Agenda: Jobs and Growth

Creating a Healthy Fiscal Climate

The Economic and Fiscal Update

Government of Canada Gouvernement du Canada

Canada

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CANADA

A strong economy is the essence of a strong society. My government will focus on a jobs and growth agenda. We will work with all our partners – provincial governments, business, labour, voluntary groups and individual Canadians.

Prime Minister Jean Chrétien
Quebec City, September 18, 1994

In Quebec City on September 18, the Prime Minister outlined four key components of the government's jobs and growth agenda:

- reforming social security;
- ensuring a healthy fiscal climate;
- reviewing government programs and priorities; and
- strengthening the performance of the Canadian economy in investment, innovation and trade.

This paper, *Creating A Healthy Fiscal Climate,* forms a key element in the government's economic strategy as set out in the companion document: *A New Framework for Economic Policy.* It fulfils the commitment to update the economic and fiscal outlook that was presented in the 1994 budget and to set out the scope of actions needed to achieve the government's fiscal goals. It provides the information necessary to begin a broad public debate on the choices to be made and the actions to be taken in the 1995 budget.

Too often in the past, the difficult tradeoffs required in budget decisions have been disguised by soft generalities. To help focus the 1995 pre-budget consultations on hard choices, this paper provides an accounting by program of government spending, together with a detailed description of the sources of government revenues.

I invite Canadians to study this document and to take advantage of the opportunity to make their budget policy views known during the pre-budget consultation process.

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

Introduction and Overview

The economic policy framework is focused on growth and jobs. The priority of the government is to foster durable economic growth and job creation within a consistent framework aimed at:

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

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

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

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

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

These broad policy objectives, all inter-related, are set out in the companion document: *A New Framework for Economic Policy*. As that paper makes clear:

"Increasing productivity and sustained job growth are the results of investment, of entrepreneurial vigour, and of consumer confidence. All are being undermined by a growing public debt that has led to higher taxes, higher real interest rates and a diminished capacity of the Government of Canada to address the other vital issues of an economic strategy for the future.

"This is all the more regrettable because many other components of Canada's economic performance are extraordinarily upbeat.

"The government is therefore committed to reverse Canada's fiscal decline, first by achieving the announced target of reducing the deficit to no more than 3 per cent of GDP (Gross Domestic Product) by fiscal year 1996-97. This is an interim step. But it is a significant step. The annual federal deficit has not been held to 3 per cent of GDP since 1974-75. The ultimate objective is to achieve a balanced budget and to significantly reduce federal debt as a percentage of the GDP".

Principles to Guide Choices

Toward these objectives, the government has launched a broad consultation process that invites Canadians to contribute their views to the making of the 1995 budget.

As this national dialogue begins, the government believes it is important to put before Canadians the principles and values it will apply to the difficult choices that lie ahead.

- Deficit reduction and debt control are essential parts of a strategy to create jobs through economic growth. Failure to reduce the deficit and control the debt will prejudice growth and job creation in both the short and long term. Success will strengthen the prospects for jobs through growth.

- Fairness is paramount. The government will ensure that the most vulnerable in society are not left behind. Expenditure reduction must not be an excuse to abandon those Canadians in greatest need.

- Deficit reduction should never be a blind accounting exercise that ignores the impact on broader economic and social goals. Deficit reduction is fundamentally an exercise in setting priorities and making reasoned choices.

- Budgetary actions should weigh toward reductions in expenditures. The government must do better with less.

- It is essential that government make *prudent* assumptions to guide its economic and fiscal projections. Past experience has proven that missing fiscal targets destroys credibility and merely postpones the need for tougher measures into the future. Meeting targets, on the other hand, not only constitutes visible progress, but also establishes and strengthens credibility for the future.

The best time to correct fiscal imbalances is when the economy is firmly on an expanding trend as it now is. The renewed confidence being shown in the Canadian economy reflects a belief that the government will keep its word to restore federal finances to health. The government's commitment to deficit reduction is unshakeable. The opportunity afforded by the recovery will not be wasted.

Outline of the Paper

Following this introduction, Section 1 addresses the importance of creating a healthy fiscal climate as a precondition for durable growth and job creation.

The requirement for prudence in the planning assumptions used to derive the deficit forecast is discussed in Section 2. Assumptions must reflect the substantial uncertainties regarding the economic outlook, the economic-fiscal relationships, and unpredictable 'shocks' that could significantly affect the deficit.

Section 3 presents updated economic assumptions for the period 1994 to 1996. The average of the current private sector forecasts is the benchmark against which more prudent alternatives are developed. The government is committed to use prudent assumptions to minimize the risk that unforeseen developments would force the deficit off track.

Section 4 presents the fiscal outlook under updated economic scenarios. Notwithstanding the higher-than-expected interest rates, the deficit for 1994-95 is still expected to be no more than $39.7 billion, the target set out in the 1994 budget. However, in the absence of further fiscal actions, the economic scenarios which are advanced in this paper for planning purposes, imply that future deficits would exceed the targets established in the 1994 budget.

The sensitivity of deficit forecasts to key economic variables underscores the dilemma confronting all budget planners – i.e. what economic assumptions, with due allowance for prudence, should be used for budget planning purposes? Section 4 concludes by addressing this dilemma and identifying a range within which the projected deficits in 1995-96 and 1996-97 are likely to fall. This range determines the likely magnitude of divergence from the established budget targets and thus the magnitude of new fiscal actions needed to get back on track. The economic assumptions will be revisited prior to setting the 1995 budget to reflect economic developments in the meantime, as well as advice from the pre-budget consultations.

The average of private sector economic forecasts would imply that the 1994 budget deficit targets would be exceeded by a) $2.3 billion in 1995-96 and b) $5 billion in 1996-97. The document argues that for fiscal planning purposes more prudent economic assumptions should be considered. If interest rates were 50 basis points above the private sector average forecast, then the gap to the budget targets would be a) $3.1 billion in 1995-96 and b) $6.3 billion in 1996-97. To further illustrate the fiscal sensitivity to the economic assumptions, if interest rates were a full 100 basis points above the private sector average, and as well nominal GDP growth were half a percentage point weaker each year, then the gap would be a) $4.7 billion in 1995-96 and b) $9.0 billion in 1996-97.

Section 5 addresses the question of *how* to get back on track. To what extent should program spending reductions be relied on? Is there scope for new revenue-raising measures?

Section 6 sets out certain questions that are submitted to the Standing Committee on Finance of the House of Commons as part of the budget consultation process.

To provide the basic background information needed to address these questions, and to assess the tough trade-offs, detailed descriptions of government spending and revenues are provided in the Annexes.

Next Steps

This paper is being released to facilitate a dialogue among Canadians on how best to restore the nation's finances to health. Deficit reduction and debt control are not ends in themselves. Rather they are a means to the creation of durable growth and meaningful jobs.

The public consultation that will precede the 1995 budget is anchored to the basic fiscal commitment of the government to reduce the deficit to not more than 3 per cent of gross domestic product in 1996-97.

As part of the consultation process, the government is asking the Standing Committee on Finance of the House of Commons to:

- Review the economic assumptions used to derive the status quo fiscal outlooks;

- Advise on:

a) the magnitude of the actions required to achieve the 3 per cent target;

b) the appropriate balance between expenditure reductions and revenue increases that should be pursued; and

c) which expenditure and revenue options are most appropriate.

The Committee is to report to the government on its findings and recommendations by year-end.

Box 1: Some of the reviews announced in the February 1994 budget

Program Review which aims to provide the best and most efficient services that can be afforded. This will be accomplished by eliminating or reducing lower priority activities and targeting scarce resources on programs of the highest priority and in areas where the Government of Canada is in the best position to provide the service.

Social Security Reform which in co-operation with the provinces, aims to create an affordable system that enhances jobs skills and fosters independence by offering incentives to work while protecting the most vulnerable.

The Science and Technology Review which is examining ways to maximize the benefits to the economy of the federal in-house research capability and its programs to encourage S&T activities in universities and businesses.

Reviews of Defence and Foreign Policy that will ensure that Canada's objectives going forward are more clearly defined and accomplished in a cost-effective manner.

The Small Business Review which will determine how the federal government can best foster the growth of small and medium-sized entreprises.

In addition to the public consultations leading to the 1995 budget, the government will benefit from the results of the comprehensive 'Program Review' now underway as well as from a number of more specific reviews which were announced in the February 1994 budget (Box 1).

The Minister of Finance will also be meeting both with his provincial counterparts and with the public to hear their views.

This statement and its companion documents are intended to provide Canadians with information they need to involve themselves more fully and effectively in the process of budget-building.

1

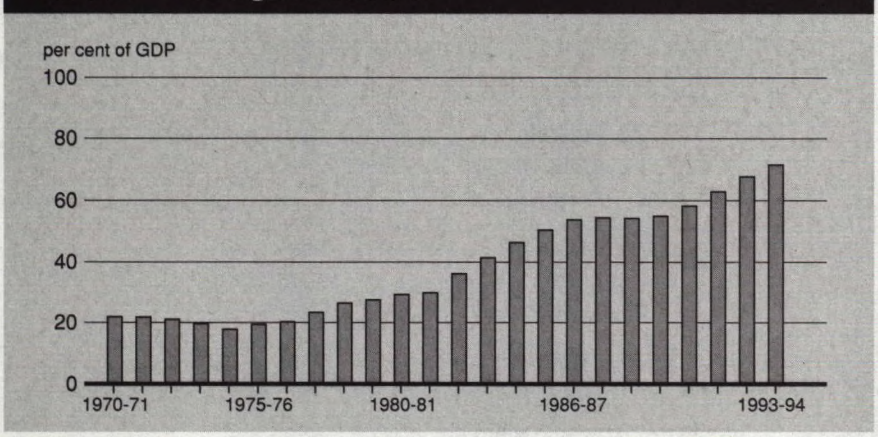
The Importance of a Healthy Fiscal Climate

The fiscal situation poses an immediate challenge for all Canadians.

■ The federal debt – the accumulation of all budget deficits and surpluses since Confederation – was $508.2 billion as of March 31, 1994. This amounts to almost $17,500 for every Canadian. (The total debt of the provincial governments was $186.5 billion or $6,500 per capita.)

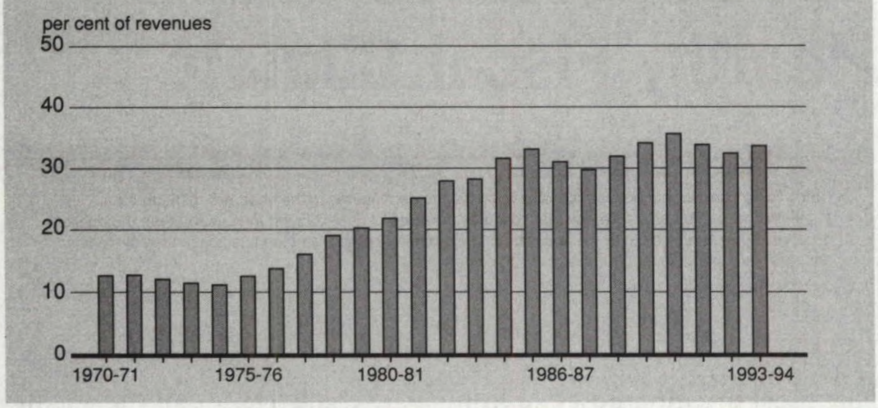
■ As a percentage of GDP, the federal debt was 71.4 per cent at last fiscal year-end. Prior to the 1990-1991 recession, it was 55 per cent. Prior to the 1981-1982 recession, it was 29 per cent (Chart 1). In dollar terms, federal debt increased almost sixfold between March 31, 1981 and March 31, 1994.

Chart 1 Federal government debt



■ Interest on the federal debt was $38 billion in 1993-94, or one-third of each revenue dollar the government collects. Twenty years ago, interest charges were one-ninth of each revenue dollar (Chart 2).

Chart 2 Federal government interest payments



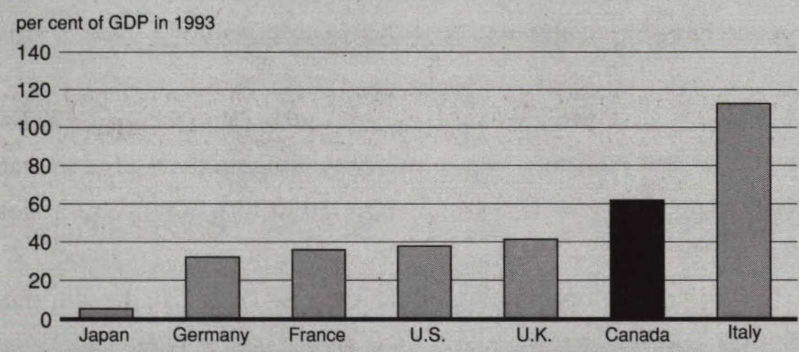
■ Canada's total government deficit, government debt and overall foreign indebtedness are larger, relative to the size of the economy, than those of almost all other G-7 countries (see Box 2).

Box 2: Canada's fiscal situation in an international context

Comparison of Canada's fiscal situation to other countries illustrates growing vulnerability.

- Canada now has the second largest deficit relative to GDP after Italy among the G-7 countries and significantly larger than the U.S., Germany and France. Japan has a budget surplus.
- Canada's public debt-to-GDP ratio is also the second highest in the G-7 after Italy (Chart 3).
- Canada has, by a large margin, the highest level of foreign debt – both private and public combined – relative to GDP among the G-7 nations.
- Canada's foreign indebtedness – $313 billion, at December 31, 1993 – was about 44 per cent of GDP while Italy is second among the G-7 at only 12 per cent.
- Canada's high and rising international indebtedness means that more and more of Canadian income must go to foreigners to service external debt, resulting in a lower standard of living.

Chart 3 Net fiscal debt in G-7 countries



Note: To be comparable on an international basis, the debt figures in the chart are measured on a national accounts basis. The national accounts measure of debt is lower for Canada than the public accounts figures referred to in the text. The primary difference between the two accounting systems is the treatment of public sector superannuation accounts.
Source: OECD.

The Consequences of Rising Debt

With the current high stock of debt and high interest rates, about one-third of each federal government revenue dollar collected must go to servicing the debt. This is money that cannot be used to protect or enhance programs that Canadians value or to bring down the tax burden, or to help the Canadian economy adjust to developments in the global economy.

This is the price that Canadians are paying today. Unless the debt problem is brought under control, our children and their children will pay an even higher price.

Reducing deficits and controlling the national debt are not ends in themselves. They are the keys to enhancing consumer and investor confidence, to ensuring durably low real interest rates and to promoting strong, sustained economic growth that translates into jobs of increasing number and quality.

The dynamics of debt

For some time there has been a strong debt dynamic firmly in place in Canada that has proven difficult to overcome. As deficits have accumulated, interest charges on a growing debt have soared.

So the vicious circle continues to turn. The deficits resulting from interest charges on existing government debt lead to growing debt, which in turn leads to higher interest rates. Unless sufficient policy actions are taken, the debt burden will continue to explode.

Aside from fiscal actions, the key determinant of this vicious circle of debt is the relationship between interest rates – which dictate the cost of financing the debt – and the growth in the economy – which drives revenue growth.

For many years the growth in the Canadian economy has not been strong enough to increase revenues at a fast enough rate to offset the rapid growth of interest costs. This is not expected to turn around in the foreseeable future.

The potential impact of growing interest costs can be illustrated as follows.

By the end of the current fiscal year - March 31, 1995 - the federal debt will be approximately $548 billion. Assuming that government revenues were sufficient to cover what the government spends on its programs (i.e. total spending less interest charges) and that the government paid an interest rate on its debt of 8.0 per cent, that stock of debt would increase by nearly 50 per cent in five years to $800 billion. Interest costs on the debt would be approximately $64 billion at the end of that period, compared to $44 billion currently. To offset this *increase* in annual interest of about $20 billion (i.e. to keep the deficit from getting bigger) would require fiscal actions equivalent to eliminating what the government spends today on elderly benefits or the entire operating costs of the government. It would be equivalent to more than all of the revenues raised by the Goods and Services Tax rate.

This compounding debt dynamic is not just a problem for the future. It can frustrate progress toward fiscal control each and every year if insufficient policy action is taken. The $42 billion deficit of 1993-94 will alone add approximately $3 billion to interest charges in 1994-95. If the deficit is not to increase, these higher costs must be paid for through some combination of revenues generated by economic growth, cuts in government programs or new tax measures. The dilemma of compound interest is that each year the amount that must somehow be covered grows larger.

Should interest rates increase one percentage point, the undertow of debt becomes much worse. In the first year, a one percentage point increase would cause interest charges to increase by $1.7 billion. By the fourth year, the effect would be to increase interest charges by $3.5 billion a year. A reduction of interest rates by one percentage point would have an effect of similar magnitude but in a *favourable* direction.

The increase in interest rates this year relative to 1993-94 has added $3.3 billion to interest payments. So the interest rate effect, plus the $3.0 billion associated with the 1993-94 deficit will raise interest payments this year $6.3 billion above that of last year.

Canada's low inflation offers the prospect of lower interest rates. Yet, there are important pressures from both international and domestic sources that are tending to push rates higher. Demand for capital throughout the world has been increasing. The resulting upward world-wide pressure on interest rates is compounded in Canada because of financial market concerns about our high debt level and political uncertainty. To place their money here, lenders demand a 'risk premium', which the federal government and all other sectors of the Canadian economy must pay through higher interest rates than prevail, for example, in the United States, Germany or Japan.

Impact on economic growth

A rising ratio of debt-to-GDP threatens economic growth for the following reasons:

- Based on analogous experience in other countries, investors fear the government will attempt to 'print money' to finance its deficit leading to higher inflation and thus to repayment of debt and interest in inflated, (and thus less valuable) dollars.

