,000 low-income Canadians – 250,000 of them senior citizens – were removed from the tax roll in 1988 and no longer paid taxes. Further, nine out of ten Canadians aged 65 and over saw their federal tax reduced.

To encourage Canada's recovery from recession, the February 1992 budget announced a two-stage reduction in the personal income surtax, from 5 per cent to 3 per cent. This was designed to provide individual Canadians with $1.2 billion in annual tax relief.

■ *Corporate income tax*

Under tax reform, the business tax base was broadened by eliminating loopholes, certain investment tax credits and fast write-offs for specific investments. This means firms no longer have grounds to make business decisions largely for artificial tax reasons – they can now base their actions on market opportunity and economic sense. Further, a large corporations tax ensures that all large corporations pay tax.

At the same time, the government has ensured that the tax regime for small business is one of the most favourable in the world.

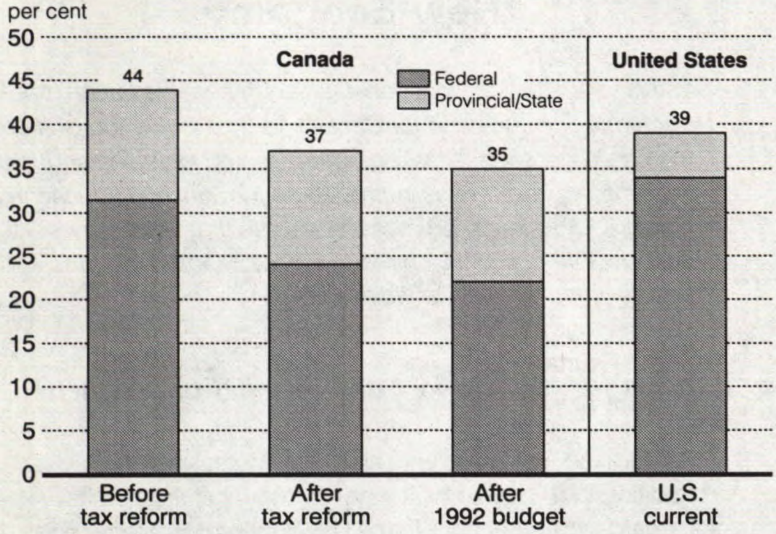
Helping small firms . . .

For example, small business corporations enjoy a special deduction that holds the federal income tax rate to 12.8 per cent (and that includes the 3 per cent surtax) on the first $200,000 of business income. By comparison, U.S. federal tax rates for small firms range from 15 to 39 per cent over the same income range.

. . . and manufacturers to compete

The 1992 federal budget also contained income tax rate reductions and increased capital cost allowances to help Canada's manufacturing and processing sector respond to global competitive pressures. When fully implemented, the full package of corporate tax changes will see Canadian manufacturers and processors facing lower statutory tax rates than their U.S. competitors. (Chart 7)

Chart 7
Tax changes help manufacturers to compete with U.S.



Source: Department of Finance.

■ *The Goods and Services Tax*

The Goods and Services Tax (GST) replaced the archaic, anti-competitive manufacturers' sales tax (MST). This has removed significant distortions in the tax structure. No longer are Canadian firms at a disadvantage in exporting or competing against imports.

GST improves Canada's competitive position

- Previously, the effective tax rate on products made in Canada had been on average one-third *higher* than on competing imports. This disadvantage has been eliminated.
- Bringing in the GST has also significantly reduced the impact of hidden taxes on the production of Canadian exports.

The Canadian Manufacturers Association has reported that the GST has saved members $3.5 billion, strengthening their competitive position.

Chapter 6: Helping People and Firms Adapt to the New Economy

In this year's pre-budget consultations, there was unanimous agreement on the need for Canada to do a better job of meeting the challenge of accelerating change in technologies and markets. In particular, this means improved performance in education and training. Labour and business recognize that yesterday's skills – like obsolete products – no longer provide the good jobs and secure incomes that Canadians need.

