w Direction for Canada

An Agenda for Economic Renewal

Canada

A New Direction for Canada

An Agenda for Economic Renewal

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Department of Finance
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Introduction

Canadians are a strong and dynamic people. As a nation we are blessed with a great endowment of natural resources. We benefit from excellent economic infrastructure built over a long period of time. Our imagination and enterprise are boundless. We have great potential for growth.

Yet over the past decade our economic performance has fallen far short of that potential. In particular, over the last five years it has been poor not only in comparison to our potential but also in comparison to some other nations much less well endowed than we are.

On September 4, Canadians voted for change, and for a better future, because they knew that as a country we could do much more to create that future. In doing so, they have provided the opportunity to make a fresh start, to build new confidence and a new national consensus toward achieving the economic promise and potential of Canada.

They voted for a change in policies and a change in the approach of government to the making of those policies. That is our mandate and our challenge.

The mandate of September 4 reflects as well a sombre judgment about Canada's poor economic performance in the recent past. Canadians looked back on a decade of soaring government deficits and rising unemployment; of expansive, intrusive government and sluggish, uncertain economic growth. They saw an economic world that had changed and a country that had not kept pace with that change. They saw that their government and their economy had gone dangerously off course and off balance.

There is no single reason for our poor performance. Volatile international markets have created difficulties for us. But they have also created opportunities, opportunities we have been too slow to seize. While changing technology has led to the decline of some of our traditional industries, it has also created new challenges which we have been slow to meet. And while rapid growth in our labour force has kept unemployment unacceptably high, it has also provided the opportunity for strong, non-inflationary growth. We have failed to exploit that opportunity.

A major reason for our poor performance has been the failure of the Government of Canada to deal with the real problems. For too long the government has ignored the causes of problems and has dealt only with the symptoms. For too long it has allowed its fiscal situation to deteriorate and debt to increase. Through excessive regulation and intervention, it has substituted the judgments of politicians and regulators for the judgments of those in the marketplace.

As a result, business – and especially small business – has been hamstrung by increasing regulation which has sapped it of the creative energy necessary to take risks, improve productivity and create permanent and satisfying jobs. The government has all too often hampered rather than helped change by protecting, at taxpayers' expense, those enterprises which have been too slow to increase productivity or unable to seize new market opportunities. Instead of providing a consistent legal and taxation framework that productive enterprise could rely on, government has made arbitrary changes, creating uncertainty and damaging confidence both at home and abroad.

Also as a result, individual workers have had insufficient opportunity to become more productive. They and their families have been unable to fulfill their hopes and aspirations. Government has all too often failed to provide the conditions to enable the young to begin productive working lives or to facilitate the movement of older workers to new jobs. The individual willing to search for new opportunities has had to do it at his or her own risk and expense, while those unwilling to change have often received considerable government support. This has drained the confidence and initiative of workers and their families.

In short, the inherent dynamism of Canadians and Canadian businesses has been eroded by economic policies which, though often well-intentioned, have been erratic, have discouraged productivity, and have often indemnified the less productive at the expense of those willing to take risks and innovate.

The government believes that Canadians have the desire to produce and to innovate, and the capability to generate much stronger growth than we have seen over the past decade. Our objective is to put in place a policy framework that will release the creative energies of Canadians to build a better future for themselves, that will give young people a chance to make a productive contribution, and that will open up new opportunities for older workers who have lost their jobs. We must put Canada back to work so that all Canadians, including pensioners, children, and adults unable to work, can have a better life. We are aiming for economic renewal – renewal that will enable Canadians to focus co-operatively and constructively on expanding the economic pie rather than on an increasingly divisive struggle for a share of a static or shrinking one.

This government will take the lead in this process of economic renewal. We have set ourselves four challenges.

First, we must put our own fiscal house in order so that we can limit, and ultimately reverse, the massive build-up in public debt and the damaging impact this has on confidence and growth.

Second, we must redefine the role of government so that it provides a better framework for growth and job creation and less of an obstacle to change and innovation.

Third, we must adopt policies that foster higher investment, greater innovation, increased international competitiveness and a positive climate for the birth and growth of new enterprise.

Finally, we must bring about these changes in a way that is fair, open, and consistent with the basic sense of compassion, tolerance and justice that is characteristic of Canadian society. We will not weaken the basic income support programs that have served Canadians well. Indeed, through stronger economic performance we will seek to provide even greater assistance to those Canadians who truly need it.

By rising to these four challenges, we believe that the process of economic renewal can be started.

But renewal will not come quickly or easily. There are no quick fixes for problems which have developed over a decade. Nor will renewal come without the co-operation of the federal government, provincial governments, business, workers and unions, and other Canadians. We will not only have to work hard, but we will have to work together in a truly national effort of economic reconstruction.

This will mean trying to replace the tension which has characterized federal-provincial relations in recent years with a more positive and productive climate. Only by working together more effectively can federal and provincial governments substantially improve prospects for economic growth in the coming years.

The purpose of this paper is to present the government's ideas on the paths which should be followed in this national effort. The following chapters set out an agenda for restructuring the federal government's economic policies. Chapter II describes the fiscal situation we now face and the economic environment likely to confront us through the remainder of the decade. Chapter III describes the obstacles we will have to overcome.

Our agenda for renewal is detailed in Chapter IV. A great many options are presented, and deliberately so. The government has devoted a great deal of time to studying the economic challenges, and we have a clear sense of the direction in which we wish to lead the country. However, we do not intend to act without seeking the opinions of all Canadians and taking them fully into account in our decisions. There are broad, pervasive problems to be resolved, and everyone must share in the effort. Our agenda is designed to stimulate discussion in the consultations over the coming months with provincial governments, labour, business and other members of the Canadian community. The process for these consultations is described in Chapter V. Chapter VI provides a summary of the challenges we all face to bring about a healthy, growing economy.

As we begin discussion on this agenda, Canadians should not lose sight of the broad national purpose to which we are pledged. We all come from different walks of life, different regions of the country, and we all have different backgrounds and interests. But our common bond is the desire we all share to see a strong and prosperous Canada. Achieving this will improve the lot of each and every one of us. We can achieve it if we work together to make it happen.

II. The Economic and Fiscal Outlook

A. The Economic Outlook

Current Economic Performance

Early in 1983 the Canadian economy began to emerge from its most severe postwar recession. From the pre-recession peak in mid-1981 to the trough of the recession in the fourth quarter of 1982, real output in Canada declined by 6.6 per cent, employment fell by almost 5 per cent with a loss of 560,000 jobs, and the unemployment rate rose to a peak of 12.8 per cent. Today, despite two years of recovery, the legacy of the worst recession since the 1930s remains. Employment has barely recovered to the pre-recession level, the unemployment rate is extremely high, and Canadian industry is still operating substantially below its potential.

Current data indicate the expansion is continuing, but at only a moderate pace. Equally important, the recovery so far has not been as broadly based or as balanced as had been anticipated, and the risks to sustaining it have increased appreciably over the course of this year. In particular, continuing high unemployment and high and volatile interest rates have weakened consumer and investor confidence. Sagging confidence is particularly evident in the interest-sensitive sectors of the Canadian economy: business investment has been sluggish as has spending on housing and major household items.

While this weakness in domestic expenditures has been partly offset by strong exports and an improving trade position, the net effect has been to tie our recovery more closely to the American expansion and thus to increase the risk of a downturn in Canada should U.S. economic growth falter.

A further disturbing feature of the current recovery is its uneven distribution. While the economies of several provinces have grown relatively quickly, activity remains depressed in other areas of the country. Similar disparities are all too common as well among the industrial sectors, with manufacturing experiencing a fairly robust recovery while many resource-based industries are still languishing in the aftermath of the recession.

In summary, although the Canadian economy has continued to grow in 1984, the uneven nature of this growth, the weak demand in several major sectors, and continued high unemployment rates have resulted in a growing perception that the recovery has run out of steam. This perception has been reinforced by comparisons of Canada's economic performance in 1984 with the recent impressive growth of the U.S. economy.

The Outlook for Canada

The economic and fiscal outlook presented in this chapter portrays the likely path of the Canadian economy and federal fiscal situation over the decade based on two key assumptions:

- first, that there will be no major crisis in the world economy and that world and U.S. real interest rates will decline to more normal levels after 1985, and
- second, that there is no change in the Canadian expenditure, taxation and regulatory framework over the decade.

The assumed decline of U.S. interest rates after 1985 has been reflected in the projections for Canada set out in Table 1 below. If this were not to occur, the outlook would be considerably worse, as described later in this chapter.

Table 1

Economic Projection: Main Economic Indicators, 1984-1990

	1984	1985	Medium-term average: 1986-1990
	(percentage change unless otherwise specified)		
Real GNE	4.2	2.4	3.4
Employment	2.4	1.9	2.7
Unemployment rate (level)	11.4	10.9	8.9
Consumer price index	4.5	4.1	3.8
90-day commercial paper rate			
Nominal	11.6	10.6	6.5
Real*	7.1	6.5	2.7

*Conventionally measured real interest rates are defined as the nominal interest rate minus the rate of inflation. The rate of inflation, as measured by the consumer price index, was used to calculate the real rate of interest.

Growth in real output in 1984 is now expected to be about 4.2 per cent, down from the 4.9 per cent forecast in the February budget. Business non-residential investment is likely to remain weak because of high real interest rates, the need for further improvement in corporate balance sheets and high levels of unused capacity. Residential investment is particularly sensitive to interest rates and is being hurt by the increases in mortgage rates during the first half of 1984. Government expenditure for goods and services will show only moderate real growth in 1984. Canada's merchandise trade surplus is now at or near record levels, and is expected to remain so over the near term, thereby stimulating employment and output growth directly in the export sector and indirectly throughout the economy.

In 1985, growth in real output in Canada is anticipated to slow to about a 2.4-per-cent pace, paralleling a forecast slowing of the U.S. economy to a similar rate. The slowdown is expected to come as both economies react negatively to current high levels of nominal and real rates of interest. High levels of unemployment are expected to dampen growth in personal income and trim consumption plans. Business and consumer confidence in Canada has been weak to date in the recovery, and in the absence of policy change is expected to remain tentative over the next year.

Employment growth is forecast to slow somewhat in 1984, averaging 1.9 per cent this year on a fourth quarter over fourth quarter basis, in contrast to the 3.5 per cent advance recorded during the first year of the recovery. The unemployment rate is forecast to average 11.4 per cent in 1984. Only modest improvement in reducing unemployment is expected in 1985, as the expected weaker growth in real output will dim the prospects for substantial employment gains.

The rate of inflation, as measured by the CPI, is expected to stay at current levels over the balance of 1984. Upward pressures from higher food prices, and higher import prices resulting from the depreciation of the exchange rate against the U.S. dollar are expected to be largely offset by weak commodity prices and softening cost pressures in labour markets. The rate of inflation should average 4.5 per cent in 1984. A somewhat lower rate of inflation, of just over 4 per cent, is expected in 1985.

The key factor shaping the medium-term projection is the assumed gradual decline in nominal and real rates of interest in the United States and Canada to more normal historical levels. Based on this assumption, real economic growth in Canada is projected to average just under 3.5 per cent per year over the 1986-1990 period. Investment spending in real terms should pick up over the 1986-1990 period, in response to the assumed lower levels of real interest rates in Canada. In addition, recent gains in terms of lower inflation and stronger competitiveness are projected to be consolidated and even furthered over the medium term.

This progress notwithstanding, the unemployment rate is expected to decline only gradually to just over 7 per cent in 1990, averaging about 9 per cent over the medium term. This would mean that it would take nine years to bring the unemployment rate down to where it was prior to the recession. Clearly this is not an acceptable economic outlook for Canadians.

B. The Fiscal Outlook

The federal government's budgetary outlook has worsened considerably in the months since the February 1984 budget. In that budget the former government presented a fiscal plan covering the period to 1987-88 which showed high, but gradually declining deficits and financial requirements. Since February, however, interest rates have climbed rather than fallen, as projected in the February budget, and the economic outlook has weakened. As a result, this government has inherited a federal budgetary situation that is far more serious than was indicated last February. The status quo deficit – that is, the deficit that does not incorporate the impact of any policy measures already taken or under consideration by the government – is now projected to be almost $35 billion this fiscal year. Next year, in the absence of policy change, the deficit would climb to more than $37 billion. And this increase would have been even greater if the previous government had not budgeted for a decline in support for direct job creation and training from $2.2 billion this year to only $1.2 billion next year.

Table 2 compares the current fiscal outlook with that presented in the February budget. At that time the deficit was projected to decline from a level of $29.6 billion in the current fiscal year to $26.2 billion by 1987-88, while financial requirements were projected to decrease from $25.6 billion to $18.7 billion over the same period. As a share of gross national product (GNP), the deficit was estimated to decline from 6.9 per cent to 4.7 per cent, and financial requirements were projected to decline from 5.9 to 3.4 per cent of GNP.

The second panel of Table 2 shows the updated projections for the deficit and financial requirements. Further details on these projections are provided in the Annex. These estimates are status quo figures. Both fiscal projections reflect the increase in the federal sales tax which took effect October 1, but the current projection also incorporates a number of accounting changes recommended by the Auditor General. These accounting changes have the effect of increasing the deficit by about $500-$600 million per year, as shown in Table 3. In other respects, the current fiscal projections have been prepared on the same basis as those in the February 1984 budget.

The government is seriously concerned about the deficit outlook, as all Canadians should be. The deficit and financial requirements are much higher than the February budget figures. The deficit is projected to be $34.5 billion in 1984-85 and to rise to over $37 billion next year. And a further warning light is flashing: the projections no longer indicate any tendency for the deficit to decline over time, even though interest rates are assumed to decline as in the February budget.

There are three main reasons for these large modifications to the deficit profile. Table 3 summarizes the main sources of the increased deficit and a more detailed explanation is given in the Annex.

Table 2

Projected Trends in the 'Status Quo' Budgetary Position: The Current Outlook Compared to that of the February 1984 Budget

	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
1. **February Budget**							
Budgetary deficit							
– millions of dollars	29,600	27,950	27,100	26,150	–	–	–
– percentage of GNP	6.9	5.9	5.3	4.7	–	–	–
Financial requirements							
– millions of dollars	25,550	23,300	19,700	18,650	–	–	–
– percentage of GNP	5.9	5.0	3.8	3.4	–	–	–
2. **November outlook**							
Budgetary deficit							
– millions of dollars	34,500	37,100	34,300	35,100	36,400	37,700	37,300
– percentage of GNP	8.2	8.3	7.1	6.8	6.5	6.3	5.8
Financial requirements							
– millions of dollars	29,800	32,000	27,900	27,700	29,500	27,800	29,800
– percentage of GNP	7.1	7.1	5.8	5.3	5.3	4.6	4.6

Table 3

Factors Contributing to Changes in Deficit Projections Since the February Budget

	1984-85	1985-86	1986-87	1987-88
	(impact on deficit in millions of dollars)			
Revenue declines	1,891	4,583	6,135	7,915
Public debt charges	2,310	3,145	2,285	2,090
Program expenditures	209	897	−1,800	−1,675
Accounting changes	490	545	580	620
Net change	4,900	9,150	7,200	8,950

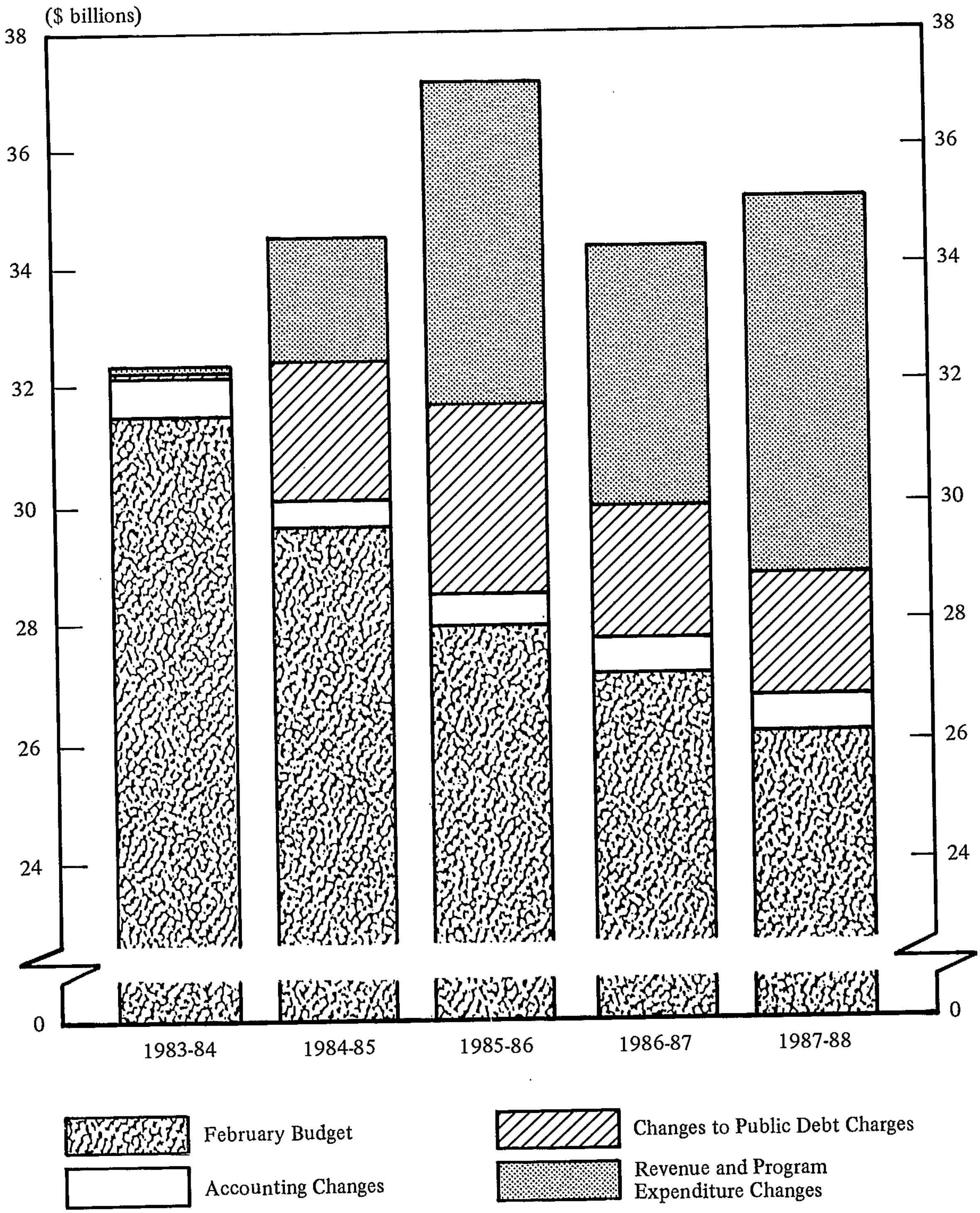
First, the economic outlook is weaker in 1984 and 1985, as a result of higher interest rates than were expected last February. Growth is also projected to be somewhat lower from 1986 to 1988 than was foreseen in February. This weaker economic outlook has in turn resulted in slower growth in the main tax bases, and resulted in lower projected levels of budgetary revenues. In addition, revenue projections have been lowered to reflect lower estimates of income tax collections based on data which were unavailable when the February budget was prepared.

Second, the higher interest rates in the short term have also raised public debt charges directly as each one-percentage-point increase in the level of interest rates increases public debt charges immediately by close to $1 billion per year. Moreover, the higher level of net debt now projected for the end of the 1985-86 fiscal year results in higher public debt charges over the remainder of the decade. The changes since February illustrate graphically the treadmill the government is on. Higher interest rates mean lower growth, larger deficits, and more debt. And this larger debt means higher interest charges and larger deficits well into the future.

Third, as already noted, the acceptance by the government of several accounting changes recommended by the Auditor General will add about $500-$600 million per year to the budgetary deficit.

Chart 1

Comparison of the Deficit Projections in the November Status Quo With Those in the February 1984 Budget



Source: Department of Finance

C. Issues and Risks

The main uncertainty in Canada's economic outlook relates to interest rates and, more particularly, inflation-adjusted or "real" interest rates. The level of real interest rates plays an important role in investment and other expenditure decisions. Measured in the conventional way, real interest rates have now reached near-record levels in both the United States and Canada. If real rates do not decline, a long period of lacklustre performance can be expected; if they increase further, a recession cannot be ruled out.

High interest rates are a global problem affecting both developed and developing countries alike. In developed countries they are stifling economic growth and undermining confidence; in the less-developed countries they are a threat to the very fabric of the economy. There is no single cause and no simple cure to the problem of high interest rates. Rising rates of inflation, excessive government spending and policy uncertainty have all played a role. Neither is there any way for a country to insulate itself completely from international economic and financial developments. To an extent that would not have been believed 30 years ago, we have become trading nations linked by interrelated world markets for goods and capital.

At present, with inflation lower than it has been for a decade, a major reason for high interest rates in Canada and elsewhere is the pressure on international financial markets from high U.S. interest rates. These pressures in turn are related to the significant financing requirements associated with the large federal government deficits in the U.S., combined with a fairly restrictive U.S. monetary policy. The U.S. government's financial requirements have put great pressure on U.S. capital markets already stretched to accommodate the financing of the current investment and consumption boom. This has been a major source of upward pressure on interest rates through 1984. Another factor has an important bearing. If the U.S. stance of fiscal policy is not changed, the large deficits projected for the rest of the 1980s will tend to sustain the expectation that ultimately they will have to be financed by "printing money". This expectation has kept inflationary expectations high, despite continued declines in recorded inflation, and in turn has helped keep real interest rates at record high levels.

To protect growth and to create employment, therefore, it is essential that real interest rates fall to levels closer to those observed historically. This requires further U.S. deficit reduction measures and a complementary adjustment in monetary policy. The United States, however, is not alone in needing to put its fiscal affairs in order. Canada also has a serious debt problem that requires responsible fiscal action to restore a more appropriate balance between revenues and expenditures.

A failure to address the deficit and debt problems in the United States would make the possibility of more normal levels of nominal and real interest rates over the medium term much less likely. Failure to control our deficit when others are controlling theirs would undermine confidence in the Canadian economy. This decline in confidence would put upward pressure on Canadian interest rates and thus jeopardize our ability to benefit fully from any decline in international interest rates.

In the event of substantially higher interest rates than those in this projection, the economic and fiscal outlook would be much worse. The precise nature of economic developments under a scenario in which real interest rates do not decline to more normal historical levels is difficult to predict, because sustained periods at current high real rates of interest are so far outside Canadian historical experience. If, for example, interest rates were to remain at about current levels through 1985 and then decline slightly to about 10 per cent over the medium term, conventional analysis would suggest that real growth in 1985 would likely be under 2 per cent and could average about 1 per cent per year less over the remainder of the decade than is currently projected. The unemployment rate would not likely drop below 10 per cent at any time. But such alternative scenarios do not adequately capture the potential strains on the international banking system of prolonged high real interest rates, the harmful effects on consumer and business confidence, and the enormous and potentially destabilizing burdens that would be placed on all borrowing sectors of our economy – young families, corporations, and governments. A severe recession would be a distinct possibility.

The changes in the projected outlook for the deficit since last February also drive home how sensitive the federal government's fiscal situation is to changes in economic circumstances, and in particular how exposed it is to higher interest rates. If interest rates were to remain above 10 per cent over the medium term and real economic growth were slower than projected as described above, then the deficit could easily rise to $45-$50 billion by fiscal year 1990-91. And this calculation does not take into account the very real possibility of a severe recession at some time during the second half of this decade if deficits, and hence interest rates, are not reduced to manageable dimensions. Clearly, with these risks, this government must take action to restore fiscal flexibility and by doing so help to create an environment that would allow interest rates to fall.

Summary

The economic outlook until the end of the decade is neither favourable nor certain. Despite the assumption that real interest rates decline sharply, real growth remains moderate and the unemployment rate declines only gradually and does not fall to near 7 per cent until 1990.

The fiscal situation is equally disturbing. There are two important dimensions to the problem. The mountain of debt is feeding on itself and the deficit shows no prospect of declining on its own in this decade even with moderate growth. The magnitude of the debt problem, if not managed prudently, will clearly have increasingly adverse impacts on investor confidence. This could deny Canada the investment, both foreign and domestic, it requires to generate growth and jobs.

Uncertainty over real interest rates, together with the prospect of continuing large deficits for at least another six years, puts a straitjacket on the use of fiscal policy in the traditional way to promote growth. In the first place, a very major injection of stimulus would be required to have any appreciable effect on growth and unemployment. However, because of the current large size of the government's deficit and debt, international investors would be even more likely to shy away after a policy shift toward stimulation, thus putting downward pressure on the exchange value of the Canadian dollar. This would create a "no-win" situation. A rapid and substantial depreciation of the Canadian dollar would put upward pressure on inflation and lead to further loss of confidence. An attempt to offset downward pressure would require higher interest rates. This in turn would depress interest-sensitive expenditures, thus blunting the impact of the fiscal stimulus.

The stark reality is that there is no easy way to "buy" growth. The government's current and prospective fiscal situations are a serious constraint on its ability to use the major levers of fiscal policy to stabilize the economy in traditional ways.

III. Obstacles to Growth

To achieve even the moderate growth that has been projected for the remainder of the 1980s, a decline in real interest rates is essential. If this does not happen, investment will be lower than projected and the underlying growth prospects and potential of the economy diminished.

Even with a decline in real interest rates and reasonable economic growth, the current outlook is for another six years of continuing large federal government deficits. This will mean a steadily growing mountain of debt. This in its simplest form is the fiscal dilemma that confronts us. Such a prospect poses a serious threat to economic growth. Without corrective fiscal action to reduce the projected pattern of large deficits, there can be no assurance that we will benefit from a decline in U.S. interest rates. We cannot sit back and expect that interest rates in Canada will decline simply because they may decline in the U.S. Interest rates in Canada will also be determined by our own actions, or lack of actions. If we fail to act, then we could very well do worse than has been projected. We would certainly not do better.

But corrective fiscal action is not enough. Achieving better growth will also require a revitalization of the private sector as the driving force behind growth and job creation. This will require that the government take steps to encourage risk-taking and entrepreneurship and to promote greater flexibility and adjustment in the economy.

A. Continuing Deficits as an Obstacle to Growth

The growing public debt has become a severe handicap to economic progress and the most serious obstacle to economic growth. The debt problem now facing the government is the unfortunate result of policies that have outlived their proper and responsible application. As a general principle, governments run deficits during recessions, which they recoup from increasing tax revenues during periods of economic expansion. Over the last decade, however, the federal government has run deficits not only in recession years, but in years of growth as well. Next year will mark the third year of recovery and the third year in which the deficit is continuing to rise.