- The fear of higher inflation leads to higher interest rates as potential lenders demand more protection against inflation and the risk of currency depreciation.

- Higher interest rates, in turn, dampen investment, economic growth and employment. This causes government spending to increase (e.g. through higher UI payouts) and depresses revenue, all of which increases deficits and debt.

- Higher interest rates also add directly to higher public debt charges and thus to more rapidly compounding debt and deficits. This heightens the fears of investors and lenders about the safety of their capital, leading to still higher risk premiums and interest rates.

- High deficits and debt also point to higher future taxes, further dampening investment, economic growth and employment.

Because concern about future inflation plays such a key role in the determination of interest rates, the inflation-control targets set jointly by the Bank of Canada and the government are critical to achieving lower real interest rates. By committing to price stability over time and to keeping underlying consumer price inflation within a 1 to 3 per cent band through 1998, Canadians can be confident that the money they hold will retain its value.

Canada used to be known as a relatively high inflation country. We now have one of the lowest rates of inflation in the industrialized world. The transitional costs to that low inflation have been paid. The gains will not be squandered by letting inflation pressures re-emerge – Canada will stay a low-inflation country.

To finally break the cycle of compounding debt, the monetary commitment must be complemented by an equally firm commitment to fiscal action.

The need to take decisive fiscal action is demonstrated by the fact that the debt-to-GDP ratio has accelerated with each recession since 1974. This indicates that factors other than the normal effect of recession on spending and revenues have been responsible.

The key factor is a 'structural' imbalance between revenues and expenditures (including interest payments) – i.e. the deficit is not eliminated even when the economy reaches the peak of the business cycle. Once this condition is present, equilibrium can only be restored through deliberate fiscal actions. Higher economic growth and lower interest rates are necessary but, given current expectations, will not by themselves be sufficient to fix the problem. This is particularly the case since our growing debt ratio tends to push interest rates higher and economic growth lower than would otherwise be the case. In short, Canada is forced to swim against the tide.

Other consequences of rising debt

Canada's extraordinarily high level of public sector debt is of concern for several further reasons.

■ First, chronic deficits and growing debt mean that the Canadian economy is becoming more and more dependent on foreign borrowing. Domestic savings could completely satisfy our private investment needs if there were no government deficit to be financed out of those savings. When government borrowing requirements are added, there is a need to draw on foreign savings as well. And this is mirrored in our current account deficit with the rest of the world. In 1993, this deficit stood at $30.7 billion or more than 4 per cent of GDP, by far the highest ratio among G-7 countries.

■ Second, high indebtedness leads to a loss of economic and fiscal sovereignty. Because of the need to pay a very large share of revenues for debt servicing costs, governments are unable to respond with appropriate fiscal measures in the event of downturns in the economy or natural disasters.

■ Finally, today's public deficits, because they are primarily paying the borrowing costs of past *consumption*, and not *investment*, are contributing little to boost the future growth potential of the economy. The deficits therefore represent a burden on future Canadians, who will have higher taxes and lower disposable incomes as a result. The situation may be likened to bequeathing a mortgage to our children but without the house to go with it. This bitter legacy will be compounded by demographic changes, – i.e. a much smaller proportion of Canadians of working age will, in future, have to support a growing proportion of retirees.

The deficit must therefore be reduced and the debt must be brought under control. There is no acceptable alternative.

Reducing the deficit and reversing the upward trend in the debt-to-GDP ratio, on the other hand, can markedly improve the prospects for sustained economic growth and job creation.

The only question is how these goals are to be achieved.

Deficit Targets

In the February 1994 budget, the government committed to achieve:

■ A deficit not to exceed $39.7 billion in this fiscal year, 1994-95;

■ A deficit not to exceed $32.7 billion in fiscal year 1995-96; and

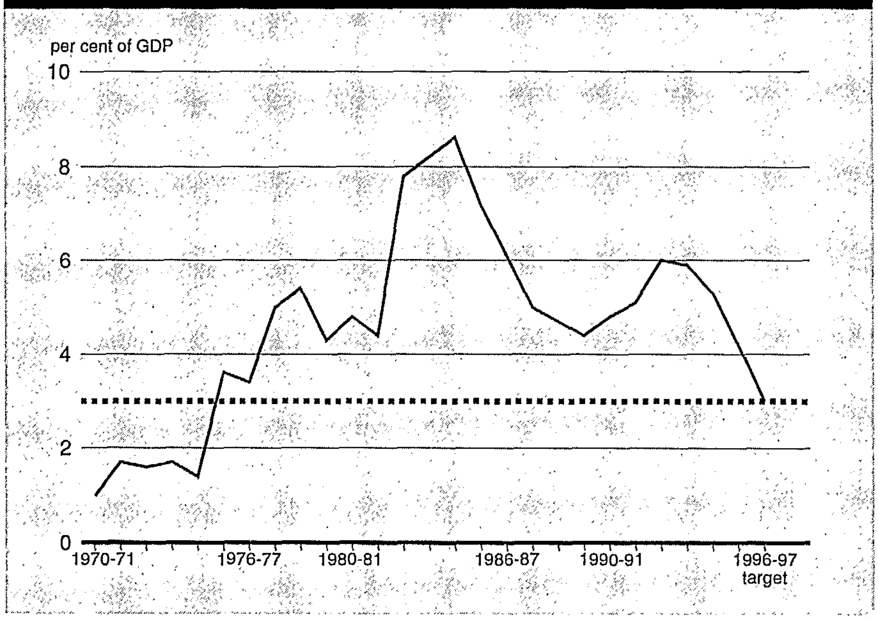
■ A deficit of no more than three per cent of gross domestic product in 1996-97. This is an interim target toward the ultimate objective of a balanced budget.

In the past, fiscal targets were cast well into the future. Interim mileposts were downplayed and were missed by progressively larger amounts.

The government, in response to the last set of pre-budget consultations, has committed to yearly deficit targets and a shorter time horizon for explicit forecasts. Consequently, progress can be measured and the government can be held accountable to its commitments.

The 3 per cent deficit-to-GDP target will be the lowest deficit-to-GDP ratio since 1974-75 (see Chart 4). Reducing the deficit to this level will also cause the debt-to-GDP ratio to decline, something that has happened only once in the past 20 years. (That was in 1988-89, at the peak of the economic cycle.)

Chart 4 Federal deficit



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Prudent Budget Planning

The government will meet the deficit targets established for 1995–96 and 1996–97. This is not at issue. The issue is how much fiscal action is needed to achieve the targets.

The magnitude of the required actions is subject to significant uncertainties that arise principally from three sources:

- Uncertainties regarding the economic assumptions covering the target period, particularly the forecast of interest rates and of the current-dollar value of GDP (which approximates the revenue base);

- Uncertainties inherent in the forecasting methods used to translate the main economic variables (e.g. growth of real GDP, inflation, unemployment, interest rates) into estimates of fiscal revenues and expenditures; and

- Unpredictable events or 'shocks' that can significantly affect government expenditure and revenue (e.g. a natural disaster).

In view of these substantial uncertainties, budget plans require prudent assumptions. Most discretionary measures that significantly affect revenue and spending require substantial lead times both to take effect and to allow taxpayers and those reliant on government programs to plan their affairs. If it is discovered close to the target deadline that the deficit is well above the objective, there may be insufficient time for corrective measures to take effect, or, at the very least, the emergency actions required to achieve the target could be disruptive to individuals and damaging to other policy objectives.

The difficult issue is to decide the most appropriate degree of prudence in budget planning. If assumptions are too rosy there is a high risk that the targets will either be missed – as too often happened in the past – or that sudden, and therefore disruptive, corrective measures will be needed. (Since the government is unalterably committed to its deficit targets, it is the risk of requiring wrenching measures that is relevant.)

The question – how prudent is prudent enough? – is ultimately a judgment call. One must be confident that the fiscal actions based on the planning assumptions will enable the targets to be met with high probability. And, if not, they must at least bring the deficit close enough to the target that any final corrections will not be too disruptive.

The degree of prudence in a budget plan is determined primarily by:

- the choice of the economic assumptions that ultimately drive forecasts of the key fiscal variables; and
- the size of the 'contingency reserve' established in the fiscal framework.

The choice of prudent economic assumptions addresses one of the three principal sources of risk in budget planning. The contingency reserve is designed primarily to cover the other two – that is, risks arising from unavoidable inaccuracies in the models used to translate economic assumptions into detailed budget forecasts, and risks arising from completely unpredictable events. The contingency reserve also provides an extra measure of back-up against adverse errors in the economic forecast. **The contingency reserve is not a source of funding for potential new initiatives.**

This contrasts with the use of reserves established in the past.

The foregoing elements were illustrated in the February 1994 budget, which employed a more prudent set of planning assumptions than had been the case in the past. The government used less optimistic assumptions for the key economic variables than the average of private sector forecasters. And a much larger contingency reserve was set aside than had been the case in recent years. These prudent measures will allow the government to meet its deficit target for 1994-95, despite higher interest rates. This experience should be borne in mind when setting the planning assumptions for the 1995 budget.

A key objective of this paper is to apply the principles of prudent budget planning to establish the likely actions needed to meet the government's targets for 1995-96 and 1996-97. (This will be complemented by an update on progress towards the current fiscal year's target of $39.7 billion.)

To set the stage requires first:

- A review of relevant economic developments in Canada and the world economies;

- A discussion of the latest set of private-sector forecasts for 1994 through 1996; and

- An analysis of the principal risks associated with the 'average' private-sector forecast.

On the basis of this information and analysis, alternative fiscal scenarios are developed reflecting the sensitivity of the fiscal outlook to changes in interest rates and income growth. In that regard, a key question for the Parliamentary Committee to consider is the choice of the most appropriate assumptions to use for fiscal planning.

The final step, which is addressed in Section 5, is to consider what fiscal measures might be taken in the next budget to ensure the deficit targets will be met in a planned and orderly way.

3

Developing the Economic Assumptions

Recent Economic Developments in Canada

Canada's economic upswing gained momentum in the first half of the year. Real output rose a strong 6.4 per cent at an annual rate in the second quarter following an increase of 4.4 per cent in the first.

In part, the stronger trend has been due to brisk demand growth over the past year in the United States and some firming of growth in other countries. But there have been strong domestic factors at play as well, in particular the improved cost competitiveness of Canadian firms.

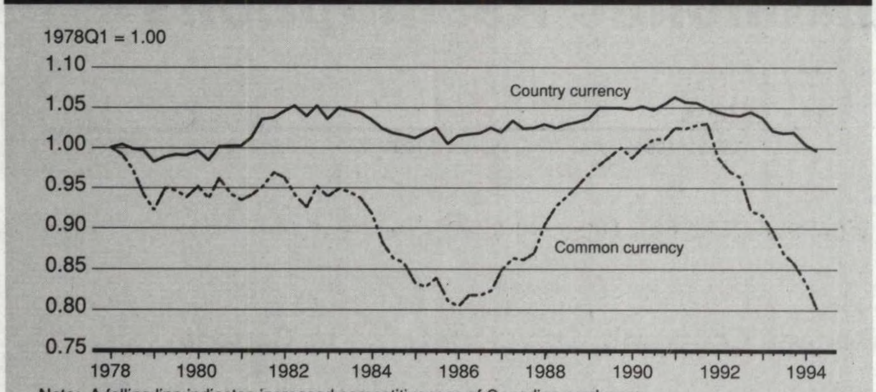
Unit labour costs have fallen in four of the last five quarters, the best performance in more than 40 years. The cumulative decline of unit labour costs over the five quarters has been 1.6 per cent, compared to a rise of 2.5 per cent in the United States. The excellent Canadian performance reflects productivity growth, as well as low wage increases (Chart 5). Combined with a lower dollar, this has resulted in a tremendous improvement in Canada's cost competitiveness.

Sales growth has been sufficiently strong in recent quarters to raise corporate profits and business confidence, encouraging firms to increase investment and hire new workers. Employment has risen steadily since January 1994, with 327,000 new jobs having been created through September, virtually all in full-time employment.

With the expansion in employment, the recovery has broadened to the consumer sector. Real consumption rose at an annual rate of 3.7 per cent in the first half of 1994. The housing sector, however, has remained weak.

Inflation as measured by the consumer price index (CPI) has remained very low, despite the significant decline in the exchange rate (which increases the cost of imports) during the past year. The 12-month rate of inflation has remained near zero since February. Even excluding the impact of the tobacco tax cuts, the 12-month rate is only about 1.5 per cent.

Chart 5 Canada-U.S. relative unit labour costs



Note: A falling line indicates increased competitiveness of Canadian producers.

Interest rates in Canada and in other G-7 countries have risen sharply since February, initially triggered by developments in the United States.

But the increase in Canadian long-term interest rates has been much more pronounced than the general global trend, reflecting continuing concerns over large government and external deficits as well as political uncertainty focused on the status of Quebec (Charts 6 and 7).

Chart 6 90-day commercial paper rate

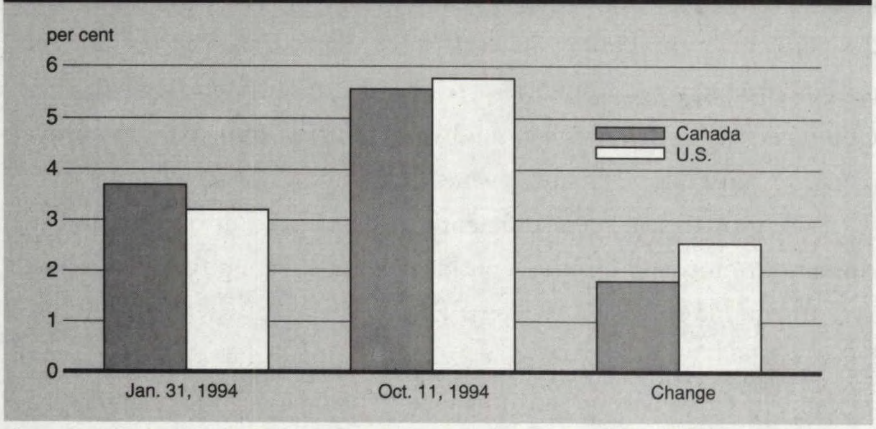
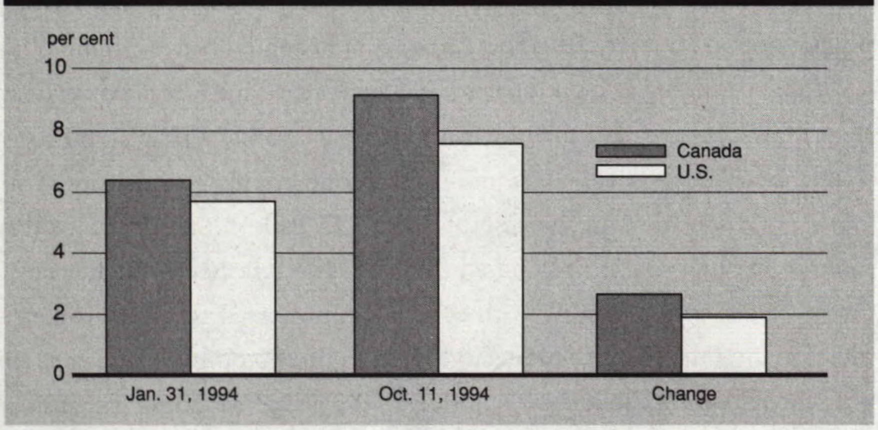


Chart 7 10-year government bond rate



Private Sector Economic Forecasts

The results from a September survey of private sector forecasters are summarized in Table 1. Most forecasters expect that the cyclical upswing will continue, but at a more moderate pace than in both the most recent quarters and comparable phases of previous cycles. Key factors dampening the outlook are a slowdown in U.S. growth and interest rates that remain high relative to inflation.

Most private sector forecasters expect growth in overseas economies to pick up over the next two years. This will support growth of Canada's exports despite a widely-expected slowdown in the U.S. expansion. Canada's improved cost position should also enable Canadian exporters to capture a larger share of world markets while domestic production should displace some imports.

Table 1
Average of private sector forecasts

	1994	1995	1996
		(per cent change unless noted)	
Real GDP growth	4.0	3.8	3.8
GDP deflator increase	0.5	1.5	1.9
Nominal GDP			
$ billion	744	783	826
Per cent change	4.5	5.2	5.5
CPI inflation	0.3	1.7	1.9
Employment growth	1.9	2.3	2.3
Unemployment rate	10.5	9.8	9.3
90-day commercial paper rate	5.6	6.2	5.6
10-year government bond rate	8.3	8.2	7.5

Note: There are 18 participants in the survey for 1994 and 1995 and eight for 1996.

In response to concerns about inflation pressures in the United States, the Federal Reserve Board increased short-term interest rates from 3.0 per cent in February 1994 to 4.75 per cent in September. With the U.S. economy operating at high capacity, most private sector forecasters expect short-term interest rates to rise a further one percentage point (100 basis points) over the next year or so in order to contain inflation pressure. The estimates range from an increase of 50 to 175 basis points. Some of the interest rate increase in the United States will be reflected in higher rates for other countries. As well, with central banks more determined to keep inflation low, the focus of monetary policy in many countries has, or soon will, move toward monetary tightening as the global economic expansion broadens and strengthens.

The average of private sector forecasts for Canadian interest rates shows an increase of about one percentage point (100 basis points) in 1995 for short-term rates from recent levels, with some moderation in 1996. On average, long-term rates are expected to decline about 70 basis points in 1995 from recent levels and fall further in 1996. As would be expected, given the volatility of interest rates and future uncertainties, the averages mask a fairly wide range of views. Domestic factors such as concerns about government and external debt as well as political uncertainty are expected to mitigate the progress toward much lower rates that lower inflation might have yielded.