■ *Policies for job support and market adjustment*

Shifting resources to training

As demand for new talents and skills increasingly replaces traditional job openings, the government established its forward-looking Labour Force Development Strategy. This strategy progressively shifted resources from passive income maintenance to worker retraining and other active employment measures. (Chart 8)

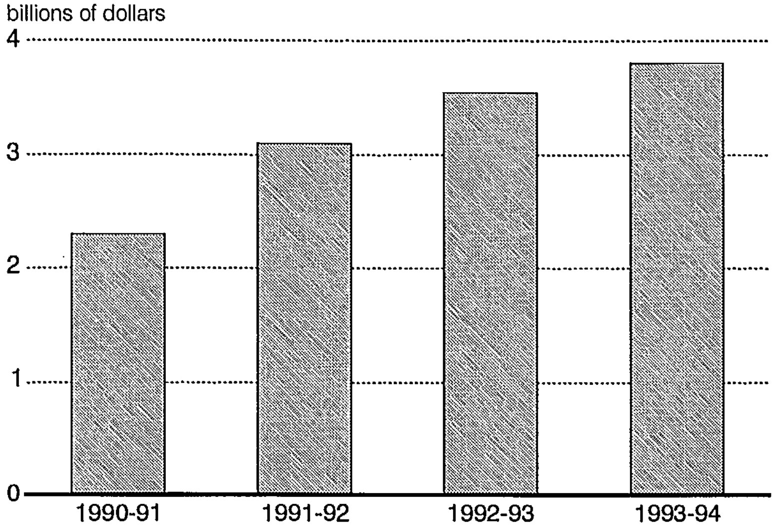
Today, taken as a proportion of the economy, total federal expenditures on active labour market programs are more than double the comparable spending in the United States.

- The *Canadian Jobs Strategy*, implemented in 1985 and now funded at $1.6 billion, was a world-leading initiative reorienting labour market programs towards increasing training.
- The *Canadian Labour Force Development Strategy*, announced in 1989, included unemployment insurance reforms to shift resources from passive income maintenance to active employment measures.
- The *Unemployment Insurance Act* was amended so that the protection it offers also helped people face the challenge of a changing economy – rather than acting as a disincentive to work.

Most of the savings from these amendments were redirected into programs that help retrain workers and upgrade skills. In 1993, unemployment insurance funds targeted towards training and human resource development will amount to $2.2 billion. All told, federal support for worker training and adjustment in 1993-94 will total $3.8 billion.

Chart 8

More federal funds are going to worker adjustment training



Source: Department of Finance.

- The *Canadian Labour Force Development Board*, created in 1991, enables government, business, labour, equity groups and training providers to work together to establish training priorities and promote national standards. Local boards will play an important role in addressing special needs and priorities of the local market.
- Federal-provincial *Employability Agreements for Social Assistance Recipients*, established in 1985 and renewed in 1991, help remove disincentives that prevent recipients from participating in employment and training programs.

■ *Preparing our youth for tomorrow's jobs*

The government has also directed substantial resources towards providing training and education for Canada's youth. In addition to financial transfers to provinces in support of post-secondary education, other assistance includes:

- The *Canada Scholarship Program,* created in 1988 to increase participation in the natural sciences, engineering and technology.

- The *Stay-in-School Initiative*, announced in February 1990, is a five-year $296 million effort to encourage young people to finish high school.

Promoting science and technology

The government understands the importance of keeping Canada at the leading edge of technology, both as a producer and a user. It strongly supports investments in Canadian research and development, despite the reduction in fiscal flexibility caused by huge deficits and debt.

- Total direct federal spending on science and technology has increased by 44 per cent, from $4.1 billion in 1984 to $5.9 billion in 1993.