Chart 2
Federal Net Public Debt as a Percentage of GNP
1974-75 – 1990-91

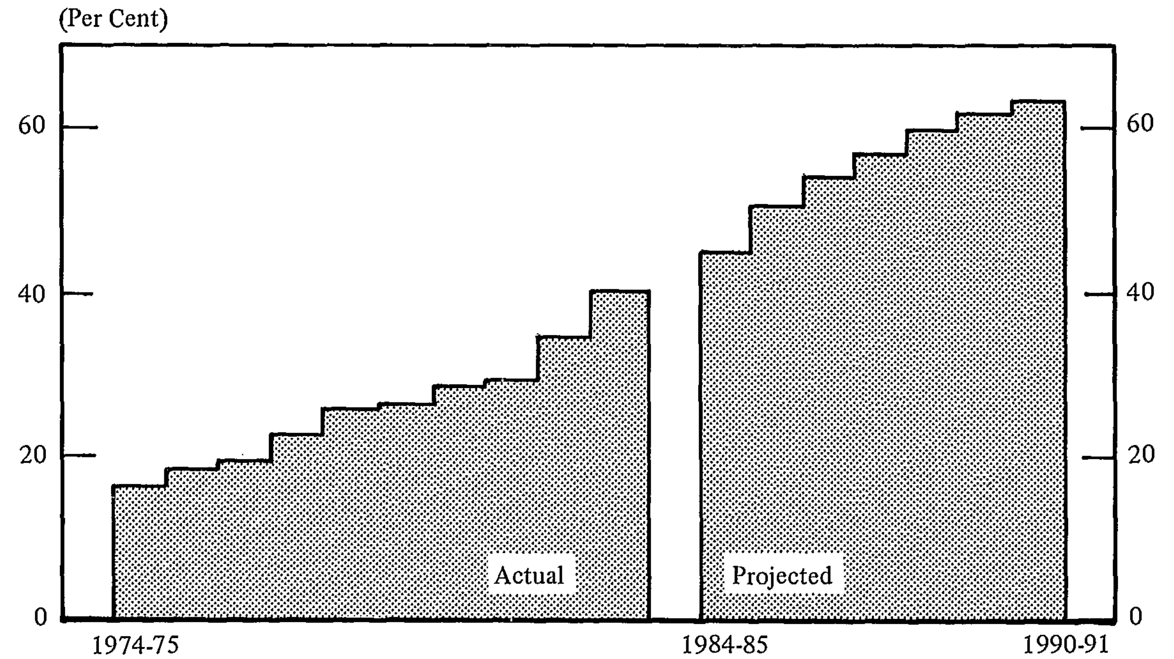
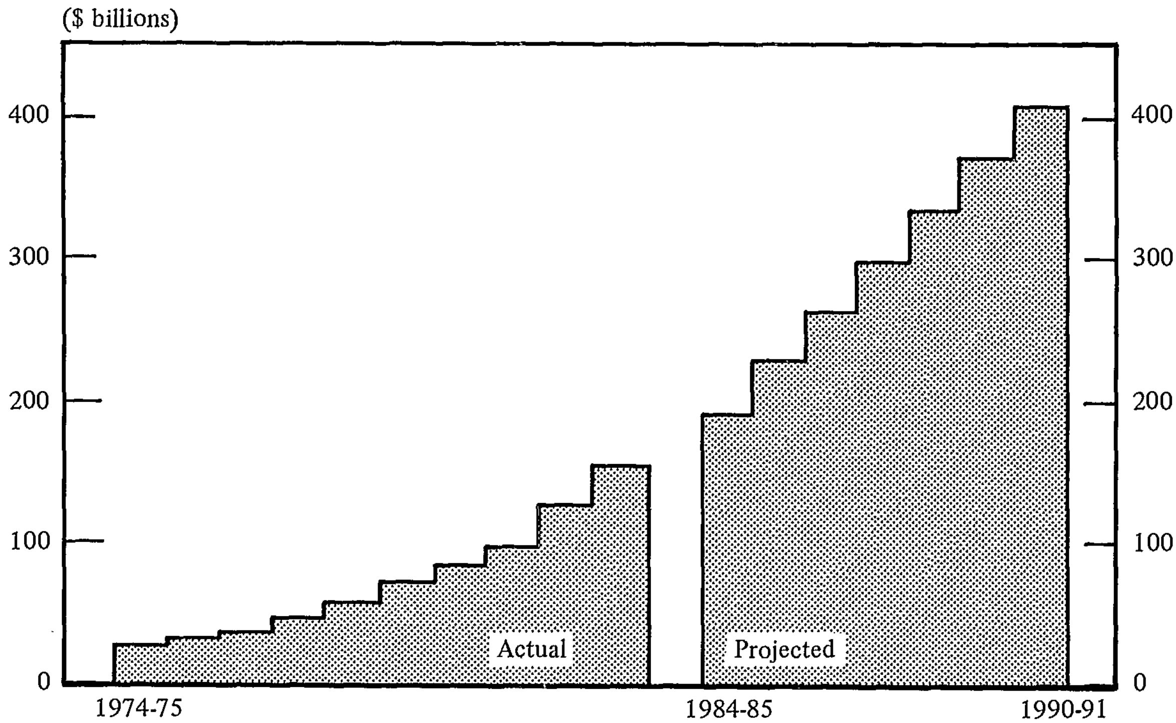


Chart 3
Federal Net Public Debt
1974-75 – 1990-91



Source: Department of Finance

The legacy of these deficits is evident in the situation that exists today. At the end of 1984-85, net public debt, the accumulation of past budgetary deficits, is likely to reach about $190 billion, eight times the $24 billion which existed at the end of 1974-75. This year more than one dollar out of every four dollars of tax revenues will go to pay the *net* interest on the national debt; in 1974-75, the amount was only one dollar out of every 20. If *gross* interest payments are used to make this calculation, the numbers are one dollar in three in 1984-85, compared with one dollar in nine in 1974-75.

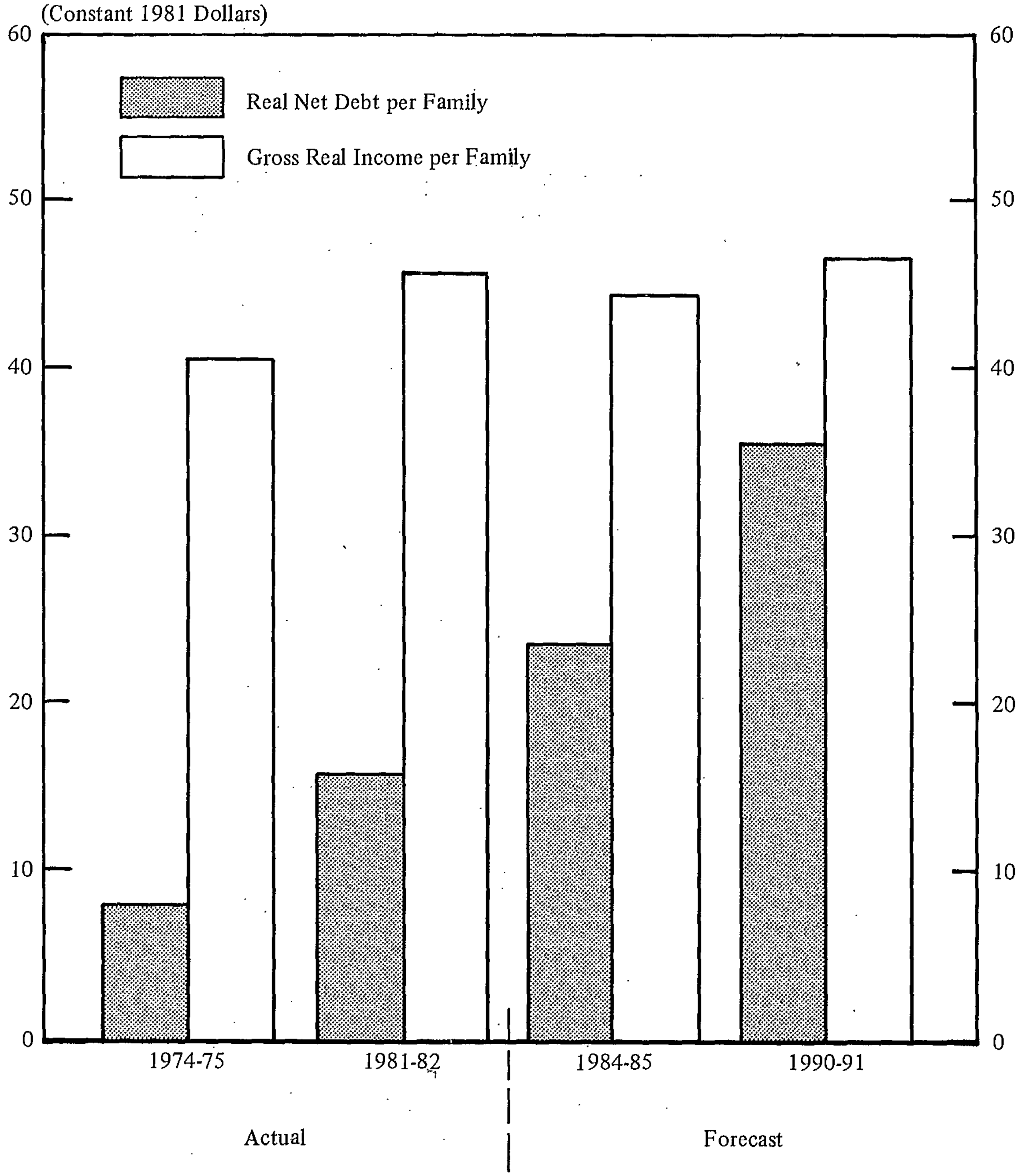
National debt is rising much faster than the economy is growing. What is particularly disturbing is that this trend has been so persistent. In relation to the size of the economy, net public debt will have increased from 16.6 per cent of GNP in 1974-75 to 45.2 per cent in 1984-85.

Increases in the level of debt and the debt-to-GNP ratio have been particularly dramatic in the past three years. The 1981-82 recession depressed tax revenues sharply and increased cyclically-sensitive expenditures such as unemployment insurance benefits. In addition, high interest rates and a rising burden of debt pushed up net public debt charges to the point where they now account for over half of this year's deficit.

Also disturbing is the fact that the pattern of deficits currently projected for the rest of this decade means continued growth in the public debt burden and steadily rising debt servicing costs. Net public debt would more than double from its present levels, rising to over $400 billion by the early 1990s. As a percentage of GNP, the debt would rise from 45.2 per cent to over 63 per cent by 1990-91. Net public debt charges would increase to the point where they would account for more than three-quarters of the deficit.

The impact of rising public debt charges on projected deficits is shown in Chart 5. In this chart the budgetary deficit is divided into a "net public debt charges" component and a "primary" component. Net debt service charges are gross public debt charges less investment income received by the government. The primary component of the deficit can generally be regarded as representing the influence of cyclical factors, as well as policy decisions affecting revenues and program expenditures.

Chart 4
Real Net Debt per Family and
Real Income per Family



Source: Department of Finance

The deficit is projected to exceed $34 billion for each year until 1990-91, in spite of a declining primary deficit. The anticipated drop in the primary deficit reflects rising tax revenues, as the economy returns to more normal activity, and slower growth of program expenditures as inflation moderates.

However, the alarming fact is that the mountain of debt inherited as a result of the string of deficits over the past 10 years requires ever-increasing interest charges on the debt. And these rising debt service charges are the driving force behind the continued pattern of high deficits and rising levels of debt. This means that with each year, more and more government money must be diverted from productive uses just to pay interest charges. In 1967-68 public debt charges amounted to only about $690 million. They are now projected to rise from almost $17 billion in 1984-85 to almost $29 billion in 1990-91, this despite an assumed drop in interest rates in 1985 and 1986 and low interest rates thereafter. Obviously the situation would be considerably worse if interest rates were to remain high.

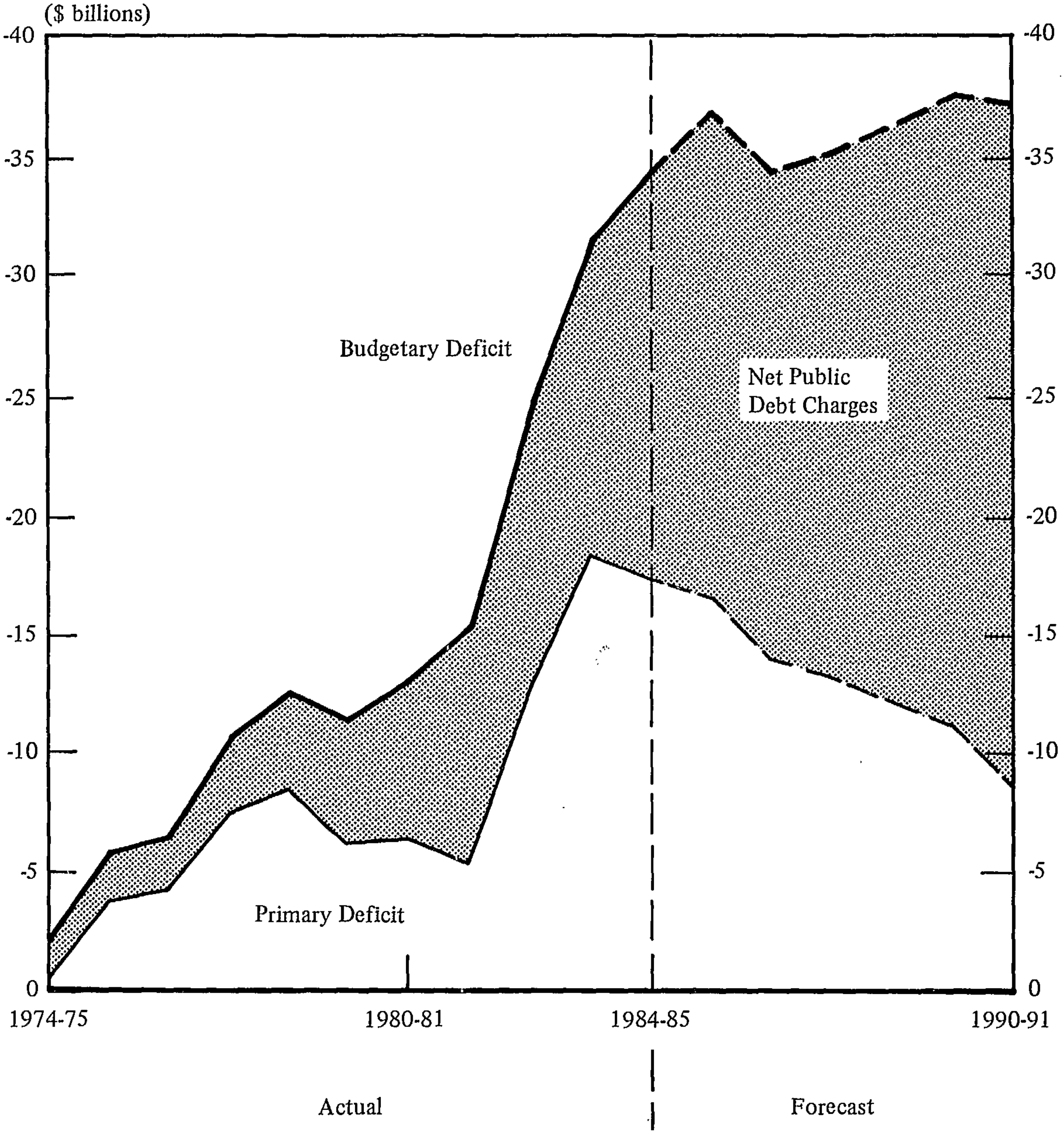
The mounting debt burden and rising debt service charges pose a serious potential threat to the long-run growth of the economy. The great danger now is that the large stock of debt has left the federal government's fiscal position extremely vulnerable to a continuation of high real interest rates. Because the real rate of interest currently exceeds the economy's real growth rate, we have reached a point where normal growth in the economy is not in itself enough to pay the rising debt service charges on the debt. Thus, the economy would have to run faster and faster just to keep even with the rising interest payments on the growing debt. It is an accelerating treadmill. The increase in public debt charges would lead to an increase in federal government debt and to an increase in the debt-to-GNP ratio. This relentless process of debt service costs and debt both growing faster than GNP would continue as long as the real interest rate exceeded the real growth rate of the economy.

There can be no guarantee that the interest rate decline which has been assumed will indeed occur. It may be that the second half of the 1980s, like the first half, will see high and volatile interest rates, and that pressures on the deficit and the size of the debt will intensify. Given this possibility, prudent economic and financial management demands government action now to stop the federal debt from growing faster than the economy. The need for such action is not a matter of ideology. It is an inescapable reality we have to deal with.

Continued high deficits and growing debt will increasingly undermine confidence, put upward pressure on interest rates and reduce prospects for growth. Moreover, they increasingly constrain the federal government's ability to discharge its responsibilities for overall economic management and effective economic leadership.

The continuation of this pattern of large federal deficits and debt accumulation would depress Canada's growth prospects in several ways. First, although the levels of Canadian interest rates are heavily influenced by U.S. interest rates, they are also affected by domestic developments. The persistence of large federal government borrowing requirements would almost certainly put upward pressure

Chart 5
The Primary Deficit and Net Public Debt Charges



Source: Department of Finance

on the effective yields of Canadian government securities and on a wide range of competing financial instruments. In addition, any widespread expectation within financial markets that the federal government might resort to "printing money" as a means of financing its deficits, would intensify this upward pressure on interest rates. As a result, some planned business investments would be shelved because financing would have become too expensive. As business investment is crowded out, the growth prospects for the economy are reduced.

Second, steadily mounting debt and debt service charges arising from continued large deficits, will result in increasing amounts of real income being transferred to the holders of government debt. These transfers will be larger the greater the increase in real interest rates required to induce investors to hold additional government debt. The income distribution will then increasingly be shifted in favour of holders of government debt, and against risk capital and labour. This process will punish work effort and risk-taking, and tend to reduce the volume of real capital formation.

Finally, it is increasingly evident that the federal government's deficits are eroding the confidence of investors, both foreign and domestic. The persistence of deficits is indicative of the previous government's inability to manage its financial affairs with prudence. If the projected pattern of deficits were allowed to materialize, confidence would be further depressed, producing adverse effects on investment, growth and jobs.

B. Obstacles to Growth in the Private Sector

It is important, both to attain our economic and social objectives and to assist in repairing our public finances, to achieve the highest sustained growth possible. Growth cannot itself resolve the structural imbalance between government expenditures and revenues. Indeed expenditures now exceed revenues by such a considerable amount that revenue would have to grow by two percentage points a year faster than expenditures simply to keep the deficit constant. Difficult policy decisions will obviously be required to restore fiscal flexibility. But at the same time, faster growth is critical to provide the flexibility to deal with the deficit problem in a measured, conscientious and fair manner.

We must, therefore, pursue all means at our disposal to promote balanced and sustainable economic growth. The growing public debt is by no means the only obstacle to growth in the private sector arising from public policy decisions. Many – perhaps most – government policies and programs have impacts, both intended and unintended, on private decisions and market outcomes. In general, these policies were originally intended to help achieve some specific national goal. All too frequently, this has required trade-offs in the form of reduced economic efficiency and competitiveness.

In many cases, the trade-offs have become far harsher than originally anticipated due to intensifying pressures arising in world markets. Essentially, many of these arrangements were made when governments were more able to insulate domestic sectors and regions from international competitive realities.

The resulting encumbrances on Canadian economic performance are widespread. In some sectors, government regulations are inhibiting needed adjustment to new competitive realities in the world marketplace. In other sectors, government subsidies have distorted market signals in a manner that encourages production for which there is no demand and discourages production that could be sold in Canada or abroad. In yet others, government services and activities, either directly or through Crown corporations, are needlessly supplanting private entrepreneurship.

Like the relentless progression of deficits, the intricate web of regulations, subsidies and other forms of intervention which has been built up over the years creates a major obstacle to growth – more diffuse, less easy to measure and quantify, but every bit as real. As the next chapter will explore more fully, these obstacles cut across the whole fabric of our national economic life.

IV A Strategy for Economic Renewal

Introduction

Building a lasting foundation for economic renewal will be a major challenge. All Canadians will be affected. Accordingly, their views on what should be done will be actively sought and listened to. This chapter sets out an agenda which will form the basis of this consultation. There are two parts to the chapter: promoting private sector growth, and restoring fiscal flexibility.

The agenda makes no claim to be exhaustive. The Ministerial Task Force on Program Review, led by the Deputy Prime Minister, is seeking ways to improve the delivery of government programs and eliminate duplication, and will initiate consultations in that connection. This will be an essential complement to the program for change envisaged in this chapter.

Moreover, many Canadians will undoubtedly identify other initiatives. The points of view expressed in the agenda make no pretense to be definitive – rather, they provide a framework for discussion among Canadians about our economic future.

A. Promoting Growth in the Private Sector

Promoting growth in the private sector is a fundamental requirement if we are to secure our objective of sustained growth and productive jobs. Decisive action to bring the public debt under control will make a major contribution to creating the necessary environment for private sector growth.

And yet, the deficit – serious as it is – is not the only difficulty. Deep-rooted problems in many federal policies and programs must be addressed if we are to achieve economic renewal.

Government has become too big. It intrudes too much into the marketplace and inhibits or distorts the entrepreneurial process. Some industries are over-regulated. Others are over-protected, not just from imports but also from domestic competition. Some programs designed to facilitate investment have the perverse effect of distorting investment decisions. Other programs carry on long after the need for them has passed, and are only a fiscal drain. In many cases, the federal government has not done the job it should have, in support of private sector initiatives. In part its resources have been misdirected, adding to a deficit that constrains the government's flexibility. Thus, while some expenditure reductions have already been made, there are still many areas where government is obstructing growth, rather than promoting it.

This is a discouraging litany. Yet, at the same time, it is an opportunity – it offers Canadians a place to start to move away from a *status quo* that clearly is unacceptable. The goals are to reduce the deficit further, to remove other obstacles to private sector growth, and to foster positive growth in investment, R&D and exports, with a particular focus on small- and medium-sized business.

The following section reviews a broad spectrum of policy areas, identifying possible obstacles and corresponding opportunities for fostering private sector growth through appropriate changes.

The scope of the review which follows is wide. It includes the four pillars of private sector growth:

- R&D, Innovation and Technology Diffusion;
- Export Markets and Financing;
- Private Sector Investment; and
- Labour Markets and Human Resources.

It also examines the broad issues of economic strength and adjustment, at the national, regional, and individual levels:

- Adapting to Economic and Technological Change; and
- Growth and Competitiveness: The Regional Dimension.

It discusses, as well, the economic rules now in place, including government's direct role in the economy:

- Economic Regulation and Intervention.

Finally, it looks closely at a sector which is a case study of over-regulation and the potential for renewal:

- Energy Policy.

The dimensions of the challenge call for a nation-wide action program. We want to work closely with provincial governments. We see considerable harmony between our views and those of the premiers, as evidenced in the communiqué of their most recent conference. Some possibilities for co-operative action with the provinces are discussed in one of the sections that follows.

In a number of areas, this review can only touch upon complex issues that require a great deal of elaboration. In these cases, discussion papers will be released over the next few months to provide further indication of the directions suggested in this chapter and their implications for particular sectors.

1. R&D, Innovation and Technology Diffusion

The Challenge

As much as two-thirds of recent economic growth has been attributed to technological change and there is every reason to believe that its influence will grow.

If we are to be competitive, we must become effective in applying leading-edge technologies in producing goods and services. Economic success will stem not only from *producing* technology, but from *using* new technology in established industries, such as car-making, steel production, agriculture, mining and the forest industries.

About 90 per cent of technology used in Canada is imported. Technology adoption, diffusion and the continued free flow of technology across international borders are, therefore, crucial for Canadian industry. Nonetheless, domestically-performed R&D remains important in gaining and maintaining competitiveness in growth industries and in ensuring the speedy adoption of imported know-how.

Both the public and the private sector have important roles to play in increasing Canada's technological strength. The private sector's contribution in Canada compared to that in other nations is shown in Chart 6. While R&D activity in Canadian industry has increased in recent years, our commitment to innovation still trails that of our trading partners. We must do better. Government must play its part, by creating the climate and fostering the entrepreneurial spirit needed to realize increased innovation and to ensure its widespread application.

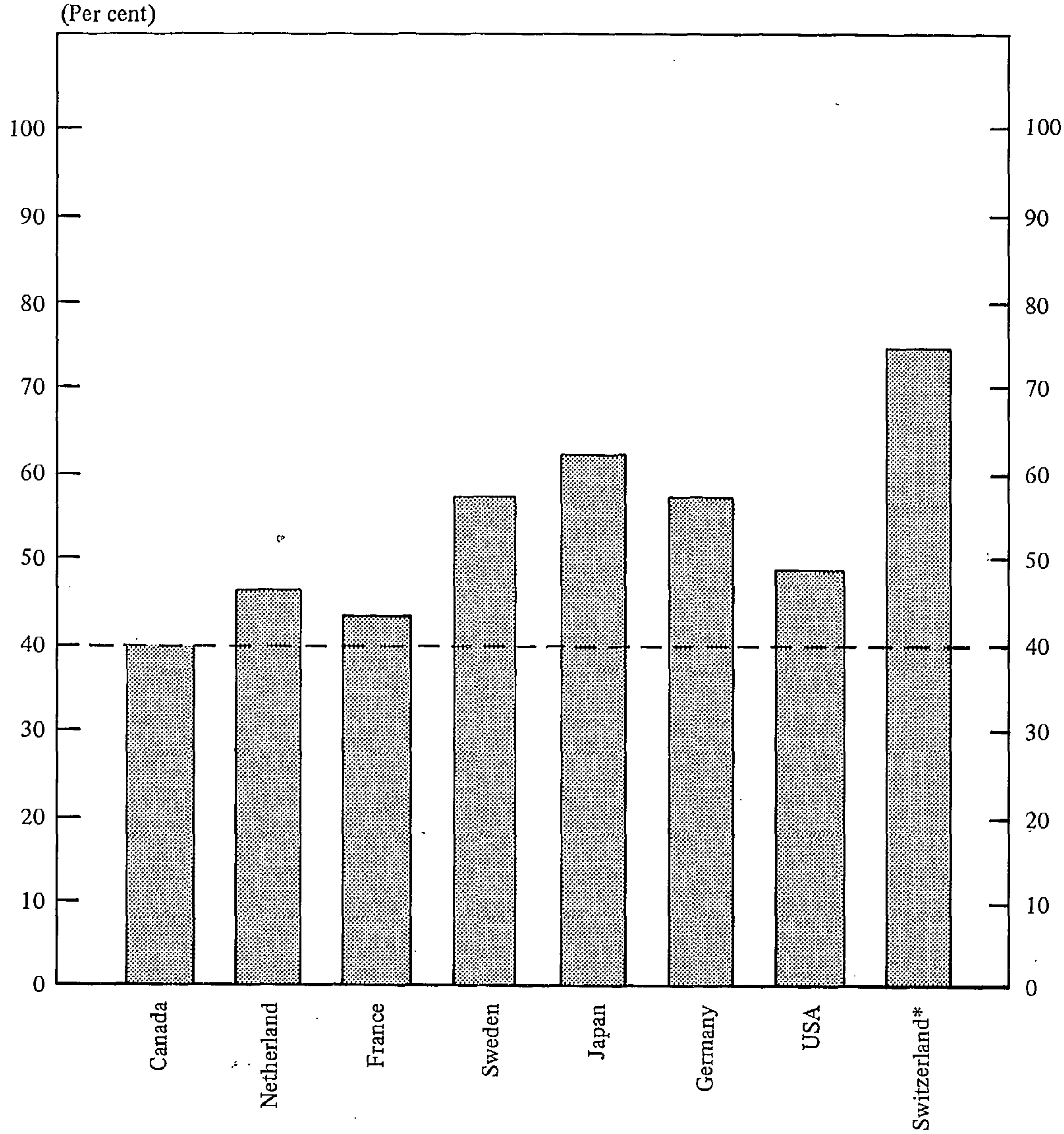
Federal financial commitments to R&D are extensive: some $2.6 billion this year. Apart from tax incentives, within the federal government alone there are 37 programs concerned with technology innovation and diffusion, and provincial governments provide significant additional assistance.

Directions for Change

Recent major studies by the Senate, the Science and Economic Councils and the Wright Task Force have recommended changes in the federal government's approach to encouraging technological advance. Such change must increase the market relevance of the federal contribution to technology funding. Only if new ideas can withstand the test of the international market will Canadians gain the maximum benefit from their technological skills.

We must establish the appropriate climate for increasing industrial R&D commitments by rationalizing the present tax and grant support system. We must examine the array of programs which has accumulated over the years without a comprehensive strategy. Canada already has some of the most generous incentives supporting R&D in the western world, yet our industrial R&D is forecast to

Chart 6
Proportion of Private Funding of R&D for Selected OECD Countries 1981



* Data for 1979

Source: O.E.C.D., *Science Resources Newsletter* No. 8, 1984 decline in real terms this year. Given our commitment to expenditure restraint, we must seek better use of existing industrial incentives as well as non-fiscal measures to improve the effectiveness and market relevance of Canadian R&D efforts. Simply spending more dollars may not be the answer; indeed, it could be counterproductive if poorly focussed.

Industry has strongly criticized the complexity and delays involved in federal direct grant programs supporting industrial R&D, preferring tax-based support. Discussions with the business community about mechanisms for delivering federal R&D support and the possible rationalization of current approaches will be intensified. Consultations are underway on the effectiveness of R&D tax incentives in the context of the Scientific Research Tax Credit moratorium. The issue of broadening the definition of R&D for tax purposes also must be urgently addressed.

There is little point in accelerating the development of new techniques in Canada and promoting the timely importation of foreign technologies if they do not quickly spread throughout the economy. Small business in particular often has difficulty remaining abreast of technological developments at home and abroad. Keeping public sector research activities in tune with small firm needs, and the broader issue of rapid technology diffusion in the small business sector, are important subjects for discussion. We must examine the role of government-financed technology centres, and the possibility of industry-wide private/public sector research efforts.

Large firms can also increase their technological and world-market orientation. Traditionally, the domestic market has served Canadian industry well, but the emerging world trade environment of declining tariff barriers and new competitors increases the challenge. One response has been to adopt a fuller range of corporate functions in Canada through world product mandates, both increasing new industrial R&D spending and leading to the quicker adoption of foreign know-how. The question that remains is: how can government foster adoption of these new approaches which are bound to increase all aspects of Canadian technological competence?