In this context, forecasters on average expect real growth of 4.0 per cent this year and 3.8 per cent in both 1995 and 1996. Given the moderate pace of the upswing, most analysts believe that industrial capacity will be more than sufficient to meet demand through 1996. As a result, inflation, measured either by the CPI or the broadest measure of prices in the economy (GDP deflator) remains below 2 per cent on average. The range of forecasts for inflation, as measured by the GDP deflator, is large. While some forecasters predict significant increases in inflation, others believe persistent excess capacity will result in further underlying disinflation.

As previously discouraged and inactive job searchers return to the labour market, the unemployment rate remains high, despite solid employment growth. From the 1993 level as a base, more than 800,000 jobs are expected to be created by 1996 according to the average private sector view.

The Organization for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) also prepare economic forecasts of the Canadian economy.

In June, the OECD forecast real growth of 3.7 per cent this year and 4.3 per cent in 1995. This is more optimistic for 1995 than the average of the Canadian private sector forecasters. This largely reflects the OECD's lower assumptions about interest rates. At that time, the OECD assumed that Canadian short-term interest rates would be 5.7 per cent and long-term rates 7.6 per cent in 1995.

Among G-7 countries, the OECD's forecast placed Canada as the second fastest growing country in 1994 behind the United States and the fastest growing country in 1995. Canada is expected to have the third fastest growing economy of all 24 OECD countries in 1995.

In a forecast released at the end of September, the IMF projected real growth of 4.1 per cent in 1994 and 3.8 per cent in 1995. Their positioning of Canada's prospects in the international context is even better than the OECD's. Canada is expected to have the fastest growing economy in 1994 and 1995 among the G-7 and the lowest inflation rate behind Japan. The IMF does not publish an interest rate projection for Canada.

Risks in the Average Private Sector Forecast

Given the very high level of federal government debt, the deficit is extremely sensitive to changes in interest rates. Interest rates have been volatile in recent years, rising and falling by several percentage points as financial market concerns about debt and political uncertainty ebb and flow.

The sensitivity of the federal deficit to interest rate changes is illustrated in Box 3. The first line in the table shows that an increase of one percentage point in all Canadian interest rates would increase the deficit by $1.7 billion in the first year. This would rise over time as the government's debt is rolled over at the higher interest rates.

The second line in the table shows the impact on the deficit in the opposite case where rates were one percentage point lower. The results are precisely the reverse of the impact of higher interest rates.

Regarding risks in the private sector forecast of interest rates, although some upward pressure on interest rates arising from higher U.S. rates has already been factored in, the pressure from international and domestic factors could turn out to be greater than most expect.

Box 3 Fiscal sensitivity analysis – changes in interest rates and in nominal income

	Estimated changes to fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Increase in deficit				
If interest rates are 100-basis points higher	1.7	2.5	3.0	3.5
Decrease in deficit				
interest rates are 100-basis points lower	-1.7	-2.5	-3.0	-3.5
Increase in deficit				
If growth rate in nominal income is 0.5 percentage point lower	0.7	1.5	2.3	3.1
Decrease in deficit				
If growth rate in nominal income is 0.5 percentage point higher	-0.7	-1.5	-2.3	-3.1

The uncertainties in forecasts of interest rates, and the sensitivity of the deficit to changes in those rates, imply that prudent budget planning should not be based simply on the **average** of the private sector forecast. That would create a 50:50 chance that things would turn out worse, perhaps significantly so.

In addition to interest rates, changes in nominal income (which approximate the tax base for federal government revenues) can have a significant impact on the deficit outcome. Although real GDP is a key indicator of the performance of the economy, it is an incomplete measure of how the economy influences fiscal deficits. Real GDP captures only the physical volume of production and misses influences such as changes in prices, wages and other forms of income that have an important bearing on government revenues.

Almost all private sector forecasters have tended to overestimate inflation and hence the growth in nominal income in recent years. For example, the average of private sector forecasts prepared in early 1992 overestimated the level of nominal GDP for 1994 by $52.4 billion (a 7 per cent error) relative to the average of current private sector forecasts. Almost sixty per cent of this difference stemmed from an overestimate of inflation rather than from errors in predicting real GDP. With an effective federal tax rate applicable to total nominal income of just below 20 per cent, this nominal GDP forecast, prepared two years ago, could account for a $10 billion overstatement of revenue prospects for this fiscal year. The potential for large errors of this kind must therefore be borne in mind when planning for budgets one and two years out.

Box 3 also shows the sensitivity of the federal government's deficit to changes in the growth of nominal income. The third line shows the impact on the federal government's deficit if the growth rate in nominal GDP is 0.5 percentage point lower each year. This would lower the level of nominal GDP each year by incremental amounts of 0.5 per cent so that by the fourth year it would be about 2 per cent below the base case value. The fourth line shows the effect on the deficit if the growth rate in nominal income is 0.5 percentage point higher each year. The results are symmetrical.

Consequently, three economic scenarios based on different interest rate and nominal income growth assumptions are developed. These are:

1) a scenario based on the average of the private sector forecasts (Scenario 1);

2) a 'prudent economic scenario' based on the average of the private sector forecasts but with interest rates 50 basis points higher in both 1995 and 1996 (Scenario 2); and

3) a scenario based on the average of private sector forecasts but with interest rates 100 basis points higher in both 1995 and 1996 and nominal income growth half a percentage point lower in both 1995 and 1996 (Scenario 3). This scenario is set out to demonstrate the sensitivity of the deficit to economic variables.

These economic scenarios are presented in Table 2. The economic and fiscal outlooks will of course be re-examined during the pre-budget consultations and revised if necessary prior to the final budget determination.

Comparison with the Budget Economic Assumptions

Table 2 also compares key economic variables from the new economic scenario with the economic assumptions in the February 1994 budget. Real output growth is now expected to be much stronger for 1994.

Table 2
Economic scenarios for fiscal planning

	1994	1995	1996
	(per cent change unless noted)		
Real GDP growth			
1994 budget	3.0	3.8	*
Scenarios 1, 2	4.0	3.8	3.8
GDP deflator			
1994 budget	0.8	1.3	*
Scenarios 1, 2	0.5	1.5	1.9
Nominal GDP (billions of dollars)			
1994 budget	739	777	*
Scenarios 1, 2	744	783	826
Scenario 3	744	779	818
Nominal GDP growth			
1994 budget	3.9	5.1	*
Scenarios 1, 2	4.5	5.2	5.5
Scenario 3 [1]	4.5	4.7	5.0
90-day commercial paper rate			
1994 budget	4.5	5.0	*
Scenario 1	5.6	6.2	5.6
Scenario 2	5.7	6.7	6.1
Scenario 3	5.7	7.2	6.6
10-year government bond rate			
1994 budget	6.4	6.1	*
Scenario 1	8.3	8.2	7.5
Scenario 2	8.4	8.7	8.0
Scenario 3	8.4	9.2	8.5

* The 1994 budget did not include forecasts of 1996 economic variables.

1 Lower nominal growth reflects a mix of lower real growth and less inflation.

With lower inflation in 1994, the difference in nominal income – and hence the tax base – is less than would be suggested by the real output revisions alone.

Interest rates, in the 'prudent' economic scenario, are sharply higher than in the February budget planning assumptions both this year and next. (The 1994 budget did not make forecasts for 1996.) In 1994, short-term interest rates in the prudent economic scenario are forecast to be 120 basis points above the February budget estimates, while long-term rates are 200 basis points higher. For 1995, short-term interest rates in the prudent scenario are forecast to be 170 basis points over the February budget estimates, while long-term interest rates are 260 basis points higher.

4

The Fiscal Implications of the New Economic Assumptions

This section develops the implications of the economic update just described for the fiscal outlook (without any new actions) and the slippage from the budget deficit targets that results.

Deficit for 1994-95 Remains On Track

In the February 1994 budget, the deficit for 1994-95 was forecast to fall to $39.7 billion. This was based on an improved economic outlook, a moderate rise in interest rates from the early 1994 lows, and the impact of the restraint measures introduced in the budget.

However, with interest rates much higher than assumed at the time of the February 1994 budget, public debt charges are now expected to be $3.3 billion higher than estimated in the budget. Nevertheless, the 1994-95 deficit is expected to be no higher than the $39.7 billion forecast in the 1994 budget. There are several reasons:

- Some of the factors contributing to the better deficit outcome for 1993-94 (see Box 4) have continued in 1994-95; for example, stronger-than-expected employment growth and fewer unemployment insurance beneficiaries have resulted in lower unemployment insurance benefit payouts;

Box 4 Deficit for 1993-94 lower than budget estimate

Final results for 1993-94, published on September 14, 1994 in the *Annual Financial Report*, put the deficit at $42 billion, $2 billion below the lower end of the $44 to $46 billion range first set out last November and included in the February 1994 budget.

The main factors accounting for the lower deficit outcome were:

- The strong increase in corporate profits in 1993 resulted in much higher corporate income tax collections in the final quarter of 1993-94.
- Sales and excise tax revenues were also up, reflecting increases in consumer demand.
- In contrast, personal income tax revenues were lower due to the faster processing of income tax refunds and payments to the Provincial Tax Collection Account at year end for underpayments during the course of taxation year 1993.
- Unemployment insurance benefit payments were lower, reflecting continued improvement in the labour market.
- Public debt charges were somewhat lower, reflecting a change in the accounting for premiums and discounts.
- Not all of the contingencies set aside for unanticipated end-of-year adjustements were required.
- Following discussions with the Auditor General, it was decided the $500 million provision for court-related corporate income tax refunds should be recorded in 1992-93 when the court decision became effective.

—*Annual Financial Report*
September 1994

- Restraint measures introduced in the 1994 budget will continue to control program spending through the balance of the fiscal year; and
- Substantial contingency reserves were built into the February 1994 budget fiscal forecast for unforeseen developments. Of the $2.4 billion reserve in the budget, to date $1.6 billion has been reallocated to offset the impact of the higher interest rates on public debt charges.

With the lower-than-expected outcome for 1993-94, the deficit falls by only $2.3 billion between 1993-94 and 1994-95. The lack of more significant improvement is attributable to the higher public debt charges, which are expected to increase by $6.3 billion between the two years.

About $3 billion of this increase reflects the interest costs associated directly with financing the 1993-94 deficit of $42.0 billion. In addition, the effective interest rate on the debt will be significantly higher this fiscal year than the average in 1993-94, thus raising the overall costs of servicing the debt by about $3.3 billion.

Table 3
Changes to the February 1994 budget deficit track

	1994-95
	(billions of dollars)
February 1994 budget deficit track	39.7
Changes:	
Personal income tax	0.9
Corporate income tax	-0.7
Revenue changes	0.2
Unemployment insurance benefits	-2.7
Transfers to provinces	0.8
Program spending changes	-1.9
Contingency reserve	-1.6
Public debt charges	3.3
Total changes	0.0
Revised deficit	39.7

Note: Negative sign indicates a reduction in the deficit.
Positive sign means an increase in the deficit.

Higher Interest Rates are Pushing Deficit Off Track Post-1994-95

To project the fiscal implications of the economic update beyond 1994-95, the economic parameters are passed through models that generate estimates of government revenues and expenditures. These economic-fiscal relationships cannot be captured precisely, which points to the importance, as previously noted, of including contingency reserves in budget planning.

The fiscal projections that follow include a contingency reserve of $2.5 billion in 1995-96 and $3.0 billion in 1996-97. Such a reserve would cover the deficit impact resulting from the combination of a 1 per cent error in both revenues (lower) and program spending (higher). This is a rough rule of thumb for establishing such reserves, the appropriateness of which is an important question for discussion of prudent budget planning assumptions.

The use of the prudent economic assumptions, coupled with an appropriate contingency reserve, should provide sufficient safeguards for planning purposes. Although the *individual components* making up the eventual deficit will almost certainly differ from those currently assumed, the deficit bottom line should be in line with expectations.

Updated Fiscal Projections

The economic scenario depicted by the average private sector forecast (Scenario 1) would imply that the deficit in 1995-96 would be $2.3 billion above the 1994 budget target of $32.7 billion while for 1996-97 the gap to the 3 per cent deficit-to-GDP ratio would be $5.0 billion. As argued above, a more prudent set of economic assumptions should be considered for fiscal planning.

The fiscal scenario based on the 'prudent' economic scenario in Table 2 (Scenario 2) is set out in Table 4. According to the updated scenario, average interest rates are about 210 basis points higher than the average forecast for 1995 at the time of the February 1994 budget. Nominal income, the applicable tax base for budgetary revenues, is only slightly higher than the 1994 budget assumption and as a result budgetary revenues are little changed.

Table 4
Fiscal projections based on the 'prudent' economic scenario (Scenario 2) set out in Table 2

	Actual	Estimate	Status Quo Update	
	1993-94	1994-95	1995-96	1996-97
		(billions of dollars)		
Budgetary transactions				
Budgetary revenues	116.0	123.7	133.0	139.0
Program spending	120.0	118.3	119.0	118.5
Debt charges	38.0	44.3	47.3	48.8
Contingency reserve		0.8	2.5	3.0
Budgetary deficit	42.0	39.7	35.8	31.3
Shortfall to 1994 budget deficit targets		0.0	3.1	6.3
Net public debt	508.2	547.9	583.7	615.0
Gross domestic product	711	744	783	826
		(percentage of GDP)		
Budgetary revenues	16.3	16.6	17.0	16.8
Program spending	16.9	15.9	15.2	14.3
Public debt charges	5.3	6.0	6.0	5.9
Deficit	5.9	5.3	4.6	3.8
Net public debt	71.4	73.6	74.5	74.5
Public debt charges as a percentage of revenues	32.7	35.8	35.6	35.1

Note: Details may not add due to rounding.

Deficit targets from 1994 Budget 39.7 32.7 25.0

Owing to the much higher-than-assumed interest rates, the deficit in each of the next two fiscal years is now projected to be considerably worse than forecast in the February 1994 budget. For 1995-96, it is now expected to reach $35.8 billion, $3.1 billion higher than the February 1994 budget deficit target. For 1996-97, it would be $31.3 billion, or 3.8 per cent of GDP. To achieve the deficit target of 3 per cent of GDP, or approximately $25 billion, further fiscal actions of $6.3 billion would be required.

The assumptions underlying the 'prudent scenario' could be further altered to incorporate still other risks to the deficit projections. The appropriate overall degree of prudence is an issue for discussion during the pre-budget consultations.

If, for example, nominal GDP growth were to be a 0.5 percentage point lower in both 1995 and 1996 than assumed in the private sector average forecast, the *level* of nominal GDP would be reduced by about $4 billion in 1995 and $8 billion in 1996. This would result in both lower revenues and higher public debt charges, as the government would be required to borrow to cover the shortfall.

If interest rates were to be another 50 basis points higher in both 1995 and 1996 than assumed in the 'prudent' planning scenario, making them a full 100 basis points above the private sector average, combined with slower growth in income (Scenario 3), the deficit would be projected to reach $37.4 billion in 1995-96, and $34 billion in 1996-97. This would be $4.7 billion and $9 billion higher than the targets set out in the February 1994 budget for 1995-96 and 1996-97, respectively.

5

Meeting the Deficit Targets

The key issue becomes 'how' to get the deficit back on the February 1994 budget track.

The fiscal actions required should come principally from reductions in program spending and the correction of inequities in the existing tax system. Tax increases in Canada in recent years have resulted in a growing sense of tax fatigue, a widespread resistance to further tax increases, and evidence of growth in the underground economy. Increases in tax rates could have very deleterious effects on the competitiveness of the economy and the prospects for sustained growth and job creation.

Because program spending is already expected to decline from the 1993–94 level, weighting fiscal actions towards spending reductions would imply that future program spending will have to be substantially below the present level. In almost all cases, spending cuts to a particular program will lower the level of spending year-over-year. This contrasts with many actions in previous budgets where spending cuts were really slowing the growth from rising reference levels.

What approach should be adopted to identify the needed reductions in program spending?

Given the size of the spending reductions required and the restraint measures which have been introduced in recent years, an across-the-board cut alone in all programs is probably not appropriate for the 1995 budget.

Some programs are of lower priority than others. Opportunities for efficiency gains vary. In order to prevent an across-the-board cut from destroying high priority, efficiently-run programs, the cut would have to be set so low as to preclude achieving the fiscal targets. Furthermore, lower priority, less efficient programs would continue to be financed, albeit at a somewhat lower level.

As was indicated earlier, a major element of the government's growth strategy framework involves a complete rethinking of the role of the federal government and a restructuring of activities to support competitiveness and growth. The Program Review will examine all programs and policies and set priorities; eliminate low-priority activities; and reduce overlap of activities with the provinces.

The policy and program reviews, which were announced in the last budget, are currently underway. These reviews will complement input from the House of Commons Finance Committee and public consultations. These reviews will identify opportunities for savings and provide ways government spending can be restructured to achieve economic and social objectives while reflecting current fiscal realities.

But, in addition to the program spending reductions, a review of expenditure options should recognize that policy objectives may also be pursued through measures contained in the tax system, such as income exclusions and deductions, tax credits and deferrals.

For example, prior to 1993, child benefit support was provided almost equally through tax credits and direct program spending. Following the reform of the child benefit system in 1993, nearly all of the benefits are now determined through the income tax system and netted against gross revenues. In many ways, measures such as this represent an alternative form of government assistance with financial implications similar to those of direct expenditures. These are generally referred to as tax expenditures and should be examined as well.

A number of principles can be utilized to determine the revenue measures which could be considered:

- improving the overall efficiency of the economy;

- increasing the fairness of the tax system; and
- broadening the tax base is preferable to raising tax rates.

Annex 1 provides detailed facts about the nature of federal government spending. It is hoped that such details will allow for better understanding and permit more informed debate about the difficult choices required to reduce program spending.