Tax incentives are the most generous among the G-7

- As well, Canada's tax incentives for research and development are the most generous among the G-7 countries. The current federal tax credit program delivers about $1 billion to business annually, including about $200 million in tax credits to small businesses.
- Based on consultations with the business and science sectors, the government last year announced changes to streamline the administration of the Scientific Research and Experimental Development (SR&ED) tax credit system, enriching it by a further $230 million over the next five years.
- In the December economic statement, the government announced it would consult with business on further changes to the tax system to better reflect the impact of rapid technological change on business and R&D operations. A further $400 million has been set aside to cover the cost of these changes.
- In 1988, the government also created the Networks of Centres of Excellence Program, aimed at encouraging greater co-operation and linkages between government labs, educational institutions and private firms. These centres have provided hundreds of millions of dollars of support to foster research excellence, networking and partnership.

Support for small businesses

In the emerging new economy, small businesses are a critical source of jobs. Between 1978 and 1990, firms with up to 50 employees accounted for 2.5 million new, full-time jobs – representing an estimated 80 per cent of all permanent new employment.

The government has worked hard to create the conditions needed for the small business sector to thrive. For example, Canada's federal tax rates on small businesses are lower than comparable rates in the U.S. And to help such firms take advantage of technological change, the government provides a 35 per cent refundable tax credit for most R&D performed by small businesses.

Assistance expanded in 1992 statement

Such benefits were supplemented by the Small Business Employment and Investment Package announced in December 1992. Its thrust was to help smaller firms modernize, attract financing, grow and create jobs. For example:

- The ceiling for loans under the *Small Business Loans Act* was increased.
- The Small Business Financing Program was extended for two years.
- A 10-per-cent investment tax credit was introduced for small businesses which invest in machinery and equipment before 1994.
- Measures were announced so that most small businesses can add new workers without paying additional unemployment insurance premiums in 1993.

Reducing government interference

The government has taken decisive action to reduce unnecessary interference in the workings of the marketplace. These include:

Promoting new investment in Canada

- In 1985, the Foreign Investment Review Agency (FIRA), which sought to limit foreign direct investment, was abolished and replaced by Investment Canada, whose mandate is to encourage foreign investment in Canada to promote economic growth. The results have been dramatic. From a yearly average outflow of $364 million between 1975 and 1985, foreign direct investment rose to a substantial average yearly inflow of $4.3 billion between 1986 and 1992.

- Extensive deregulation has also occurred in key economic sectors – energy, transportation, and financial industries. For example, the government eliminated the intrusive National Energy Program (NEP) and got rid of the Petroleum and Gas Revenue Tax.

Modernizing regulations

- The government is modernizing all federal regulations so as to ensure that its regulatory powers encourage – rather than stifle – the efficiency and innovative capacity of Canadian business. Agriculture Canada has already eliminated 15 regulations that no longer served a public purpose, and is modernizing 38 others. Nineteen federal departments and six agencies are completing a review of their regulations.

Financial sector reform

The government also recognized the critical role our financial institutions play in national development. As a result, in June 1992, the government passed a new legislative framework for federally regulated financial institutions.

These reforms are strengthening competition within the sector and broadening the range of financial services and products available to Canadians, while also increasing the safety and soundness of the financial institutions themselves.

Chapter 7: Making Government More Efficient

While the consultations confirmed that most Canadians want national action to bring down deficits, the participants made clear that this should not be done at the cost of higher taxes. They want government to work harder at controlling its own operating costs. And business wants to see further action on reducing regulation that no longer serves a real public purpose, and impedes economic efficiency.

There are things a government should do – and many it shouldn't.

Government must deliver services as efficiently and effectively as possible to minimize the burden it creates on the economy to achieve its objectives. Quality service from government can improve Canada's economic performance.

But government should also be alert to the possibility it is creating burdens and interference that impede firms and workers from responding to new opportunities.

Since 1984-85, the Government of Canada has:

- trimmed the costs of its core operations;
- privatized Crown corporations and government holdings that could operate better in the private sector;
- eliminated agencies that no longer provide useful services; and
- is pursuing a wide-ranging review of regulations that raise the cost of doing business.