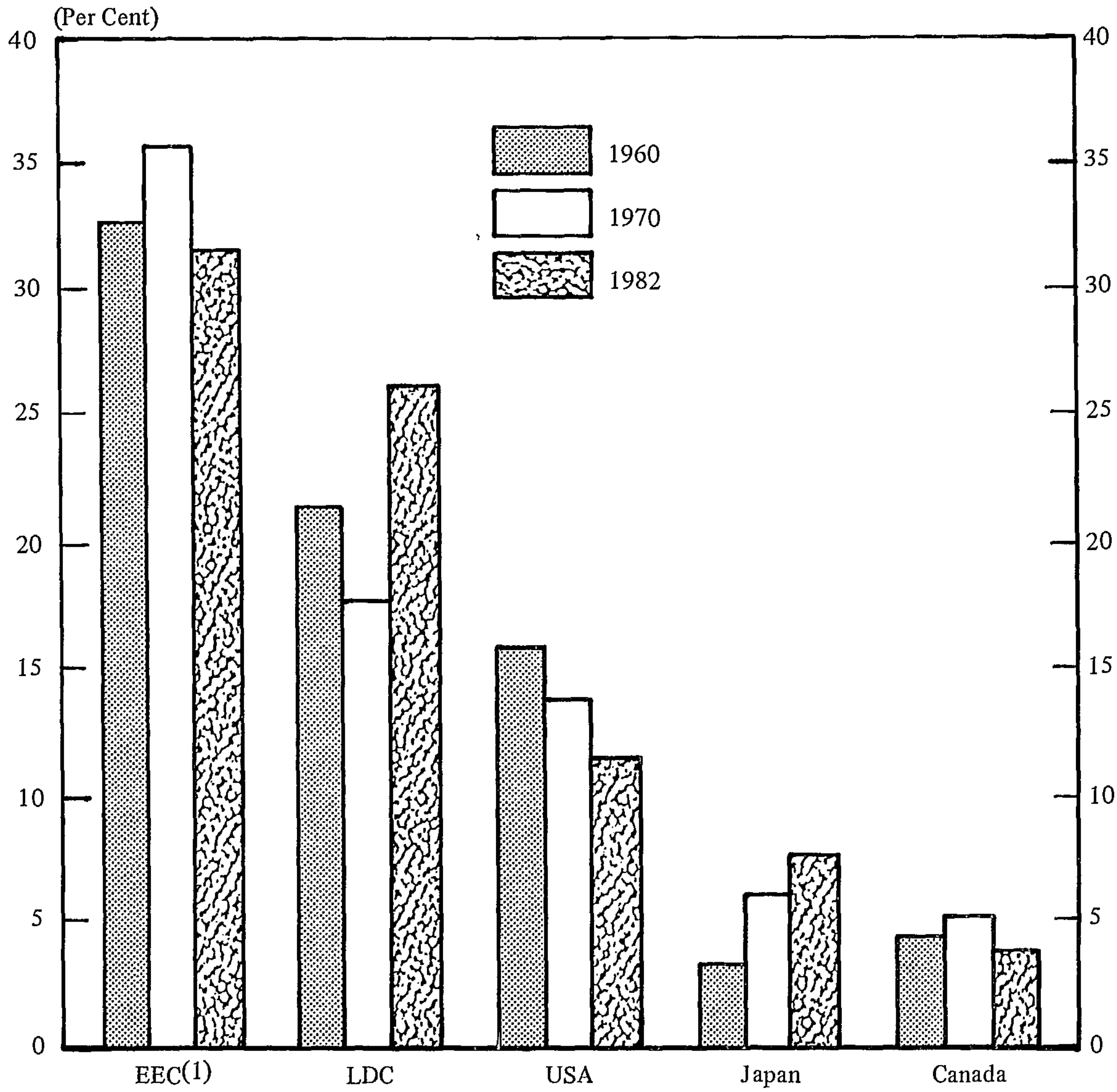
2. Export Markets and Financing

The Challenge

Trade is Canada's life-blood. Exports account for almost one-third of our national income. Some two million Canadians work in industries that directly or indirectly depend on exports.

It is a sobering thought that, while in 1968 Canada exported more than the Japanese, today Japan's share of world trade is twice ours. We have fallen from fourth to eighth place in the world.

Chart 7
Comparative Share of World Trade
(Based on Exports F.O.B.)



(1) Calculated on the basis of the EC of 10; note that this includes intratrade, which has averaged 50-52% of the total in recent years.

Source: U.N. Statistical Office.

Restoring Canada's stature as a first class world trader is fundamental for economic renewal. Developing an effective action plan for fostering private sector growth, with a special focus on export growth, requires a hard look at all federal programs and policies.

Effective Trade Promotion

The challenge is to determine how best to assist industry – particularly small- and medium-sized firms – to gain and secure access to markets.

Many Canadian firms can compete successfully. They can respond quickly to changing demand. It is also true, however, that many firms, especially smaller companies, often lack good information on export opportunities, conditions in foreign markets and the requirements for selling abroad. Because informed management is often their scarcest resource, the complex and time-consuming process of assessing information is crucial to their trade performance.

The range of export promotion services provided by the federal government is extensive. These include advice to business by industry specialists within government, computerized systems providing information on export market opportunities, sponsorship of trade fairs and missions, and direct financial support for companies seeking export markets. In addition, provincial governments have become increasingly active in support of development of new markets. In today's competitive world, we must examine whether the quantity and the composition of the government export support system are consistent with the dimensions of the challenge.

Directions for Change

Answers to the following questions will help the government make its export assistance more relevant to the needs of business, particularly small- and medium-sized businesses.

Can dissemination of information about export assistance programs, as well as access to such information, be improved?

Are there ways in which trade commissioners can be made even more business-oriented and goal-sensitive in markets where they are serving? Should their role be extended to seek out new technologies and encourage prospective investors to come to Canada?

Is the distribution of trade development services abroad biased in favour of historical trade patterns (e.g. Europe) at the expense of markets that may have stronger prospects (e.g. Pacific Rim countries)?

Is the sectoral/product expertise in government unduly weighted in favour of traditional sectors, competing in a low-growth market, rather than high-growth sectors such as services and innovative products?

Should there be a more active role for the private sector, including industry associations and Chambers of Commerce, in penetrating foreign markets?

To what extent has more decentralized delivery of export assistance programs made them more accessible, especially for small businesses? Is further decentralization warranted? Is the current government infrastructure successful in making market opportunities known to Canadian companies?

Do federal and provincial export promotion efforts overlap? Can co-ordination be improved?

Export Financing

Canada is not alone in seeking to expand its share of world markets. Many countries are aggressive marketers, and their firms make full use of export financing mechanisms. The challenge for Canada is to ensure that our exporters continue to have available competitive insurance, guarantee and financing facilities, with due regard to the associated economic and financial costs. Also at issue is whether or not the government should make room for the private sector to provide competitive export financing services.

The Export Development Corporation and the Canadian Wheat Board are the main government instruments used to finance exports. Over the years, however, governments have established Crown corporations and given them an export-facilitation role for selected sectors, particularly in agriculture and fisheries. These have not always been effective. The government has decided to wind down Canagrex and scale back the operations of the Canadian Commercial Corporation. It is timely to consider the ongoing role and mandate of Canada's export financing organizations.

Export Development Corporation (EDC)

The EDC's normal terms for export financing are in line with international understandings on minimum interest rates and maximum maturities for export financing. Its exposure fees appear to be in line with guarantee fees and insurance premiums charged by the competition. In addition, the EDC may offer mixed credit financing to exporters to match foreign concessional financing offers.

Concern has been expressed that small business is not using EDC financing extensively. There is a question whether private Canadian financial institutions could play a larger role in medium and long-term export financing. There are questions also about whether the EDC's creditworthiness requirements are too severe. These various concerns need to be discussed.

Canadian Wheat Board

About 12 per cent of total wheat sales last year were on credit terms, most on the maximum repayment terms of three years. Credit grain sales by the Board involve the government assuming significant contingent liabilities – at present about $3.0 billion.

In recent years some of Canada's grain customers have suffered a serious deterioration in their economic and financial situation, leading to an increased risk of non-payment or serious delays in payment for grain sold on credit. Six of the ten countries which have purchased grain on credit from the Wheat Board have already rescheduled portions of their debt, affecting more than 75 per cent of the Board's 1984 receivables. Credit extended originally for three years is now often being repaid over eight to 10 years.

One important issue, then, is how we should balance the desirability of more aggressive export promotion against the dangers of over-extending in high-risk markets.

Canadian Commercial Corporation (CCC)

The CCC is a Crown corporation whose main activity historically has involved defence products sold to the United States under the Canada/U.S. defence production-sharing agreement. In 1976, the CCC took on the new role of prime contractor in capital projects, and reorganized into a corporate form with a full-time president and corporate head office. In its new role, the CCC has had little success to date.

Other Crown corporations which have an export-facilitation role include the Canadian Dairy Commission, the Canadian Salt Fish Corporation, and the Canadian Freshwater Fish Corporation.

Directions for Change

Can the existing export financing system be made more effective and more competitive in matching the facilities available in other countries? Should government create more room for Canadian banks, trading companies and other private sector interests to provide export financing and facilitation services? Are there gaps in the product or service coverage of the export financing institutions, particularly from the perspective of small and medium-sized firms?

Can **Export Development Corporation** procedures be streamlined, to be more responsive to private sector needs? Can Canadian private financial institutions perform some of the services now offered by the EDC, and would this increase Canadian exports? Can the EDC improve the marketing of its services to better meet the needs of smaller companies?

Given the financial risks now assumed by the **Canadian Wheat Board** as a result of the recent economic and financial difficulties faced by its major customers, should changes be introduced to safeguard the integrity of the credit grain sales program by, for example, charging a fee for government guarantees?

Will a reduction of the mandate of the **Canadian Commercial Corporation** to that required under the Canada-U.S. defence production-sharing agreement spur the development of private sector trading companies?

Is it clear that a need exists for **other specialized services** promoting the export of selected agricultural and fish products? Could this role be assumed by the private sector or by other established government programs?

Should there be a greater linkage between **trade and aid**? Some 10 per cent of Canada's current exports are to the developing world. Our exporters are being placed at a disadvantage through the increasing use by other exporting countries of aid funds to subsidize export financing. Canada has worked to reach international agreements which would bring such practices under greater discipline. But problems remain and, until they are resolved, Canadian exporters must be backed by competitive financing.

Can Canada's aid budget, while maintaining its goals of promoting economic development in third world nations, play a more effective role in promoting Canadian exports in developing countries? Should a portion of aid resources be used to support the export of goods and services, on concessional terms, of competitive Canadian firms involved in developmentally-sound projects in the third world? If such an aid/trade mechanism were implemented, what should be the future role of EDC's existing mixed credit program?

Increased and Secured Access to Markets

The Challenge

Canada is the only major industrial country without unimpeded access to a market large enough to permit substantial economies of scale. If we are to foster growth through trade, we must obtain more secure and improved access to foreign markets on the broadest possible basis. This would require, of course, that Canada would also have to move to increase access to its domestic market.

There is an emerging international consensus, led by the United States, in favour of a new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT). These negotiations will provide an opportunity to reduce barriers to trade, to tighten discipline on the use of non-tariff measures, to facilitate the adjustment of industries which are internationally threatened, and to secure increased commitments to multilateral trading obligations from newly industrialized and developing countries.

There are also opportunities to pursue trade liberalization on a bilateral basis with the United States which, as Chart 8 shows, is an increasingly dominant market for Canada's exports. There are, and will remain, differences between the Canadian and United States' economies. But the benefits of proximity to that marketplace are enormous. The question is how best to capitalize on this advantage, while managing the adjustment that freer trade would entail. Although, by 1987, approximately 80 per cent of Canadian exports to the U.S. will be duty-free, there remain significant tariff barriers and an array of non-tariff measures which substantially impede bilateral trade. Examples are the Buy America provisions of the federal and state governments which significantly impede our access, and special sectoral "safeguard" protective measures. The United States can point to several analogous provisions in Canada. Canada and the U.S. have been considering whether there are sectors where new bilateral arrangements could be negotiated. This initiative has generated public interest in exploring broadly-based bilateral arrangements with the U.S.

Directions for Change

The government will examine, as a matter of priority, and in close consultation with the provinces and the private sector, all avenues to secure and enhance market access. This will include a careful analysis of options for bilateral trade liberalization with the United States in the light of various private sector proposals, as well as preparations for and opportunities provided by multilateral trade negotiations.

This examination will address a number of questions, including:

What are the advantages and adjustment implications of the reduction of tariff and non-tariff barriers to trade for the Canadian economy generally and for specific sectors, firms and employment?

What would be the effects on investment and access to technology for Canada in a more open trading environment?

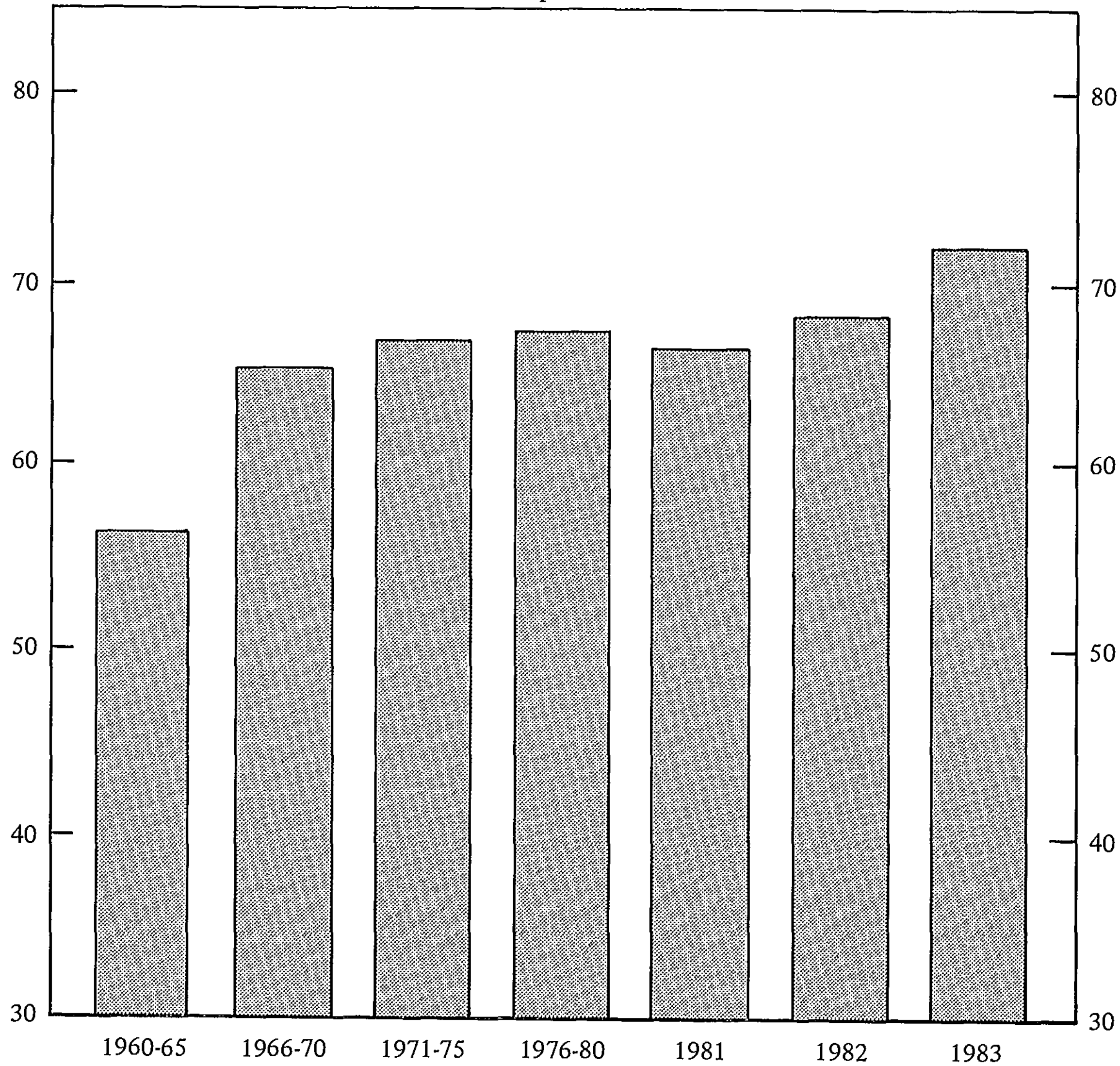
What constraints would freer trade place on Canada's domestic economic policies with regard to, for example, regional and industrial development programs?

Are there new institutional approaches which might assist in the management of the Canada-U.S. trade and economic relationship?

Are there complementary or alternative approaches to sectoral trade liberalization which should be considered? For example, should we focus on liberalization of particular functions, such as government procurement?

How would Canadian firms and regions adjust to the changed trade flows in a Canada/U.S. free trade arrangement? Are there special considerations relating to certain sectors and to small and medium-sized firms? What transitional measures would be necessary?

Chart 8
Canadian Merchandise Exports to the U.S.
as a Percentage of Total Merchandise Exports



Source: Statistics Canada

3. Private Sector Investment

The Challenge

In Canada, real investment has recovered much more slowly than in the U.S. Investment in Canada, as shown in Chart 9, peaked in the 1980-81 period, but suffered a steep decline through the recession, with little recovery through mid-1984. By contrast, U.S. investment was weaker than Canada's in 1980 and 1981 but increased sharply in 1983, and has remained strong since.

To compete, Canadian industry must invest. It must maintain existing plant and equipment in good operating form; it must adopt new, state-of-the-art technology; it must expand capacity to meet new markets; and it must enter new, high-growth lines of business. Job opportunity and income growth for Canadians depend on a healthy level of business investment. Yet investment is faltering, at a time when the level of domestic savings is high. The past few years have witnessed large scale capital investment by Canadians in the United States; we cannot take for granted our attractiveness as a place to invest. Restoring investment growth, particularly among small and medium-sized business, is a critical component of the overall strategy for economic renewal.

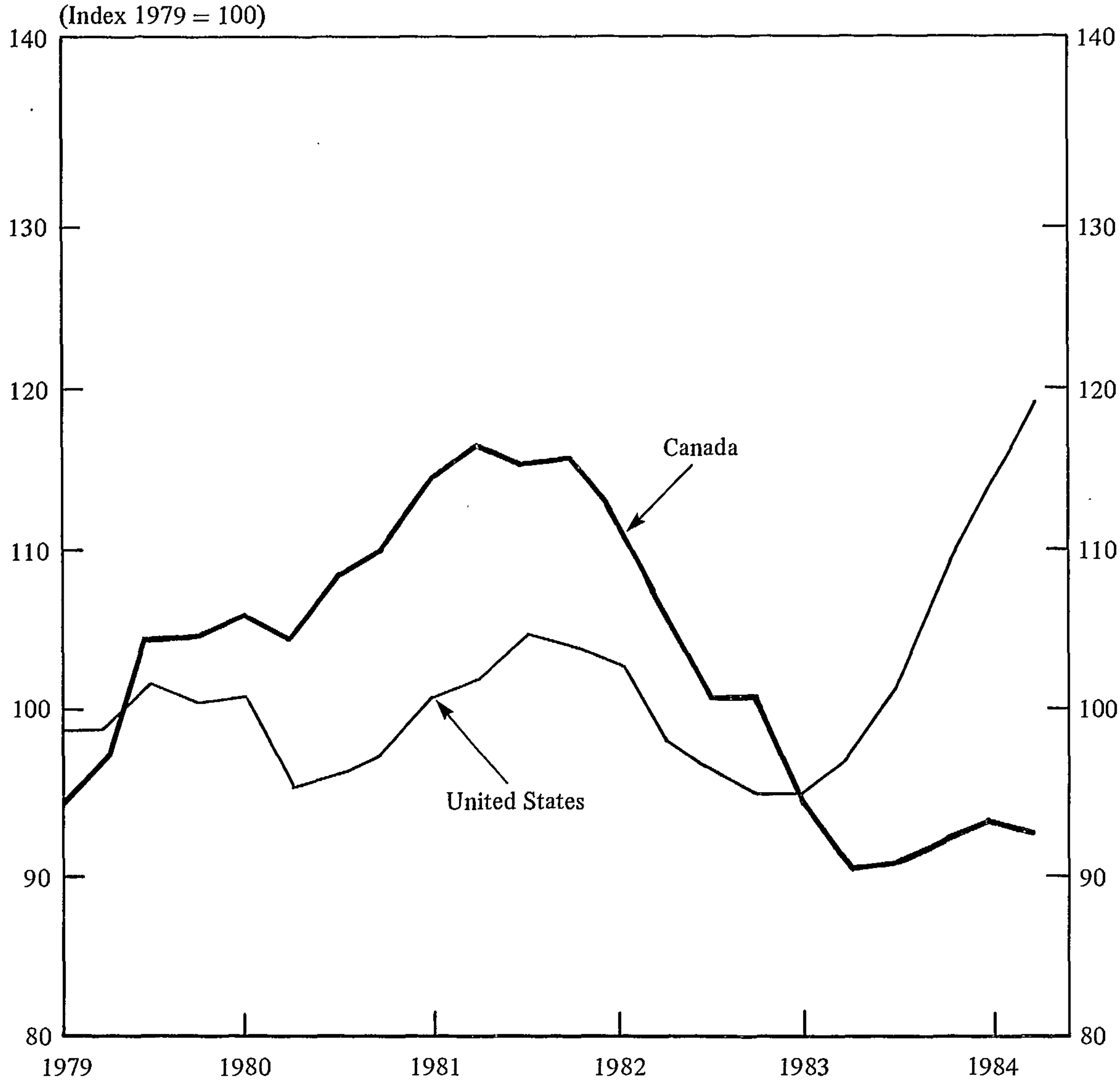
There are numerous causes of Canada's slow investment recovery. Some are a function of weak domestic demand. Others emanate from the world marketplace. For example, Canadian industry still has significant excess capacity. Demand has not yet recovered for some commodities, and competition from developing countries in Canada's traditional resource exports and in semi-manufactured products limits opportunities for profitable investment in some sectors.

It has been suggested that our relatively slow investment recovery is the result of Canadian companies, particularly Canadian-controlled firms, having a weaker equity base than their American counterparts. This situation, which existed throughout the 1970s, contributed to the high number of business failures in Canada during the recession. As a result, many companies are now giving priority to cash flow and external equity to reduce their level of bank loans; a net reduction of some $7.6 billion was achieved in 1983 alone.

Lack of business confidence is one of the most significant obstacles to investment and growth in Canada. Frequent and arbitrary shifts in the direction of government policy and concern about the federal deficit are frequently cited as causes of weak confidence. This, in turn, is reflected in the high threshold rates of return which company executives are seeking in investment proposals. Improved confidence will be reflected in a lowering of these thresholds and, therefore, increased investment.

As the provincial premiers stated at their annual conference, "economic adjustments will have to be made if investor confidence is to be rebuilt and Canada's competitiveness restored." The government must create a more positive

Chart 9
Real Business Investment
Canada/USA



Note: Investment for both countries is set at a level of 100 in 1979 to be able to compare their progress since then. Actual Real Investment in 1979 was $170 billion for the U.S. and $20 billion for Canada.

Source: Based on National Accounts Data; total for all corporations for both Canada and the U.S.

and stable environment, as a prime ingredient in spurring growth. It must consider issues such as the financial health of the private sector companies, to see whether the condition of their balance sheets is inhibiting economic growth.

Government should also examine carefully its policies and programs, to see whether they cause companies to take decisions which, when evaluated from a purely business-oriented perspective, would be rejected. Moreover, it should be recognized that the benefits from less government intervention of this kind include reduced expenditures and a lower deficit.

Indeed, the most important act of the federal government in this area will be to implement a plan for reducing the deficit. This is important not only because of the impact of government deficits on real interest rates, a key factor in investment decisions, but also because the deficit is a symptom of a deeper problem of economic management. Resolute action, now, would do much to restore business confidence, with a consequent boost to the economy.

The government can also foster a more co-operative relationship with other levels of government to ensure a concerted stimulus to economic renewal, and with foreign governments whose role in Canada's economic prospects will be crucial.

Finally, the government can ensure that its policies affecting the financial sector, its incentives, and its stance towards foreign investment reflect the national desire for growth.

These areas for action are discussed below. The government will ensure that thorough consultations precede any major changes in policies affecting the business climate.

Directions for Change

Regulation of Financial Institutions

Regulatory change in the financial services sector has become a prominent issue. In financial capitals around the world, new technology and increased competition have led to a proliferation of innovative financial products and the development of more varied roles for traditional institutions. In their efforts to stay competitive in international markets, various sectors of the financial industry have entered into activities which have had the effect of blurring the distinctions among them.

Many of these changes have both benefitted the Canadian public and increased the efficiency of the Canadian capital market by providing more sensitivity and flexibility. However, the current regulatory framework has not come to grips with the evolving needs of the financial community or the public. The government intends to respond by working with the provinces, the public and the financial community to ensure that legislation reflects the reality of a rapidly changing financial sector. Among the objectives must be the efficient delivery of financial services, while maintaining adequate protection for investors and savers, and intergovernmental harmonization of the regulatory framework. An additional priority will be an examination of the current system of deposit insurance to ensure that it more adequately responds to the needs of the financial community and the public.

Regulations restricting the investment behaviour of pension funds have become a special focus of attention. Over the past decade, increasing amounts of funds have been diverted to pension funds until, at the end of 1982, their total assets reached $173 billion, of which $81 billion were in trusteed plans. This process is expected to continue.

The current restrictions on the investment of trusteed pension funds may be preventing these funds from attaining the best possible return, at prudent levels of risk. They may also be inhibiting pension fund investment in Canadian business in general, and the small business sector in particular. But problems may not lie entirely in the regulatory framework. It is important to examine whether growth opportunities for small business are being constrained because of attitudinal or structural rigidities affecting pension fund investments.

The prospects for economic renewal would be enhanced by greater competition among the financial institutions and, in general, less regulatory interference in the flow of capital. Consultations with the financial community, the provinces, and the business sector in general should focus on how the traditional thinking about financial institutions and their regulation should be altered to help improve the economy. A major question to be addressed is: how far should financial regulation move from the present approach, which emphasizes specialization in services by different types of financial institutions, toward more of a "supermarket" approach in which each institution could offer as broad a range of services as it felt was commercially justified?

Another key question involves the kind of regulation which should be imposed on the activities of financial institutions, and in particular on their ability to invest directly in Canadian businesses. For example, do the restrictions on pension funds and life insurance companies, governing which firms and which type of securities they may invest in, appropriately balance the current financial needs of the economy, and the need to protect savers?

Investment and Government Financial Support

There are now more than 20 federal expenditure programs that provide financial assistance in one form or another to business. These programs range from broad, general support for expansion, modernization, and market development, to specific sector-oriented grants such as those under the Canadian Industrial Renewal Board. Of the more general programs, the largest is the industrial and regional development program (IRDP) administered by the Department of Regional Industrial Expansion.

Are these programs, individually and in the aggregate, the best way to spur the private sector investment Canada needs? Some grant programs have been criticized by business for slowness, red tape, unfairness, and excessive bureaucratic discretion. Moreover, from the perspective of fostering growth in the private sector, do they really encourage the efficient allocation of Canada's scarce resources?

The general tax system, too, incorporates many features which support investment and business growth. These include the investment tax credit and the accelerated capital cost allowance, as well as the lower corporate tax rates for manufacturing and processing and small business. According to the latest available data (1980), the effect of the tax incentives has been to reduce the average federal corporate income tax rate from 36 per cent of financial statement profits to 15 per cent. Tax changes since 1980 have ensured that this situation continues today. The rates for small businesses are even lower.

The government will seek views on whether direct financial support to business is still warranted and, if so, at what level and in what form. Are the current programs too narrowly focused? Do they arbitrarily exclude activities that could contribute to growth? Could the government reduce its financial requirements by reducing some direct grants, as has been suggested recently by some business organizations? While governments need to establish a positive and stable climate for investment, surely government programs and tax provisions should not override the economic basis for business decisions. Should governments instead emphasize service-oriented support, wherein resources are directed toward such programs as the provision of information to assist business decision-making?

Another issue is the extent to which the tax system can be used in place of investment incentive grants. Tax incentives and direct government programs have very different structures, administration, and effects on industry, and consequently there are real differences in the types of benefits that can be delivered by each mechanism. Grant programs tend to target relatively large subsidies (in terms of percentage of total costs) to projects after review on a case-by-case basis. The tax system is a good mechanism to deliver broad-based reductions in rates, or broad-based tax credits.

The tax system is demand-driven, with all qualifying activities benefitting from its provisions. It is, thus, difficult to subject tax incentives to pre-specified cost limits, as can be applied to grant programs. Because the tax system is based on self-assessment, the law and regulations must define as completely as possible who and what qualifies for particular measures.

