November 2, 1999

The Economic and Fiscal Update

Translating better finances into better lives

Department of Finance Canada
Ministère des Finances Canada

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Dedicated to the memory of our friend and colleague, Larry Hagen

Presentation

by the
Honourable Paul Martin, P.C., M.P.

to the
House of Commons
Standing Committee on Finance

November 2, 1999
CHECK AGAINST DELIVERY

A Strong Economy

Mr. Chairman, a year ago when we met, there was great concern over the turmoil emanating from Asia, its contagious effect on the world economy and the impact this might have on our country. Thankfully, while the international recovery is still fragile, things have turned out much better than many had feared.

In Canada, in fact, on almost every economic measure that matters, we have made enormous strides.

Since January of last year, over 600,000 new jobs have been created – a pace matched by no other Group of Seven (G-7) country.

As a result, while still too high, the unemployment rate has fallen to 7.5 per cent, its lowest level in more than nine years.

Interest rates remain low and inflation is within our target range.

Canada's current account has improved sharply.

World prices for our natural resources are rebounding strongly from the lows recorded last year, while at the same time, Canada continues to make healthy progress in diversifying into new areas of manufacturing, agriculture and services.

Given these developments, average economic growth estimates for 1999 have gone from just over 2 per cent to 3.6 per cent.

Looking ahead, the major international economic institutions – the Organization for Economic Co-operation and Development and the International Monetary Fund – project that Canada will record this year and in the year 2000 one of the best rates of economic growth among the major industrial countries.

Even more importantly, over the same period, we are expected to lead all G-7 nations in job creation.

A New Era of Financial Flexibility

Mr. Chairman, our strong economic performance reflects in part our strong financial performance.

Thanks to the efforts of Canadians, this country is in the process of achieving a financial turnaround of historic proportions.

In the space of only four years, the deficit was eliminated.

Last year, we announced that for fiscal year 1997-98, the Government recorded a surplus – the first time it had done so in 28 years.

In September of this year, when the final numbers for 1998-99 were in – a year in which we invested heavily in health care, knowledge and tax relief – we announced that Canada had recorded a surplus of $2.9 billion.

This is the first time in almost 50 years that our country has recorded back-to-back surpluses and I can assure you, as set out in last February's budget, that this trend will continue.

Mr. Chairman, clearly, Canada has entered a new era, one of financial surplus. And clearly, a great debate is now underway as to how these surpluses should be used.

This is an important debate. It should go to the heart of the country's values, its goals and its options for reaching them. It should not be a debate about numbers.

Unfortunately, this is exactly what is happening. Too much of the debate so far has revolved around that very issue – not the use but the size of the surplus.

Therefore, in order to establish greater common ground, the Department of Finance, over the past several months, has conducted an unprecedented process of consultation with the chief economists of Canada's major chartered banks and four leading forecasting firms.

The objective was to agree upon a set of economic assumptions for planning purposes, which the forecasters would then use to develop projections of the surplus for each of the next five years.

Allow me to say how grateful we are to all those who participated in the process. Their contribution has been invaluable.

Mr. Chairman, the dialogue with the economists in which we have been engaged for the past several months has yielded agreement on a number of important points.

First, they believe that we should maintain our practice of setting aside $3 billion each year as a Contingency Reserve to guard against unforeseen developments – and that this Reserve, if not needed, should at the end of the year be used to pay down the debt.

This, we will continue to do.

The reality is no one can predict with sufficient confidence when world interest rates will rise and by how much; nor can anyone predict precisely when an economic downturn will hit, how deep it will be or how long it will last.

Second, the economists endorsed our practice of adding an extra degree of prudence in order to ensure that we do not fall back into deficit.

This, we also will continue to do.

Economic forecasting is hardly a precise science. This reality must be allowed for in budget planning.

Third, the economists were unanimous that the extra prudence we build into our forecasts must be explicitly shown.

Mr. Chairman, henceforth, that is what we will do.

Finally, the economists proposed that for the purposes of public debate on policy options, a five-year rather than a two-year time horizon was now appropriate.

We agree.