These actions are bearing results.

Operating expenditures – the cost of running government itself – declined by 13 per cent between 1984-85 and 1991-92, after adjusting for inflation.

This means that government operating expenditures fell from 3.5 per cent of Canada's economy in 1984-85 to 2.7 per cent of GDP in 1991-92. (Chart 9)

Privatizing Crown corporations

The government has also privatized 23 Crown corporations and other corporate holdings and has wound up 14 more. As well, steps have been taken to eliminate or consolidate over 40 agencies, boards and commissions.

Overall, federal government employment was reduced by 9.5 per cent between 1984 and 1991, after rising 8.7 per cent in the decade before 1984. (Chart 10)

Chart 9

Operating expenditures have been cut 13 per cent in real terms

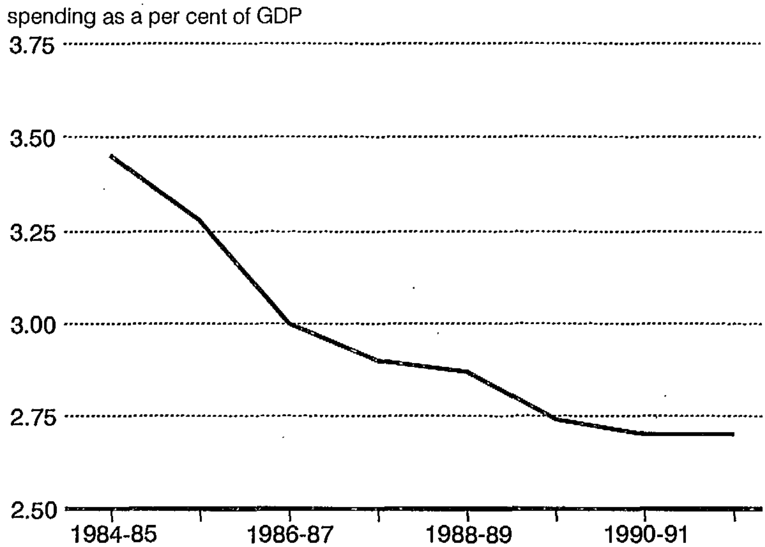
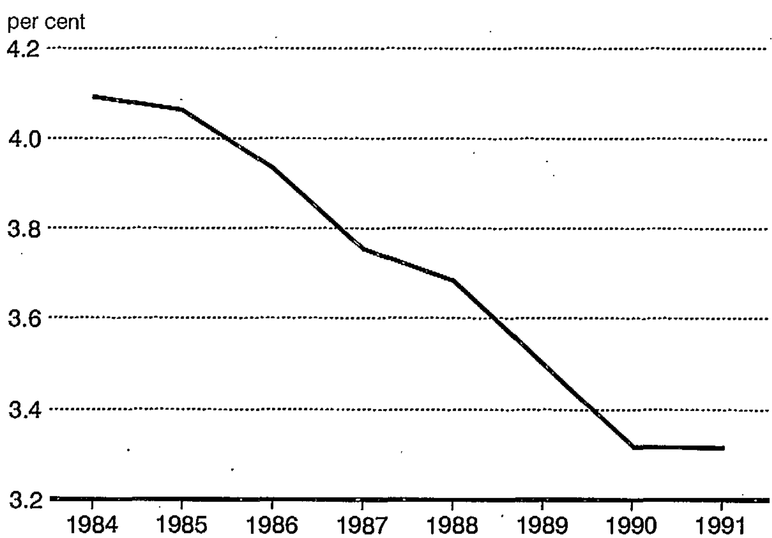


Chart 10

Federal employment was reduced significantly as a share of the total Canadian work force



Chapter 8: Increasing Opportunities for Trade

Many Canadians understand the critical role that international trade plays in our economy. The pre-budget consultations confirmed that even critics of specific trade agreement provisions believe the government must be committed to helping Canadians gain secure access to offshore markets. There is also growing recognition that trade barriers within Canada – between provinces – do real economic harm to many Canadians.