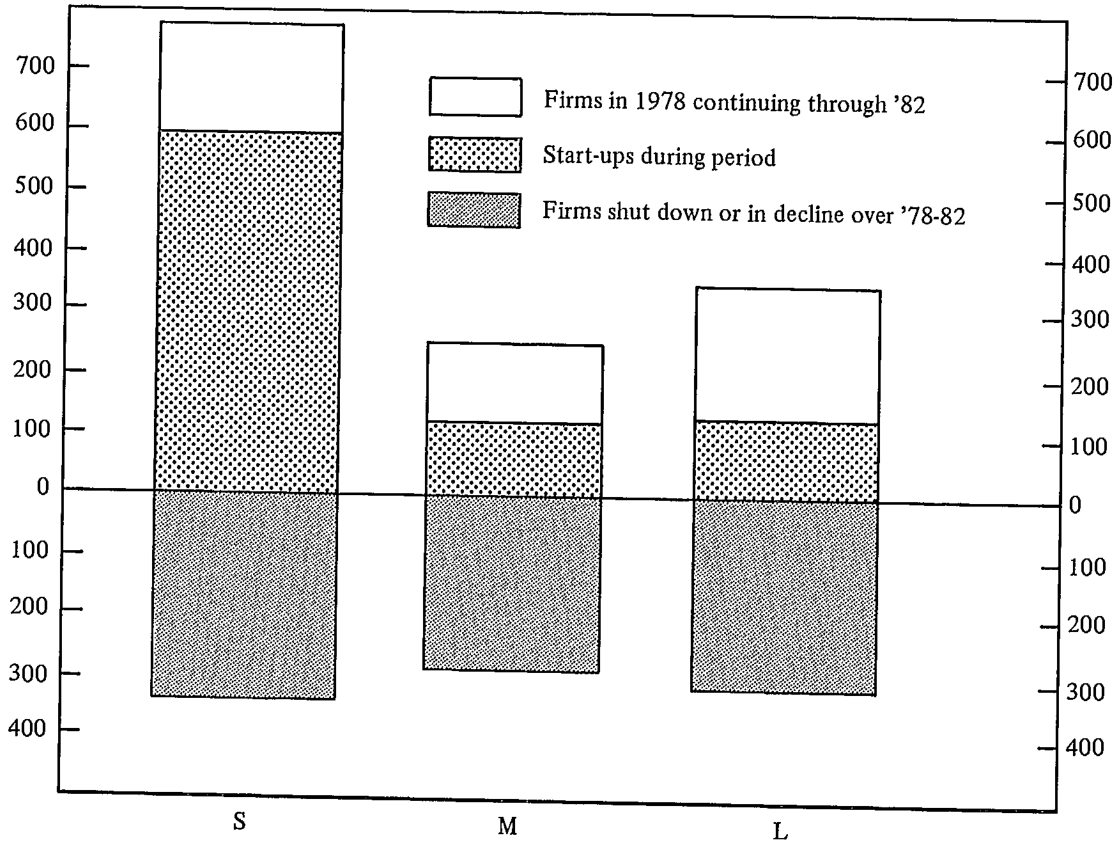
We must discuss the scope for substituting tax incentives for direct government programs, given the basic differences between the mechanisms. In doing so, we must bear in mind that using the tax system to deliver more incentives would increase its complexity.

In the past, tax incentives have normally been available only to firms in a taxable position. Grants, on the other hand, can be used by all firms regardless of their tax status. Recent tax changes have, in certain cases, allowed firms in a non-taxable position to obtain more immediate use of tax benefits.

Chart 10
Change in Private Sector Full Year Employment (FYE)
By Firm Size at Start of Period
1978 – 1982

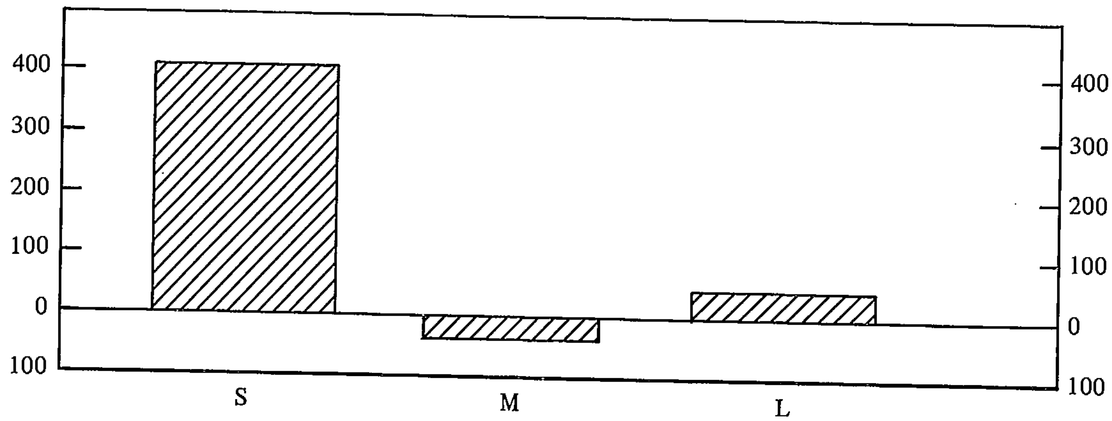
Gross Employment Change

(Thousands)
FYE



Net Employment Change

(Thousands)
FYE



S = Small firms, less than 20 employees
M = 20 to 100 employees
L = More than 100 employees

Source: Statistics Canada

Increasing the ability to transfer tax deductions and credits within corporate groups deserves serious consideration and could reduce the complexity of business operations. Transfers from companies to outside investors pose difficult questions. They have the potential to be either a means for firms to obtain needed financing to ensure that investment projects go ahead, or they can be simply a sale of tax credits or deductions that is costly to the treasury and which undermines the integrity of the tax system. These considerations prompted the moratorium on "quick flips" under the Scientific Research Tax Credit and the decision to cease advance rulings on limited partnerships and joint-venture financing. The whole area warrants a thorough review.

As for the total level of incentives, governments must consider the degree to which tax incentives and grants overlap, resulting in unduly generous government support. Should not tax and grant policies be reviewed to ensure that the combined level of incentives is not so high that it negates market signals? If so, could a reduction in the level of certain incentives contribute not only to enhancing the efficient allocation of resources but also to reducing the federal deficit?

Tax Simplification

The tax system is overly complex. It imposes on taxpayers and their advisors an unnecessary cost in time and money just to understand and comply with the law. And the more complicated the tax system is, the less effective will be the investment incentives contained in it.

A start has already been made. The small business tax simplification package that will be tabled in Parliament illustrates how complexity can be reduced. Yet more simplification is possible, and this will be a high priority for this government. The Department of Finance is identifying areas of possible simplification, and will be consulting with the private sector.

Improved tax administration is also important to remove barriers to business operations and to ensure fairness in the tax system. The Minister of National Revenue is implementing many of the changes identified in the report of the Progressive Conservative Task Force on Revenue Canada. Other proposals in that report requiring changes in tax law are under active study with a view to early decisions. The items being reviewed include the powers of search and seizure, and the establishment of a small claims tax tribunal. The Economic Statement announces the government's intention to legislate, as soon as possible, to allow taxpayers to postpone paying taxes that are the subject of an objection or appeal.

The Environment for Foreign Investment

Robust, sustained growth depends on investment. Much of this investment must come from foreign sources – both as new investment from abroad, and reinvestment by foreign-owned companies resident in Canada. Canada is fundamentally attractive to foreign investors. However, in recent years its image abroad, and its capacity to compete for foreign investment, has been tarnished.

Canada must adopt a more positive stance toward foreign investment if we want to attract the capital to create job opportunities, attract new technology and introduce new production processes and management systems, all of which will make our industries more competitive.

Real opportunity exists in this area to remove obstacles to private sector growth and foster increased investment. The government intends to make changes in the National Energy Program to respond to the concerns from both foreign and domestic investors about provisions of Canada's frontier land regime, including the back-in clause. It will also introduce legislation to raise the threshold for FIRA review of foreign investment proposals, and exempt some transactions from review. It will also clarify understanding here and abroad of the agency's role. Tabling of this legislation and our statements in this connection will, it is hoped, initiate a broader discussion of foreign investment and public policy toward it.

The clear message is that Canada wishes to become a better place for foreign investors to do business. This in turn should give domestic investors increased confidence in the Canadian business environment.

Small Business

Small business is a major part of our economy. According to a recent study conducted for the Department of Regional Industrial Expansion, almost 80 per cent of net new employment in manufacturing industries during the 1970s occurred in establishments employing less than 50 people. Chart 10 compares the amount of job-creation by each of small, medium and large business between 1978 and 1982. This engine of economic growth must be fuelled by a business climate which rewards the entrepreneur for individual initiative and risk-taking.

In addition to general direct assistance programs available to all businesses, three federal programs apply specifically to small business:

The Federal Business Development Bank provided about $320 million in loans and $8 million in equity investments in 1983-84, as well as services under the CASE (Counselling Assistance for Small Enterprises) program;

The small business loans program provided some $690 million in guarantees to 25,820 small businesses in 1983; and

The small business bond program reduces the cost of borrowing to farms and small businesses in financial difficulties.

Small business also benefits from special tax incentives, at the federal and provincial level. Canada's small business tax rules, including the treatment of shareholders, compare favourably with those in the U.S. This must be, however, an area of ongoing study and discussion in the context of measures to promote private sector growth.

In general, small businesses have relied heavily on debt financing. Individual entrepreneurs have tended not to seek external equity, apparently because they desire to keep full control of their operation. There is, however, concern on the part of small business about access to funds, particularly for start-up purposes.

Finally, when small businesses apply for government assistance, or bid on government contracts, they face a sea of forms and paperwork. They find themselves at a competitive disadvantage with larger companies which have tax, legal, financial and technical expertise readily at hand.

If small business is to play its role in economic renewal, it is essential that federal and provincial governments and private financial institutions respond to their special needs. Some consultations in this regard are underway; others will begin soon.

We should explore further simplification of the tax and regulatory environment.

We should examine closely the role of federal and other governments in providing information and financial assistance to small business. How can we better co-ordinate, integrate or "piggy-back" federal and provincial incentives? Is the current role of the FBDB appropriate?

We need to ensure that federal government departments are more aware of and responsive to the special needs of small business. Should we have "small business ombudsmen" in the economic departments?

We should consider the possibility, where financial guarantees are now involved, of more balanced risk-sharing between the government and financial institutions.

We should ask whether further assistance to increase exports by small business is warranted. What forms might be the most effective?

We should examine closely with provincial governments, and with help from businessmen and their advisors, the competitiveness of the federal and provincial tax systems, including the overall balance of fiscal burdens, such as payroll taxes, and incentives for small business.

We should discuss the capitalization issue. If the government had the fiscal resources, should it focus new tax incentives primarily on capital investment by existing small business, or on new investment into small business?

4. Labour Markets and Human Resources

Employment Development

The Challenge

Canadians have weathered a severe recession that has left a legacy of double-digit unemployment. The government is committed to meeting the challenge of employment development. Expanding employment and creating opportunities is the fundamental objective of national economic renewal.

We must build a climate which fosters investment – not only in machines and buildings, but in people. Investment is the key to job opportunity. We must support that process and help individuals invest in themselves. We must ease adjustment in the labour market and ensure that all Canadians – men and women – have equitable access to new job opportunities.

The government recognizes that there are groups in society facing particularly difficult barriers and poor employment prospects. They will require special efforts if they are to be provided fair access to viable job opportunities.

Directions for Change

In meeting these challenges, co-operation and consultation will be the basic principles of the government's approach. At a time when the resources of all governments are strained, we cannot afford to work at cross purposes with the provinces. In this light, how can the two levels of government work together and harmonize their efforts to expand employment? What are the most effective measures for strengthening the job opportunity capabilities of the private sector? How can the government enhance the potential for co-operation between business, labour and the voluntary sector in creating jobs?

In working with its economic, political and social partners, the federal government will review its current employment programs to simplify them and to ensure that labour adjustment measures, training, unemployment insurance and the special efforts required to strengthen the prospects of those least advantaged in the labour market are mutually supportive and are consistent with the principle of partnership.

Training

The Challenge

This government places high priority on ensuring that individual Canadians have the best possible opportunity to develop and use their skills and talents. Training and skill development promotes economic growth and provides firms with the skilled people they need to be competitive. But it is equally important to help individuals adapt to changing job opportunities brought about by highly competitive imports, shifts in international economic activity, and rapid and widespread technological change.

Most existing federal support is provided under the National Training Act. Current training programs under the Act are intended to help balance the supply and demand for occupational skills in the economy as a whole, and to upgrade skills individuals need to find work.

The national training program has three main components: (1) *institutional training* ($900 million and 215,000 participants in 1984-85), under which the federal government purchases training courses from provincial institutions and provides income support to trainees; (2) *industrial training* ($180 million and 60,000 participants in 1984-85), under which the federal government subsidizes trainee wages and the direct costs of training undertaken by private sector firms; and (3) the *Skills Growth Fund* ($145 million in 1984-85) under which the government contributes to the financing of capital projects and equipment to expand and update the capacity of educational institutions to provide training in high-demand occupations.

Directions for Change

In 1982 the emphasis of federal training policy shifted toward providing training in high-demand occupations. Although further moves in this direction are possible, they would require consultation with the provinces in the context of the upcoming renegotiation of the current three-year federal-provincial training agreements, due to expire March 31, 1985.

There is also a need for a wider review of federal programs that support skill development. Is training sufficiently geared to the real needs of the labour market? Are the responsibilities of the private sector for training adequately recognized and supported? Is training sufficiently innovative and flexible?

Are support programs sufficiently geared to the very different training and income support needs of various groups – young people making the transition from school to work, the unemployed, women re-entering the labour market, and more mature workers including those faced with technological obsolescence? Finally, what should be the role of the federal government in assessing future occupational requirements?

This review must extend beyond the present scope of the National Training Act. It must include the development of a national alliance among the federal government, the provinces and our economic and social partners to provide young people with the practical experience and training needed to ensure fair access to job opportunities. It should examine arrangements for providing more mature workers with opportunities for skill development leave.

The review must emphasize the training needs of the unemployed and ensure that programs further the interests of women in seeking full equality of opportunity. More innovative uses of unemployment insurance for training purposes should be examined, as should ways of making training more suited to the needs of those in receipt of unemployment insurance.

A serious review of this kind cannot be conducted by the Government of Canada, or any other body, acting in isolation. It requires a renewed commitment to co-operation among governments and to consultations with the private sector if the major issues are to be addressed adequately.

Unemployment Insurance

The Challenge

Unemployment insurance is expected to cost $11.2 billion in 1984, including $10.0 billion in benefits paid to the unemployed and the balance for interest and administration. To cover this, the federal government will collect premiums of $7.8 billion from employers and employees; it will also contribute $2.9 billion from general revenues to pay for the cost of regional extended benefits and benefits paid to fishermen. The federal government contributions will make up about 25 per cent of the program's total cost in 1984. In addition, a deficit of $500 million in the U.I. account will be covered by a loan from the federal government, bringing the account's accumulated deficit to $4.4 billion (compared with $2.4 billion in 1982).

Concern has been expressed about the mounting cost of the program and the tax burden it imposes on the private sector, particularly labour-intensive small businesses, where it risks becoming a deterrent to job creation.

Directions for Change

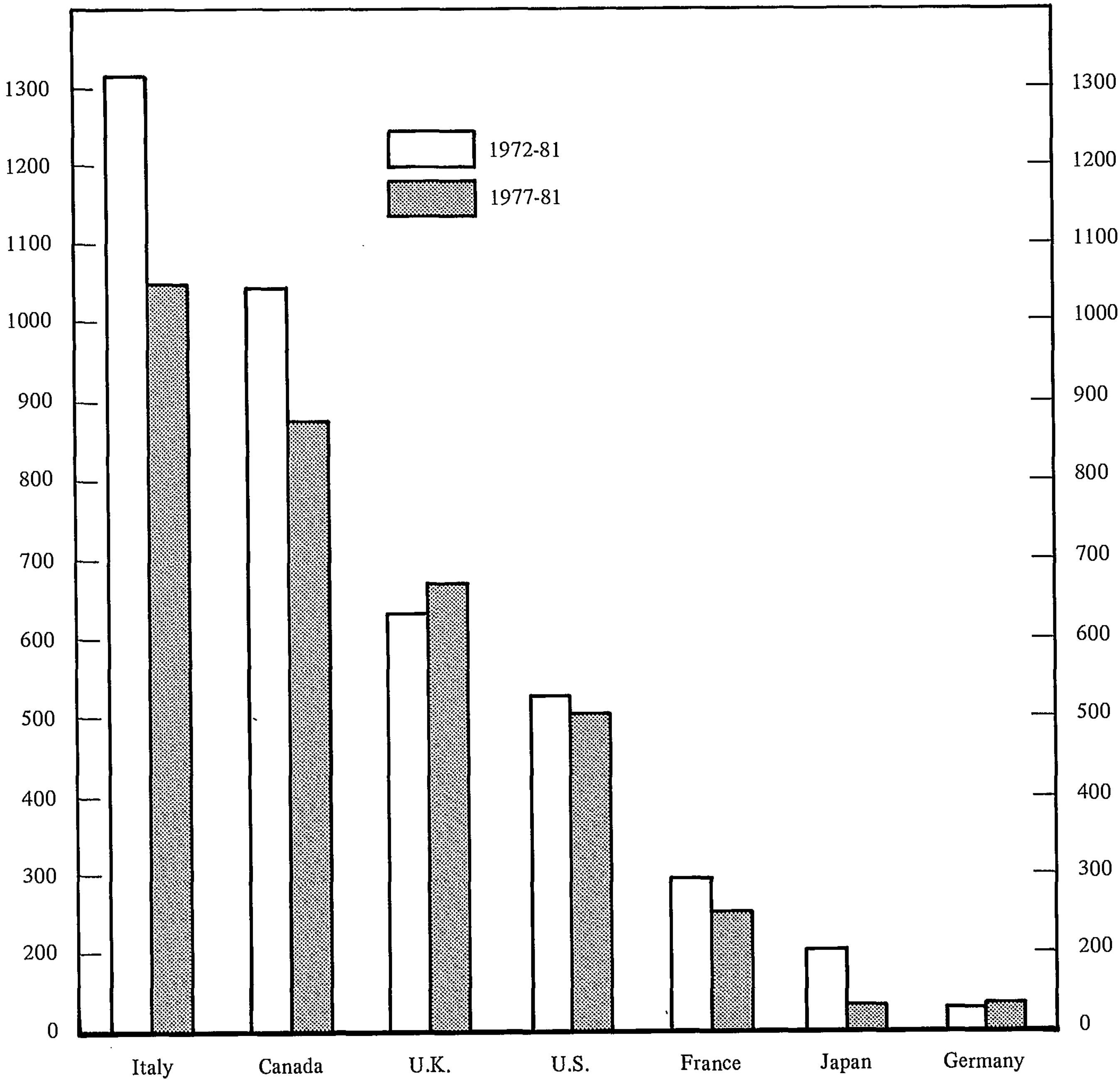
Several options exist for strengthening the insurance orientation of the program, reducing its current inefficiencies, allocating more equitably the costs of the various elements of the existing program, and reducing its costs by way of lower payroll taxes and lower expenditures for the federal government. Other options might involve possible expansion of the use of unemployment insurance funds in a way that would facilitate labour market adjustments. These options for change, ranging from purely administrative modifications to a fundamental restructuring of the program, are discussed further in Part B of this chapter.

Industrial Relations

The Challenge

Canada's industrial relations system is the product of more than 80 years of evolution which has, until recently, taken place in an environment of substantial

Chart 11
Annual Working Days Lost Per Thousand Employees in All Industries Due to Work Stoppages



Source: Employment Gazette, March 1983.

economic growth. Collective bargaining has generally worked well as an effective mechanism in distributing gains from improved productivity and ensuring a steady improvement in working conditions.

This period has not been without its tensions, reflected in the number of working days lost due to strikes and lockouts. As Chart 11 shows, Canada's record in this respect has been among the worst in the industrialized world. Viewed from the perspective of direct production losses and revenue forgone, the amount of time lost due to work stoppages still represents a very small proportion of total working time. Indeed, the time lost due to industrial accidents and illness is more than double that due to industrial disputes. However, to the extent that work stoppages are an indication of the state of industrial relations, Canada's recent performance in this area compared with its main competitors is a matter of some concern.

Increasing international competition requires understanding on both sides of the bargaining table of our economic prospects as a country and of the conditions faced by individual sectors. The challenge is to ensure that the industrial relations system is sufficiently flexible and responsive to contribute to growth and structural adjustment, while continuing to provide a fair distribution of income, access to employment and a decent working environment.

Directions for Change

Obviously the institution of collective bargaining must be preserved so that workers participate as fully as possible in decisions which affect their work environment. Too often, however, the structures which we have for employer/employee relations are built around an ethic of confrontation and mistrust. If we are to make progress in improving industrial relations in Canada, that ethic must change. A fresh start is needed and new ways must be explored to establish a more harmonious and co-operative relationship between management and labour and to reduce the number of industrial conflicts. While governments have a role to play in this effort, the solution must ultimately come from the private sector.

The federal government intends to discuss with the provinces different ways by which we could together help improve the situation, including the possibility of better harmonizing our respective legislative and regulatory regimes. The government also intends to consult with public sector unions in order to initiate a thorough review of the Public Service Staff Relations Act in the federal public service to ensure that the collective bargaining system works in the mutual interests of all parties – public sector employees, the federal government and the public.

The government will also consult its public service unions on a broad range of other issues of mutual concern. It believes that its employees have an important stake in the health and success of the institutions in which they serve, and of the federal government as a whole, and must be consulted and involved in significant decisions affecting them. Their support and co-operation is essential to the efficient and effective re-ordering of federal priorities and programs which will be taking place. A new spirit of consultation and co-operation will facilitate the reconciliation of interests that is inherent in a healthy collective bargaining process within a governmental environment.

More broadly, management, labour and government need to strive to achieve a national consensus on how, jointly, we can create an atmosphere of common purpose, co-operation and fairness in business and industry. Both labour and management have ideas on ways to improve the situation; we need to hear and debate those ideas. In few areas is there greater promise in terms of improving the foundations of economic renewal.

5. Adapting to Economic and Technological Change

The Challenge

Canada's future economic performance will in large part be determined by how successfully Canadians respond to the challenge of an ever-quickening pace of technological change and an increasingly competitive world trading environment. We must export, and we must also import. The balance must be determined, in the end, by our capacity to compete, not by artificial barriers. We are part of a world trade partnership that is working to reduce such barriers, and it is very much in Canada's interest to play its full part in this process.

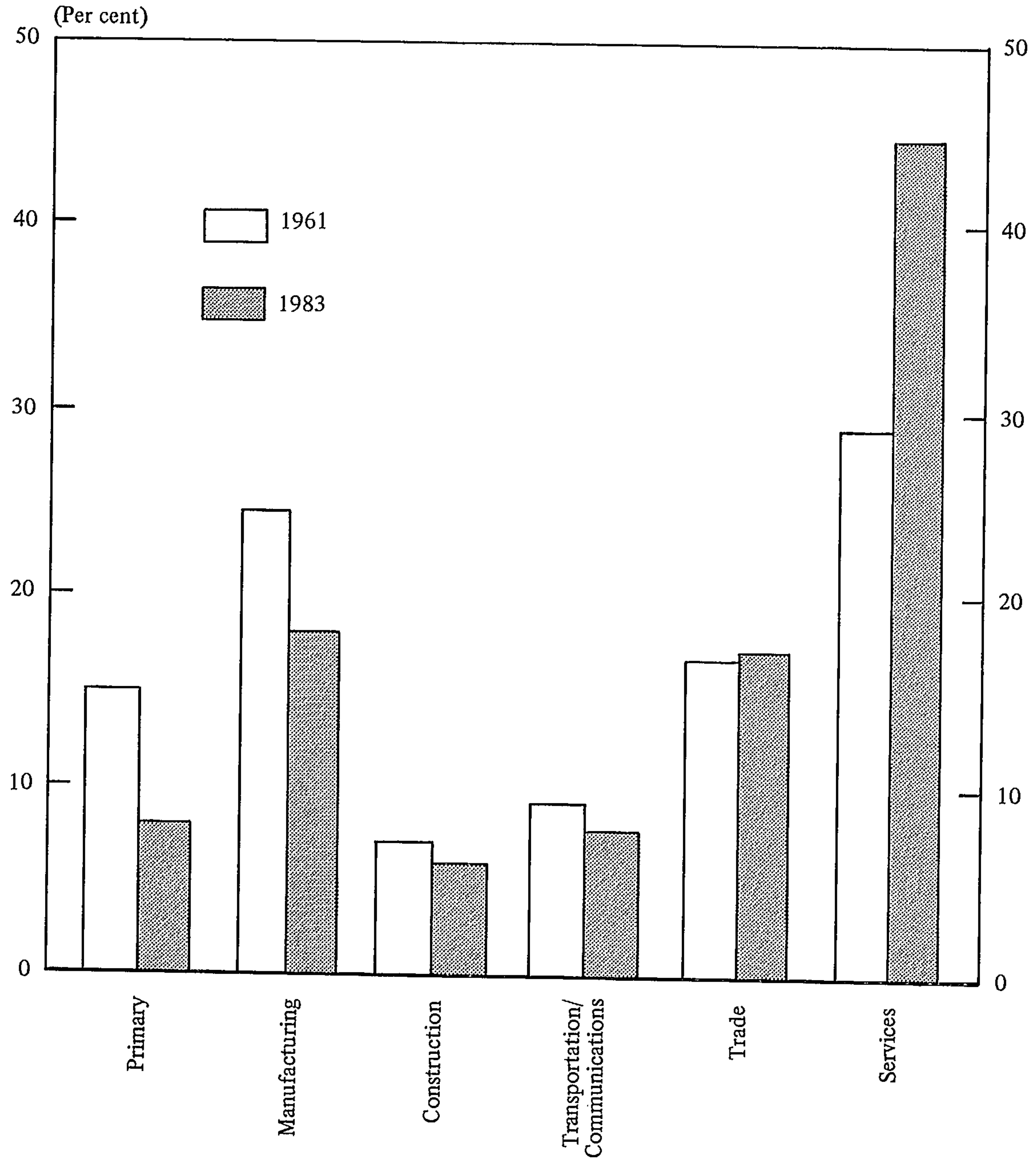
If we are to be competitive at home and abroad, we cannot impede change. To resist change is to erect an obstacle to growth. Canada's resource endowment cannot shield us from an increasingly turbulent economic environment. We will have to take full advantage of technological innovation and develop effective ways to help Canadians adjust to changing economic conditions and circumstances.

It has been said that the art of progress is to preserve order amid change and to preserve change amid order. The new competitive reality of the world market place will test the ability of Canadians – and of their governments – to practise this "art of progress".

This is a challenge that cannot be avoided or even substantially delayed. It is also an opportunity for Canadians to shape change to their advantage. Capitalizing fully on that opportunity, however, will require government policies which support successful adaptation and ease the necessary adjustments.

In the past, the federal government often seemed confused about its role in economic adaptation. Was it to stand in the way of change, by attempting to preserve activities which failed to meet the market test, or was it to facilitate adjustment and movement of resources to more viable uses? While there have been some positive initiatives to assist adjustment to changing economic circumstances, other initiatives have impeded or postponed needed adjustments.

Chart 12
Employment by Industry
1961 and 1983



Source: Statistics Canada, *The Labour Force* Cat. No. 71-001

The Industrial and Labour Adjustment Program was introduced in 1980. Under this program, $450 million was made available for locational grants, modernization loans, job creation projects and special labour benefits in designated communities and sectors facing severe adjustment problems. Examples are asbestos, iron ore, autos, and major appliances. The Canadian Industrial Renewal Board was established in 1981 with a budget of $270 million to facilitate adjustment in the textile, clothing and footwear sectors.

These attempts to foster adaptation have mèrit. Nevertheless, they and other measures having similar purposes need a re-appraisal, to see whether they are adequate today and for the economic pressures of tomorrow.

Some federal initiatives have slowed or impeded the adjustment process. For example, import quotas and restraints to trade have gone well beyond the objective of providing a "breathing spell" during which industry could restructure to more viable lines of production. In some cases, there has been little effort at restructuring while the protection remained in place.

While such protection measures are far from unique internationally, experience has shown that they are generally ineffective over the long run in avoiding change. Moreover, to the extent that substantial resources are absorbed by such measures, and prices to Canadian consumers rise, economic growth can be impeded and an obsolescent industrial structure maintained. This makes us less competitive.

Directions for Change

Canadians should consider whether there is a better way. Would our interests be better served by shifting government policy emphasis and resources away from attempts to forestall change, and towards more effective adjustment? At the centre of such a renewed emphasis on adjustment would necessarily be an overriding concern for the individual as distinct from the firm.

If we have learned anything from the past decade, it is that the real source of wealth is human resources: the ingenuity, intelligence and ideas of people. In this regard, the government cannot disregard both the importance and the vitality of Canada's voluntary sector. The strength of the voluntary sector is surely one of the untapped resources challenging all Canadians in the years ahead.