Annex 2 provides details on revenue collections by source and on major tax expenditures. As noted earlier, government policy objectives can be also be pursued through the tax system.

6

Conclusions and Main Issues

The vulnerability of the federal government's fiscal situation was clearly exposed by the rise in interest rates early in 1994. With interest rates higher than assumed in the February 1994 budget, the deficit targets set out in that budget for 1995-96 and 1996-97 will not be met without further fiscal actions.

The vicious circle of rising debt burdens must be broken. The price that Canadians are currently paying and the price that future Canadians will have to pay is just too great. That is why it is so important that the fiscal targets set out in the February 1994 budget be met. A deficit-to-GDP ratio of 3 per cent has not been achieved since 1974-75. It will also lower the debt-to-GDP ratio, which has been rising steadily, with one year's exception, since 1974-75. Meeting the 3 per cent target in 1996-97 will also be the first step to a balanced budget.

Achieving the February 1994 budget deficit targets will likely require substantial fiscal actions. The average private sector economic outlook suggests that actions of $2.3 billion in 1995-96 and $5 billion in 1996-97 would be required. This document argues that for fiscal planning purposes a greater degree of prudence is advisable. Under an economic scenario with interest rates 50 basis points above the private sector averages, the required fiscal actions would be $3.1 billion and $6.3 billion in 1995-96 and 1996-97 respectively. To further illustrate the fiscal sensitivity to the economic assumptions, if interest rates are assumed to be a full 100 basis points above the private sector averages and as well growth in nominal GDP is somewhat weaker, then the required fiscal actions would be $4.7 billion in 1995-96 and $9 billion in 1996-97.

The economic and fiscal outlooks will be reassessed at the time of the 1995 budget to reflect the latest economic developments and advice from the House of Commons Finance Committee and elsewhere during the pre-budget consultations.

Difficult tradeoffs will be required. The government must choose how to bring this about. But, the input from all Canadians on these difficult decisions will be important. The deficit and debt problem is not just an abstract financial issue – it affects every Canadian and every Canadian should be part of the process of finding the solution.

In the February 1994 budget, the Government promised to open up the budget process and to more actively involve Parliamentarians and Canadians in the important decisions that must be made in order to break the vicious circle of deficits and debts.

This document honours that commitment. It provides the basis for a serious, open, national dialogue between the Government and the people.

The House of Commons Finance Committee is being asked to conduct public hearings on the appropriateness of the economic and fiscal assumptions contained in this document. It is also being asked to solicit the views of Canadians on the appropriate actions to address the deficit problem. These results and recommendations, along with the results of consultations with provincial Finance Ministers and others will be considered in constructing the next budget.

The House of Commons Finance Committee will be asked to address three core questions:

1. What is the appropriate basis to select the planning assumptions, including both the economic assumptions and the magnitude of the contingency reserve?

2. What is the appropriate balance between expenditure and revenue actions?

3. Which specific expenditure and revenue options are most appropriate to pursue?

In addressing these core questions, the Committee and all Canadians, may wish to consider as well a number of ancillary issues that must be addressed in making decisions for the 1995 budget:

1. What should be the priority areas for cuts?

2. Which specific principles should be used in deciding where to reduce spending and where not to reduce?

3. For which government services should people pay directly for a larger share of the cost?

4. Are there fiscal actions the federal government could take which would create scope for provincial governments to reduce their deficits as well?

5. What can or should be done to define the role of each level of government more clearly in order to address the issue of overlap of government services?

6. Are there government assets that should be considered candidates for privatization?

7. Is it time for community-level agencies to deliver services that are now in the hands of the federal government? And if so, how should that be funded?

Annex 1

Where the Government Spends

This section provides details on government spending. The federal government spent $158.0 billion in 1993-94. Twenty-four per cent of that spending was for interest payments on the debt. This the government had to pay. These payments accounted for 33 cents of each revenue dollar taken in.

That left $120.0 billion for program spending.

Annex Table 1
Structure of spending: 1993-94

	Billions of dollars	Per cent of total
Total spending	158.0	100.0
Interest on debt	38.0	24.0
Program spending	120.0	76.0

Program spending breaks down in the following way:

Annex Table 2
Program spending

	1993-94	1994-95	1995-96
		(billions of dollars)	
Total program spending	120.0	118.3	119.0
Of which:			
Transfers to persons			
Elderly benefits	19.9	20.6	21.3
Unemployment insurance	17.6	15.6	15.5
Veterans' pensions/allowances	1.7	1.9	1.9
Indians and Inuit	3.2	3.4	3.6
Total	42.4	41.5	42.3
Transfers to other levels of government[1]			
Established Programs Financing			
Health	7.2	7.3	6.7
Post-secondary education	2.4	2.3	2.1
Canada Assistance Plan	7.2	7.4	7.3
Equalization	7.8	8.5	9.0
Transfers to territories	1.1	1.2	1.2
Other	1.9	0.4	0.4
Total – cash	27.6	27.2	26.8
Subsidies and other transfers			
Business subsidies[2]	3.1	3.3	3.1
International assistance	2.6	2.6	2.6
Other	7.7	7.9	8.7
Total	13.4	13.8	14.4
Crown corporations			
Canadian Broadcasting Corporation	1.1	1.1	1.1
Canada Mortgage and Housing Corporation	1.9	2.1	2.2
Other	2.3	1.4	1.3
Total	5.3	4.6	4.5
Defence	11.3	10.8	10.5
All other departmental spending	20.0	20.4	20.5

1 Transfers under Established Programs Financing and Canada Assistance Plan to other levels of government are made as a combination of cash and a transfer of tax points. Total transfers, including cash and tax transfers are estimated at $39 billion in 1993-94.

2 Includes transfers in 1993-94 under Industry Canada ($1.6 billion), Natural Resources ($0.4 billion), the regional agencies ($0.7 billion), and Transport Canada ($0.4 billion).

Of this $120.0 billion, over one-third went directly to individuals, in the form of elderly and unemployment insurance benefits and transfers to Indians and Inuit.

This is the largest component of our program spending.

Twenty-three per cent was for cash transfers to provincial, territorial and municipal governments. Included in this are transfers for social security, (i.e. federal transfers under the Canada Assistance Plan for welfare and Established Programs Financing – EPF – for post-secondary education), for health, and for equalization payments to the less-wealthy provinces.

Direct subsidies to businesses, International Assistance, Agriculture, Culture, etc. accounted for another 10 plus per cent.

Subsidies to Crown corporations, primarily to the Canada Mortgage and Housing Corporation ($2.1 billion) and the Canadian Broadcasting Corporation ($1.1 billion), accounted for about 4 per cent of total program spending. This represents only the direct subsidy payments that the government makes to these Crown corporations. A number of Crown corporations also raise revenues, such as the levying of fees.

In 1993-94, the government spent $11.3 billion or about 9 per cent of program spending on defence. Of this amount, $5.7 billion is for personnel expenses.

The cost of running government amounted to $20 billion or about 17 per cent of spending. Of this amount about $14 billion is for personnel costs (excluding defence).

What are the Options?

The sections that follow review federal government spending by major program spending category.

As shown in Annex Table 2, major transfers to persons and to other levels of government amounted to about $70 billion, or 58 per cent of total program spending in 1993-94. This left about $50 billion of other spending. Before going into the details of the Major Transfers to Persons and to Other Levels of Government categories, this residual category is first examined.

To better understand what is included in this $50 billion of spending, it is appropriate to examine what is being delivered and at what cost by program area. In a number of cases, the policy objective or program is delivered through direct grants and contributions, while in others, it is delivered directly by the government through its operating expenditures or through a Crown corporation. By combining subsidies and other transfers, payments to Crown corporations, and operating and capital expenditures, one obtains a more comprehensive picture of the full cost of delivering such programs to Canadians and possible options for change.

This puts the $20 billion identified earlier as 'operating costs' of government into its proper perspective. Significant savings in operating costs require reductions or eliminations of the programs which are being supported. And in a number of cases, sizeable reductions or elimination of the programs are clearly not feasible. For example, operating costs include the staffing of federal penitentiaries and the costs of the federal judicial system. There are tremendous pressures in these areas.

This is not to suggest that there can be no efficiency gains. Almost all organizations in Canada have been securing efficiency gains in recent years. But significant operating cost reductions cannot be achieved if all of the current programs continue to be supported. That is why the focus should start with an examination of the programs.

Privatization of Crown corporations is often cited as a means to quickly resolve Canada's deficit and debt problems. And although there may be many reasons to consider privatization opportunities, the impact of privatization on the budget deficit is very limited, especially in the near term. The impact on the deficit in the near term is two-fold:

1. Cash received from the sale of Crown corporations would directly reduce the government's borrowing requirements and therefore reduce its debt servicing costs on an ongoing basis.

2. If the sale price received exceeds the book value at which the asset is recorded, then the deficit would be further reduced by that amount in the year in which the sale was completed. There are few such cases where this would apply at this time.

Over the long term, privatization of Crown corporations could improve the overall operating efficiency of the corporation and eliminate the possible need for government assistance.

In the last budget, the government launched a major review of all aspects of government spending, under the direction of the Minister Responsible for Public Service Renewal. The Program Review is a department-driven assessment of all federal programs and responsibilities, including grants and contributions, tax expenditures, cost recovery, and overhead. Its main objective is to identify the federal government's core roles and responsibilities. The guidelines for assessing the role of government programs and policies are:

- **Public interest test:** Does the program area or activity serve a public interest?

- **Role of government test:** Is there a legitimate and necessary role for government in this area or activity?

- **Federalism test:** Is the current role of the federal government appropriate, or should the program be devolved to the provinces?

- **Partnership test:** What activities or programs should or could be transferred in whole or in part to the private or voluntary sector?

- **Efficiency test:** If the program is to continue, how could its efficiency be improved?

- **Affordability test:** Is the program affordable in light of the current fiscal situation?

The results of this review, along with the input from Canadians will be reflected in the budget decisions.

Program spending, excluding the major transfers to persons and to other levels of government, can also be subdivided into the following policy sectors:

1. Natural Resource-Based Programs;

2. Transportation;

3. Justice and Legal Programs;

4. Industrial, Regional, and Scientific-Technological Support Programs;

5. Heritage and Cultural Programs;

6. Social Programs (Excluding Major Transfers but including funding to Aboriginals);

7. Foreign Affairs, International Trade and Assistance;

8. Defence; and,

9. General Government Services.

In the following sections, spending details in each of these major policy sectors are shown for 1993-94 and 1994-95. For 1993-94, the figures are the amounts spent as reported in the Public Accounts of Canada. The figures for 1994-95 are from the Main Estimates for 1994-95, adjusted to reflect certain decisions since that time. For 1995-96, only the aggregate planned reference levels are shown. These figures will be updated in the planning for the 1995-96 Main Estimates to fully incorporate all policy decisions made since the tabling of the Main Estimates for 1994-95. The totals will not necessarily correspond to the aggregate spending projections shown in Annex Table 2, as they exclude certain consolidation and other accounting adjustments, which are not part of the Main Esimates. Major reorganizations were made to the structure of certain ministeries in 1993. These changes are reflected in the 1994-95 and 1995-96 figures but not in all cases in the 1993-94 figures.

In most cases, spending in these areas is already expected to decline over time, primarily due to the impact of restraint measures introduced in the 1994 budget. The challenge will be to bring the level of spending down even farther.

Natural Resource-Based Programs

Federal spending on natural resource-based programs applies to agriculture, energy, mines, forestry, fisheries and the environment.

Total spending in 1994-95 is expected to be $5.1 billion. Nearly 40 per cent will be in the form of transfers, primarily to the agricultural sector. Spending on operations in this sector is largely directed to a wide range of scientific and technological research and inspection services.

The overall objective is to support the orderly development of natural resources in ways that maximize economic benefits to Canadians while ensuring that the quality of the environment is protected and enhanced.

Annex Table 3
Natural resource-based programs

	1993-94	1994-95	1995-96
	(millions of dollars)		
Agriculture	2,185	2,141	2,009
Natural Resources	1,275	1,259	1,120
Fisheries and Oceans	1,057	978	709
Environment	700	733	664
Total	5,216	5,112	4,502

Agriculture

Agriculture and Agri-Food Canada defines its key roles as:

- helping the agri-food industry exploit growth and diversification opportunities, particularly through research and marketing activities;
- encouraging industry to increasingly provide its own financial security from a competing marketplace;
- helping to improve the quality of life in rural areas;
- focussing on environmental sustainability; and
- maintaining high levels of food safety and quality.

Departmental support to the sector focuses on the following areas: farm income stabilization, grains policy and transportation, supply management, inspection and quarantine, research, trade and market development, environmental sustainability, adaption and rural, as well as policy and economic analysis.

Approximately 60 per cent of planned spending is for grants and contributions (transfer payments) and 40 per cent for operating and capital.

Most of the transfer payments are directed to farm income support and adaptation programs, including the Gross Revenue Insurance Plan (GRIP), Crop Insurance Program, Net Income Stabilization Account (NISA) and other payments under the Farm Income Protection Act.

These are largely tripartite cost-sharing programs, involving participation by agricultural producers as well as provincial governments.

Agriculture Canada is also involved in grading and inspection, regulation and scientific research, which accounts for most of its operating spending.

Annex Table 4
Agriculture

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfer payments			
Farm Income Protection Act			
Crop Insurance	171	180	
GRIP	467	487	
NISA	71	86	
Other	115	98	
Dairy	225	217	
Other	264	244	
Total	1,313	1,312	
Operating and capital	869	827	
Canadian Dairy Commission	3	3	
Total	2,185	2,141	2,009

Substantial savings in the tripartite programs would require renegotiation of federal contributions or significant program redesign.

Potential areas for savings in the inspection, research and regulatory areas include reducing overlap with the provinces, achieving much greater cost recovery for services, securing efficiency gains, and increased promotion of industry/government partnerships in research activities.

Natural Resources

The Department of Natural Resources promotes sustainable development and responsible use of Canada's mineral, energy, and forestry resources and the international competitiveness of the natural resource industries.

About half of the department's budget is expended on science and technology and on structuring a federal policy environment that promotes a sustainable and competitive natural resource sector. Science and technology activities include mapping and remote sensing, geological surveys, mineral and energy technology development, developing sustainable forest management practices, environmental monitoring and amelioration, and programs that protect the health and safety of Canadians. Current policy work is directed towards enhancing the international competitiveness of the energy, forest, and mining industries and promoting the sustainable development and use of Canada's natural resources. These two objectives are increasingly interdependent, as are the science and technology and economic expertise employed to meet them.

About half of the department's budget is in transfer payments. The largest of these is support for the Hibernia project. The federal government's support to Hibernia and to other resource megaprojects will terminate by the end of the 1997-98 fiscal year. Other transfers include the Forestry and Mineral Development Agreements, support for alternate energy and energy efficiency programs, and statutory payments for resource management and revenue-sharing agreements with Nova Scotia and Newfoundland for oil and gas resources.

The Minister of Natural Resources is also responsible for Atomic Energy of Canada Ltd., the Crown corporation, which researches and develops nuclear technology, as well as three regulatory agencies: the Atomic Energy Control Board, the National Energy Board, and the National Pipeline Agency.

Annex Table 5
Natural Resources

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfer payments			
Hibernia project	247	250	
Interprovincial Pipeline	2	16	
Provincial revenue agreements	24	9	
Forestry	105	88	
Other	51	54	
Total	429	418	
Operating and capital	602	593	
Atomic Energy of Canada Ltd.	174	174	
Atomic Energy Control Board	42	42	
National Energy Board	28	31	
Total	1,275	1,259	1,120

An assessment of departmental priorities and relationships with the provinces and other stakeholders could identify several opportunities for change.

This could include reductions in or withdrawal from some programs, and increased cost recovery or commercialization of services.

Fisheries and Oceans

Since 1867, the federal government has had exclusive legislative authority over both seacoast and inland commercial fisheries.

In exercising its authority, the federal government, through the Department of Fisheries and Oceans, currently conserves and protects the fishery resource base, and manages the commercial, Aboriginal and recreational fisheries in marine and inland waters.

Most of the operating expenditures relate to biological research into fish stocks, development and implementation and enforcement of fish management plans, oceanography, fish habitat management, fish inspection, and the management of some 2,300 small craft harbours.

Spending in the fisheries sector was recently supplemented by special income replacement assistance for fishermen and plant workers affected by the collapse of the Atlantic groundfish fisheries. In the February 1994 budget, the government provided $1.7 billion over the 1994-95 to 1998-99 period in new spending for a long-term adjustment program for the Atlantic groundfish industry, with most of the funding being provided in the first three years. Funding under this program is managed by the Minister of Human Resources Development and the Minister of Fisheries and Oceans. The key challenge is to establish a smaller but viable groundfish sector that provides adequate earnings without the requirement for ongoing federal income support.

Annex Table 6
Fisheries and Oceans

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfer payments			
Special Groundfish Programming	355	39	
Atlantic Groundfish Strategy (TAGS)		205	
Other	18	43	
Total	373	287	
Operating and capital			
Fisheries Operations	219	207	
Corporate Policy and Programs	225	250	
Science	202	195	
Inspections	33	34	
International Negotiations	5	5	
Total	684	691	
Total spending	1,057	978	709

Opportunities for change include focusing on the department's core role of conservation and sustainable development, extensive use of partnerships and co-management agreements as well as cost recovery in areas where private sector benefits are provided. Other areas could include reduced involvement in fresh water, restructuring and streamlining the science program, divestiture and rationalization of small craft harbours, and increasing co-ordination or consolidation of the departmental fleet operations with other departments.

Environment

Funding for programs under Environment Canada, including environmental conservation and protection programs, and weather and climate services, amounted to $0.7 billion in 1994-95.