International trade is Canada's bread and butter.

The relatively small size of the domestic market makes it impossible for Canadians to enjoy a high standard of living without international trade. Per capita, Canadians are the most dependent on international trade among the peoples of the G-7 major industrialized countries and have benefited from this.

From 1950 to 1992, the growth of exports and imports outstripped all other components of Canada's production. At the same time, our real per capita annual income rose from $6,871 to $20,162.

Canada's strategy has been to promote vigourously the GATT multilateral trade negotiations which seek to make the world trading system more open.

Securing access to critical markets

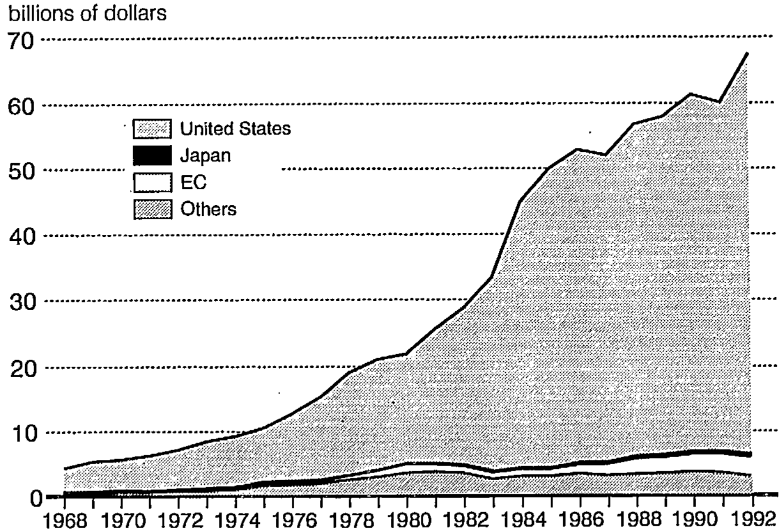
At the same time, the government has pressed forward toward free trade in North America, first with the Free Trade Agreement (FTA) with the U.S. and then with the current North American Free Trade Agreement (NAFTA) to include the fast growing Mexican economy.

Underlying the FTA and NAFTA is the fact that, of all Canada's trade partners, the U.S. is the most critical.

- Exports to the U.S account for 18 per cent of our total economy.
- The U.S. is the only market that has demonstrated strong growth potential for Canadian exports with high added value (advanced products that provide the good jobs and profits our economy needs). The U.S. accounts for 89 per cent of Canada's exports of high value-added goods. (Chart 11)

Chart 11

Canada is exporting more higher-valued goods to the United States



The FTA has worked for Canada

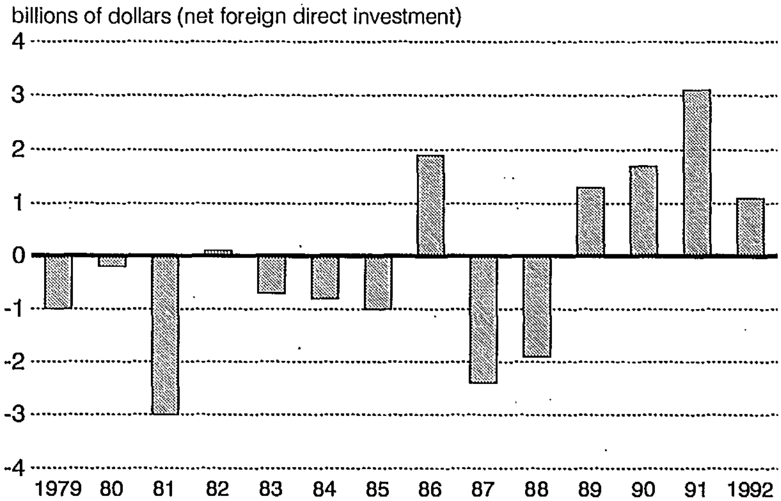
The FTA strengthened and consolidated the world's biggest bilateral trade relationship. The agreement not only liberalized trade by lowering barriers between Canada and the U.S., but also established a mechanism for settling disputes to put this trade on a more secure footing.