More effective adjustment does *not* mean removing the social safety net; indeed, it probably needs to be *strengthened* in ways that foster adaptation, rather than inertia and fear of change. The pride and self-reliance that are so basic to the Canadian character leave no room for doubt that those affected *want* to adapt, particularly if they have confidence that adapting will prove beneficial to them.

Fairer and more realistic incentives for workers to adapt to change would be essential. This might entail, for example, more generous assistance for workers relocating to take on a new job. Consideration could also be given to compensating individuals for the capital losses related to housing equity, and to the special requirements of two-income households. Ways of facilitating early retirement as well as access by displaced workers to savings locked in pension funds should be examined. It would also be desirable to ensure the availability of adequate termination benefits in the event of large-scale lay-offs or firm closures.

Essential to any new approach would also be the recognition that, while standing still is not an option, "preserving order amid change" takes time. We will not precipitously expose all of our industries to unbridled foreign competition. Nor will we expose youth, or women, or other groups in our society to an unfair burden in adjusting to labour market changes. An orderly plan would be fundamental to successful adaptation in any specific sector, and more emphasis should be placed on ensuring that the overall set of policies works towards facilitating economic change in a consistent manner.

Moreover, there is no prospect for success if the initiative consists of the federal government attempting to "go it alone". It will be imperative to ensure that provincial and municipal governments, labour unions, employers, community leadership – as well as the individuals directly affected – participate fully. Where a firm is under heavy international competitive pressure, should an agreed adjustment plan for the firm be a condition of government assistance by way of import quotas, grants, or other measures?

Of course, the government has a special obligation to ensure that its own policies and activities, including those of its Crown corporations, foster adaptation to economic change, rather than impede growth. An early priority for the federal government must be to put its own commercial house in order.

Clearly, this path is not without difficulties. Yet successful change and adaptation are not a new challenge for Canadians. Adapting to new market realities is a Canadian tradition with a long and profitable history. For example, a quarter of working Canadians were employed in the agriculture sector as the 1940s began. Today, agriculture accounts for only 4 per cent of Canada's labour force; and in many products this sector is second to none in terms of international competitiveness.

The Canadian economy is generally resilient, if market forces are allowed to work. Consider, for example, the fact that of the 32,000 manufacturing firms operating in Canada in 1971, 13,000 have ceased business, but some 17,000 new firms have started up in the meantime. With a sensitive, compassionate and generous approach to Canadian workers affected by change, many of the current impediments to change could be removed. Co-operation among federal and provincial governments, management and labour could overcome many others. Can Canada really afford not to explore these possibilities?

6. Growth and Competitiveness: The Regional Dimension

The Challenge

Regional disparities reflect real differences in economic endowment and market position both among regions and within regions. These are reflected in the income statistics depicted in Chart 13. Government action to redress these has been a continuing theme within the Canadian federation.

To restore growth and competitiveness for Canada in the international marketplace, we must enhance and draw upon the inherent strengths of all regions in Canada. Meeting this challenge will require a joint enterprise between the federal and provincial governments to harmonize policies and provide a more positive environment for the private sector to play its part.

Table 4

Index of Personal Income Per Capita (National Average 100)

	1955	1983
Atlantic	65.1	74.9
Quebec	86.6	92.5
Ontario	119.5	109.2
Prairies	94.8	101.4
B.C.	123.3	106.0

At first glance, the last few decades have witnessed large gains, in terms of narrowing inter-regional income disparities.

On closer inspection, however, the evidence indicates that regional economic development efforts have not fully achieved the goal of improving *employment* and *earnings* in the slower-growth regions. Disparities in these measures remain substantial. For example, in 1983, earned income per working-age person in the Atlantic region was only 70.2 per cent, and in Quebec 88.7 per cent, of the national average, as illustrated in Chart 14.

Much of the reduction in personal income disparities, then, has been through increased federal transfer payments. Such intervention does little to secure the economic future of the recipients or to increase regional and national economic growth. Indeed, it may represent an obstacle to growth. Regional economic development policy must be reoriented. Canadians want more economic opportunities, not more dependency on government.

Chart 13
Total Personal Income Per Capita By Region in 1983

Canada = 100

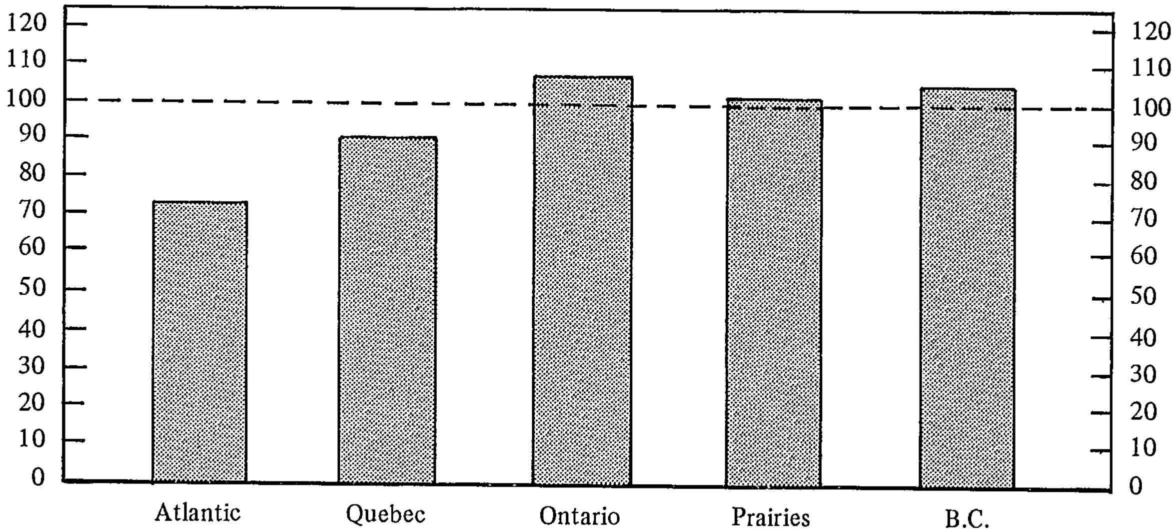
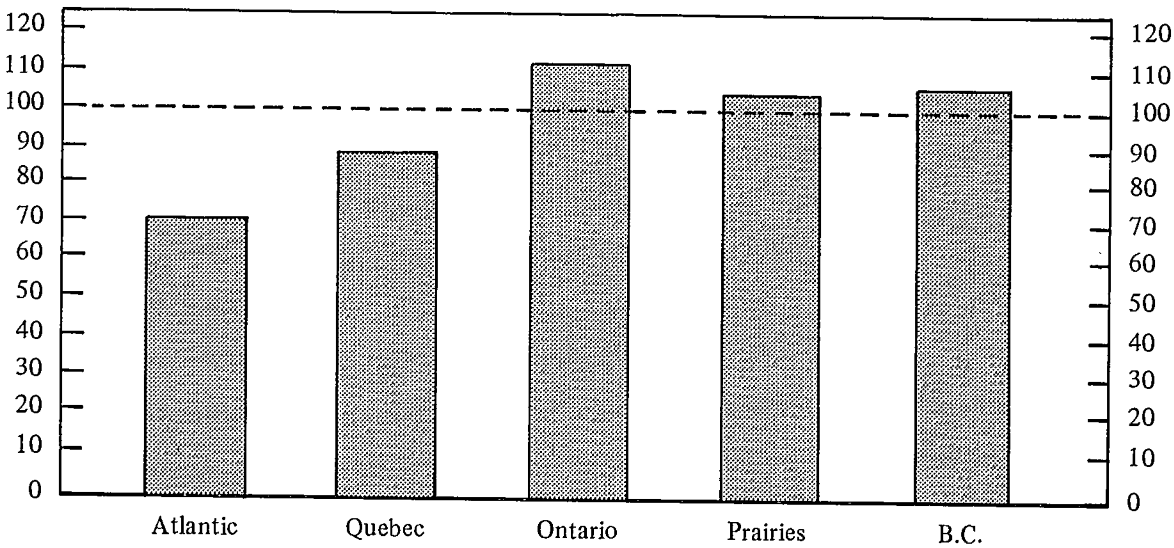


Chart 14
Earned Income Per Person of Labour Force Age By Region in 1983

Canada = 100



Source: Statistics Canada, *Estimates of Population for Canada and Provinces at June 1; National Income and Expenditure Accounts.*

The major federal programs oriented to regional economic development are:

- The industrial and regional development program (IRDP), which provides higher incentive levels for investment in designated slow-growth areas.
- The regional investment tax credit program for new investments in slow-growth areas.
- The federal-provincial economic and regional development agreements (ERDAs) and associated sectoral agreements (e.g. transportation, agriculture) by which the federal government jointly plans and funds with the provinces initiatives to promote growth in particular sectors.

Regional considerations generally have influenced a wide range of other policies and programs including energy policy, job creation, and commercial and industrial policy. More attention needs to be given, however, to the *economic* impact of regionally-oriented interventions, including the costs to some regions, and to the national economy, of policies favouring specific regions. Regional development should not be a zero-sum game. In an adaptable society, strong growth in one region should be of benefit to other regions as well.

Directions for Change

The issue is clear: how can we best draw upon the strengths of all regions to maximize Canadian growth? The federal government must be concerned with the welfare of all citizens wherever they live in Canada, and strive to foster growth in all regions. Is it not time, however, to consider new approaches to harmonize the objectives of equity and efficiency, and to seek regional participation in this endeavour?

Such an approach would require productive federal-provincial co-operation and much greater grass roots involvement. Many policies will need to be reassessed. Alternatives must be found to permanent subsidization of non-viable enterprises, whether private or public.

We must also review the effectiveness of existing tax and grant incentive programs, particularly in terms of their impact on business investment decisions and their contribution to regional competitiveness. Their cumulative impact, and the expectations raised by their availability, may retard rather than facilitate adjustment to market forces. They may be unduly blurring the market signals that the private sector needs for decision-making purposes.

Also, the present industrial incentives system favouring slow-growth regions may be unduly complex. There appears to be overlap with similar endeavours undertaken at the provincial level, and between taxes and grants. Private sector groups have often asked for a simpler system.

More emphasis could be placed on improving the competitiveness and productivity of all regions through more effective diffusion of technology, an improved investment climate and investment promotion, small business development, manpower training and mobility, and promotion of export trade. This would help restore a productive environment for the efforts of employers and workers in the creation of wealth throughout Canada.

7. Economic Regulation and Intervention

The Challenge

The Canadian business climate has been adversely affected by uncertainty about the future course of the basic "rules of the game" or "framework policies". Moreover, in a number of specific sectors, there is undue government regulation and intervention. Action in these areas could make an important contribution to fostering private sector growth and economic renewal. Moreover, regulatory reform would be of major benefit to consumers.

Directions for Change

Framework Policies

A major element of uncertainty in Canada's business climate could be removed by bringing to an early and successful end the protracted debate over the shape of Canada's future *competition policies*. There now seems to be a measure of consensus on the changes to the Combines Investigation Act. The early reflection, in legislation, of a new competition policy framework could contribute significantly to the business environment.

Canada's *Copyright Act*, unchanged since 1921, has been overtaken by new technologies. This has created ambiguities and uncertainties and has, in some cases, left Canadian copyright owners with less protection or compensation than would be available to them in other countries which have more modern copyright laws. Impacts are particularly significant for the vitality of our cultural and computer services industries. This is a real obstacle to economic growth, particularly in an economy which is increasingly service-oriented, with a growing role for the creation, transmission and processing of information, and in which automation may be a powerful source of productivity gains.

A broad-based update of Canadian copyright legislation is needed to create an appropriate and balanced copyright environment. Much preparatory work has already been done and extensive consultation will continue.

As well, there are a considerable number of *other laws and regulations* that affect the ways in which business is conducted in Canada. Corporation laws, patent laws, bankruptcy laws, trademarks, packaging and labelling regulations, hazardous product legislation – these are but a few obvious examples. The government will be examining and consulting on all such areas, with a view to streamlining and modernizing them wherever possible, so that our markets can be flexible and productive, and so that modern practices can be encouraged and adopted, while respecting the obvious need for "rules of the game" and for basic protection for consumers and investors.

Sectoral Policies

Transportation

Transportation is a key productive input upon which virtually all other sectors depend, and which often determines their ability to compete in both domestic and export markets. In no country is this more important than Canada. A healthy and efficient transport sector is vital to achieving Canada's full economic growth potential.

There are important opportunities to remove obstacles to the growth and competitiveness of Canada's transportation industries. A new transportation policy and legislative framework is required to meet the realities of the 1980s and 1990s as well as providing a solid foundation for meeting the challenges and opportunities of the next century.

These initatives must reflect Canada's unique transportation needs as well as providing a climate for growth and innovation. Regulatory reform is taking place within the airline industry. Federal and provincial governments are working with industry to achieve a more uniform and relaxed regulatory framework for the trucking industry. The scope for increasing competition between the railways, especially *vis-à-vis* transborder routes, should be examined. There is also scope for freer access by other transportation companies to railway infrastructure. And there is a need to review our traditional maritime policies – both domestic and international – to ensure that maximum benefits and competitive efficiencies are being received. As part of this exercise, the role of the transportation Crown corporations will be reassessed.

Federal transportation subsidies amount to roughly $1.4 billion annually. There are opportunities to enhance the competitiveness and efficiency of our transportation systems while contributing to deficit reduction. For example, rail passenger services in Canada are now priced at less than one-third of their real cost. The government currently spends nearly $500 million a year to subsidize VIA rail passenger operations, much of it in central Canada. While attention must be paid to the unique transportation problems of particular regions, the current policy, from a national perspective, may inhibit private investment in more cost-effective modes of transportation and result in a less efficient overall transportation system. While some expenditure reductions have already been achieved, more may be possible. Similarly, in freight transportation, the "At and East" subsidies, costing roughly $40 million each year, may discourage shipment of grain and flour by the most efficient mode. Bringing the price of these services more in line with their real costs would help provide a sounder basis for economic decisions in the private sector.

In transport, as in other areas of the economy, the government has too long thwarted entrepreneurial spirit. If Canada is to achieve significant national economic growth and enhance our position as one of the world's great trading nations, the private sector must be free to take advantage of technical and operational efficiencies. The potential gains appear too great to ignore.

Communications

The communications sector is also extensively regulated, including federal and provincial regulation of market entry, pricing, conditions of service and technical standards in both broadcasting and telecommunications. Yet this sector, perhaps more than any other in Canada at the present time, offers opportunities for important market-driven innovation, if governments' regulatory interventions are kept to an essential minimum. Through regulatory reform, government can spur innovation and provide a major stimulus to the Canadian economy.

There is a clear need for a national telecommunications policy to take advantage of the opportunities presented by rapidly advancing technology and the growing demand by Canadians for new telecommunications services. The issues surrounding a review of telecommunications policy are inevitably complex. The traditional structure of the industry is facing a set of major new pressures in light of the massive restructuring of the telecommunications industry in the United States. At the heart of the matter is how to meet the challenge of competition in the provision of telecommunications services, while at the same time ensuring that all Canadians continue to enjoy universal telephone service at reasonable rates. In developing this new policy we will undertake extensive consultations with the provinces, business, labour and consumer groups to ensure that their views and interests are taken into account.

Fisheries

Canada has some of the world's richest marine and freshwater fish habitat containing some of the most productive fish stocks in the world. The challenge is to transform this endowment into economic wealth. We have to manage better. We must also seek out, develop, and compete aggressively for world markets, which account for more than 70 per cent of our production.

New approaches to meet this challenge must be tailored to the wide resource and economic diversity of Canada's commercial fisheries. For instance, some fisheries, such as the crab and the lobster fisheries, are on a reasonable economic footing. Others, such as the Atlantic groundfish fisheries, while exploiting a healthy resource base, are set in the context of regional economies in which alternative employment opportunities are scarce. Because these fisheries have often functioned as the employer of last or only resort, economic viability is a continuing challenge. Still others, such as the B.C. salmon fishery, are facing serious difficulties because they are based on over-fished and declining stocks brought about by excessive fishing capacity.

The crisis in the B.C. salmon fishery requires urgent attention. The regulatory system has failed to control over-investment in fishing vessels and gear, resulting in an excessively large and highly indebted fleet. For the stocks to rebuild and for fishermen to make a decent living, there must be a significant reduction in the size and fishing power of the fleet. This can be done through a voluntary buy-back program with appropriate flexibility to obtain a significant reduction of catching capacity, coupled with other measures to ensure that fleet rationalization is effective. Parallel initiatives to maintain and restore habitat and enhance salmon stocks would also be required. Clearly, these are issues requiring close consultation and co-operation among the various interests.

On the Atlantic coast, the major problems lie with over-capacity in the processing sector and low and unstable incomes in the inshore fisheries. The groundfish industry is still in serious economic difficulty. The operation of market forces has been inhibited and governments may well have contributed to excess processing capacity in a well-intentioned, but possibly counter-productive, effort to maintain and increase employment. New approaches are required on the part of the federal and provincial governments, to ensure that processing capacity matches resource availability.

Government financial rescues are not the solution. If it is to be self-sustaining, the industry must attract new investment both domestically and from abroad, adopt new technology, enhance product quality and consistency, achieve a higher degree of product and market diversification, and improve its overall marketing performance. Government policies must be designed to facilitate these industry improvements, not to hinder adjustment to market realities. In some fisheries, fleet rationalization is also required to improve the economic viability of the harvesting sector. The role of foreign fishing fleets also must be examined.

Planning for an improved Atlantic fishery must take place within the context of an overall approach to economic development for Atlantic Canada. Hundreds of communities depend solely on the fishery and have limited potential for alternative employment. Consolidation of employment in the sector would have to be complemented by public and private initiatives to promote job opportunities in other sectors of the economy, as well as fair and generous adjustment programs for workers in the sector.

The present regulatory regime is overly complex and gives rise to unproductive tensions within the industry and between the industry and the government. Fisheries regulations need to be reviewed to make them more simple and fair. Fisheries decision-making needs to be more open, with greater involvement by commercial fishermen and processor organizations, as well as by native and sport fishermen.

Agriculture

Canada is a leading force in the world agricultural marketplace. Agriculture is a pillar of the economy in the west, and the mainstay of many communities in the east. The sector has demonstrated its resilience in responding to change to an extent probably unmatched by other industries.

Canadian farmers must compete, in most products, with foreign suppliers on both domestic and export markets. This competition has contributed to the development of a sector that is efficient by world standards, as witnessed by a continuously improving trade performance in the face of an increasingly adverse international market environment.

However, government involvement, both federal and provincial, is significant. In addition to substantial regulatory intervention, annual federal budgetary allocations to the sector amount to some $1.35 billion through Agriculture Canada. Of this, some $700 million is devoted to price and income supports.

The federal government must examine its involvement in the sector to ensure that it is directed at maintaining a strong, efficient, and competitive Canadian agricultural sector, and that it recognizes its special challenges. It will be important to determine whether existing price and income support programs are still appropriate for present-day conditions and to ensure that they are not causing structural inefficiencies in the industry. The new tripartite approach to red meat stabilization may be a good example of how both levels of government and the producers themselves can co-operate to develop improvements over former arrangements.

Similarly, there is a need to examine closely, with a view to streamlining and rationalizing, the whole complex of regulatory interventions to ensure that they are working in the best interests of a productive and efficient Canadian agricultural industry. It will be important to ascertain whether, and to what extent, there is scope for reshaping federal commitments to this sector in a manner which contributes to a reduction of federal financial requirements, while maintaining or enhancing the effectiveness of federal support. We need also to consider how best to meet the international competition, especially in cases where other governments provide large direct or indirect subsidies to their agricultural exports.

We will seek the views of farmers, food processors, distributors and consumers, as well as the provinces, in developing strategies to further improve Canadian agriculture's efficiency and international competitiveness.

Construction

Construction is another tightly-regulated industry. We must ask whether some of the regulations which past legislators felt necessary are still needed today or whether the net costs of these regulations are excessive.

This is an area where co-operation with the provinces will be critical, as most of the regulations affecting this industry fall under provincial jurisdiction. However the federal government has some legislation of its own, including the Fair Wages and Hours of Labour Act, which needs to be re-examined.

This Act was passed in the 1930s to ensure that construction workers working on federal government contracts receive a "fair wage" and that certain minimum standards are met with respect to overtime pay and maximum hours of work in a specified period.

The Fair Wages and Hours of Labour Act addressed a real need which existed in the 1930s. There is a question, however, as to whether this legislation is still needed today and whether the basic requirements which were identified in the 1930s cannot be met through the competitive process. The government intends to consult with labour and business representatives on this issue.

Other Major Sectors

We need also to look at the problems and prospects of our forestry, mining, and tourism sectors. These are a major part of the national economy, and are the key to prosperity and growth for many communities and regions in Canada. They must continue to make a contribution; government must ensure that it does not inhibit the process of growth and adjustment that is necessary.

While world market factors have their effect on all of these industries, government must also examine whether its own interventions have been appropriate, and what changes might be indicated by the new market conditions. In the forestry area, the richness of our resource base may have caused government and the private sector to be complacent about the competitive position of our industry, and not to give sufficiently high priority to the effective management and protection of Canada's forests and the need for technological change.

Similarly, in the mining sector, governments may have taken too short a view of the industry's strengths and challenges. They may not have recognized the emergence of new world suppliers and the threat they posed to our industries, particularly if our enterprises were heavily regulated. In the tourist sector, government must examine the mix of policies and programs now in place to see if they reflect the needs and special characteristics of the industry, and do not inhibit its growth.

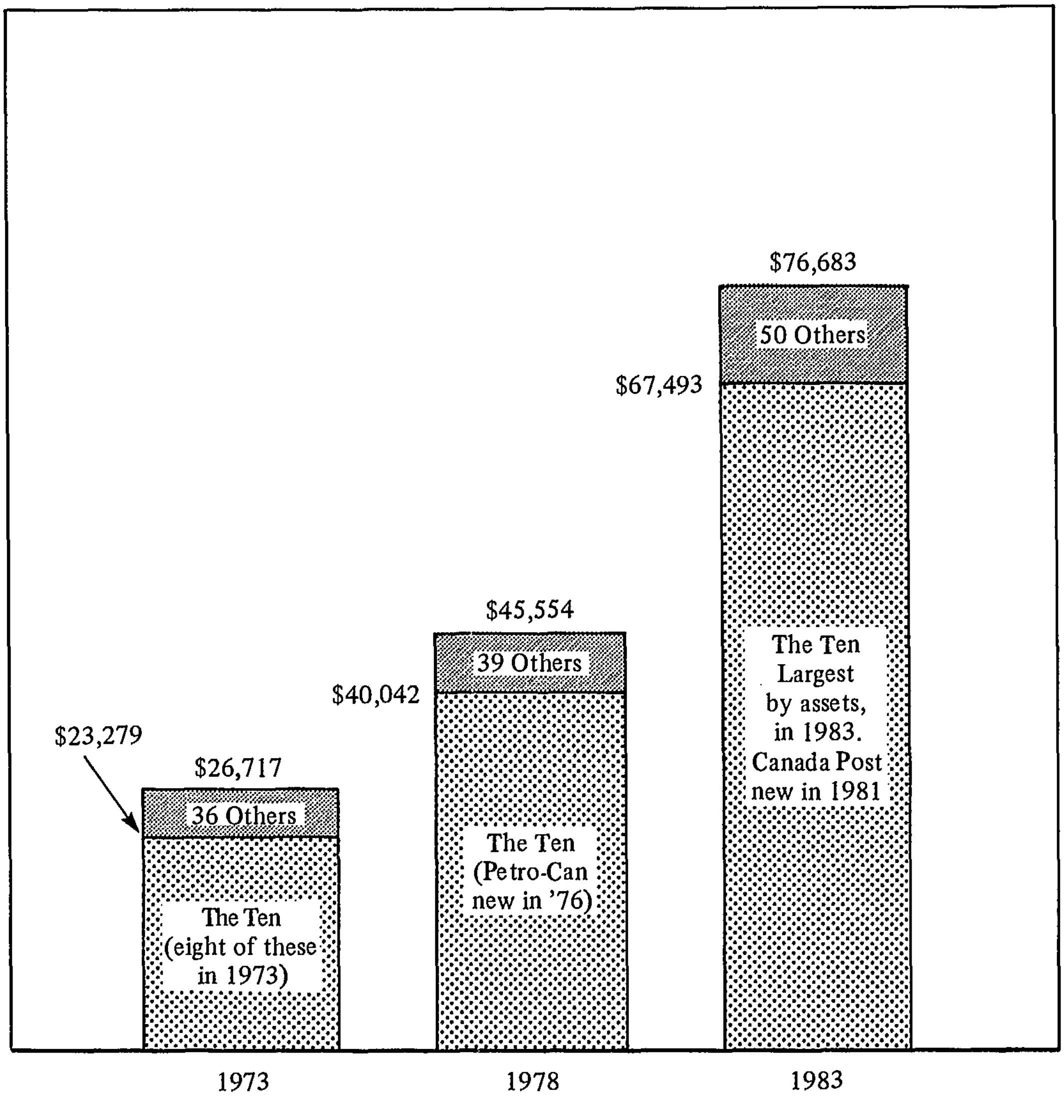
These are key areas of focus in the national debate. As will be noted later in this chapter, the federal government will be exploring areas for co-operation with provincial governments, and these sectors should be high on this list.

Crown Corporations

No examination of government intervention is complete without considering federal Crown corporations. With assets of over $50 billion and more than 200,000 employees, these corporations and their subsidiaries are a significant presence in the national economy. The growth of these corporations is shown in Chart 15.

Chart 15
The Growth of Crown Corporations 1973 to 1983, by Assets Measure

($ millions)



Note: The 60 corporations comprise 57 parent Crown Corporations plus Eldorado Nuclear, Canadair and deHavilland Aircraft.

Source: Department of Finance.

The magnitude of the public financial commitment and the pervasiveness of these organizations in the economy dictate a careful review of whether their mandates are clearly defined and publicly understood, whether reasonable objectives have been set, whether resources are efficiently managed and effectively deployed and whether their objectives could be achieved by some other mechanism at lower cost to the public purse.

The government is determined to pose these questions. Our Crown corporations must set new standards for sound management and financial performance, rather than providing examples of inefficiency and massive losses. Not all Crown corporations pose a financial burden on the government, but for those that do, we must examine how that load could be reduced and how, generally, our corporations can be more effective agents of economic growth. To that end, the government's approach to management will center on the themes of financial discipline and efficiency.

Better management of Crown corporations is only part of the challenge. We must also consider the appropriateness of our present investment mix and of the level of support provided by the public treasury. Although each corporation was established to serve what, at the time, might have been an important public policy purpose, we must ask ourselves whether that remains the case. If it does not, it is surely important to consider whether the corporation should be retained. The Minister of Regional Industrial Expansion has already indicated the government's intention to seek buyers for the holdings of the Canada Development Investment Corporation.

There are several other Crown companies which are predominately, or in some cases entirely, commercial in character, and it is appropriate to consider whether continued public ownership is in the best interests of either the company or the country. The government will be examining the scope for further divestiture and would like to hear the views of Canadians on this matter.

For many corporations in the government's portfolio, their future role and level of support will depend upon decisions taken about the policies and programs considered appropriate for particular economic sectors. For example, the consensus we forge together about transportation policy and the role for rail passenger transportation in Canada will define the future for VIA. As major policy and program reviews take place, the role of Crown corporations now involved in those sectors will have to be reassessed and appropriate changes made.

8. Energy Policy

The Challenge

The energy sector, a potential engine of growth, has become rife with government intervention and regulation. The domestic price of oil and gas is set administratively, not by the market. Many new pieces of legislation and regulations affecting the industry have been introduced over the last decade. Taxes have changed frequently. Fiscal incentives have changed as well, sometimes in a manner that discriminates against certain investors. Disputes between federal and provincial governments have caused energy – potentially a source of unity – to divide the country.

The reasons for intervention have included concerns about security of oil supply, the distribution of revenues that resulted from price increases, and the ownership patterns in the producing industry.

These concerns are valid. However, the means used to address them have engendered uncertainty on the part of the public, apprehension on the part of domestic and foreign investors, federal-provincial tensions, and a level of investment in the oil and gas industry that is well below what is needed if the industry is to make its full contribution to the economy. Moreover, the level of the deficit is too high to permit unnecessary financial involvement by the federal government in the sector.

The challenge is to free up this engine of growth in a manner that is compatible with fiscal responsibility and the urgent national imperative of reining in the deficit by shifting reliance from government expenditures and regulations, towards market mechanisms and private sector initiatives.

The Economic Statement referred to actions to reduce federal energy expenditures, regulations, and direct Crown involvement in the energy sector. It noted the government's intention to address investor irritants such as the Crown Interest (the back-in) on the Canada Lands. Further action will be taken in the coming months in several other areas including oil pricing, energy taxation and incentives. A comprehensive review is now underway. Because of the many vital national interests affected by energy policy changes, the government intends to consult closely with all affected parties.