Federal spending on environmental-related programs also takes place under other departments. For example, Environment Canada manages only 35 per cent of spending under the Green Plan.

Annex Table 7
Environment

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfer payments	64	59	
Operating and capital	636	674	
Total	700	733	664

Opportunities for changes would include improving program delivery through harmonization of programs with the provinces (monitoring, environmental assessment, compliance and wildlife), targeting funding to a limited number of program areas and considering alternative mechanisms for service delivery or commercialization.

Transport

The federal government supports transport primarily through programs of Transport Canada and the National Transportation Agency.

Transport Canada owns and operates $19 billion in assets including the air and marine navigation systems, harbours and ports, airport runways and facilities, and vessels which provide search and rescue, icebreaking and environmental response services.

Transport Canada recovers, mainly through user fee charges for airport and marine services and through the Air Transportation Tax, approximately one-third of its total expenditures (including subsidies).

Transport Canada also sets the regulatory and policy framework for all transportation sectors, through legislation/regulation development, compliance (inspection and testing), certification, licensing and education programs relating to transportation safety, security and environmental protection in the marine, aviation, rail, and motor vehicle modes.

In addition, Transport Canada provides operating subsidy payments for transportation to organizations such as VIA Rail for rail passenger services, Marine Atlantic and provincial and private operators for ferry services and to the provinces under agreements to develop and restore highways.

The National Transportation Agency is responsible for the economic regulation of transportation and provides various transportation subsidy programs. The latter includes the Western Grain Transportation Act, which provides subsidies to railways for the transportation of grain, and the Atlantic and Maritime Region Freight Assistance Acts, which provides subsidies to railway, marine, and trucking companies involved in the transportation of goods in Atlantic Canada.

Annex Table 8
Transport

	1993-94	1994-95	1995-96
	(millions of dollars)		
Department			
Transfer payments			
Ferry and coastal service	29	29	
Strategic Capital Investment Initiative	123	138	
Highway agreements	81	63	
Municipal airports	30	32	
Rail crossing improvements	10	9	
Payment to Canada Wheat Board	18	15	
VIA Rail	343	331	
Marine Atlantic	129	128	
Other	70	62	
Total	833	807	
Operating and capital			
Gross	2,264	2,129	
Revenues	929	931	
Net operating	1,335	1,198	
Total department	2,167	2,005	
National Transportation Agency			
Transfers			
Western Grain Transportation Act	633	629	
National Transportation Act	15	24	
Atlantic Region Freight Assistance Act	96	91	
Maritime Freight Rates Act	9	8	
Railway Act	9	9	
Total	763	761	
Operating and capital	33	33	
Total	796	794	
Agencies			
Civil Aviation Tribunal	1	1	
Grain Transportation Agency Administrator	4	15	
Total	2,969	2,815	2,645

The Minister of Transport is undertaking a major review of the activities of Transport Canada and the National Transportation Agency to improve efficiency and to substantially reduce current net spending. The review is designed to:

- commercialize and rationalize services;
- cut subsidies;
- cut overhead; and
- generate revenue.

The Minister of Transport announced on July 13, 1994, the government's intention to transfer ownership and/or operation of 149 airports to local authority groups. The goal is to provide more efficient transportation services for users.

Industrial, Regional and Scientific-Technological Support Programs

These programs are designed to foster regional and industrial development and to enhance Canadian competitiveness by stimulating private sector investment across Canada.

Industry Canada supports programs to promote international competitiveness and increased investment in Canada, to promote regional development in northern Ontario, and to assist aboriginal people to realize their economic potential. Regional development agencies provide complementary programming tailored to the unique economic circumstances of the regions, in close consultation with the provincial governments.

About two-thirds of spending is in the form of transfer payments, including contributions under the Canada Infrastructure Works Program, contributions to businesses under the Defence Industry Productivity Program, and contributions under the Aboriginal Economic Program.

These transfer payments are expected to decline over time, reflecting the impact of previous budget measures.

There are three regional agencies – Atlantic Canada Opportunities Agency, Federal Office of Regional Development – Quebec, and Department of Western Economic Diversification. Among the key functions of the regional agencies are to support the development of each region's economic potential and ensure the fair access of regional businesses to federal programs and services and procurement opportunities and to ensure that federal policies and programs are sensitive to regional concerns.

The first two focus primarily on strengthening the base of small- and medium-sized businesses and business infrastructure to provide sustainable long-term employment and economic growth in all regions of Atlantic and Quebec.

The Department of Western Economic Diversification promotes economic diversification in western Canada to lessen the West's reliance on traditional resource sectors. Industry Canada itself performs a comparable role in terms of regional development in northern Ontario.

Funding levels exclude contributions to provinces under the Canada Infrastructure Works Agreement. The federal contribution to this program is shown separately.

Increasing emphasis is being placed on providing assistance through repayable contributions rather than direct grants.

The Canadian Space Agency is responsible for federally funded activities in research, development, and applications in space science and technology.

In the last budget, the government moved to establish a long-term viable space plan by providing additional funding of $800 million to the space sector over the next 10 years. The government also announced and successfully negotiated an orderly reduction in its current commitments to the Space Station program.

Total federal government direct funding in science and technology amounts to about $6 billion a year, most of which is spent in 20 science-based departments and agencies. These include Environment, Natural Resources, Agriculture, National Defence, Fisheries and Oceans, the National Research Council, the Canadian Space Agency, and the three granting councils (the Natural Sciences and Engineering Research Council, the Social Sciences and Humanities Research Council, and the Medical Research Council). Tax credits to encourage science and technology amount to an additional $1 billion of claims by business per year.

Over half of the funding provided to the National Research Council is for in-house research and development. In contrast, most of the funding to the Natural Sciences and Engineering Research Council, and the Social Sciences and Humanities Research Council is directed to providing grants and scholarships to selected individuals, groups and organizations.

As announced in the 1994 budget, the Minister of Industry is conducting an intense national dialogue leading to a new national science and technology strategy.

The Federal Business Development Bank provides loans, venture capital, and management counselling to small business enterprises.

Operating subsidies are provided to the Cape Breton Development Agency to rehabilitate and reorganize the coal mining industry on Cape Breton Island.

There are also programs to promote a fair and efficient Canadian marketplace and to protect, assist, and support consumer interests.

The level of funding for the programs administered by Industry Canada and the regional agencies will decline over time reflecting the impact of reductions announced in previous budgets. As well, some programs such as the Canada Infrastructure Works Program are of finite duration.

Further savings could result from program rationalization and consolidation, more efficient program delivery and, where feasible, greater reliance on loans and repayable contributions rather than grants.

Annex Table 9

Industrial, Regional, and Scientific-Technological Support Programs

	1993-94	1994-95	1995-96
	(millions of dollars)		
Industry – Department			
Transfer payments[1]			
Defence Industry Productivity Program	167	158	
Aboriginal Economic Program	69	64	
Canada Scholarships Program	21	25	
Sector Campaigns	24	44	
Strategic Technologies	21	23	
Other	242	175	
Total	544	489	
Operating and capital	424	569	
Total	968	1,058	899
Regional Agencies[1]			
Atlantic Canada Opportunities Agency	276	299	
Federal Office of Regional Development – Quebec	185	235	
Western Economic Diversification	173	233	
Enterprise Cape Breton Corporation	10	10	
Cape Breton Development Corporation	38	25	
Total	682	802	744
Canada Infrastructure Works Program		684	977
Canadian Space Agency	378	362	
National Research Council	434	446	
Natural Sciences and Engineering Research Council	495	474	
Social Sciences and Humanities Research Council	101	101	
Total	1,408	1,383	1,423
Competition Tribunal	1	2	
Copyright Board	1	1	
Standards Council of Canada	6	5	
Federal Business Development Bank	15	14	
Investment Canada	9		
Total	32	22	22
Grand total	3,090	3,949	4,065

1 Excludes funding for Canada Infrastructure Works Program, which is shown separately.

Justice and Legal Programs

Programs in this sector are directed at the administration of justice and law enforcement and are aimed at supporting a fair and equitable justice system and maintaining law and order through policing and custodial activities.

Programs carried out by the Department of Justice include:

- the provision of legal services to the government and its agencies;
- funding to provinces to help provide criminal legal aid across Canada and for shared-cost programs, such as juvenile justice services.

The Solicitor General is responsible for:

- the administration of sentences imposed by the courts and the preparation for the return of offenders as law-abiding citizens through the Corrections Services;
- the operation of the National Parole Board;
- the maintenance of peace, order, and security through the Royal Canadian Mounted Police;
- the implementation of the First Nations Policing Policy involving tripartite negotiations with the federal, provincial/territorial and First Nations' governments in order to provide adequate and culturally sensitive policing services to the First Nations communities;
- national security through the Canadian Security Intelligence Service; and
- forums for redress of grievances by the public or members of the RCMP through the RCMP External Review Committee and RCMP Public Complaints Commission; a forum for redress for offenders through the Office of the Correctional Investigator.

Expenditures for the Royal Canadian Mounted Police represent net funding. Provincial and municipal governments, who receive law enforcement services from the RCMP, pay a fee for these services.

Annex Table 10
Justice and Legal Programs

	1993-94	1994-95	1995-96
	(millions of dollars)		
Justice			
Transfer payments			
Young Offenders Act	156	158	
Legal aid	89	88	
Other	13	18	
Total	258	264	
Operating and capital	204	183	
Total	462	447	430
Solicitor General			
Transfer payments			
Indian Policy Program	27	48	
Other	43	50	
Total	70	98	
Operating and capital			
Correctional Services Canada	997	1,024	
RCMP	1,204	1,148	
Department	36	27	
Total	2,237	2,199	
Total	2,307	2,297	2,256
Federal Judicial Affairs	198	208	
Supreme Court of Canada	17	18	
Federal Court of Canada	32	19	
Tax Court of Canada	10	10	
Office of Information and Privy Commissioners	7	6	
Canadian Human Rights Commission	18	17	
Canadian Security Intelligence Service	244	207	
National Parole Board	27	26	
RCMP External Review Commission	1	1	
RCMP Public Complaints Commission	3	4	
Office of Correctional Investigator	1	1	
Law Reform Commission		1	
Total	557	518	502
Total all spending	3,325	3,262	3,188

There are considerable funding pressures in this area. The Supreme Court ruling in 1992 limiting the length of delay before a trial is putting increased pressures on the court system. Many prisons are crowded and ageing. The challenge is to find more efficient ways of administrating the criminal justice and corrections system while better protecting Canadians.

Heritage and Cultural Programs

These programs foster the growth and development of Canada's cultural identity, promote knowledge and understanding of Canada, national unity and social cohesion, ensure the provision of official languages and aboriginal language programs, enhance Canada's multicultural heritage, and protect national parks and historic sites.

The programs are largely delivered by Canadian Heritage and its associated agencies and Crown corporations. The department's activities can be subdivided into the following main areas:

Canadian Identity: promote knowledge and understanding of Canada, pride in being Canadian and full participation in Canadian life through the provision of financial and other forms of support to non-profit organizations, institutions and individuals to support Canadian studies, Canada Day and state ceremonial activities, Aboriginal Friendship Centres, Aboriginal language retention, appreciation of cultural diversity, and amateur sports, including contributions to sponsoring organizations of national and international games.

Official Languages: promote, in partnership with the provinces, linguistic duality in Canadian society through the provision of financial and other forms of support to foster the vitality of Canada's official language minority communities and to encourage second language learning and minority language education.

Cultural Development and Heritage: financial assistance and structural policy support for the culture sector to enhance its contribution to Canadian identity, employment creation, economic development, and export promotion and to ensure that there continues to be a strong Canadian voice in the global market and on the information highway.

Parks Program: enhance understanding and appreciation of Canadian heritage through commemoration of nationally significant heritage places, provide sustained economic activity in disadvantaged regions, protect ecosystems centred in national parks and provide many of the core attractions and products which make Canada a unique tourism destination.

Parliament votes appropriations to Crown corporations involved in the development of Canada's cultural identity. Funds of about $1.1 billion are provided annually to the Canadian Broadcasting Corporation (CBC). This supports the Corporation's radio and television services. Revenues from television advertising amount to about $300 million annually. Payments are also made to the Canada Council for assistance to the arts community, the Canadian Film Development Corporation to promote the feature film and television industries, and the National Film Board to produce and distribute Canadian films.

Appropriations are also provided for federally-owned museums and the National Arts Centre.

Annex Table 11
Heritage and Cultural Programs

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfers			
Canadian Broadcasting Corporation	1,090	1,091	
Canadian Film Development Corporation	124	122	
National Film Board	81	81	
Canada Council	99	98	
National Museums	104	99	
National Arts Centre	22	22	
National Archives	60	59	
National Library	47	37	
Official Languages	281	290	
Amateur sports	76	64	
Postal subsidy	81	77	
Other	150	172	
Total	2,215	2,212	
Parks Canada	412	348	
National Battlefields Commission	5	5	
Canadian Radio-television and Telecommunication Commission	35	21	
Operating and capital	168	160	
Total	2,835	2,746	2,664

Any sizeable reduction in the Canadian Broadcasting Corporation's appropriations would require an examination of the corporation's current mandate. Parks Canada's business plan projects large increases in revenues, reductions in operating costs, and leveraging of funds from other partners in managing parks and historic sites. All other areas of the Department, which provide financial assistance to sports, culture, official languages, multiculturalism and native citizenship, are being reassessed under the Program Review.

Foreign Affairs, International Trade, and International Assistance

The purpose of this program is to carry out Canada's foreign policies, represent Canada's interests abroad, and to provide assistance to developing countries.

These programs are carried out by the Department of Foreign Affairs and International Trade, the Department of Finance, the Canadian International Development Agency (CIDA) and other agencies such as the International Development Research Centre (IDRC).

Net of its spending on international assistance, the Department of Foreign Affairs and International Assistance will spend $1.3 billion in 1994-95. Of this amount, $286 million is for membership obligations including UN peacekeeping and contributions to international organizations, such as the United Nations and the World Health Organization, among others.

Operating costs consume most of the remaining budget, including the cost of staffing embassies, consulates, and other offices around the world.

Assistance to developing nations was set at $2.6 billion in the February 1994 budget. Funding was frozen thereafter at this reduced base level.

The largest part of this funding is managed by the Canadian International Development Agency. This program provides bilateral and multilateral aid, food, special development programs and international emergency relief.

As well, the Department of Finance provides support to international financial institutions such as the World Bank and also funds multilateral agreements for debt reductions.

Annex Table 12
Foreign Affairs and International Assistance

	1993-94	1994-95	1995-96
	(millions of dollars)		
Foreign Affairs			
Transfers			
United Nations Agencies	80	92	
United Nations Peacekeeping	128	160	
Other International Organizations	32	34	
Bilateral relations	23	22	
International trade development	15	20	
Other	42	41	
Total	320	370	
Operating and capital	881	913	
Total	1,201	1,283	1,213
International Assistance			
Transfers			
CIDA Partnership Programs	736	617	
CIDA National Initiatives	1,026	1,143	
International Financial Organizations	461	435	
Loan repayments	-69	-60	
Other	217	193[1]	
Total	2,371	2,328	
Operating and capital	165	154	
International Development Research Centre	142	112	
Total	2,678	2,594	2,601
Agencies			
Canadian Secretariat	2	2	
International Joint Commission	5	4	
Export Development Corporation	173	185	
Total spending	4,059	4,067	4,005

1 Figure includes assistance to Former Soviet Union, international assistance grants and contrubutions made by Foreign Affairs, scholarship program, and administrative costs related to Foreign Affairs programs under international assistance envelope.

As announced in the February 1994 budget, a comprehensive review of foreign aid policy is underway.

Social Programs

The major part of federal spending on social programs is through major transfers to persons, such as elderly benefits and unemployment insurance benefit payments, as discussed later.

However, an additional $11 billion is directed to other social programs through the departments of Health, Human Resources Development, Indian Affairs and Northern Development, and Citizenship and Immigration.

Annex Table 13
Social Programs

	1993-94	1994-95	1995-96
	(millions of dollars)		
Citizenship and Immigration	598	662	613
Health	1,635	1,757	1,750
Human Resources Development	2,744	3,044	3,001
Indian Affairs and Northern Development	3,586	3,759	4,051
Canada Mortgage and Housing	1,945	2,149	2,156
Total	10,508	11,370	11,570

Citizenship and Immigration

The department is responsible for promoting the values of Canadian citizenship, for managing immigration, for managing the entry of visitors and temporary workers, for the refugee determination system, for ensuring proper enforcement of the Immigration Act, and for assisting newly arrived immigrants to adapt and settle. The Immigration and Refugee Board of Canada determines refugee claims, hears immigration appeals and adjudicates immigration inquiries and detention reviews.

Annex Table 14
Citizenship and Immigration

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfers			
Canada-Quebec Accord on Immigration	85	90	
Language instruction	79	106	
Adjustment assistance	64	51	
Settlement and adaption	13	14	
Other	3	3	
Total	244	264	
Operating and capital	271	316	
Immigration Refugee Board of Canada	83	82	
Total	598	662	613

About $250 million is provided for settlement and integration services, including income support and language instruction. The funding is largely paid to provinces and non-government organizations, which provide the services.

Canada's immigration policy is currently being reassessed following extensive consultations with Canadians. A key objective of any changes is to secure greater program effectiveness while adhering to the principles of fairness, affordability and sustainability.

Health

Excluding transfers to provinces under Established Programs Financing, spending amounts to about $1.5 billion.

About $900 million is directed towards ensuring the availability of health services for Inuit and Status Indian populations, including treatment services, hospital services, the National Native Alcohol and Drug Abuse Program along with a variety of non-insured health benefits in addition to provincial, territorial, and municipal health services.