The record shows that the FTA has worked for Canada, delivering proven benefits.

- Canadian business in 1992 sold $122.3 billion in merchandise to the U.S. – a record high. That's an increase of nearly 19 per cent since the pact was put in place. And it represents a 13.6 per cent increase over 1991 – the largest year-over-year increase since 1984.
- Canada's merchandise exports to the U.S. have risen faster than exports to other countries according to a study by the C.D. Howe Institute. Moreover, Canada's exports performed strongest in sectors where the FTA lowered U.S. trade barriers.
- Canadian manufactured goods have won a record-high share of the U.S. domestic market over the 1989-1991 period, Statistics Canada has reported.

Chart 12

Foreign direct investment in Canadian manufacturing has surged under the FTA



Source: Statistics Canada, cat. 67-001.

- Canada's attractiveness to investors has improved. Since the FTA, net foreign investment in Canada's manufacturing sector has risen dramatically. (Chart 12)
- Canadian businesses have been eager to take advantage of opportunities provided by the FTA. They have actively encouraged the government to proceed with two rounds of faster reductions in tariffs. Products now subject to accelerated tariff elimination represent $8 billion in bilateral trade. Owing to continuing business support, a third round of accelerated tariff reductions is under way.

NAFTA

In December 1992, Canada, the United States and Mexico signed the North American Free Trade Agreement. Once implemented by the three parties, NAFTA will create the biggest free trade area in the world, exceeding the European Community (EC) in both population (about 360 million for NAFTA against 327 million for the EC) and production ($7,300 billion for NAFTA against $7,020 billion for the EC).

NAFTA improves the FTA

Under the agreement that was negotiated, Canada would achieve four main objectives in joining NAFTA.

- NAFTA extends the FTA to include the fast-growing Mexican market, which has a population of more than 80 million. NAFTA would also improve access to Mexico for Canadian businesses, since Mexican tariffs on Canadian products are three times higher than Canadian tariffs on Mexican products.
- NAFTA would improve upon the FTA by clarifying rules of origin and strengthening the dispute settlement system.
- NAFTA would preserve Canada's commercial interests in the U.S. market, where we face increasing competition from Mexico. As a result of NAFTA, Canada should be in a better position to be competitive in high-value-added and capital-intensive goods.
- NAFTA maintains Canada's attractiveness for business investment. It would give firms based here – or who are interested in establishing Canadian operations – the same access to all three markets as if they were based in the U.S. or Mexico. Without our participation in NAFTA, only firms based in the U.S would have been able to trade freely across the continent.

With NAFTA, Canada's export markets become even larger and our position as an attractive place to invest is enhanced. The proposed agreement will permit Canada to make further gains from trade.

■ *Removing barriers to interprovincial trade*

According to the most recent data from Statistics Canada, the value of interprovincial trade in primary and manufactured goods was $90 billion in 1988. That's about one-quarter of Canada's total domestic production of goods.

However, there are many areas where trade between provinces is restricted by regulations and other obstacles. The Canadian Manufacturers Association has estimated that these barriers cost Canada's economy some $6 billion each year.

On March 18, 1993, the federal, provincial and territorial governments agreed to work towards the elimination of such barriers. Discussions were to take place on the precise identification of barriers, with formal negotiations slated to begin by mid-year, with the objective of reaching an agreement by June 30, 1994.