Directions for Change

As indicated in the Economic Statement, it is now time to close the modest gap between the regulated Canadian price and the market price for oil, and move toward a regime that would allow the market to establish the price of oil in Canada. However, the federal government agrees with those who have suggested that a "safety valve" mechanism to deal with major price shocks is needed.

The natural gas sector in Canada for the last five years has been demand-constrained: domestic and export markets have failed to keep pace with the growth in supply capability. It is hoped that the flexible pricing now in place for Canadian natural gas exports will improve our market share. Further growth in domestic sales may require similar price flexibility. It seems therefore appropriate to consult with the natural gas industry and with the producing and consuming provinces on a more market-responsive system for natural gas sales within Canada.

In the 1983-84 fiscal year, federal expenditures on energy demand and supply programs amounted to $3.5 billion. With lessened concern over oil security, renewed faith in the functioning of the energy marketplace, and serious national concern about the level of the federal deficit, there is less justification for subsidy programs designed to cut oil use by conservation or substitution. Hence the government has announced the phasing out and consolidation of various demand reduction and off-oil programs.

On the supply side, there is a broad consensus that the Petroleum Incentives Program (PIP) should not continue for long in its present form. PIP is a cash grant program introduced in 1980 to encourage exploration activity in the frontier and to provide assistance on a preferential basis to Canadian-owned companies. The previous government also reserved 25 per cent of all interests in the Canada Lands for the Crown and included under the PIP a Crown share incentive of 25 per cent for all companies in the Canada Lands. A review of the Canada Lands regime, including the Crown share, is urgent. However, the system – including PIP – will be altered only after the federal government has consulted interested parties on this question, including the issue of what incentives, if any, should replace the Petroleum Incentives Program.

Many have called for major modifications in the *tax regime* applying to the oil and gas sector. In 1983-84, federal energy taxes, not including corporate income taxes, yielded $3.7 billion in revenue. In view of the major changes in the energy price outlook and the need for more appropriate investment incentives, a comprehensive review of federal energy taxation is in order. As shown by the announcement in the Economic Statement doubling the small producer credit against the petroleum and gas revenue tax, there is scope for further flexibility in the federal energy tax system. However, we must balance carefully the interests of the producers, the producing provinces, the consuming provinces and the general taxpayer.

The government's involvement in the energy sector includes Crown corporation activities (Petro-Canada, Atomic Energy of Canada Ltd. and Canertech). It may now be time for the public sector to pull back in some cases, leaving more room for the private sector to exploit market opportunities: cases in point are our decisions to stop funding Canertech and to cease injecting any further equity funds into Petro-Canada unless there is a specific priority of the government to be served.

The energy sector faces many rules, regulations and demands originating from federal and provincial energy legislation and regulatory bodies. There is little doubt that these, taken together, discourage activity in the energy sector. The federal government will put its own house in order and begin discussions with the provinces on means of streamlining these regulatory requirements through such devices as the "single-window" approach.

The government attaches top priority to renegotiating energy agreements with the governments of Alberta, British Columbia and Saskatchewan, and pursuing accords with Newfoundland and Nova Scotia with regard to the offshore. These negotiations and consultations with the energy industry and consumers, together with greater reliance on market forces and streamlining the regulatory burden on the energy industry, will open the way for renewed growth and investment in Canada's energy resources.

9. Co-ordination With the Provinces

As the previous discussion makes evident, provincial governments play an important role in securing economic renewal. It is therefore essential that federal and provincial governments work closely together if we are to provide the necessary incentive to the private sector, and attain a higher rate of economic growth for all Canadians.

The task is not a simple one. The different economic circumstances prevailing across the country and the needs and aspirations of the various regions must be taken into consideration. However, we must assure ourselves that we are doing everything possible to encourage economic growth itself.

It might be useful, for example, to look jointly at how our labour and capital markets function. Are there any impediments to the ability of individuals to pursue their chosen vocation, or to move to another region of the country if that makes economic sense? Are there any regulations or measures which unduly influence investors to make decisions in a manner which differs from what the market would suggest? Are there any impediments associated with undertaking construction or building activities or developing natural resources, which could be removed? Is there an undue burden of regulation on firms establishing new plants and hiring workers? Do any government policies or regulations give an undue advantage to certain types of firms? Are our tax and incentive systems, individually and together, conducive to economic growth? Should we not better co-ordinate our economic programs?

Some of these questions may also involve the effect which provincial government programs, together with federal regional initiatives, may have on the flow of goods, services, capital or individuals within Canada. The preliminary report of the Macdonald Commission and the Ontario Economic Council have drawn attention to this area. Some action is underway to remove unnecessary barriers, for example, in the field of trucking.

Because of the extensive role of all governments today in Canadian economic life there may be instances where the activities of federal and provincial governments overlap, thereby causing needless duplication. Federal and provincial governments must also recognize that there is only "one taxpayer". We must both strive to reduce the overall burden of government on the Canadian taxpayer.

There is ample evidence that the provincial governments have been waiting impatiently for an opportunity to work with the federal government, to remove long-standing barriers to economic growth in Canada. The opportunity has arrived.

B. Restoring Fiscal Flexibility

The current and projected size of the deficit is simply too large. It implies a steadily rising debt/GNP ratio, which will have serious consequences for interest rates, private investment, and the government's room to manoeuvre. In short, the federal deficit is a major obstacle to growth, and the government must take immediate action to deal with it.

The government's focus must be on reducing the growth of federal expenditures. Tax increases cannot be ruled out, but they must be avoided if at all possible. The government will continue to examine its tax system, not only from a revenue standpoint, but in terms of its impact on growth, equity, and simplicity. As already noted, there is a need to examine closely the incentives provided to business investment. It may be that some incentives are no longer appropriate, in terms of current economic needs and the burden of the federal deficit.

There also may be merit in other changes to the tax system, which should be made on an evolutionary basis. In this context, some have suggested that Canada adopt a "value added" tax, possibly as a replacement for the current federal sales tax. The implications of such a major change would require careful study, which has begun. It would have important federal-provincial implications. Close consultation between governments, the private sector and other affected groups would be necessary before deciding whether to proceed with such a tax.

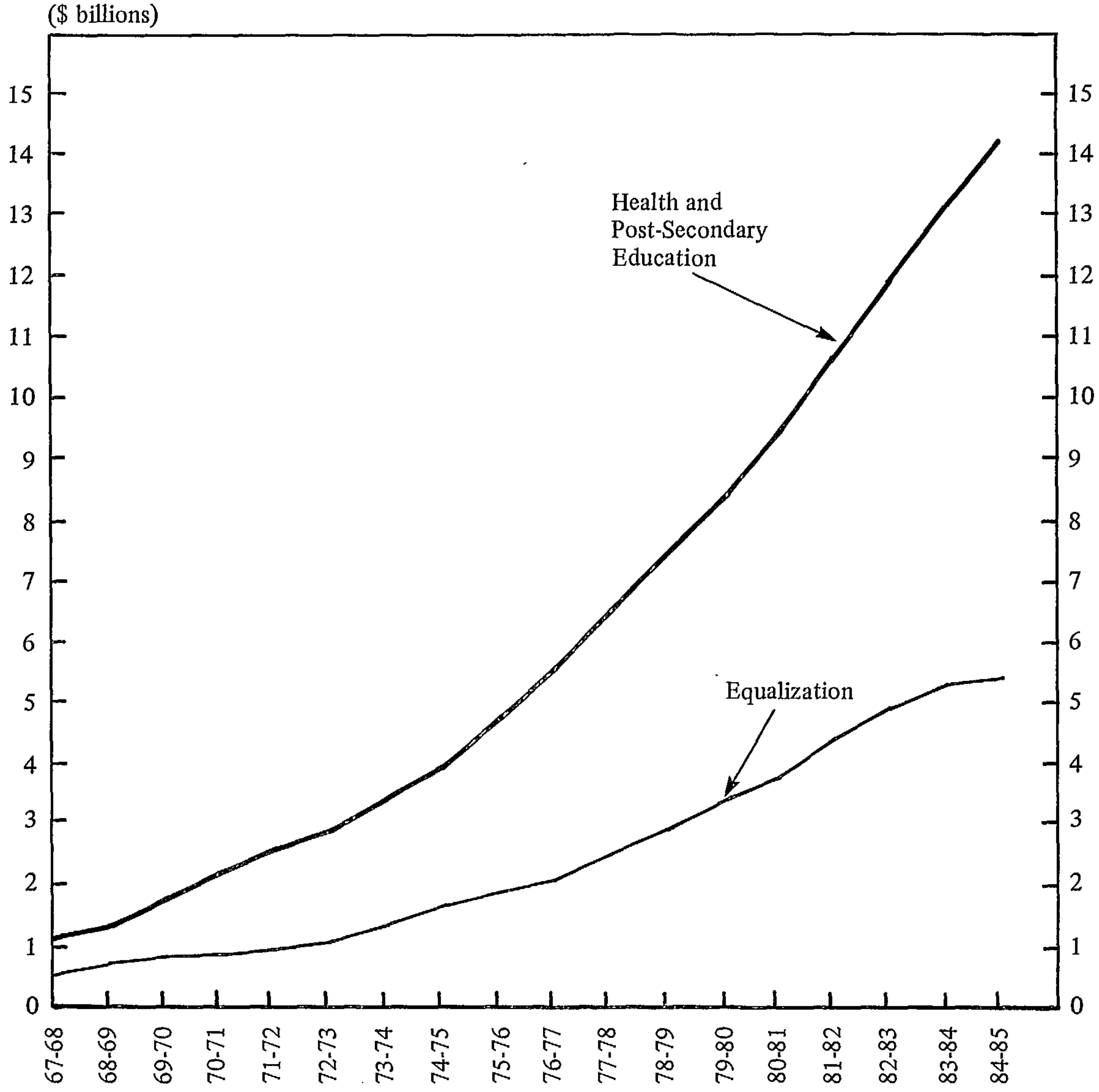
Fiscal prudence and flexibility must be restored on the expenditure side, to the greatest possible extent. We must reshape the composition of federal expenditures, while simultaneously slowing their growth, in order to minimize the effects of contraction on the economy. We must also reduce the growth of federal expenditures in a way which is seen to be fair to all Canadians, and which improves the overall effectiveness of federal programs.

The first round of expenditure reductions has yielded several billions of dollars in savings. These were difficult to achieve, although they were consistent with the thrust of this government's policies. They represented the most that could be achieved without extensive consultation. The sober reality is that, after all this effort, we are now only back where we started; we have brought the 1985-86 deficit down toward the 1984-85 level. More must be done.

Further major expenditure reductions will be difficult. About 77 per cent of federal spending can be regarded as "discretionary", since public debt interest accounts for 23 per cent. Some saving can and must be achieved through improved management of the public sector itself, but this will make only a small dent in the problem. Most of the savings must be made in the other three major areas of federal spending, which each account for about a quarter of discretionary expenditures: transfers to persons; transfers to provincial and municipal governments; and transfers to other groups including federal Crown corporations, private businesses, the less developed countries, scientific researchers, cultural groups, and others. The challenge, over time, will be to limit the growth of these transfer programs in an equitable, effective and enduring way.

In Part A, we reviewed numerous obstacles to growth that have to be addressed. In a number of cases, we suggested that actions to remove obstacles would probably lead to reduced federal expenditures. In others, there might be no change in

Chart 16
Growth of Federal Transfers to Provinces for Health, Post-Secondary Education, and Equalization 1967-68 to 1984-85



Note: Health and Post-Secondary Education includes cash payments and tax transfers.

Source: Department of Finance.

expenditures; while in still others, there might be grounds for increased financial commitment, if the resources now allocated to other purposes could be freed up.

This section therefore provides a matching focus upon other possibilities for reducing, or achieving greater effectiveness in, federal expenditures, as part of the overall exercise of removing obstacles to growth. In this review we are conscious that while expenditure reductions have already been made in many areas, this can be only the first step in putting the federal financial house in order, so that the government can play its appropriate role in supporting economic renewal.

The first-round expenditure reductions have shown clearly that the government's approach to expenditure reduction is even-handed. Moreover, the combination of the expenditure reductions and the new expenditure measures announced in the Economic Statement effectively demonstrate this government's commitment to social justice and the social safety net. Indeed, establishment of a $1 billion fund primarily for employment creation is testimony to our determination to provide opportunity to Canadians to share in, and contribute to, economic renewal.

The next step is to analyse the major spending areas, with a tighter focus on current priorities and real needs, with the objective of freeing up additional resources for re-allocation or to reduce financial requirements. The process has to involve careful phasing, with a clear plan, to avoid disruptive changes.

1. Economic Development

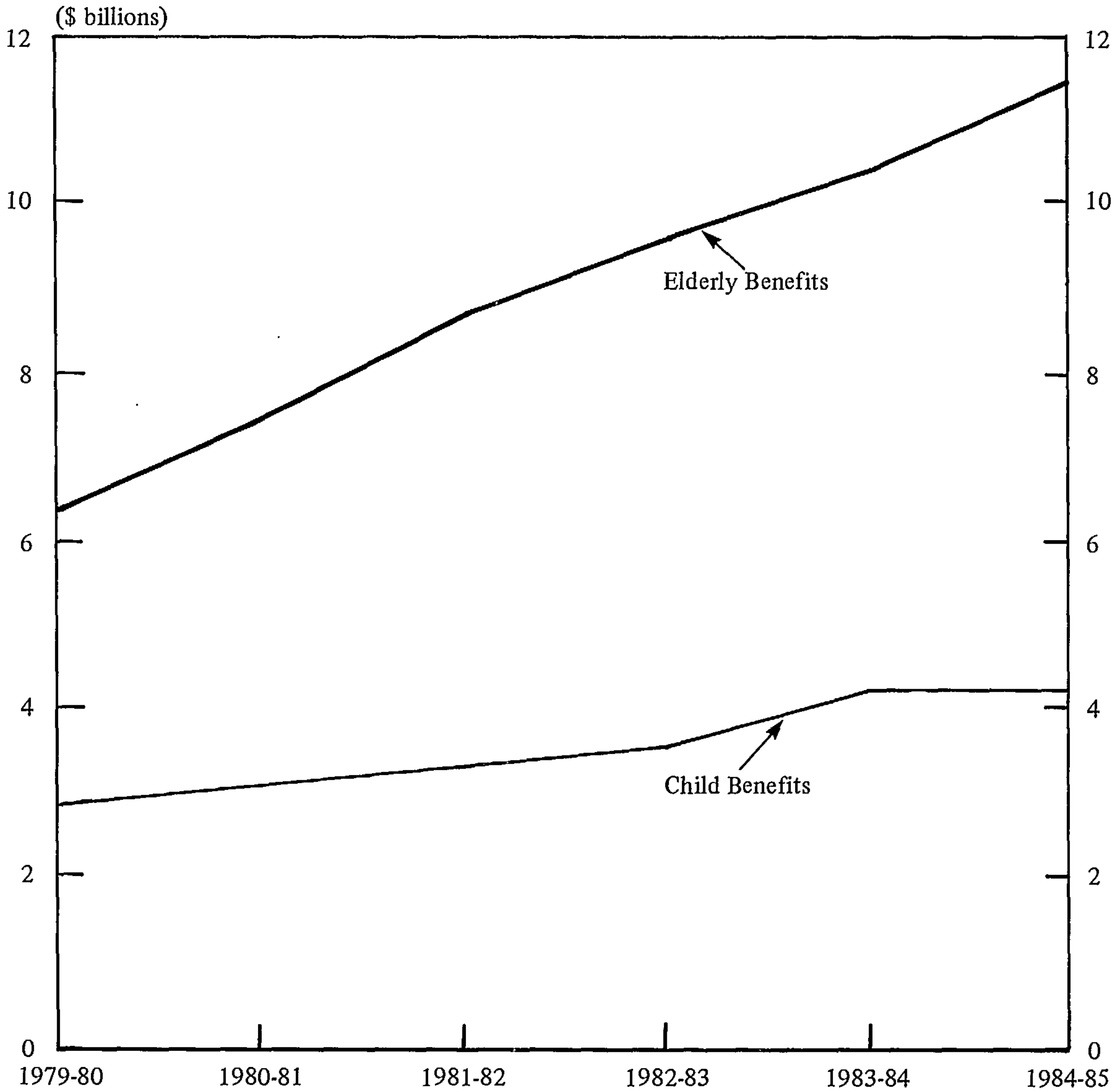
Over the next several months, the federal government intends to carefully examine further possible expenditure reductions in the economic development area. These need not be repeated in this section. It suffices to emphasize that these are areas for close scrutiny. The preceding review of opportunities for promoting growth in the private sector amply shows that a substantial element of current federal spending on economic development may be doing more to hinder than to promote private sector growth. Cutting back in some of these areas can provide greater scope for private sector initiative and growth, and either permit reduced federal spending or free up funds for redeployment in more productive areas. We cannot seriously consider further financial support to even the most attractive measures for spurring private sector growth, until we are confident that there is a source of funds from savings elsewhere, from both economic and other programs.

2. Social Programs

Social policy is about people. This government is committed to the principle that people come first. All groups should have the opportunity of participating fully in our society.

Indeed, special effort is required to ensure that certain groups who have been disadvantaged in the past are given the occasion to become equal partners in a fair society. Barriers restricting full participation by natives, women, visible minorities and the disabled must be pulled down, and obstacles that prohibit individuals from

Chart 17
Net Federal Elderly Benefits and Child Benefits by Fiscal Year



Elderly Benefits
Include Old Age Security (after tax), Guaranteed Income Supplement, Spouses Allowance and Foregone Tax Revenue from the age exemption and the pension income deduction.

Child Benefits
Include Family Allowance (after tax), Child Tax Credit and Foregone Tax Revenue from the Child Tax Exemption for children under 18. For the credit it is assumed that in respect of taxation year 1978, payments were made in 1979/80 and so on.

1984/85 values are estimates.

Source: Department of Finance.

participating fully in Canadian society must be removed. These are the reasons why, for example, the government is committed to affirmative action.

Canadians are rightfully proud of the size and scope of our national social system. Federal spending on the "social safety net" in 1984-85 will be roughly $40 billion, more than 40 per cent of federal outlays. Provinces also provide a variety of social benefits. Some, such as health care and post-secondary education, are funded partly by transfer payments from the federal government which are depicted in Chart 16. In the case of social assistance and social services, the federal and provincial governments share costs under the Canada Assistance Plan.

It is being increasingly suggested that a review of existing social programs is necessary to ensure that the government's social policies are sensitive to the continually changing needs of Canadian society.

The government agrees that a frank and open discussion is timely, and that there is considerable scope for improving and redesigning social programs based on the twin tests of social and fiscal responsibility. *Social responsibility* dictates that wherever possible, and to a greater extent than is the case today, scarce resources should be diverted first to those in greatest need. *Fiscal responsibility* suggests that the best income security is a job, and that government expenditures must be allocated to provide immediate employment opportunities and better ensure sustained income growth.

As a first step in this consultative process, the following sections raise for discussion some aspects of our major social programs – the elderly benefits system, the child benefits system, unemployment insurance and housing. The expenditure on programs for child benefits and elderly benefits is depicted in Chart 17. We need to begin now a debate which will identify the advantages and disadvantages of different approaches. This will help to ensure that Canada's social safety net remains one of the most comprehensive and fair in the world, as well as efficient and well-directed, in a period when government's financial capacity is heavily constrained.

Child Benefits

The federal government directly assists Canadians with young children in several ways. Child benefits include family allowances, the child tax exemption and the child tax credit. Costs to the federal government will be $4.2 billion in 1984-85.

Family allowance is a universal program. All families with children under age 18 are eligible. Allowances are paid on a monthly basis, regardless of family income, to 3.5 million families with 6.5 million children. Benefits currently stand at $29.95 per month per child and are indexed annually to the cost of living. Family allowances will cost approximately $2.4 billion in 1984-85, of which some $450 million will be recovered by the federal government because benefits are taxable.

The *child tax exemption* allows the parent who pays taxes on the family allowance benefits to deduct $710 per child from his or her income before calculating how much taxes are payable in any given year. The rationale for the exemption has been that families with children should be treated differently by the tax system than families in identical circumstances who do not have children. It benefits taxpayers in proportion to their tax bracket, thereby providing high-income families with the greatest support. The exemption is filed in respect of some six million children and will reduce federal tax revenues by approximately $800 million in 1984-85.

Finally, the refundable *child tax credit* is paid only to low- and middle-income recipients of family allowances. The maximum credit is currently $343 per child, is indexed annually to the consumer price index and is reduced by $5 for every $100 of family income exceeding $26,330. For a family with two children, this means benefits of $686 in 1984, if net family income is below $26,330, a diminishing credit if income is between $26,330 and $40,050, and no credit at all if income exceeds $40,050. Approximately 2.4 million families, nine out of 10 of whom are below average income, claim the child tax credit in respect of some five million children. The credit will reduce federal tax revenues by approximately $1.4 billion in 1984-85.

The child benefit system has evolved in response to the changing needs of Canadian families. There were frequent changes to the system prior to 1974, but they involved adjusting the level of benefits rather than fundamental changes in the way the various programs worked. Since 1974, however, the child benefit system has been gradually restructured in order to be more progressive – that is, of greater assistance to families with lower and middle incomes.

Suggestions have been advanced by various groups to change the child benefit system further. What these suggestions have in common is a reduction in benefits for high-income families. They have arisen in part because middle-income families receive higher benefits than low-income families and because families with high incomes receive substantial assistance from the government.

Table 5 illustrates how benefits vary with income and raises a number of questions about the design of federal child benefits.

Is it fair to provide benefits of more than $500 per child to families with income of more than $45,000 a year, in the face of other pressing social problems, including family violence and the plight of many single parents?

Is it fair that families with annual income in the $20,000 to $30,000 range have larger benefits than families with income below $10,000?

Should the child tax exemption be retained, since it is of no assistance to low-income families?

Should the child tax credit be provided to families with annual income as high as $40,000? Should some families with even higher incomes, by using various devices to reduce their income for taxation purposes, become eligible for a child tax credit?

Table 5

Net Annual Benefits *per Child* for One-Earner Families with Two Children Residing in Ontario at Selected Income Levels, 1984

Program	Below $10,000	$20,000	$30,000	$45,000	$80,000
			(dollars)		
Family allowances (after taxes)	359	256	235	197	175
Child tax exemption	0	203	246	320	363
Child tax credit	343	343	303	0	0
Total Net Benefits	702	802	784	517	538

Should the structure of benefits be designed to ensure that only those families in greatest need receive government assistance? Should it recognize that families with children have a larger burden than childless families?

The following options illustrate the sorts of changes that could be made to the existing benefits.

One possibility is to phase out the child tax exemption over several years. Such a proposal would make the system more progressive while maintaining family allowances.

Some have suggested that indexation of family allowances could be reduced or eliminated.

Another option would be to maintain the universal nature of the family allowance program, but reduce the amount of family allowances available to higher-income families. Family allowances already benefit lower-income families more than families with higher incomes because the benefits are taxable. However, it would be possible to make the payments taxable at higher than normal rates, or subject to some other tax recovery scheme, so that practically all benefits going to higher-income families would be subject to taxation.

Another possibility would be to scale back both family allowances and the child tax exemption and to enrich the child tax credit to compensate families with low and middle incomes. Families with low incomes would receive the highest benefits and, above a certain income level, benefits would be reduced as income rises. This approach would result in a substantial boost in the child tax credit, which would likely require that it be paid more than once a year.

In considering any of these possibilities special attention would have to be paid to the trade-off between increased fairness, the added administrative complexity to the system, and the impact of changes on the government's fiscal position. However, the clear objective of any change would be to maintain or, if possible, to enhance the support provided to low-income families.

Elderly Benefits

The federal government assists elderly Canadians to meet their needs through a comprehensive system of transfer payments. This includes direct expenditures in the form of old age security and the guaranteed income supplement, and tax expenditures in the form of the age exemption and the pension income deduction. Total net expenditures for these transfer payments will reach $11.8 billion in 1984-85. Costs are expected to grow significantly in future years as a result of the rapid aging of the population.

It is therefore time to examine whether these federal transfer payments should continue in their present form or whether they need to be redesigned to increase fairness, assist those in greatest need, and reduce the burden on the federal government. If major changes were to be made, sufficient lead time would be required for current workers to plan for their own retirement needs. It will also take some time to make appropriate changes to public and private pension arrangements, and to related tax provisions, to encourage Canadians to prepare for their own retirement. Indeed, increased individual retirement savings will reduce the use of government revenues for financing old age assistance programs, and thus help to lower the tax burden on individuals and companies. It should be quite clear, however, that the government has no intention of reducing benefits for low- and middle-income individuals already retired or nearing retirement. Indeed, the spousal allowance initiative in the Economic Statement is evidence of our desire to *ensure that elderly Canadians enjoy improved financial security.*

The government plans to work actively with provincial governments to bring about the necessary changes to private and public pension plans. The government is also reviewing the previous proposals for changes in tax rules governing RRSPs and employer sponsored pension plans. Modifications which would achieve the goals of the original proposals but address some of the concerns expressed during consultations are under active study.

The *old age security* (OAS) is payable regardless of income to all elderly Canadians meeting minimum residence requirements. The full benefit currently stands at $272 monthly and is indexed quarterly. More than 2.5 million elderly Canadians will receive a total of $8.3 billion in 1984-85, of which some $450 million will be recovered in taxes by the federal government. Prior to 1973, the OAS was financed by special earmarked taxes.

The *guaranteed income supplement* (GIS) guarantees a minimum income to 1.3 million lower-income elderly. As of December 1984, maximum benefits, which are indexed quarterly, will be $323 and $211 per month for single and married pensioners respectively. OAS and GIS combined assure single pensioners a

Table 6

The Elderly Benefit System: Net Annual Benefits for Single Individuals and Married Couples at Selected Income Levels and residing in Ontario, 1984

Income*	OAS (after tax)	GIS	Tax Exemptions	Total Benefits
		(dollars)		
I Single				
0	3,219	3,419	0	6,638
4,000	2,809	1,525	410	4,744
8,000	2,361	0	925	3,286
15,000	2,272	0	1,022	3,294
30,000	2,009	0	1,308	3,317
50,000	1,767	0	1,569	3,336
II Married				
0	6,438	5,004	0	11,442
6,000	5,712	2,165	726	8,603
12,000	4,834	0	1,657	6,491
25,000	4,342	0	2,100	6,442
40,000	3,746	0	2,699	6,445
50,000	3,721	0	2,725	6,446
70,000	3,396	0	3,048	6,444

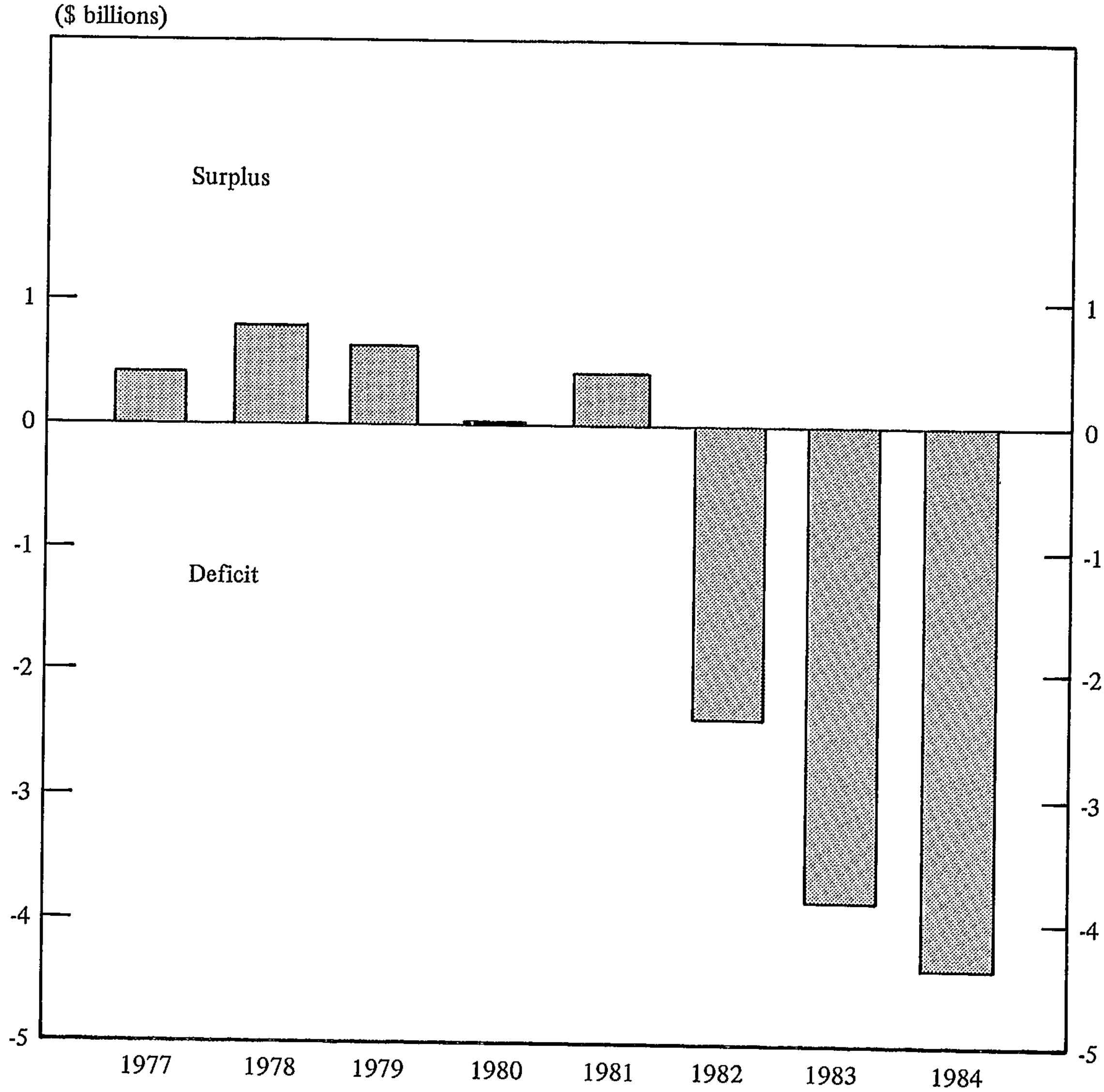
*Excluding OAS and GIS

minimum income of $7,140 per year – $3,264 annually from OAS and $3,876 per year from GIS. However, GIS benefits are reduced by 50 cents for every dollar of income, other than OAS. Costs of GIS to the federal government amount to $3.3 billion annually.