Grants are also made to support the health needs of groups such as children at risk, seniors, and persons with AIDS and to promote healthy behaviour.

An additional $400 million is for operating costs associated with reducing health risks through research, regulation of pharmaceuticals, inspection, testing, population health intelligence and health promotion.

Annex Table 15
Health

	1993-94	1994-95	1995-96
	(millions of dollars)		
Department			
Transfers			
Indian and Northern Health Services	808	930	
Other	122	162	
Total	930	1,092	
Operating and capital	443	412	
Total	1,373	1,504	1,500
Other			
Medical Research Council	258	248	245
Patent Medicine Prices Review Board	3	3	3
Hazardous Materials Information Review Commission	1	1	1
Total	1,635	1,757	1,750

About $250 million is provided for health research through the Medical Research Council.

Reassessment of federal priorities in these fields has already yielded some efficiencies. Continued reappraisal of priorities and health system renewal can be expected to yield significant additional savings. Increased co-ordination of inspection services with other departments and fees for certain services would also yield savings.

Human Resources Development

Human Resources Development is responsible for income security programs for the elderly and the unemployed, for student loans, and for labour market adjustment programs. It also provides funds to the provinces for social welfare and assistance and for post-secondary education.

Excluding the major transfer programs, which are discussed later, and operating costs, there is about:

- $1.6 billion in the grants and contributions for employment and training programs;
- $195 million for the Vocational Rehabilitation of Disabled Persons;
- $479 million for interest subsidies and defaults under the Canada Student Loans Program;
- $89 million for Older Worker Adjustment, which provides long-term income support to laid-off older workers who have been involved in major permanent layoffs and have not been able to obtain alternative employment before expiry of their Unemployment Insurance benefits;
- $61 million to provincial workers' compensation boards to pay for compensation benefits to federal government workers and/or their dependents for injuries suffered in employment; and,
- $39 million for Children's Special Allowance, which provides payments to welfare agencies, government departments and institutions, and foster parents who are caring for a child under age 18.

In addition, there are two large income-tested tax expenditures provided to low-income families. In January 1993, the family allowance benefit, the dependent child credit and the refundable child tax credit were replaced by the child tax benefit. This program has two main components: a basic benefit and a working income supplement. Maximum benefits are available to families with net income between $10,000 and $21,000. Over that amount, the working income supplement is recovered at a rate of 10 per cent of income. The basic credit is recovered from families whose net income exceeds $25,921 – at a rate of 5 per cent of income, for families with two or more children.

Additional federal support is also provided through the GST credit. These cash payments assist low- and modest-income Canadians to offset their costs associated with the payment of GST on their purchases. The basic benefit is $199 per adult and $105 per child for those families with a net income under $25,921. The credit is reduced by 5 per cent of income over that amount. The credit is fully phased out at a family income of $35,181.

Annex Table 16
Human Resources Development

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfers			
Training programs	1,278	1,282	
Atlantic Groundfish Strategy		347	
Labour adjustment benefits	113	38	
Workers' Compensation benefits	49	61	
Vocational Rehabilitation of Disabled Persons	187	195	
Canada Student Loans	521	479	
Children's Special Allowance	36	39	
Other	85	53	
Total	2,269	2,494	
Operating and capital	462	538	
Total	2,731	3,032	2,989
Canada Labour Board	10	9	9
Canadian Centre for Occuptional Health and Safety	3	3	3
Total	2,744	3,044	3,001
Tax Measures			
Child Tax Benefit	5,196	5,150	5,100
Low-income GST Credit	2,685	2,750	2,800
Total	7,881	7,900	7,900

Much of this program spending falls under the purview of the social security review process. In that context, Canadians are being asked how to bring social programs into line with changing needs and fiscal realities. This will require hard trade-offs and the setting of clear priorities.

Aboriginal Programs

Federal funding for Aboriginal people is currently about $5 billion. In addition to the Department of Indian Affairs and Northern Development (DIAND) and the Department of Health, 12 other departments have programs directed to aboriginal people, including Industry Canada and the Canada Mortgage and Housing Corporation.

Funding for Aboriginal programs represents one of the fastest growing components of federal spending – having increased about 10 per cent per year on average over the past six years. Fastest growth has been in Health Canada's provision of health services for aboriginal people, which have been growing at an annual rate of about 12 per cent and DIAND's programs, growing in excess of 8 per cent per year.

Annex Table 17
Indian Affairs and Northern Development

	1993-94	1994-95	1995-96
	(millions of dollars)		
Transfers			
Education	928	1,032	
Social Assistance	822	998	
Capital (including housing)	669	669	
Local and self government	278	292	
Claims	318	250	
Lands and trust	18	21	
Economic development	50	51	
Northern Affairs	60	58	
Other	20	12	
Total	3,163	3,383	
Operating and capital	423	376	
Total	3,586	3,759	4,051

A major contributing factor to these increases in the rate of growth is the fact that Canada's Aboriginal population is growing at about 2 per cent per annum or double the rate for the total Canadian population.

The February 1994 budget moderated the rate of growth of Aboriginal programs.

Canada Mortgage and Housing Corporation

Through the Canada Mortgage and Housing Corporation, the federal government assists Canadians to obtain affordable and adequate shelter. The bulk of federal transfers to the Corporation is to subsidize the cost of shelter for lower-income families.

Almost all of CMHC's spending on social housing is used to pay subsidy obligations for existing housing and very little is associated with new housing assistance. Recently, $50 million per year for 1994 and 1995 was reallocated for new spending on housing renovation assistance.

Annex Table 18
Canada Mortgage and Housing Corporation

	1993-94	1994-95	1995-96
	(millions of dollars)		
Social housing	1,845	2,052	
Other	100	97	
Total	1,945	2,149	2,156

Any new social housing activity can currently only be funded from efficiencies within the existing housing portfolio. CMHC is currently working with provinces and others to identify avenues to secure greater efficiencies.

Defence

The February 1994 budget reduced the absolute level of defence spending by 5 per cent in 1994-95 with further incremental reductions of 1 per cent per annum through 1998-99.

In addition, wages and salaries were frozen for two years as part of the government's overall wage strategy.

As announced in the February 1994 budget, a comprehensive review of defence policy is underway.

Annex Table 19
Defence/Emergency Preparedness Canada

	1993-94	1994-95	1995-96
	(millions of dollars)		
Defence			
Capital	2,832	2,884	
Operating	8,151	7,776	
Pensions	828	679	
Other	193	196	
Total	12,003	11,535	11,251
Emergency Preparedness Canada	30[1]	28[1]	17

1 Includes payments under the Disaster Financial Assistance Agreement.

General Government Services

General government services covers a range of departments and agencies, most engaged in activities that support and coordinate the operation of other federal organizations.

Annex Table 20
General Government Services

	1993-94	1994-95	1995-96
	(millions of dollars)		
Parliament/Governor General	523	405	352
Central Agencies	926	927	959
National Revenue	2,383	2,207	2,108
Public Works and Government Services	1,823	1,878	1,798
National Capital Commission	91	89	88
Statistics Canada	271	282	264
Agencies			
Canadian Centre for Management Development	11	11	11
Canadian Intergovernmental Conference Secretariat	3	3	3
Canadian Transportation Accident and Safety Board	27	26	25
Commissioner of Official Languages	12	12	11
Public Service Staff Relations Board	6	6	6
Security Intelligence Review Board	1	1	1
Public Service Commission	142	129	125
Canadian International Trade Tribunal	8	8	7
Procurement Review Board	0.4	1	1
Office of the Superintendent of Financial Institutions	2	3	3
Status of Women – Office of Co-ordinator	6	5	4
Advisory Council on the Status of Women	3	3	3
Canada Post	14	14	14
Canadian Commercial Corporation	14	13	12
Purchase of domestic coinage	36	42	42
Total	6,302	6,062	5,837

Parliament/Governor General

The cost of operating Canada's Parliament – including salaries for Members, Senators and staff – was about $290 million.

Funding of the Governor General's functions amounts to about $10 million per year.

The Chief Electoral Office supervises the conduct of federal elections, while the Auditor General provides audit information for use by Parliament in its scrutiny of government programs and financial activities.

Annex Table 21
Parliament

	1993-94	1994-95	1995-96
	(millions of dollars)		
Senate	41	42	41
House of Commons	241	238	228
Library of Parliament	16	16	16
Governor General	10	10	10
Chief Electoral Office	157	42	4
Auditor General	58	57	53
Total	523	405	352

Central Agencies

The Privy Council provides advice and support to the Prime Minister, Cabinet, and Cabinet Committees to ensure the effective operation of the decision-making process.

As the central agency of the federal government responsible for advice on the economic and financial affairs of Canada, Finance is concerned with all aspects of the performance of the Canadian economy. It is also responsible for a number of programs, including Equalization, international development agreements, and with the Bank of Canada manages the borrowing program.

Treasury Board supervises the management of government spending and its human and material resources. Much of the budget relates to the payment of the employer's share of health, income maintenance and life insurance premiums, for payments relating to provincial health insurance plans and provincial payroll taxes.

Annex Table 22
Central Agencies

	1993-94	1994-95	1995-96
	(millions of dollars)		
Privy Council Office	109	71	54
Finance	69	66	64
Treasury Board			
Department	86	87	83
Employer contributions to insurance plans	662	703	758
Total	926	927	959

National Revenue

Revenue Canada is responsible for administering Canadian tax, border, and trade policies. It collects: federal income tax; personal income tax on behalf of all provinces except Quebec; corporate income tax on behalf of all provinces except Alberta, Ontario and Quebec; the Goods and Services Tax (GST) in all provinces except Quebec; commodity taxes, Excise duties and import levies; provincial sales, alcohol and tobacco taxes at the border on behalf of certain provinces; employee and employer contributions under the *Canada Pension Plan*; and employee and employer premiums for Unemployment Insurance.

Revenue Canada also oversees various federal and provincial tax credit programs, and is responsible for trade-policy administration and for protecting Canadian society against the illegal movement of goods and people across Canada's borders.

Annex Table 23
National Revenue

	1993-94	1994-95	1995-96
	(millions of dollars)		
Customs and Excise	1,069	922	878
Taxation	1,314	1,285	1,230
Total	2,383	2,207	2,108

Public Works and Government Services

This department provides integrated products, common services and accommodation to other federal departments and agencies. In the area of federal real property, the services provided include reality, architectural and engineering services. As well, other products and common services are offered related to communications, consulting, auditing, banking and cash management, pension payments, procurement of goods and services, disposal of surplus federal goods, provision of common-use items, translation, information, management/information technology, and other corporate services in support of government-wide initiatives. With regard to the provision of accommodation, the department manages a diverse portfolio of office and other general purpose real property to accommodate federal tenants.

Annex Table 24
Public Works and Government Services[1]

	1993-94	1994-95	1995-96
	(millions of dollars)		
Real Property Program	1,223	1,250	
Supply and Services Program	557	602	
Other	43	26	
Total	1,823	1,878	1,798

1 Excludes federal grants to municipalities in lieu of taxes which are included in transfers to other levels of government.

Statistics Canada

This agency collects, analyzes and publishes information on virtually every aspect of Canada and its population.

Other Agencies

There are a number of agencies which provide common services to other departments (Canadian Centre for Management Development) or are regulatory in nature (Office of Superintendent of Financial Institutions).

In many cases, options for savings in these areas will largely be dependent upon the reduction in programs and services delivered by other federal departments and agencies.

This concludes the examination of the $50 billion of government spending that is directed to spending other than to the major transfers payment the federal government makes to persons and to other levels of government.

Major Transfers to Persons

The federal government spent $39.5 billion in 1993-94 on direct income support for individuals. This excludes payments to Aboriginals, which were discussed earlier. These payments account for over one-third of total program spending – the single largest category of spending. The bulk of the payments go to the elderly and the unemployed.

Elderly Benefits

Direct federal spending on elderly benefits, which includes the Old Age Security (OAS), Guaranteed Income Supplement (GIS) and Spouses' Allowance (SPA) programs, amounts to $20.6 billion in 1994-95:

■ Old Age Security is paid monthly (maximum benefit of $387.74 – October 1994) to Canadians aged 65 and over. OAS payments are taxable and recovered from high-income seniors upon tax filing. Payments are currently recovered at a rate of 15 per cent of individual income over $53,215, which means that the benefit is fully recovered at an income of just under $84,000. This recovery will yield about $400 million in 1994-95.

■ Guaranteed Income Supplement is a non-taxable monthly benefit (maximum single benefit of $460.79 per month – October 1994) paid to lower-income OAS recipients on the basis of family income. The maximum income, including OAS, below which GIS is payable is about $15,700 for a single pensioner and about $23,800 for married pensioners. More than 40 per cent of OAS/GIS benefits go to the low-income seniors who qualify for GIS.

■ Spouses' Allowance is a non-taxable benefit (maximum widowed benefit of $759.42 per month – October 1994) paid to low-income individuals aged 60 to 64 who are spouses of OAS pensioners or are widow(er)s. Like GIS, this benefit is based on net family income.

Payments to the elderly are one of the fastest growing areas of program spending. This growth reflects increases in the elderly population and the fact that benefits are fully indexed to inflation. This growth rate will continue to rise sharply, especially after the year 2010, as the 'baby boomer' generation retires. Indeed, the proportion of the population of elderly people will almost double in the next 40 years.

Annex Table 25
Elderly Benefits

	1993-94	1994-95	1995-96
		(billions of dollars)	
Expenditures			
Old Age Security	15.0	15.8	16.5
Guaranteed Income Supplement	4.4	4.4	4.4
Spouse's Allowances	0.4	0.4	0.4
Total direct spending	19.9	20.6	21.3
Tax Measures			
Age Credit	1.5	1.5	1.4
Pension Income Credit	0.3	0.3	0.3
Taxation of OAS benefit	-1.8	-1.9	-2.0
OAS repayment	-0.4	-0.4	-0.4
Net tax measures	-0.4	-0.5	-0.7
Total Assistance	19.5	20.1	20.6

In addition to the three spending programs, elderly Canadians are also eligible for two tax credits, which lower income tax.

- Individual taxpayers aged 65 or over are entitled to claim a maximum federal tax credit of 17 per cent of $3,482. Beginning with the 1994 taxation year, the age credit is income-tested. The credit is reduced based on the amount by which an individual's net income exceeds $25,921.

- Individual taxpayers are entitled to claim a federal tax credit of 17 per cent on the first $1,000 of private pension income. About three-quarters of those claiming the credit are age 65 or over and one-quarter are under 65.

The following table shows the distribution, by household income, of net elderly benefits, on an after-tax basis. Nearly three-quarters of the benefits go to households with incomes less than $30,000.

Annex Table 26
Distribution of Net Federal Elderly Benefits[1] by Household Income – 1994

Household income [2]	Number of households [3]	Net benefit
(dollars)	(thousands)	(millions of dollars)
Less than 15,000	800	7,020
15,000 to 20,000	390	2,650
20,000 to 25,000	380	3,230
25,000 to 30,000	250	1,700
30,000 to 40,000	280	1,830
40,000 to 50,000	200	1,290
50,000 to 60,000	120	730
60,000 to 75,000	110	670
Over 75,000	100	480
Total	2,630	19,600

1 OAS (net of taxes), GIS, SPA, pension income and age credit. (Does not include pension income credit and SPA received by non-elderly families.)

2 Includes OAS, GIS and SA of head and spouse.

3 Households with at least one person age 65 or older.

The Canada Pension Plan (CPP) is a contributory, earnings-related social insurance program which ensures a measure of income protection to a contributor and his and her family against the loss of income due to retirement, disability, or death. The plan operates throughout Canada except in the province of Quebec, where a similar program – the Quebec Pension Plan (QPP) – is in effect.

Canada Pension Plan premiums and benefits are not part of the federal government's revenues or expenditures and therefore do not directly affect the federal government's deficit.

Unemployment Insurance Benefits

Benefits under the Unemployment Insurance Program are paid from the Unemployment Insurance Account. In 1993, unemployment insurance benefit and developmental uses payments amounted to $18.0 billion. On average, about 1.3 million Canadians received unemployment insurance benefits each month in 1993. Administrative and other expenses amounted to $1.8 billion, bringing total program costs to $19.8 billion.

Since 1990, all expenses incurred by the account are to be financed through employee and employer contributions. Employers pay 1.4 times the employee premium rate. Unemployment insurance premium contributions by employers and employees totalled $18.5 billion in 1993. Another $100 million was received from penalties.

As a result, there was an annual deficit of $1.2 billion in 1993, bringing the accumulated deficit in the account to $5.9 billion by the end of 1993.

Premium contributions to the account form part of the federal government's overall budgetary revenues. Likewise, costs of the program are part of overall program spending. Annual deficits or surpluses in the account therefore directly affect the federal government's financial situation.

Unemployment insurance benefits are taxable as income and unemployment insurance premiums give rise to a tax credit. Claimants whose annual net income (including unemployment insurance benefits) is more than one-and-a-half times a prescribed limit ($58,100 in 1993) must repay 30 per cent of those benefits that are in excess of the prescribed limit. Benefit repayments from higher-income claimants were estimated at $27 million. These repayments are credited to the account and help finance program expenses.

Annex Table 27
The Unemployment Insurance Account – 1993

	(billions of dollars)
Revenues	
Premiums	18.5
Penalties	0.1
Total revenues	18.6
Expenses	
Benefits	
Regular	14.3
Maternity/parental	1.3
Sickness	0.4
Fishing	0.3
Total	16.2
Developmental Uses Program	1.8
Administration costs	1.3
Other (interest, doubtful debts)	0.5
Total expenses	19.8
Deficit for the year	1.2
Cumulative deficit at year end	5.9

Important structural changes were made to the Unemployment Insurance Program in the February 1994 budget. These changes, however, were only the first step. In the discussion paper, *Improving Social Security in Canada*, proposals are advanced which would bring about further structural changes to the current unemployment insurance program, and result in additional significant reductions in expenditures, for two purposes: to lower premium rates and enhance employment development services. With lower premium rates, businesses will find it easier to create jobs and put Canadians back to work. This, in turn, will result in higher incomes, increased tax revenues and a lower deficit. With enhanced investment in employment development services, unemployed workers will make a more effective transition back into employment.