Chapter 9: Promoting an Effective Social Safety Net

During the 1993 pre-budget consultations, a number of groups raised concerns about the impact of government expenditure control on important social programs. Some other participants argued that the design and funding levels for many programs actually encourage unemployment and increase welfare dependency. Where the two views met, however, was in recognizing the importance of delivering assistance to those in real need as effectively and efficiently as possible.

A strong economy is the foundation for social benefits

Canadians are justifiably proud of their social policies and programs and the contribution they have made to our society, standard of living and quality of life. An economy with high rates of productivity growth made these benefits possible.

In the 1960s, Canada's social programs were based on two fundamental assumptions:

- that economic growth would always be great enough to support ever-growing income maintenance programs; and
- that these programs would not themselves affect economic performance and our ability to adapt to a changing environment.

The experience of the 1970s and early 1980s showed that these assumptions were questionable. The cost of key social programs was increasing faster than economic growth. At the same time, some of these programs were encouraging dependency rather than self-reliance, and were acting as a disincentive for Canadians to do what was needed to take advantage of new economic conditions.

■ *New directions*

In November 1984, the government's paper *A New Direction for Canada: An Agenda for Economic Renewal* recognized the links between social policy and economic growth. It retained the principle that people come first, but also recognized there was considerable scope for improving social programs to meet the twin tests of social and fiscal responsibility.

- Social responsibility means that wherever possible, those in greatest need have first call on scarce resources.
- Fiscal responsibility means that the best income security is a job, and that government must direct expenditures to improving employment opportunities and supporting sustained income growth.

The steps taken

Making programs more flexible, better targeted

The government has also made social programs more flexible, tailoring them to meet different needs and targeting them to help those most in need. It has also added elements to assist people to upgrade their skills so that they can better seize new opportunities. For example, unemployment insurance was reformed into a more active labour market program as opposed to a purely passive income support program, by devoting a significant portion of the fund to training and development.

Better targeting and control of program spending has enabled the government to improve benefits to Canadians most in need. Since 1984, transfers to persons have increased not only in real dollars – faster than the rate of inflation – but considerably faster than total program spending. (Chart 13)

Helping families with children . . .

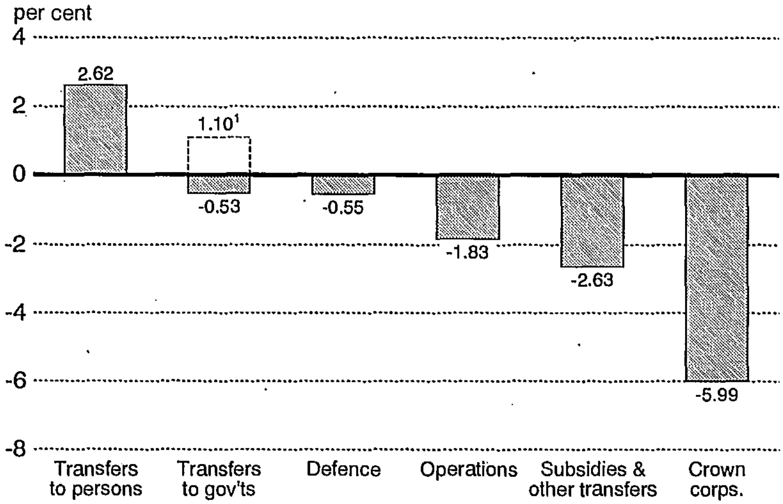
- The new *Child Tax Benefit*, started in 1993, consolidates family allowances, the refundable child tax credit, and the non-refundable dependant child credit into a single tax-free monthly payment. It includes an earned-income supplement of up to $500 annually for low-income working families with children. The government's commitment to child assistance under the new system is $5 billion a year.
- The government has also implemented the five-year, $500 million *Brighter Futures* program to address the needs of children at risk.

. . . the disabled

- The government has increased the *Disability Tax Credit* several times, most recently to $700 starting in the 1991 tax year. In addition, eligibility has been broadened and measures introduced to assist employees with disabilities and to help businesses make their premises more accessible.