The *age exemption* and *the pension income deduction* are income tax provisions available to elderly Canadians by virtue of their age or their having private pension income. They benefit 1.5 and 1.0 million Canadians respectively and reduce federal tax revenues by some $650 million annually.

The elderly benefit system has been developed over several decades, although its current structure goes back to the mid-1960s with the introduction of the GIS. In recent years, the program has evolved in a way that ensures that new resources directed at the elderly are received by those in greatest need. For example, the three benefit increases provided to the elderly since 1979, other than by regular indexation, have been directed only to recipients of the GIS.

Chart 18
Year End Cumulative Surplus or Deficit
Unemployment Insurance Account



Source: Canada Employment and Immigration Commission.

The benefit structure, as outlined in Table 6, raises a number of questions about the fairness of providing assistance to high-income pensioners and the adequacy of benefits at low-income levels. It has led to suggestions for further changes. Most of them involve reducing benefits available to higher-income pensioners and to increasing benefits to lower-income pensioners.

For example, one possibility would be to reduce the amount of OAS available to high-income pensioners, by making benefits taxable at higher than normal rates or subject to some other tax recovery scheme.

Another possibility could be to increase the progressive nature of the system by phasing out the two tax deductions over several years.

Another alternative involves reducing or eliminating the indexation of OAS while compensating pensioners in need.

In examining options for change to elderly benefits, careful consideration should be given to the administrative implications of the various proposals as well as to their effects on Canadians' incentive to save for their retirement.

Unemployment Insurance

Unemployment insurance plays a vital role as a safety net for unemployed workers and as a stabilizing force in the economy. Its main objectives are to protect workers against temporary interruption of earnings from loss of employment, and to facilitate job search so as to achieve the best possible match between workers and jobs. The program has served particularly well in providing income protection during the recent recession, paying benefits totalling $10.2 billion to almost 3.5 million unemployed workers in 1983 – more than double the level of three years earlier.

The dimensions of the program will continue to be substantial as long as unemployment levels remain high. Total program costs in 1984 are expected to be $11.2 billion, of which $10.0 billion will be paid directly to the unemployed. Employers and employees will pay U.I. premiums totalling $7.8 billion and the federal government will also contribute $2.9 billion from general revenues to pay for the cost of regional extended benefits and special benefits paid to fishermen.

A deficit of $500 million in the U.I. account in 1984, which will be covered by a loan from the federal government, will bring the accumulated deficit of the account to $4.4 billion, as shown in Chart 18. Under the current financing arrangements this deficit, largely created during the recent recession, will ultimately have to be financed by the private sector. This has led to calls to contain the costs of the program.

The vast majority of unemployed Canadians want to find a job. However, in its present form, the U.I. program may create obstacles to labour market adjustment and to economic growth and investment. Reviews of the program have suggested that it may create disincentives to job search and, in some cases, encourage individuals to work just long enough to qualify for benefits. It has also been argued that the program may discourage labour mobility among regions and industrial sectors, and encourage employers to overuse lay-offs as a means of adjusting to changing levels of activity.

In response to such criticisms the government has announced a number of administrative changes to the U.I. program. These include treating pension income and severance pay as income for the purpose of defining U.I. benefits, and the intensification of the claimant interview program. Various other options to improve the labour market incentives of the program must also be considered.

Some options to contain costs would entail amendment of the Unemployment Insurance Act. For example, should the benefit disqualification period for those who quit work voluntarily be lengthened from the current maximum six weeks to 10 or even 12 weeks? Might the waiting period before benefits begin be increased from two weeks to perhaps three weeks? Should the minimum length of time a claimant is required to work to qualify for U.I. be increased? Should the number of weeks of insurable employment required for each week of benefits claimed be increased?

Other related proposals have also been put forward. Would it be appropriate to modify the formula which determines the annual increase in the level of maximum insurable earnings? Should the rate of benefits paid, which is now 60 per cent of insurable earnings, be modified? Might the current benefit duration of 50 weeks be reduced, say to 40 weeks, despite continuing high levels of unemployment which generate pressures to extend the period?

Consideration might also be given to more far-reaching changes to the U.I. system. On the financing side, for example, should the financial responsibility for job creation, work-sharing costs and maternity benefits be reconsidered? Should contributions to the plan be more closely related to the "risks" of unemployment associated with certain industrial sectors as determined by their past lay-off pattern? Another departure could be to develop a program component which would be based on insurance objectives and a separate component based on social and redistribution considerations.

At the same time, it must be recognized that there may be demands to modify and perhaps expand the use of unemployment insurance to assist individuals in adjusting to rapidly changing social, economic and technological conditions. Should greater emphasis be placed on the labour market adjustment objectives of unemployment insurance by allowing recipients to be involved in training and skill development programs?

Should the use of unemployment insurance for job creation be expanded and should the use of U.I. to support entrepreneurship be introduced? Should more U.I. funds be directed to such programs as maternity benefits in order to facilitate a better integration of parenthood and work? Finally, is the distribution of benefits to individuals in higher-income groups disproportionately high?

In reviewing options to redesign the unemployment insurance program, it must be recognized that the program has evolved over time to meet a variety of social, economic and redistributive objectives. These objectives may at some times be in conflict with each other and some balance among them must therefore be achieved. Consultations among governments, employers and employees will be essential in order to arrive at an appropriate balance.

Housing

The government plans to spend almost $1.5 billion on housing through the Canada Mortgage and Housing Corporation (CMHC) in 1985-86. Most of these expenditures are directed to those Canadians who cannot gain access to suitable and adequate shelter (social housing) and to resolving various problems that arise in housing markets from time to time (market housing).

The principal expenditures relate to *social housing*. The major programs are: the non-profit and co-operative housing programs; the rural and native housing program; the residential rehabilitation assistance program; and the public housing program. Virtually all of the planned 1985-86 expenditures relate to this area. Further, close to 90 per cent of these expenditures are non-discretionary in the sense that they represent expenditures for commitments made in the past. These relate to the existing stock of over 200,000 public housing units jointly financed with provincial governments, and close to 179,000 non-profit and co-operative housing units. While there are still housing problems to be solved, the lack of discretionary funds allows little room to manoeuvre.

The question is whether there are better and more equitable ways of helping those most in need. Some have suggested changes to the non-profit and co-operative programs so that they better serve low-income households. Others have argued for changes to these programs which reduce their cost but still provide support for non-profit housing. Still others have suggested a shelter allowance as an alternative. These are important proposals which have to be explored with the provinces and with other interested groups.

In the area of *market housing*, no major expenditures are planned. However, there are two current market housing programs which are designed not to cost public funds. These are the mortgage rate protection plan and the mortgage insurance program. The mortgage rate protection plan is available to homeowners who wish to reduce uncertainty about mortgage interest rates at renewal, while mortgage insurance has served to improve access to home ownership and to assist private rental production.

The federal role in market housing needs to be reviewed. Should the government continue to be involved in rental production or should market forces be allowed to operate more freely? Some national housing industry associations have questioned the past practice of using short-term grants to stimulate housing construction designed to improve access to home ownership, arguing that in the longer run these are disruptive to the industry. At the same time they argue for greater stability in the industry. Are there ways of achieving greater stability without cost to government?

There is much that needs to be determined in establishing the federal government's housing policy. In social housing, program changes or alternatives should ensure that those who receive federal housing assistance are truly in need of such assistance. In the domain of market housing, consideration should be given to improving the conditions under which the private sector operates. The formulation of an effective federal housing policy will require discussion with, and the co-operation of, the provinces and other interested Canadians.

3. Federal-Provincial Transfers

Fiscal arrangements between the federal and provincial governments are a central feature of Canada's federal system. These arrangements consist of numerous and varied financial links between the federal and provincial governments. For example, the federal government provides unconditional equalization payments to provinces with low capacity to raise revenues from taxes; it block funds health and post-secondary education; it shares with provinces the cost of programs such as the Canada Assistance Plan; it shares the revenue from certain federal taxes; it makes payments to provinces in lieu of taxes and it purchases specific services such as manpower training.

Federal payments to provinces have grown substantially over the years, and a large proportion of federal expenditures is now devoted to financing transfers to the provinces, territories and municipalities. In 1984-85 federal cash transfers to these other governments will total more than $18 billion and equal almost 20 per cent of total federal outlays. In addition, at various times in the past the federal government has transferred income taxes to the provinces by reducing its tax rates, thereby creating room for the provinces to increase their rates without raising the total tax burden on individuals. This enabled provinces to substantially increase their revenues and their ability to finance health and post-secondary education.

The fiscal equalization program provides essential help to the lower-income provinces to make it possible for them, along with their local governments, to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Six provinces (Newfoundland, Nova Scotia, New Brunswick, Prince Edward Island, Quebec and Manitoba) will receive a total of approximately $5.5 billion in 1984-85. Equalization accounts for approximately 25 per cent of the total budgetary revenues of the four Atlantic Provinces and, in each case, is their most important single source of revenue. For Manitoba and Quebec, the program accounts for approximately 15 per cent of total budgetary revenues. Equalization payments have increased rapidly since they were introduced in 1957-58 and have tripled in the past 10 years. The fiscal equalization program expires at the end of March 1987, and will be reviewed in consultation with the provinces.

The federal government also makes a substantial contribution toward provincial expenditures for health and post-secondary education. This contribution takes the form of an equal per capita transfer to all provinces, which increases each year in line with the growth of the economy. The amounts transferred to the provinces are in recognition of the broad and continuing national interest in these important fields.

The total transfer for health and post-secondary education will amount to over $14 billion in 1984-85, of which $8 billion is cash. The growth of these payments has been steady and rapid, having considerably more than doubled since 1977-78, when the contributions took their present form.

Nowhere are the benefits of co-operative relations between governments more striking than in our tradition of sharing the costs of essential public services. At the same time, if the federal government is to contain its expenditures in general, it is appropriate to ask whether transfers to the provinces should be insulated from policies of restraint. If the answer is that they should be insulated, then the full burden of restraint would fall within program areas that are exclusively federal, and restraint would have to be relatively more severe in these areas. Any decision on this matter must take account of the particular importance which some federal programs have for certain parts of the country.

The contributions for health and post-secondary education have already been the subject of considerable discussion among governments. Some changes have been made and there have been calls for more. For example, there have been suggestions that health and post-secondary education have been under-funded, accompanied by debate over which level of government has been responsible. Some groups have contended that the problems about funding could be lessened by a return to the cost-sharing system which existed prior to 1977, under which federal support was tied to specific areas of spending. Others, including provinces, have argued that the present arrangement is superior and have called for a renewed commitment to the principles of block funding. Those who support the present arrangement contend that it brought important advantages when it was introduced and provides a system that can be built upon in the future.

Consultations between governments on the extent to which further change is necessary or desirable should take place over the coming months. The upcoming meeting of federal and provincial ministers of finance will provide an opportunity to start the discussions that will lead up to the fiscal arrangements for 1987-1992. The need to contain costs and reduce deficits is a concern shared by governments, both federal and provincial. Health and post-secondary education are undoubtedly areas where both levels of government can determine priorities and work more effectively and efficiently to contain pressures on scarce financial resources.

The answer for the future is not simply to top up federal or provincial funding for health and post-secondary education. The answer is not simply more money. We need to talk about ways in which we can use our existing resources more effectively. Neither level of government has the economic capacity to invest large amounts of new money in these areas. It is time for all interested parties to look for new approaches within the limits of budgetary realities.

A new climate of communication will be needed. By working together more effectively, and heeding fully the concerns of Canadians speaking as both recipients and taxpayers, the federal and provincial governments can have a significant impact on our country's economic growth over the coming years. There is a widely felt need to restore co-operative, sensible and productive relations among governments and regions. A commitment to rebuild co-operative federalism is essential if we are to address major issues such as retraining for the unemployed, new jobs for youth, research and development, the future of health and post-secondary education services, and pension reform.

4. Official Development Assistance

Since 1980 Canada has committed itself internationally to increase our official development assistance (ODA) to levels equivalent to 0.5 per cent of GNP by mid-decade and 0.7 per cent of GNP by 1990. The mid-decade goal is close to attainment. On the basis of the latest estimates of GNP, ODA will reach 0.5 per cent of GNP in 1985-86, about $2.1 billion. It would have to double in dollar terms if were were to achieve the 0.7 per cent target by 1990.

Following reductions in Canada's ODA in the late 1970s, aid allocations have been increasing in real terms over the last few years. Since 1980 Canada's ODA levels have been set to achieve a planned ODA/GNP ratio. By 1983, Canada had raised its ODA/GNP ratio to 0.45 per cent, well above the average of 0.36 per cent achieved by member countries of the OECD development assistant committee (DAC). Canada's ODA/GNP performance was tenth among the 17 members, but was substantially better than the United States, the United Kingdom, Japan, and Italy.

Canada's current program is provided through a number of channels including bilateral, multilateral, food aid and non-government organizations. Emphasis is given to assisting low-income countries, particularly the least developed among them. There are significant direct economic benefits to Canadian industry from this program as the bulk of resources are used to procure Canadian goods and services for the benefit of developing countries.

A growing volume of ODA will continue to remain a high priority for the Government of Canada. However, the current fiscal situation and the serious domestic economic situation has required the government to review the current ODA program and reconsider the pace at which it could proceed towards achieving the 0.7 per cent ODA/GNP target. A slower pace would provide significant fiscal savings for the government but still permit substantial real growth in the ODA program, ensuring that Canada would continue to allocate a growing proportion of its GNP to international development and that our ODA effort would continue to compare favourably with that of other major donors.

5. National Defence

Defence funding in the late 1960s and early to mid-1970s was insufficient to allow for adequate capital investment, with the result that equipment modernization was almost non-existent. The forces were run down and sorely in need of repair. In recognition of this a decision was taken in the late 1970s to implement consistent real growth in defence spending. Thus, the Department of National Defence was able to increase the percentage of its expenditures on capital from about 8 per cent in the early 1970s to about 26 per cent in the mid-1980s. This level has allowed for large-scale re-equipment projects such as the Canadian patrol frigate and the CF-18 new fighter aircraft.

The process has begun, but much remains to be done. It is generally recognized that the armed forces are still inadequately equipped to carry out their present mandate. The previous government gave a commitment to its NATO defence partners to provide 3 per cent real growth in defence expenditures (based on the GNE deflator) until 1986-87. This government has stated that it plans to attach even higher priority to national defence despite the extremely difficult economic environment in which we find ourselves. However, given the financial constraints it will not be possible to satisfy every need. There will have to be priorities, within the defence program, and among the defence and other programs of this government. Difficult choices will have to be made. We will be consulting widely on these choices.

At the same time, we will be looking for ways to increase the efficiency with which the defence mandate is carried out. We will be examining the way we do things – the way we use our personnel, our material, our capital equipment and our bases – to see where improvement can be made or resources found to help manage the program better.

C. Conclusions: Implementing the Strategy

Canada clearly requires a fundamental economic renewal to ensure sustained growth and productive jobs. To build a strong foundation for that renewal, Canadians and their governments must proceed together to develop an action plan to remove the many obstacles to economic growth. This action plan must address with vigour and commitment two closely related major thrusts.

First, government policies and programs must be changed to ensure that Canada's private sector can become the driving force of economic renewal in an increasingly competitive world marketplace. To foster growth in the private sector, Canadians must begin a process of change towards a new environment that encourages entrepreneurship and facilitates adaptation to new market realities. In some cases, this will mean less government regulation and intervention. In other cases, it will require reducing government subsidies and other expenditures which undermine the efficient allocation of our scarce resources. In yet others, it will be necessary to redirect or reinforce government activities which support growth and adjustment. This will be especially true in the case of R&D, exports, and investment, and especially for small- and medium-sized business.

Second, the federal deficit must be reduced to limit the steadily rising federal debt burden and its serious consequences for interest rates, private investment and the government's room to manoeuvre. Bringing the deficit down will require restraining the growth of federal outlays. A reduction of $10-15 billion from projected expenditure levels, phased in by the end of the decade, would be a prudent and realistic target. A start has been made, with the measures announced in the Economic Statement. To achieve the target will necessitate a careful examination of all federal expenditures – economic and regional development, social programs, federal-provincial transfers, official development assistance, defence – to develop an orderly plan to slow their growth, while re-shaping their composition to minimize the effects of contraction on the economy.

Any action plan will have to be fair. Some of the changes necessary for an economic turnaround are strong medicine. The pill may in some instances be hard to swallow, but it will be indigestible unless all economic groups and regions bear only their fair share of burdens. Moreover, the pace of change will in some cases be a critical factor. We must take the time necessary to find compassionate solutions to our problems.

Refusing change is no longer an option for Canada. If Canadians recoil from the very idea of change, such as the termination of a federal expenditure program affecting a specific sector, region, or group, Canada will be deflected off course in its search for solutions, and for renewal. If we are all to reap the rewards of renewal, we all must invest in the renewal effort.

Finally, the process of coming to the decisions must, and will, be open. There is no hidden agenda for expenditure cuts. The areas for change have been noted. We must now consult widely, fully, and with the realization that the government alone cannot solve these problems. It is a challenge and opportunity for all Canadians. The national dialogue will be an essential ingredient in the search for equitable, measured progress towards economic renewal.

This chapter has raised numerous questions. Together, they go to the heart of Canadian public policy. We have suggested possible avenues for improvement to stimulate the public debate that must now take place. Now, it is time to consult Canadians on the options. An alternative course would have been for the government to act unilaterally, without consultation, but that is not our way. In our view, that would be a continuation of the attitudes that have contributed so much to the current national malaise. The government will, of course, make its full contribution to the national debate, but we have intentionally refrained from imposing our solutions to problems that Canadians have to deal with together.

As noted earlier in this chapter, the Deputy Prime Minister is leading a Ministerial Task Force conducting a fundamental review of federal programs and regulations, with a view to consolidation, simplification, ending duplication, and improving service to the public. That exercise is an essential complement to the task set out in this chapter.

Our next step is to provide discussion papers in key subject areas. Ministers will be releasing these papers over the next few months, in the hope that they will add useful information and help focus discussion of the issues. These papers, and the federal government's position in the consultations to follow, will be governed by our view of the necessary policy objectives for the economy, which may be summarized as follows:

- downsize government, while ensuring maintenance of the social safety net
- reduce economic regulation, and foster entrepreneurial spirit
- increase self-reliance of individuals and business in responding to changing circumstances
- establish policies that attract investment and encourage growth
- begin building a national consensus

This chapter has addressed the first four of these objectives; the next chapter considers the process of achieving consensus among Canadians on the fundamental issues.

V. Consultations

One of the elements of our mandate for change is to consult. Canadians want a chance to be heard and to participate in discussions leading to decisions that affect them. This principle is fundamental, for although the government wants to ensure that the benefits of economic renewal are shared by all Canadians, the costs and burdens of the specific changes must also be fairly and equitably shared. Moreover, economic renewal cannot become a reality unless everyone works towards solutions with the same broad understanding of the problems.

The government is committed to a consultative process that will forge a better understanding with the private sector and the provinces. It intends to lay down the foundation for a continuing, ongoing dialogue with all the economic players.

Issues for Consultation

In the months ahead, consultations between the government and the private sector will deal with the agenda for economic renewal tabled in this paper and in the Economic Statement.

Specifically, the upcoming series of consultations will deal with four broad issues:

1. The federal government's responsibility to get its own fiscal house in order. Discussion would focus on the growing debt problem and on ways to get government expenditures under control. Specific areas of expenditure where savings could be made as summarized in Chapter IV above would also be discussed;
2. Removing major obstacles to growth. Chapter IV highlights a large number of areas where the government believes action could be taken to promote private sector growth. Ministers will listen to views from the private sector in their areas of specific responsibilities;
3. Encouraging entrepreneurship and risk-taking, especially in the small and medium-sized business sectors; and,
4. Better targetting of social support to those genuinely in need.

The consultations will focus on three key areas: the problems and issues facing Canada's economy; the broad directions in which we must go to remedy the situation; the options available to the federal government and the private sector.

The Consultation Process

This agenda paper is being distributed widely and will be discussed with all Canadians. In addition, a series of discussion papers on specific and related issues will be released within the next few months. A serious effort is being made to ensure that areas for future government action are included in the discussion, even if they are tough and unpleasant to deal with. This is being done to ensure that interested groups focus on all of the proposals and to make clear from the outset that there is no secret agenda. Our economic agenda is public and open for discussion.

The government will make a concerted effort to consult with all groups in Canadian society, on the whole range of issues raised in its program for economic renewal.

The Prime Minister and other members of the government will be meeting with their provincial colleagues over the fall and winter to discuss the directions set out in the Economic Statement and this paper. Concurrently, a broad round of consultations will be undertaken by the Minister of Finance and other ministers to discuss specific elements of the agenda.

These consultations will culminate in a National Economic Summit to be held early next year in which representatives of the private sector will meet with the government to seek a better understanding of the challenges and opportunities we face and how to meet them. The government will then prepare a budget which will set out the next steps in the economic renewal program.

The budget will not signal the end of the consultative process. In general, major measures presented for the first time in the budget will be tabled in draft form before being introduced in the House of Commons. This will enable the government to conduct further consultations focussing on these specific issues and to solicit opinions from all Canadians.

The government also intends to ensure that Parliament plays a full and constructive role in the consultation process, through expanded use of Parliamentary committees and task forces.

In addition to the formal Parliamentary process, all ministers will consult actively on an ongoing basis in their areas of specific responsibilities and with all segments of the population that might be affected by specific measures under consideration.

The budgetary process itself and various aspects of the income tax system will be the subject of a discussion paper to be issued within the next few months. Both have come under increasing criticism from tax professionals and the public at large so that the present system of developing, enacting and administering the income tax laws is now widely perceived as inefficient and less than fair.

The traditional and long-standing Canadian practice of provisionally collecting taxes before Parliament has enacted the relevant legislation should be reviewed. It is time to improve the Parliamentary process of turning budgetary proposals into tax laws and to involve the public more meaningfully in the development of budgetary proposals. Consultation will pave the way for major improvements in these vital areas.

Conclusion

The consultative process will be flexible yet thorough. It will *not* be used as an excuse to postpone making decisions. The government's commitment to consultation is an affirmation that the only way to meet the challenge of economic renewal is through co-operation and the willingness of all Canadians to work together.

VI. Better Economic Performance: The Challenge for Canadians

Canada is blessed with a rich endowment of resources. Our people are well-educated, motivated and hard-working. Our country has vast quantities of natural resources. Our economic potential is nothing less than enormous. Our capacity to use this potential to benefit all Canadians has been amply demonstrated in the past.

Nevertheless, the sorry fact of the last decade is that Canada has not lived up to its economic potential. And this failure to achieve our potential has tended to permeate our attitude toward the future as well. Most economic projections for the remainder of this decade tend to foresee a relatively lacklustre outlook for Canada. Forecasters are relatively pessimistic about the prospects for growth, job creation and unemployment, investment, productivity and inflation. Relative to the 1950s and 1960s, these reduced economic expectations reflect a number of factors: the seeming intractability of the fiscal deficit problem; a sense of policy uncertainty; an apparent decline in entrepreneurial and consumer confidence; and a general hangover from the less than sparkling economic performance of the 1970s and early 1980s. Is the long period of slowing growth, rising unemployment and rising inflation of the last decade an unchallengeable harbinger of the future for Canadians? We think not.

While this outlook is not good enough, Canadians know we can do better if we work together. The economic outlook can be improved. That is the challenge for this government – to remove the obstacles to growth in the Canadian economy that years of excessive government tampering with the marketplace have wrought. But it is also the challenge for each and every Canadian. Doom and gloom can become a self-perpetuating illness. Failures of government policy can become excuses for failed economic leadership in the private sector as well.

Difficult choices face the government. This document has discussed what this government can do to remove impediments to growth in the Canadian economy. Clearly, given the economic and fiscal situation that it has inherited, there is much that this government must, and will, do. Deficits must be reduced. Government intervention in the marketplace must be reduced. Investment must be encouraged. Confidence must be restored.

But difficult choices and hard decisions are not the sole preserve of the government. The private sector in Canada must ask itself some tough questions:

has it done its utmost to increase R&D investment; has it modernized its capital stock and kept up with technological change; has it aggressively pushed itself into the world market where we, as a trading nation must be; has it pushed productivity growth as aggressively as is required to remain competitive in world markets?

How these challenges can best be met will form the basis of extensive consultations with all segments of the private sector. The end result of these consultations should be a clear blueprint for government action to restore fiscal responsibility, flexibility and credibility. The government's objectives must and will be clear, and it will be judged on how well it attains these goals. At the same time, Canadians must recognize that this government is promising less intervention, not more. This is an opportunity, but also a responsibility. All key players in the economy – government, business and labour – must lift their sights and set new and challenging objectives for themselves. Doing better individually means we do better collectively. And do better we must.

Consider in turn the beneficial implications for our economy if the private sector were to challenge itself to increase more rapidly its investment spending, to expand export markets, to improve research and development, to enhance human resource development and to achieve healthy productivity growth.

The Investment Challenge

Investment plays a key role in shaping the economic future of an economy. Investment spending contributes directly to growth in real output and employment. But, even more important, the ability to put in place the right types of investment when they are required, and to respond rapidly to changing technology and to new world market conditions, strongly influences the future productivity growth and international competitiveness of a country. Increasing productive investment would benefit all sectors of the Canadian economy significantly. As the government moves to eliminate obstacles to investment growth, business must ask itself how it can do better and how much better it can do.

The R&D Challenge

In 1983, R&D expenditures in Canada totalled $5.2 billion, or 1.4 per cent of nominal GNP. In the terminology of the OECD, this made us a medium R&D country, far behind the likes of the United States, Japan, Germany, the United Kingdom and France. Is this where a country with our endowment of human capital, educational skills and know-how should be? Do we want to take the risk of falling behind these huge trading countries in a world that is changing rapidly in terms of technology? Increased R&D effort, and its rapid, widespread application, will require a substantial commitment from all sectors. It will be expensive. But, from the perspective of enlightened self-interest, can any segment of the economy – indeed, can we as a nation – afford to do otherwise? Would specific goals for individual industries help focus our national R&D efforts?

The Productivity Challenge

Productivity growth in Canada averaged 2.5 per cent over the 1966-1973 period. Average productivity growth was zero from 1974 to 1982. The implications of this dismal performance have been profound for the Canadian economy: shrinking real income growth, falling competitiveness, lower profitability and higher government deficits. In a very real sense, improving productivity enables all Canadians to live better. To produce more goods and services with the same inputs of labour and capital means that there is a bigger economic pie to be shared by all. Productivity gains come from investment and R&D, but significant gains can also come through more effective management and production systems. Improved productivity can build on itself by increasing our competitiveness, and our exports, and our ability to finance more investment and R&D spending. This means more jobs and a rising standard of living for all Canadians and should lead to an improvement in the quality of working life. A major challenge for the private sector is to improve productivity growth.