Annex Table 28
Unemployment Insurance Benefits

	1993-94	1994-95	1995-96
	(billions of dollars)		
Regular benefits	13.8	11.8	11.6
Special uses benefits	1.9	1.9	2.0
Development uses	1.9	1.9	1.9
Total benefit payments	17.6	15.6	15.5

The restraint measures announced in the February 1994 budget, the measures being discussed as part of social security reform, and the improved labour market situation will result in a sharp turnaround in the financial status of the account. Under current legislation, premium rates would be lowered, as the account moves into a surplus.

Over the course of the most recent recession, a cumulative deficit developed in the Unemployment Insurance Account. This deficit stood at $5.9 billion at the end of 1993, or roughly one-third of unemployment insurance expenditures.

The annual deficits that occurred in the account during the recession necessitated raising premium rates – at a time when they should have been lower to encourage employment. To avoid a recurrence of this, a surplus could be allowed to build up. This would still allow for a significant decline in premium rates, while providing some stability to premium rates should the account come under pressure in future.

Veterans' Pensions and Allowances

A range of benefits and services are provided to veterans and their dependants, to survivors of veterans and to eligible civilians. They include disability benefits, income support, health care and other benefits.

Annex Table 29
Veterans' Pensions and Allowances

	1993-94	1994-95	1995-96
	(millions of dollars)		
Pensions	1,103	1,151	
Allowances	130	133	
Health care	168	178	
Other	346	417	
Total	1,747	1,879	1,854

Cost pressures in this area primarily relate to health care expenses and the provision of services, under the Veterans Independence Program, which provides home support to veterans who might otherwise be institutionalized.

Neither War Veterans' Allowance nor disability benefits are taxable.

Major Transfers to Other Levels of Government

The federal government makes transfers to provincial, territorial, and municipal governments in Canada to help them provide services to the Canadian public. Most of these transfers support the Canada-wide system of medicare, higher education and a network of social assistance and services.

In 1994-95, the federal government expects to transfer about $39 billion in both cash and tax transfers to provincial, territorial, and municipal governments under major transfer programs:

- Cash transfers are expected to total $27.2 billion.

- An additional $12 billion will take the form of 'tax point transfers'. These transfers provide provincial and territorial governments with a portion of income taxes that would otherwise go to the federal government.

The three major programs are the Canada Assistance Plan, Established Programs Financing, and Equalization.

Canada Assistance Plan

Through the Canada Assistance Plan, the federal government contributes toward the costs incurred by provinces in providing social assistance to those in need and welfare services to persons in need or likely to be in need. Prior to 1990-91, the federal government cost-shared 50/50 all eligible expenses.

Since 1990-91, the annual growth in Canada Assistance Plan contributions to provinces not receiving equalization (Ontario, Alberta, and British Columbia) has been limited to 5 per cent per year to the end of 1994-95. Open-ended cost-sharing with the other provinces continued.

In the February 1994 budget, the federal government announced that CAP entitlements would be frozen at their 1994-95 levels in 1995-96, pending the outcome of social security reform. The February 1994 budget also announced that, in 1996-97, the combined entitlements of CAP and EPF–Post-Secondary Education, or their successor programs, are to be no higher after reform than they were in 1993-94.

The discussion paper, *Improving Social Security in Canada*, sets out options for improving Canada's social programs. In order to achieve the savings required by the February 1994 budget, the discussion paper states that, beginning in 1996-97, total entitlements under the Canada Assistance Plan, or its successor program(s), will not exceed the level of CAP entitlements in 1993-94.

Annex Table 30
Canada Assistance Plan

	1993-94	1994-95	1995-96
		(millions of dollars)	
CAP	7,230	7,373	7,322

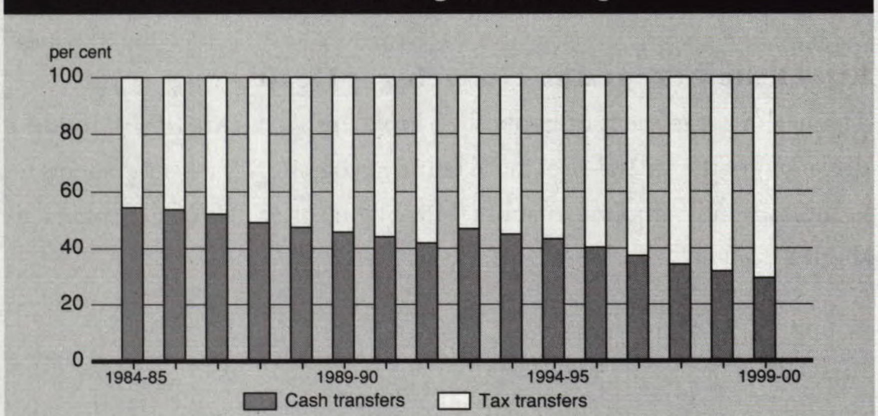
Established Programs Financing

Established Programs Financing (EPF), which helps provincial and territorial governments finance their health and post-secondary systems, is the largest single federal transfer to the provinces. It exceeds about $21 billion in 1994-95. Each province receives the same amount per capita.

This total is a combination of tax transfers and cash payments. A tax transfer involves an ongoing transfer of personal and corporate income 'tax room' from the federal government to the provinces, as an alternative to direct cash transfers. A tax transfer takes effect when the federal government reduces its tax rates to allow provinces to raise theirs by an equivalent amount. Since the governments act in a co-ordinated fashion, there is no net financial impact on the taxpayer. The value of these tax transfers grows in line with the growth in the applicable tax bases. They represent a permanent and growing endowment in the hands of provinces for supporting health and post-secondary education.

The difference between the total entitlement ($21.5 billion) and the value of the tax transfers ($12 billion) is made up in a cash transfer ($9.5 billion) from the federal government to the provinces. Since 1990-91, total EPF entitlements have been frozen in per capita terms. As a result of this restraint and ongoing growth in tax transfers, the cash portion of EPF has begun to decline. This decline in EPF cash transfers is projected to continue in the future.

Annex Chart 1 Established Programs Financing



Established Programs Financing – Post-Secondary Education

Post-Secondary Education transfers by the federal government to provincial governments amount to about $6 billion. This total is a combination of cash and tax points. The cash portion (about $2.4 billion) is declining.

Federal assistance to the post-secondary education sector is a key part of the social security reform process. As indicated earlier, the February 1994 budget established joint fiscal parameters for the PSE portion of EPF and the Canada Assistance Plan. The social security reform discussion paper proposes, as an option, replacing the existing declining EPF-PSE cash transfers with enhanced and stable support to students through a new program of student loans. The rate of repayment of these loans could depend on the future earnings of the PSE students.

The PSE tax transfer would remain as a permanent and growing federal endowment to help support provincial post-secondary education.

Annex Table 31
Established Programs Financing – Post-Secondary Education

	1993-94	1994-95	1995-96
	(millions of dollars)		
Post-Secondary Education	6,108	6,177	6,238
Of which:			
Tax point transfers	3,697	3,848	4,124
Cash transfers	2,411	2,329	2,114

Established Programs Financing – Health

The health component of Established Programs Financing (EPF-Health) is the largest of the federal-provincial transfer programs. Total entitlements for health currently amount to about $15 billion, of which cash transfers are about $7 billion.

Annex Table 32
Established Programs Financing – Health

	1993-94	1994-95	1995-96
	(millions of dollars)		
Entitlements	15,129	15,300	15,452
Of which:			
Tax point transfers	7,812	8,131	8,716
Cash transfers	7,317	7,169	6,736

For the period 1990-91 to 1994-95, EPF health entitlements are frozen in per capita terms, with the result that they have been growing at the same rate as population. Under current legislation, in 1995-96, per capita EPF health entitlements will begin to grow in line with the growth in nominal Gross National Product less 3 percentage points.

All governments in Canada have recognized that the history of unrestrained growth in provincial health expenditures cannot be sustained. Accordingly, provinces have taken measures recently to start to bring spending under control. Further steps remain to be taken in renewing the health care system so that Canadians remain well served at the same time as producing cost-saving efficiencies.

Equalization

The purpose of the Equalization program is to enable all provinces to provide reasonably comparable levels of public services at reasonably comparable tax levels.

Eligibility for Equalization is determined by a formula that compares all provinces' per capita revenue-raising capacity with the average fiscal capacity of a five-province standard. If a province's per capita revenue-raising capacity is below that of the standard, the province qualifies for Equalization. Seven provinces currently qualify: the four Atlantic provinces, Quebec, Manitoba, and Saskatchewan. Equalization is subject to a ceiling that limits the cumulative growth of the program to no more than the cumulative growth of GNP from 1992-93. Equalization is projected to increase by about 4 to 5 per cent per year on average.

The commitment to the principle of making Equalization payments was enshrined in the Constitution Act of 1982. Subsection 36.(2) states:

"Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation".

The Equalization program is traditionally authorized for five-year periods. It was recently renewed for a five-year period beginning April 1, 1994. With the retention of the ceiling, the program is expected to grow roughly in line with the growth in the economy. This provides a stable funding regime for the provinces receiving equalization.

Annex Table 33
Equalization – Entitlements

	1993-94	1994-95	1995-96
	(millions of dollars)		
Newfoundland	915	971	1,020
Prince Edward Island	171	191	202
Nova Scotia	919	999	1,059
New Brunswick	874	923	975
Quebec	3,545	3,725	3,918
Manitoba	926	1,031	1,090
Saskatchewan	518	660	701
Total	7,868	8,500	8,964

Transfers to Territories

The federal government makes direct cash transfers to the Territorial governments to assist them in providing public services. The transfers are based on a formula which takes into account both expenditure requirements and revenue capacity. Since 1990-91, the growth in the transfers has been limited by a ceiling on the growth of expenditure requirements in the formula. Current transfers represent around two-thirds of revenues for both the Northwest Territories and Yukon.

Territorial Formula Financing is currently under review and will be renewed on April 1, 1995.

Annex Table 34
Transfers to Territories

	1993-94	1994-95	1995-96
	(millions of dollars)		
Current funding	1,056	1,193	1,217

Other Transfers

There are a number of smaller programs under which the federal government transfers cash to provincial and municipal governments.

■ Public Utilities Income Tax Transfer Act (PUITTA): The federal government remits a portion of federal corporation income tax paid by investor-owned utilities on income from generating, distributing or selling electricity, gas or steam energy. Existing measures, including a ceiling on the total transfer and a 10 per cent reduction in the amount paid, are restraining the program level and growth. Any further restraint would need to take into consideration implications for the competitive position of private investor-owned utilities vis-à-vis publicly-owned utilities, which are constitutionally tax exempt, as well as implications for provincial governments.

■ The federal government makes grants to municipalities in lieu of taxes for municipal services provided to federal properties. Payments under the program were frozen in 1993-94 and 1994-95 at their 1992-93 levels.

■ Statutory subsidies: These continuing payments, which are explicitly defined in the Constitution Act, were introduced in support of provinces when they joined Confederation. In the majority of the cases, this includes a per capita allowance to assist provinces in the provision of public services.

■ Fiscal Stabilization: This program compensates provinces for year-to-year declines in revenues due to economic circumstances. Due to the economic situation in the early 1990s, which saw low income growth, many provinces experienced revenue declines which triggered claims under this program.

■ Preferred Share-Dividend Taxes: In lieu of provincial governments imposing taxes similar to federal taxes on preferred share dividends, the federal government transfers 35 per cent of a special federal tax to the provinces.

■ Youth Allowances Recovery: In the mid-1960s, Quebec received a special transfer of tax points under contracting-out arrangements which permitted any province to assume administrative and financial authority for certain federal-provincial programs. One of the programs – Youth Allowances – was subsequently discontinued. Accordingly, a payment is now made each year to the federal government to ensure recovery of the relevant tax points transferred to Quebec for the discontinued program.

Annex Table 35
Other transfers

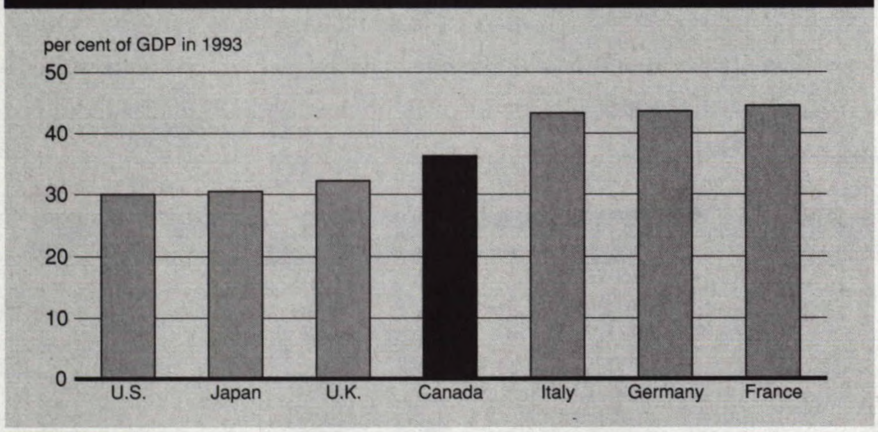
	1993-94	1994-95	1995-96
	(millions of dollars)		
PUITTA	238	237	249
Municipal grants	426	426	426
Statutory subsidies	38	40	40
Stabilization	1,400		
Preferred share-dividend	138	150	165
Youth Recovery Allowance	-382	-423	-446
Total	1,858	430	434

Annex 2

Overview of Government Revenues

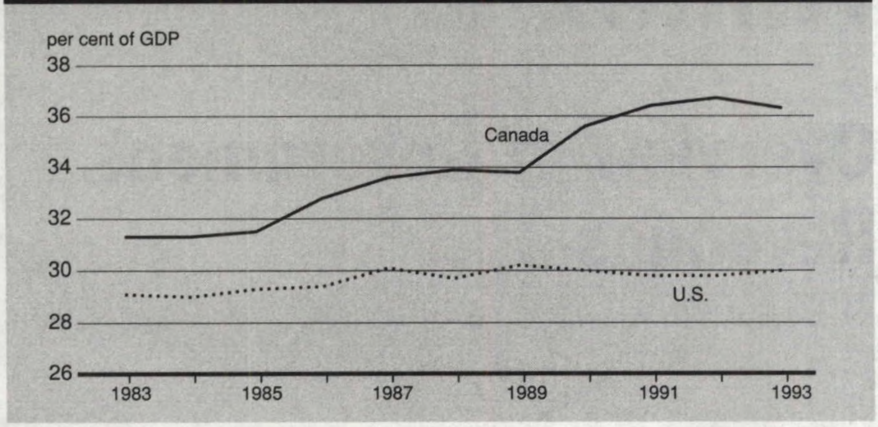
This section provides background on government tax revenues in Canada. In 1993, total tax revenues on a national account basis stood at $258.1 billion, which represented about 36.3 per cent of GDP. This placed Canada above the U.S. (for which tax revenues represented 30.0 per cent of GDP) and in the middle of the G-7 countries.

Annex Chart 2 **Comparison of total tax revenues – OECD**



In Canada, tax revenues have grown significantly relative to GDP. Between 1980 and 1993, tax revenues as a percentage of GDP increased from 29.5 per cent to 36.3 per cent (a 23.1 per cent increase). On the other hand, tax revenues in the U.S. as a percentage of GDP increased from 29.8 per cent to 30.0 per cent (a 0.7 per cent increase) over the same period.

Annex Chart 3 **Comparison of government tax revenues – Canada-U.S.**



Federal Revenues

On a public accounts basis, as reported in the *Annual Financial Report* for 1993-94, federal government revenues amounted to $116.0 billion in 1993-94. Personal income tax is the most important revenue source for the federal government, at 44 per cent of total revenues. Sales and excise taxes, which include the Goods and Services Tax, customs import duties, motive fuel excise taxes and other excise taxes/duties, are the second largest federal revenue source, at 23 per cent of the total, followed by unemployment insurance premiums (16 per cent), and corporate income tax (8 per cent). Other revenues (9 per cent of the total) include items such as return on investment (Bank of Canada profits, interest income, etc.) and other miscellaneous tax and non-tax revenues.

Annex Chart 4 **Federal revenue mix 1993-94**

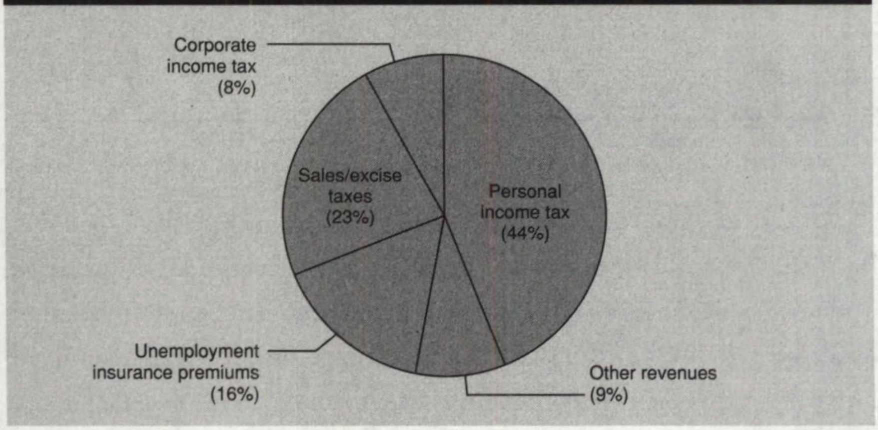


Table 36 provides an overview of the outlook for the major revenue components to 1995-96. Budgetary revenues are expected to increase to $123.7 billion in 1994-95, up 6.6 per cent from 1993-94. Nearly half of the increase between 1993-94 and 1994-95 is attributed to one-time factors, primarily affecting 1993-94. These included the transitional costs associated with the restructuring of the child benefit system and the faster processing of personal income tax refunds in late 1993-94. In 1995-96, revenues are expected to grow slightly faster than the economy, due to the non-indexation and progressivity of the personal income tax system, with higher marginal tax rates at higher levels of taxable income.