Chart 13

Between 1984-85 and 1991-92,
the biggest increase in program spending went to help people



[1]Cash payments plus tax points.

. . . and seniors

- The *Seniors Initiative*, introduced in 1988 and renewed this year, has already provided funding of $184 million for programs including the Seniors Independence Program and the New Horizons Program.

- Comprehensive pension reform has made it fairer and easier for Canadians to save for their retirement through *registered pension and savings plans*. It has made private pension plans more equitable, notably through improving the treatment of spouses when a partner dies or a marriage breaks down. At the same time, to help spur economic growth following the recent recession, the government allowed Canadians to access their RRSP funds for use as a downpayment in buying or building a home.

- The government has moved to put the *Canada Pension Plan* (CPP) on a sounder financial footing and improved it in several ways. Contributors may now draw a pension at age 60. Pension credits may be split upon divorce. Spouses may share benefits upon retirement. Survivors' benefits continue upon remarriage. Disability benefits were increased substantially.

- Expenditures on *elderly benefits* (Old Age Security, the Guaranteed Income Supplement, and Spouse's Allowance) have grown very rapidly since the government came to office – from $11.4 billion in 1984-85 to $18.4 billion in 1991-92. This represents an average annual increase of 7.1 per cent while total program spending has grown by 4.1 per cent during the same period. The extension of the Spouse's Allowance to all needy widows and widowers aged 60 to 64 benefits 50,000 Canadians annually.
- The *GST Credit* – an important element of the reform of Canada's sales tax system – will deliver about $2.8 billion to 9.4 million recipients in 1993. The level of the credit – $199 per adult and $105 per child – has been set to ensure that families with incomes below $30,000 are better off as a result of replacing the old federal sales tax with the GST.

Conclusion: Preparing for the Future

As we look ahead to a new century, Canada is in an excellent position to realize the benefits of strong, sustainable growth.

Clearly, the policies that grew from the 1984 Economic Agenda have significantly improved our economic and fiscal fundamentals.

- The deficit has come down as a share of the economy.
- Inflation is at the lowest level in 30 years.
- Interest rates are down dramatically.
- Our tax system is fairer and more efficient.
- Trade agreements are securing key export markets.
- Labour productivity is growing strongly.

But not all problems are resolved, and new policy challenges continue to emerge – as they always will in a world of change.

- Canada's deficit and debt problem is national in scope. Deficit reduction is continuing in order to further reduce interest rates and release domestic savings for productive investment in the private sector and to lower our reliance on foreign indebtedness. The government shares the view held by many Canadians, that increased federal-provincial co-operation is needed to achieve the common objective of reducing deficits and debt.
- The government is continuing to examine areas where the private sector could operate more efficiently than the public sector, through further privatization and deregulation. It is working actively to provide necessary government services in an efficient and cost-effective way by simplifying relations with businesses and individuals.
- The government is focusing on ways to reduce unemployment and improve the functioning of the labour market. In particular, it is developing training and other assistance for workers to enable them to meet the skill requirements of the newly emerging economy, with its knowledge-intensive industries and high-technology production.
- The government continues to work with our economic partners in the G-7 and others to promote better economic policies worldwide.

- The government is committed to providing the right conditions for firms to develop new export markets. In this view, the government continues to push for the successful completion of the GATT multilateral trade negotiations and for elimination of interprovincial trade barriers.
- The government will make sure that Canadians have access to social programs that enable them to take full advantage of their economic opportunities. But, it is pursuing this goal in ways that ensure that these programs are cost-effective and do not create a cycle of dependency.

To meet such challenges, Canadians and their governments must work effectively together to reinforce and build on the foundations already in place for a stronger, more productive economy. If we continue to advance – through a constant effort to improve our competitiveness, sustain the benefits of low inflation and interest rates, reduce deficits and debt, and adjust to change – Canada can assure its success in the world economy of the 21st century.