The Challenge to Develop Better Our Human Resources

The success of any economy ultimately rests on the skill, motivation and talents of its people. Canada has long been a leader among industrialized countries in terms of opening up educational opportunities for all Canadians. Canadians must have the best possible opportunities for training and skill development so that they can adapt efficiently and quickly to changes in job opportunities. Business and labour must seek new ways to adjust rapidly and positively to a constantly shifting economic environment, in a spirit that reflects a shared national commitment to improved economic performance.

The Export Challenge

Canada's share of world trade has declined in the post-war period. We have fallen from fourth to eighth place in the ranks of the world's major trading nations. Stronger export growth would increase real economic growth in Canada. It would mean many new jobs for the Canadian economy. But rising to this challenge would mean even more. Confidence in our entrepreneurial and marketing skills would be emboldened by succeeding in competition with the best the world can offer. Improving our performance in investment, R&D, productivity and human resources will enhance our ability to compete in the world. But we should also address other ways in which the private sector can play a more aggressive role in world markets, and discuss whether setting meaningful objectives can help trade performance.

All of these challenges need to be pursued. The government is prepared to explore, in consultations with Canadians, whether setting ambitious but realistic objectives in these areas could help our quest for economic renewal.

When Canadians voted massively for change, they indicated their desire for a government that would tackle the causes, not the symptoms, of our economic problems. This government wants to work together with Canadians to improve the current economic situation, and to ensure an economic legacy for our children befitting our richly endowed country. Better economic performance is clearly the challenge for all of us. As we rise to this challenge, we will have not only a healthier economy but a stronger society, with a much greater awareness of what we can achieve by working together.

Annex

Status Quo Fiscal Outlook to 1990-91 and Comparison With the February 1984 Budget

Introduction

The purpose of this Annex is two-fold: first, to provide detailed information on the medium-term fiscal outlook for the federal government to the end of the decade; and, second, to show how the fiscal outlook has changed from that given in the February 1984 Budget.

The projections are based on an updated set of economic assumptions, and can be viewed as status quo projections assuming no change in government policy. They reflect the "state of the books" as the government found them and do not reflect the policy changes announced in the Economic Statement of November 8. The projections do, however, incorporate the impact of the 1 per cent increase in the manufacturers' sales tax, which took effect in October. As well, a number of accounting changes recommended by the Auditor General have been incorporated. In other respects, the current fiscal projections are directly comparable to those presented in the February budget.

A. The Fiscal Outlook to 1990-91

Overview

The fiscal projections are based on the medium-term economic projections, discussed in Chapter II of this paper. The economy is expected to grow less quickly in 1985 than in 1984, but to achieve growth slightly above potential over the remainder of the decade. Inflation is projected to remain relatively stable, and the unemployment rate to decline from an average of 11.4 per cent in 1984 to about 7 per cent by 1990. Personal income growth is expected to average around 7 per cent per year, reflecting the projected strength in employment growth coupled with modest gains in wages. Corporate profits are projected to increase by around 25 per cent in 1984, reflecting recovery from the low levels recorded during the 1981-1982 recession, and thereafter, to increase at about 10 per cent per annum.

Given this economic outlook, the status quo fiscal projections, as summarized in Table A.1, show a budgetary deficit of $34.5 billion in 1984-85, rising to $37.1 billion next year. By the end of the projection period, the deficit is still expected to be in excess of $37 billion, even though budgetary revenues are projected to grow at a faster rate than budgetary expenditures. Budgetary revenues are expected to grow at an average annual rate of 8.4 per cent between 1984-85 and 1990-91 while, over the same period, budgetary expenditures are projected to increase by 6.5 per cent. Given the large base of expenditures relative to revenues, the deficit does not decline significantly over the remainder of the decade despite the fact that revenues are growing about 2 per cent per year more rapidly than expenditures.

Table A.1

Summary Statement of Transactions November 1984 Status Quo(1)
1983-84 to 1990-91 (Fiscal Years)

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(millions of dollars)				
Budgetary transactions								
Revenues	57,131	65,435	69,542	74,552	80,162	86,608	92,555	100,629
Expenditures	−88,915	−99,935	−106,642	−108,852	−115,262	−123,008	−130,255	−137,929
Deficit	−31,784	−34,500	−37,100	−34,300	−35,100	−36,400	−37,700	−37,300
Non-budgetary transactions								
Loans investments and advances	−673	−665	−1,058	−948	−838	−892	−945	−1,071
Specified purpose accounts	4,400	4,344	5,833	6,314	6,832	7,293	8,518	7,743
Other transactions	2,975	1,021	325	1,034	1,406	499	2,327	828
Net source of funds	6,702	4,700	5,100	6,400	7,400	6,900	9,900	7,500
Financial requirements (excl. foreign exchange transactions)	−25,082	−29,800	−32,000	−27,900	−27,700	−29,500	−27,800	−29,800
Total outlays	−89,588	−100,600	−107,700	−109,800	−116,100	−123,900	−131,200	−139,000
Percentage change	12.2	12.3	7.1	1.9	5.7	6.7	5.9	5.9
Percentage of GNP	−23.0	−23.9	−24.0	−22.7	−22.4	−22.1	−21.8	−21.5
Program outlays	−71,442	−77,940	−82,155	−83,865	−89,310	−94,325	−99,375	−104,955
Percentage change	13.6	9.1	5.4	2.1	6.5	5.6	5.4	5.6
Percentage of GNP	−18.3	−18.5	−18.3	−17.4	−17.2	−16.8	−16.5	−16.2
Public debt charges	18,146	22,660	25,545	25,935	26,790	29,575	31,825	34,045
Percentage change	6.9	24.9	12.7	1.5	3.3	10.4	7.6	7.0
Percentage of GNP	4.6	5.4	5.7	5.4	5.2	5.3	5.3	5.3
Budgetary expenditures								
Percentage change	11.1	12.4	6.7	2.1	5.9	6.7	5.9	5.9
Percentage of GNP	−22.8	−23.7	−23.7	−22.5	−22.2	−22.0	−21.7	−21.3
Budgetary revenue								
Percentage change	3.6	14.5	6.3	7.2	7.5	8.0	6.9	8.7
Percentage of GNP	14.6	15.5	15.5	15.4	15.4	15.5	15.4	15.6
Budgetary deficit								
Percentage of GNP	−8.1	−8.2	−8.3	−7.1	−6.8	−6.5	−6.3	−5.8

Table A.1 (Cont'd)

Summary Statement of Transactions November 1984 Status Quo[1]
1983-84 to 1990-91 (Fiscal Years)

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(millions of dollars)				
Financial requirements (excl. foreign exchange transactions)								
Percentage of GNP	−6.4	−7.1	−7.1	−5.8	−5.3	−5.3	−4.6	−4.6
GNP (billions of dollars)	390.3	421.7	449.4	482.9	519.0	560.2	601.4	646.4

[1] The 1983-84 figures are presented on the same basis as the projections for 1984-85 to 1990-91 and include the gross proceeds from the Canadian Ownership Special Charge in budgetary revenue. Financial requirements are unaffected by this treatment as loans, investments and advances and the specified purpose accounts have been adjusted accordingly. This contrasts with the public accounts treatment, where the net proceeds are classified as a specified purpose transaction.

Budgetary Revenues

The flow of budgetary revenues is contingent upon the economic outlook, given the tax system. The 1981-1982 recession slowed the growth in the tax bases considerably, thereby restraining the increase in budgetary revenues in both 1982-83 and 1983-84. In 1984-85, budgetary revenues are projected to increase by 14.5 per cent (see Table A.2), up significantly from the advance of 3.6 per cent registered in 1983-84. Most of the expected increase in 1984-85 results from a rebound in personal and corporate income tax revenues, as their respective tax bases improve, and also from an increase in return on investments due to the behaviour of interest rates. The projected growth of budgetary revenues weakens somewhat in 1985-86, but revenues continue to grow in line with the advances in economic activity through the rest of the decade. As a percentage of GNP, budgetary revenues are projected to increase to 15.5 per cent in 1984-85 and to show little change thereafter.

Among the components of budgetary revenue, personal income tax revenues are expected to increase in line with the growth in the economy. The somewhat faster rate of increase in personal income tax revenues in 1985-86 reflects, in part, the impact of various tax measures announced in past budgets.

Corporate income tax revenues are expected to increase significantly in 1984-85 due to a rebound in corporate profits in both 1983 and 1984 from their recession levels. These tax revenues should slow somewhat in 1985-86 and 1986-87, due largely to the slowdown in economic activity in 1985. Thereafter, the flow of corporate income tax revenue is expected to increase faster than GNP as the economy improves. The growth in sales tax revenues is affected by the 1 per cent increase in the manufacturers' sales tax effective October 1, 1984.

Table A.2

November 1984 Status Quo Budgetary Revenue Projections[1] 1983-84 to 1990-91

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(millions of dollars)				
Personal income tax	26,967	29,190	32,495	35,670	39,270	42,860	46,500	50,695
Corporate income tax	7,286	10,506	11,005	11,182	12,234	13,148	14,734	16,667
Sales tax	6,660	7,710	8,309	8,823	9,565	10,234	9,917	10,650
Other tax and non-tax revenue	16,218	18,029	17,733	18,877	19,093	20,366	21,404	22,617
Total budgetary revenue	57,131	65,435	69,542	74,552	80,162	86,608	92,555	100,629
				(percentage change)				
Personal income tax	2.4	8.2	11.3	9.8	10.1	9.1	8.5	9.0
Corporate income tax	2.1	44.2	4.7	1.6	9.4	7.5	12.1	13.1
Sales tax	13.0	15.8	7.8	6.2	8.4	7.0	−3.1	7.4
Other tax and non-tax revenue	2.9	11.2	−1.6	6.5	1.1	6.7	5.1	5.7
Total budgetary revenue	3.6	14.5	6.3	7.2	7.5	8.0	6.9	8.7
				(percentage of GNP)				
Personal income tax	6.9	6.9	7.2	7.4	7.6	7.7	7.7	7.8
Corporate income tax	1.9	2.5	2.4	2.3	2.4	2.3	2.4	2.6
Sales tax	1.7	1.8	1.8	1.8	1.8	1.8	1.6	1.6
Other tax and non-tax revenue	4.2	4.3	3.9	3.9	3.7	3.6	3.6	3.5
Total budgetary revenue	14.6	15.5	15.5	15.4	15.4	15.5	15.4	15.6

Note: Details may not add due to rounding.

[1] The 1983-84 figures are presented on the same basis as the projections for 1984-85 to 1990-91 and include the gross proceeds from the Canadian Ownership Special Charge in budgetary revenue. This contrasts with the public accounts treatment, where the net proceeds are classified as a specified purpose transaction.

Budgetary Expenditures

The projections for budgetary expenditures are set out in Table A.3. The table lists total budgetary expenditures by major expenditure category, including projections for public debt charges and for major statutory programs, such as equalization payments to provinces, the government's contribution to unemployment insurance and net payments under the petroleum compensation program.

Budgetary expenditures are projected to increase by 12.4 per cent in 1984-85, but thereafter are forecast to grow at annual rates which are less than the projected growth rates for the economy. Over the first three years of the projection period, the annual growth rates are largely influenced by the behaviour of public debt charges. Public debt charges are expected to increase by approximately 25 per cent in 1984-85 owing to the impact of high interest rates. Even though the stock of debt increases, the decline in interest rates projected for 1986 substantially reduces the growth in public debt charges in both 1986-87 and 1987-88. Budgetary expenditures are also affected in 1986-87 by the effect of net receipts flowing into the petroleum compensation account, as this account is assumed to be in a balanced position by the end of 1986. The slowing in the rate of expenditure growth in the later years of the projection period reflects the improvement in the economic and inflation projections.

Table A.3

November 1984 Status Quo Budgetary Expenditure Projections

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(millions of dollars)				
Public debt charges	18,146	22,660	25,545	25,935	26,790	29,575	31,825	34,045
Major statutory programs								
Petroleum compensation account	483	1,141	36	−1,177	0	0	0	0
Unemployment insurance contributions	2,854	2,883	2,572	2,303	2,052	1,958	1,647	1,416
Family Allowance	2,327	2,416	2,507	2,570	2,686	2,812	2,933	3,026
Established programs financing	7,629	8,273	8,762	9,519	10,112	10,716	11,476	12,221
Canada Assistance Plan	3,288	3,643	3,875	4,063	4,250	4,410	4,570	4,725
Old Age Security, Guaranteed Income Supplement and Spousal Allowance	10,406	11,555	12,731	13,326	14,154	14,879	15,669	16,499
Equalization	5,357	5,437	5,207	5,647	6,233	6,777	7,388	8,032
Other	4,180	4,975	5,206	5,402	5,534	6,259	6,469	6,696
Total statutory programs	36,524	40,323	40,896	41,653	45,021	47,811	50,152	52,615
Non-statutory expenditures	34,245	36,952	40,201	41,264	43,451	45,622	48,278	51,269
Budgetary expenditures	88,915	99,935	106,642	108,852	115,262	123,008	130,255	137,929

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(percentage change)				
Public debt charges	6.9	24.9	12.7	1.5	3.3	10.4	7.6	7.0
Major statutory programs								
Petroleum compensation account	–	136.2	−96.8	−3369.4	−100.0	–	–	–
Unemployment insurance contributions	32.9	1.0	−10.8	−10.5	−10.9	−4.6	−15.9	−14.0
Family Allowances	4.3	3.8	3.8	2.5	4.5	4.7	4.3	3.2
Established programs financing	36.4	8.4	5.9	8.6	6.2	6.0	7.1	6.5
Canada Assistance Plan	16.1	10.8	6.4	4.9	4.6	3.8	3.6	3.4
Old Age Security, Guaranteed Income Supplement and Spousal Allowance	7.9	11.0	10.2	4.7	6.2	5.1	5.3	5.3
Equalization	6.3	1.5	−4.2	8.5	10.4	8.7	9.0	8.7
Other	19.5	19.0	1.7	3.9	2.4	13.1	3.4	3.5
Total statutory programs	17.6	10.4	1.4	1.9	8.1	6.2	4.9	4.9
Non-statutory expenditures	7.1	7.9	8.8	2.6	5.3	5.0	5.8	6.2
Budgetary expenditures	11.1	12.4	6.7	2.1	5.9	6.7	5.9	5.9

Table A.3 (Cont'd)

November 1984 Status Quo Budgetary Expenditure Projections

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(percentage of GNP)				
Public debt charges	4.6	5.4	5.7	5.4	5.2	5.3	5.3	5.3
Major statutory programs								
Petroleum compensation account	0.1	0.3	0.0	−0.2	0.0	0.0	0.0	0.0
Unemployment insurance contributions	0.7	0.7	0.6	0.5	0.4	0.3	0.3	0.2
Family Allowance	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Established programs financing	2.0	2.0	1.9	2.0	2.0	1.9	1.9	1.9
Canada Assistance Plan	0.8	0.9	0.9	0.8	0.8	0.8	0.8	0.7
Old Age Security, Guaranteed Income Supplement and Spousal Allowance	2.7	2.7	2.8	2.8	2.7	2.7	2.6	2.6
Equalization	1.4	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Other	1.1	1.2	1.2	1.1	1.1	1.1	1.1	1.0
Total statutory programs	9.4	9.6	9.1	8.6	8.7	8.5	8.3	8.1
Non-statutory expenditures	8.8	8.8	8.9	8.5	8.4	8.1	8.0	7.9
Budgetary expenditures	22.8	23.7	23.7	22.5	22.2	22.0	21.7	21.3

Note: Details may not add due to rounding.

Accounting Changes

The November 1984 projections incorporate a number of accounting changes. These accounting changes were made in response to some of the reservations expressed in the past by the Auditor General regarding the government's accounting policies.

The Auditor General has stated three major reservations regarding the government's financial statements. These reservations relate to:

- the practice of establishing non-budgetary specified purpose accounts, such as the Canadian Ownership Account, the Unemployment Insurance Account and the Canada Pension Plan Account. In the Auditor General's opinion this practice results in making budgetary transactions too narrow in scope;
- the practice of recording international development assistance loans and subscriptions at the full amount advanced. The Auditor General would prefer to have such assets recorded at a much lower level to better reflect their true economic value, given that they carry low interest rates or none at all; and
- the practice of not recording certain liabilities. These include financial obligations related to certain items to be paid from statutory authorities, earned and unpaid annual vacation leave, and employee termination benefits. As well, the Auditor General feels that a valuation allowance should be provided against debts guaranteed by the government.

The consolidation of specified purpose accounts would require amendments to the legislation establishing these accounts. The consolidation of certain of these accounts require consultations with third parties. As a result, with the exception of the Canadian Ownership Account, the government has decided not to proceed with these changes at this time. We will be consulting further with the Auditor General and other interested parties on such changes.

The government has, however, decided to proceed with respect to the recording of liabilities heretofore unrecorded, provided that doing so is consistent with existing legislation. The accounting changes incorporated in the current status quo projections are listed in Table A.4 along with their impacts on the budgetary deficit and financial requirements.

The overall impact of these accounting changes on the deficit is to increase it by $300 million in 1983-84. The accounting changes add approximately $500 million to the projected deficit for 1984-85, increasing to over $750 million by 1990-91. It should be noted that, with the exception of the additional interest charges resulting from the outstanding debts of Canadair and de Havilland, the increases in the reported deficit resulting from these accounting changes impact on the internal accounts of the government and will not affect financial requirements.

Table A.4

November 1984 Status Quo Projections — Impact of Accounting Changes

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
				(millions of dollars)				
Impact on budgetary expenditures and deficit								
Subsidies under the Railway Act	–50	0	0	0	0	0	0	0
Entitlements under Petroleum Incentives Program	–50	0	0	0	0	0	0	0
Entitlements under Fiscal Stabilization Program	100	0	0	0	0	0	0	0
Entitlements under Western Grain Transportation Act	150	0	0	0	0	0	0	0
Earned and unpaid vacation leave	50	0	0	0	0	0	0	0
Employee termination benefits	100	100	100	100	100	100	100	100
Canadair and de Havilland interest on outstanding debts	–300	190	245	280	320	365	405	455
Revaluation of international financial institutions subscriptions	300	200	200	200	200	200	200	200
Total impact on budgetary expenditures and deficit	300	490	545	580	620	665	705	755
Less:								
Impact on non-budgetary transactions	300	300	300	300	300	300	300	300
Equals:								
Impact on financial requirements (excl. foreign exchange transactions)	–	190	245	280	320	365	405	455

Note: With the exception of the interest on the debts of Canadair and de Havilland, the other accounting changes do not impact on financial requirements but represent rather the establishment of either liabilities or allowances for valuation against existing financial assets. With respect to 1983-84, none of the accounting changes impacts on financial requirements.

Non-Budgetary Transactions

The government's net financial requirements are a reflection not only of its budgetary revenues and expenditures, but also of its non-budgetary transactions. Non-budgetary transactions include loans, investments and advances, specified purpose accounts, and other transactions. Net funds provided by, or required for, the non-budgetary transactions are subject to wide variations from year to year. In recent years, these transactions have provided a net source of funds to the government and thus have lessened the extent to which the government has needed to borrow on financial markets.

As shown in the summary statement of transactions (Table A.1), total net funds to the government from this source are forecast to range between $4.7 billion and $9.9 billion. Most of the variation in net funds over the planning period is due to the behaviour of the unemployment insurance account which is assumed to be in a balanced position by the end of 1989.

Included in non-budgetary transactions are several accounting changes which were noted above. These accounting changes increased non-budgetary transactions by $300 million throughout the entire projection period.

Financial Requirements (Excluding Foreign Exchange Transactions)

Given the projected budgetary deficit track together with the forecast net source of funds from non-budgetary transactions, financial requirements (excluding foreign exchange transactions) are projected to increase from $29.8 billion in the current fiscal year to $32 billion in 1985-86, and then to remain above $27 billion throughout the remainder of the projection period. Financial requirements are often considered to be the most comprehensive and economically meaningful summary measure of the federal fiscal position, as they show the net direct impact of federal activities on financial markets.

B. Comparison With the February 1984 Budget: 1983-84 to 1987-88

Overview

Differences between the current fiscal projections and those of the February 1984 budget are shown in Table A.5. Public accounts data for 1983-84 indicate that budgetary revenues were about $1.5 billion lower than projected at the time of the February budget. However, this shortfall in revenue was offset by lower than expected budgetary expenditures such that the increase of $334 million in the deficit was almost entirely the result of the accounting changes noted above. Non-budgetary transactions provide a larger net source of funds compared to that expected at the time of the February budget. Most of this increase was concentrated in the "other transactions" component reflecting a higher net source of funds from cheques issued in March, but cashed only after the end of fiscal year

1983-84. As a result, financial requirements (excluding foreign exchange transactions) were about $2 billion less than forecast in the February budget.

For the outlook period the current economic assumptions imply weaker growth and somewhat lower inflation than the corresponding assumptions in the February budget. With higher interest rates projected for both 1985 and 1986 and weaker growth throughout the entire period, the revised fiscal projections indicate substantially higher deficits and financial requirements than were projected in the February budget. For 1984-85, the deficit is projected to be about $5 billion higher than estimated at the time of the February budget. Throughout the remainder of the outlook period, the deficit is now projected to be up to $9 billion higher per year. These increases in the deficit primarily reflect slower growth in revenues coupled with substantially higher public debt charges.

Table A.5

Differences Between the November 1984 Status Quo Projections and the February 1984 Budget

	1983-84	1984-85	1985-86	1986-87	1987-88
			(millions of dollars)		
February 1984 budget					
Revenues					
millions of dollars	58,626	67,326	74,125	80,687	88,077
percentage of GNP	15.0	15.7	15.8	15.7	15.9
Expenditures					
millions of dollars	90,076	96,926	102,075	107,787	114,277
percentage of GNP	23.1	22.6	21.7	21.0	20.6
Budgetary deficit					
millions of dollars	31,450	29,600	27,950	27,100	26,150
percentage of GNP	8.1	6.9	5.9	5.3	4.7
Non-budgetary transactions					
millions of dollars	4,450	4,050	4,650	7,400	7,500
Financial requirements (excl. foreign exchange transactions)					
millions of dollars	27,000	25,550	23,300	19,700	18,650
percentage of GNP	6.9	5.9	5.0	3.8	3.4
Changes					
Revenues:					
Total changes to budgetary revenues	−1,495	−1,891	−4,583	−6,135	−7,915
Expenditures:					
Program expenditures (excl. accounting changes)	−1,477	209	877	−1,800	−1,675
Public debt charges	16	2,310	3,145	2,285	2,090
Accounting changes	300	490	545	580	620
Total increase in the deficit	334	4,900	9,150	7,200	8,950
Non-budgetary transactions:					
Loans, investments and advances (excl. accounting changes)	−399	409	−83	−35	135
Specified purpose accounts	605	−16	−217	−1,591	−173
Other transactions (excl. accounting changes)	1,746	−43	450	326	−362
Accounting changes	300	300	300	300	300
Total Non-budgetary transaction changes	2,252	650	450	−1,000	−100
Total change in financial requirements (excl. foreign exchange transactions)	−1,918	4,250	8,700	8,200	9,050

Table A.5 (Cont'd)

Differences Between the November 1984 Status Quo Projections and the February 1984 Budget

	1983-84	1984-85	1985-86	1986-87	1987-88
			(millions of dollars)		
November 1984 status quo					
Revenues					
millions of dollars	57,131	65,435	69,542	74,552	80,162
percentage of GNP	14.6	15.5	15.5	15.4	15.4
Expenditures					
millions of dollars	88,915	99,935	106,642	108,852	115,262
percentage of GNP	22.8	23.7	23.7	22.5	22.2
Budgetary deficit					
millions of dollars	31,784	34,500	37,100	34,300	35,100
percentage of GNP	8.1	8.2	8.3	7.1	6.8
Financial requirements (excl. foreign exchange transactions)					
millions of dollars	25,082	29,800	32,000	27,900	27,700
percentage of GNP	6.4	7.1	7.1	5.8	5.3

Budgetary Revenues

The reduction in projected budgetary revenues as shown in Table A.6, is almost entirely due to lower projected personal income tax revenues. About one half of this downward revision is due to the revised economic forecast, as the downward revisions to the projected level of economic activity directly lower the tax bases and these, in turn, have implications for the growth of personal income tax revenue. In comparison to the February budget, gross national product has been revised downwards by about $44 billion by 1988, and as most of this decline is concentrated in personal income, revenues from this source have fallen. A further downward adjustment to personal income tax revenues was also made to reflect new tax collection data made available since February. The new data indicate the possibility of a change in the historical relationship between personal income and tax collections. The reasons for this change are not well understood. The central issue is whether it represents a permanent change in the relationship or whether over time the earlier historical relationship will be restored. Resolving this issue is particularly difficult because of the significant economic changes which have occurred in labour markets and the composition of personal income over the past three years and also because of changes in the tax system which have been introduced. In preparing the current status quo outlook, it was assumed that the change in relationship was permanent. This has reduced revenues by about $2 billion in 1987-88 compared to the February budget. This assumption, therefore, has not changed the central message in the status quo outlook – the deficit is not projected to decline over the remainder of the decade.

Table A.6

Budgetary Revenues Comparison with the February 1984 Budget

	1983-84	1984-85	1985-86	1986-87	1987-88
			(millions of dollars)		
February 1984 budget level	58,626	67,326	74,125	80,687	88,077
Changes since February 1984					
Personal income tax	−1,288	−3,620	−4,455	−5,090	−5,935
Corporate income tax	−545	700	690	−240	−313
Sales tax	100	395	−471	−722	−800
Other tax and non-tax revenue	238	634	−347	−83	−867
Total changes	−1,495	−1,891	−4,583	−6,135	−7,915
November 1984 status quo	57,131	65,435	69,542	74,552	80,162

Budgetary Expenditures

The major changes in budgetary expenditures since the February budget are contained in Table A.7. For the outlook period, public debt charges account for most of the differences in budgetary expenditures. In 1984-85 and 1985-86, the increase in public debt charges results, in large part, from the higher interest rates than forecast at the time of the February budget. Also contributing to higher public debt charges over this period, as well as in the remaining years of the forecast period, are increases in the annual deficit.

Higher than expected deficits in the petroleum compensation account also contribute to the increase in budgetary expenditure in 1984-85. In 1986-87 the petroleum compensation account provides a source of funds as the deficit in the account is assumed to be eliminated by the end of 1986. Established Programs Financing payments are also higher than anticipated in February, reflecting adjustments for prior years. Also contributing to the increase in budgetary expenditures compared to the forecast in February, is the implementation of certain accounting changes noted above. Lower projections for inflation, resulting in lower costs in many expenditure categories, coupled with higher estimates for anticipated lapses, dampen the impact of the above increases.

Table A.7

Budgetary Expenditures Comparison with the February 1984 Budget

	1983-84	1984-85	1985-86	1986-87	1987-88
			(millions of dollars)		
February 1984 budget level	90,076	96,926	102,075	107,787	114,227
Changes since February 1984					
Public debt charges	16	2,310	3,145	2,285	2,090
Petroleum compensation account	222	850	279	−1,155	−16
Established programs financing	−117	738	650	520	280
Old Age Security, Guaranteed Income Supplement and Spousal Allowance	−36	−29	−17	−351	−466
Accounting changes	300	490	545	580	620
Other	−1,548	−1,350	−69	−814	−1,473
Total changes	−1,161	3,009	4,567	1,065	1,035
November 1984 status quo	88,915	99,935	106,642	108,852	115,262

Non-Budgetary Transactions

Table A.8 identifies the major components of the change in the projections for the non-budgetary transactions since the February 1984 budget. The accounting changes imply that the net source of funds provided by the non-budgetary account will be higher by $300 million per year. From 1985-86 to 1987-88 there are additional requirements forecast for the unemployment insurance account. The increases in the deficit of the unemployment insurance account, in comparison with the February budget, generally reflects the changes in economic conditions as well as the assumption that the account will return to balance by the end of 1989 rather than 1987. The revision of $1,746 million in 1983-84 in the "other transactions" category reflects a higher net source of funds from cheques issued in March but cashed only after the end of fiscal year 1983-84.

Table A.8

Non-Budgetary Transactions Comparison with the February 1984 Budget

	1983-84	1984-85	1985-86	1986-87	1987-88
			(millions of dollars)		
February 1984 budget level	4,450	4,050	4,650	7,400	7,500
Changes (excluding accounting changes) since February 1984					
Loans, investments and advances	–399	409	–83	–35	135
Specified purpose accounts					
Unemployment insurance account	298	58	–210	–1,781	–522
Superannuation	21	95	192	171	201
Western grain stabilization	—	–186	–255	–47	76
Other	286	17	56	66	72
Other non-budgetary transactions	1,746	–43	450	326	–362
Accounting changes	300	300	300	300	300
Total changes	2,252	650	450	–1,000	–100
November 1984 status quo	6,702	4,700	5,100	6,400	7,400