Annex Table 36
Budgetary revenues

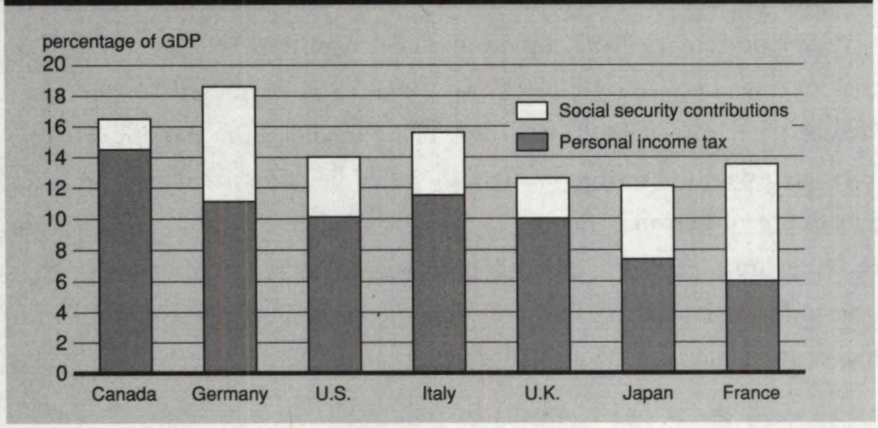
	1993-94	1994-95	1995-96
	(millions of dollars)		
Personal income tax	51,051	58,600	63,800
Corporate income tax	9,819	11,000	13,300
Unemployment insurance premiums	18,233	19,300	20,100
Goods and Services Tax	15,696	16,250	17,100
Sales and excise taxes/duties	10,939	10,250	10,000
Other tax revenues	1,594	1,600	1,650
Non-tax revenues	8,652	6,700	7,050
Total revenue	115,984	123,700	133,000

Tax on Personal Income

Tax on personal income in Canada stands at 16.5 per cent of GDP on a national accounts basis, and is higher than in all other G-7 countries except Germany, which is at 18.6 per cent. It includes both personal income taxes and the employee portion of social security contributions (in Canada, these are primarily unemployment insurance premiums and Canada/Quebec Pension Plan contributions).

Relative to other G-7 countries, Canada relies to a much greater extent on personal income taxes, which are 14.5 per cent of GDP, and less on social security taxes.

Annex Chart 5 Taxes on personal income in G-7 countries, 1992



Tax Burden on Corporations

Canadian corporations pay a variety of taxes and other levies to the various levels of government in Canada. These include:

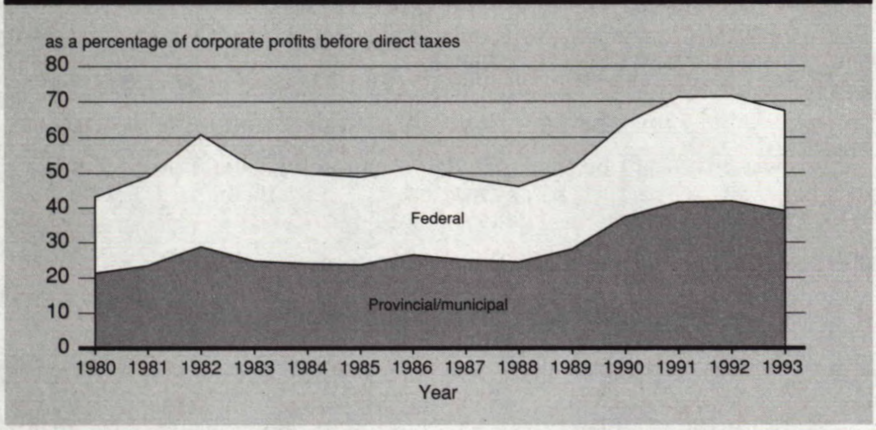
- corporate income taxes;
- capital and insurance premium taxes;
- payroll levies (e.g., health taxes, Unemployment Insurance, Canada Pension Plan, Quebec Pension Plan, Workers' Compensation);
- property taxes; and
- indirect taxes, such as sales and excise taxes, on business inputs.

With the exception of corporate income taxes, these taxes paid by corporations do not vary with the level of profits and must be paid whether or not the corporation makes a profit. Taxes that are not based on profits represent approximately 70 per cent of all direct taxes paid by corporations.

In 1993 (the latest year available), Canadian corporations paid about $51 billion in direct taxes – about $21 billion to the federal government and $30 billion to provincial and municipal governments.[1] This amount is

1 Exact figures on the amount of indirect taxes paid by the corporate sector are unavailable. However, estimates suggest that these taxes represent a relatively small component of the total corporate tax burden.

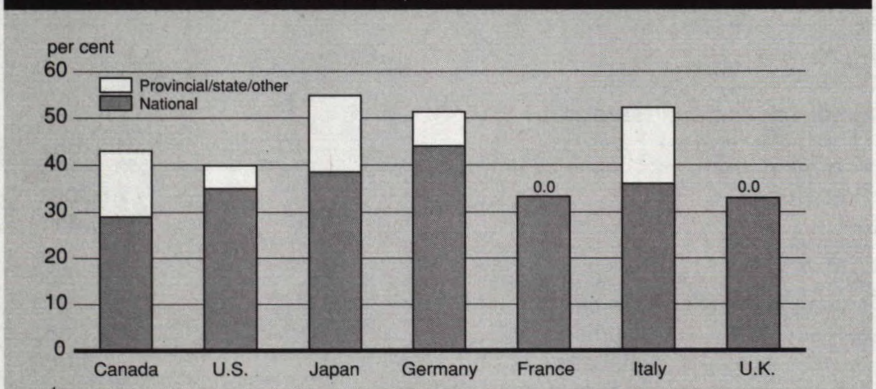
Annex Chart 6 Total corporate direct taxes



an increase from $36 billion (1993 dollars) in 1980. Measured as a percentage of corporate profits, direct taxes also increased significantly between 1980 and 1993: from 43.2 per cent to 67.3 per cent.

Income tax rates can be an important consideration in investment and location decisions by business, especially in the context of today's integrated global economy.

Annex Chart 7 International comparison of corporate income tax rates, 1993[1]



[1]General rates (includes surtax in Canada).

Major Tax Expenditures

The magnitude of the actions required to meet the fiscal targets makes it necessary to consider possible initiatives on the tax side. However, expenditure reduction must be the first priority. In determining which areas of the tax system should be scrutinized more closely, several principles have been adopted:

- initiatives should help make the economy more efficient;
- initiatives should improve the fairness of the system; and
- broadening the tax base is preferable to rate increases.

With these principles in mind, it is useful to review some of the major tax expenditures. Table 37 sets out all tax expenditures where the revenue foregone exceeds $300 million.

Tax expenditures provide assistance or incentives to particular groups of individuals, businesses or to certain types of activities. The estimated cost of individual tax expenditures takes no account of possible changes such as in taxpayer behaviour. Consequently, eliminating the measure will not necessarily raise the entire amount of foregone revenues shown. Descriptions of all tax expenditures and the revenue foregone are to be found in *Personal and Corporate Income Tax Expenditures* published by the Department of Finance.

Annex Table 37
Major tax expenditures

	1991
	(millions of dollars)
Non-taxation of lottery and gambling winnings	860
Education and tuition fee credits	314
Married/equivalent to married credit	1,665
Partial inclusion of capital gains	1,080
Non-taxation of employer-paid premiums for group private health plans	830
Non-taxation of workers' compensation payments	695
Age and pension income credits	1,600
Tax assistance for retirement savings	14,915
$500,000 lifetime capital gains exemption on small business shares	585
Charitable donations credit	845
Low tax rate for small businesses	2,037
Low tax rate for manufacturing and processing	353
R&D investment tax credit	543
Accelerated write-off for exploration and development	465

Lottery and gambling winnings

Lottery and gambling winnings are not subject to tax. The foregone tax revenues from this tax expenditure were estimated at $860 million in 1991. This estmate reflects only lottery and horseracing gains. The actual potential revenue from the taxation of these winnings, however, would depend on design issues – for example, whether there would be a threshold under which prizes would not be taxable. Moreover, under two separate agreements, the federal government has agreed to vacate the lottery field in return for payments by the provinces – $49 million was received in 1993-94.

Education and tuition fee credits

Tax assistance is provided to students enrolled at prescribed educational institutions such as universities and colleges. A 17 per cent tax credit is available for tuition fees above $100 paid by students to prescribed educational institutions. In addition, students can claim an education tax credit of 17 per cent of $80 for every month of full-time attendance. Amounts not used by the student may be transferred to a supporting spouse, parent or grandparent, to a maximum of $4,000. The structure of Canada's social programs, including training and assistance to post-secondary education, is currently under review. The tax assistance provided to students through these federal tax credits amounted to $314 million in 1991.

Married and equivalent-to-married credits

A married taxpayer supporting a spouse is entitled to a tax credit of 17 per cent of $5,380 for taxation year 1994. This is reduced by 17 per cent of the amount by which the dependent spouse's income exceeds $538. Similarly, single parents can claim an equivalent-to-married tax credit in respect of a child. The amount of the credit and the limitation of the dependent child's income are the same as those for the married credit. These credits recognize that taxpayers in one-earner or single-parent families have a reduced ability to pay tax relative to taxpayers with the same income but without a financially dependent spouse or child to support. Eliminating or a significantly reducing the amount of the married credit would raise the issue of the equity in the tax treatment of one- and two-earner couples. This tax expenditure cost the federal government $1.665 billion in 1991.

Partial inclusion of capital gains

Only three-quarters of net realized capital gains accrued since 1972 are included in income. The remaining one-quarter of the capital gain is tax free. This reduced income inclusion rate provides an incentive for individuals and corporations to invest by increasing the after-tax return on their investment and provides some recognition of the inflation-related portion of capital gains. This measure involved an estimated tax expenditure for 1991 of $1.08 billion.

Employer-paid health benefits

Approximately 8 million employees receive employer-paid health benefits tax free while other individuals without plans have to finance such expenses out of after-tax income. The non-taxation of these benefits is estimated to have cost the federal government $830 million in forgone revenues in 1991. Including an amount in an employee's income for tax purposes in respect of these benefits would reduce this tax expenditure.

Workers' compensation benefits

Workers' compensation benefits are not taxable even though contributions to Workers' Compensation Boards are deductible. Normally, where a deduction or credit has been allowed for premiums, benefits are taxable. Workers' Compensation Boards, established under provincial authority, set benefits levels on the assumption that benefits are not taxable. Generally, the benefit rate is 90 per cent of *after-tax* earnings, to a dollar maximum. There is concern that the non-taxation of workers' compensation results in perverse work incentives due to the high after-tax benefit rate. Not taxing these benefits also results in inequity between taxpayers receiving the same amount in income, but from different sources. The non-taxation of workers' compensation cost the federal government $695 million in foregone tax revenues in 1991.

Age and pension income credits

Individual taxpayers aged 65 or over are entitled to claim a maximum federal tax credit of 17 per cent of $3,482. Beginning with the 1994 taxation year, the age credit is income-tested. The credit is reduced based on the amount by which an individual's net income exceeds $25,921.

Individual taxpayers are entitled to claim a federal tax credit of 17 per cent on the first $1,000 of private pension income. About three-quarters of those claiming the credit are age 65 or over and one-quarter are under 65.

The age credit cost the federal government $1.315 billion in 1991. Income-testing the credit, which was announced in the 1994 Budget, is estimated to reduce its 1995 cost by about $300 million. The pension income credit cost $285 million in 1991. Together these two credits for older Canadians cost the federal government $1.6 billion in 1991.

Tax assistance to retirement savings

The level of tax assistance provided to saving in registered pension plans, deferred profit sharing plans and registered retirement savings plans was estimated to be $14.915 billion at the federal level in 1991. This tax assistance results from the deferral of tax on income contributed to these plans, and on investment income earned inside the plans, until benefits are paid out. Each year, about 9 to 10 million individuals either claim deductions for contributions to retirement savings plans or receive benefits from them. Private saving for retirement plays a major role in the retirement income security of Canadians, and this role is increasing in importance as the 'baby boom' generation moves towards retirement age.

$500,000 lifetime capital gains exemption for small business shares

A $500,000 lifetime capital gains exemption is available in respect of the disposition of small business shares. The exemption was designed to encourage investment in small business, provide retirement support and facilitate transfers. This tax expenditure cost the federal government $585 million in 1991. The government is currently holding consultations on the tax treatment of capital gains on small business shares to determine whether the tax assistance could be delivered in a manner that better achieves these objectives. Any replacement measure would only be introduced if it were clearly beneficial and reflected the needs of small business owners. Potential replacement measures could include, for example, a reduction in the inclusion rate for capital gains on small business shares.

Charitable donations credit

A tax credit of up to 20 per cent of net income is available in respect of donations by individuals to registered charities. Donations in excess of 20 per cent may be carried forward up to five years. The credit is 17 per cent on the first $200 of donations ($250 prior to taxation year 1994) and 29 per cent on the remaining portion. The purpose of the credit is to enhance the incentive for charitable giving in recognition of the important work of charities. The estimated cost of this measure was $845 million for taxation year 1991.

Small business deduction

The small business deduction reduces the basic federal corporate tax rate on the first $200,000 of income earned by Canadian-controlled private corporations from 28 per cent to 12 per cent. This lower tax rate provides small corporations with more after-tax income for reinvestment and expansion to recognize the special financing difficulties they face. This measure had an estimated tax expenditure for 1991 of $2.037 billion and, in conjunction with other special tax measures for small business, provides Canadian small businesses with a more favourable income tax regime than in most other countries.

Manufacturing and processing profits deduction

The manufacturing and processing (M&P) profits deduction reduces the basic federal corporate tax rate on M&P income from the general rate of 28 per cent to a rate of 21 per cent. This lower tax rate provides M&P corporations with more after-tax income for reinvestment which increases their productivity and enhances their ability to compete in international markets. This measure had an estimated tax expenditure for 1991 of $353 million.

R&D investment tax credits

R&D investment tax credits are provided in recognition of the fact that the benefits of R&D accrue beyond the R&D performer to other participants in the economy. These credits are intended to encourage firms to perform R&D in Canada and are important given the key role of R&D in the emerging new economy.

The current system of tax credits for R&D provides significant tax relief (the estimated tax expenditure for 1991 is $543 million). Indeed, studies have shown that the Canadian system of R&D tax incentives is one of the most attractive in the world – particularly when one includes the incentives offered by some provinces.

Accelerated write-offs for exploration and development

Accelerated deductions have been available for exploration and development expenditures in the mining and oil and gas sectors since 1947. Development expenditures incurred in mining and oil and gas are classified as Canadian Development Expense (CDE) and written off at a rate of 30 per cent on a declining balance basis. Exploration expenditures are classified as Canadian Exploration Expense (CEE) and deducted for tax purposes at a rate of up to 100 per cent. Unused amounts of CDE or CEE may be carried forward indefinitely.

These deductions are provided in recognition of the high-risk nature of these resource investments. Economic benefits arising from exploration and development can extend over many years. In comparison, the CEE and CDE deductions allow these expenditures to be written off much more quickly and thereby provide significant tax benefits (estimated tax expenditures for 1991 are $106 million for CDE and $359 million for CEE).

Other income tax expenditures

While the above list describes the major tax expenditures, the publication *Personal and Corporate Tax Expenditures* provides a comprehensive listing of all tax expenditures. These range from those where the revenue foregone is relatively close to the $300 million cutoff, such as the deduction of limited partnership losses and the non-taxation of social assistance payments to lower cost ones such as the logging tax credit and the Labour-Sponsored Venture Capital Credit, and the deduction for employee stock options. Some may wish to propose changes in these tax expenditures. Similarly, some others may wish to argue that tax provisions, characterized in that document as 'memorandum items', and which include the deduction for union and professional dues, the meals and entertainment expense deduction and the moving expense deduction, should be considered in this exercise.

Other taxes

Consideration might also be given to broadening the base of excise taxes and duties. For example, excise taxes could be extended to apply to a broader range of goods and services, such as certain so-called 'luxury' goods or 'non-essential' services.

For further information, the sensitivity of revenue to illustrative changes in selected tax parameters are set out in the following table.

Annex Table 38
Estimated revenue impact of tax parameter changes (when mature)

	(millions of dollars)
Personal income tax	
Federal surtax (per percentage point)	
On total basic federal tax	650
On basic federal tax above $12,500	100
Change in marginal rates (per percentage point)	
Lowest rate (17 per cent)	2,000
Middle rate (26 per cent)	860
High rate (29 per cent)	420
All	3,280
$10 change in selected credits	
Basic personal credit	150
Married/equivalent to married credit	25
Age credit	25
Corporate income tax	
Rate changes (one percentage point)	
General income tax rate	290
Manufacturing and processing tax rate	100
Small business income tax rate	160
Surtax	110
Large corporation tax	
0.025 per cent change	160
Sales and excise taxes/duties	
GST (one percentage point change)	2,760
One cent per litre motive fuel	525
1 per cent in excise levies	
Spirits	5
Beer	6
Wine	1
Tobacco	20