The debate over the use of the surplus will inevitably involve proposed strategies for debt and tax reduction and investment, whose impact will take effect over a longer period of time. Therefore, it makes sense to allow for discussion on both the greater resources that may be available in later years, as well as the more limited resources that will be available in earlier years.

But let us be clear. Although longer-term projections are appropriate to facilitate public debate and planning, the economists agreed with us that caution was warranted in their use as a basis for budget decisions. Why? Because the uncertainties underlying five-year projections are simply too great.

As we have seen over the past several years, we live in a world of great volatility and, for this reason, it would be a mistake to make commitments today of significant resources that may not be available five years down the road.

From the beginning we have felt strongly that government must have sufficient room to respond to the needs of tomorrow; that its financial commitments must evolve only as the economy evolves.

Therefore, as a parliament and as a people we should debate the use of the surplus over the longer term – and plan on that basis. As a government, however, we will continue to take decisions only within a rolling two-year time horizon, as we did throughout the successful process of deficit elimination.

In a world that calls for maximum flexibility, we must maintain the capacity to respond to the unexpected.

In this sense, prudence is much more than a financial principle. It is a prerequisite for sound economic and social policy.

With that as background, Mr. Chairman, and taking the average private sector forecast of the surplus, the following are the estimates of the planning surpluses for the next five years – this is after subtracting the annual Contingency Reserve of $3 billion and the extra prudence of $1 billion in the first year, rising to $4 billion in the fifth year:

for the next fiscal year – 2000-2001 – a surplus of $5.5 billion;

for 2001-2002 – $8.5 billion;

for 2002-2003 – $12.5 billion;

for 2003-2004 – $17.5 billion; and

for 2004-2005 – a surplus of $23 billion.

Now obviously, each year these projections will have to be updated – and we will continue to seek the views and advice of private sector economists and forecasters in that process.

Mr. Chairman, we now have the financial context for the debate that lies before us.

Building the Canada of the 21st Century

That being said, Mr. Chairman, there is still a critical part of the broader context that is missing if the debate is to be fruitful.

Fiscal responsibility is essential. But by itself, it does not constitute a road map to the future.

Before deciding how surpluses should be used, before working out how numbers should be divided, we must be clear about the kind of future we want and how we propose to achieve it – all of this within an understanding of the kind of world in which our children will be living, because the consequences of our actions today will be felt for generations to come.

The questions, therefore, are:

First, what will it take to firmly establish our place as a leader in the new economy of the new millennium?

Second, how can we provide every Canadian an equal opportunity to succeed?

And third, how can we ensure the best quality of life for all Canadians, not simply a fortunate few?

Mr. Chairman, in these – the closing days of the 20th century – Canada has a unique opportunity to take hold of its destiny.

To translate better finances into better lives for all.

To give Canadians what they have a right to expect: the promise of higher incomes and increased security.

However, we must accomplish all of this against the backdrop of an economy that is undergoing historic change.

Some talk of the new economy as if it were a distant concept – removed from our daily lives and set in the far-off future.

This is not so. It is all around us. It is here. And it is here now.

The fact is, we are experiencing the early stages of a new wave of advanced growth – one that is as powerful as it is pervasive.

This is giving rise to whole new industries – information technology and environmental technology today, biotechnology and fuel cell technology tomorrow, to name only a few.

What does this mean for us?

It means that new times require new approaches.

It is becoming clearer with every passing day that the fundamental challenge and opportunity before us is to make the entire economy one of innovation and excellence.

The solution is not to set aside the old economy and somehow or other replace it, as if by magic, with the new.

Our opportunity is to infuse the entire economy with the potential the new economy presents, for such is the transforming capacity of the new technologies that our traditional industries are being revitalized and renewed. Just as new areas of enterprise are being invented, so too are the staples of Canada's 20th century industrial base being remade in the image of a new high-tech, value-added global economy.

It is an economy where ideas are shared instantaneously.

It is an economy where technological innovation and intense competition are reshaping the marketplace – and the rules that run it.

It is an economy where challenge is as likely to come from the other side of the world as from the other side of town.

Needless to say, the implications of all this are vast.

For individual Canadians, it is manifest in their daily workplace; in the fact that lifetime learning is a condition of lifetime advancement.

For business, it means new definitions of success; where companies will spend more on research and development than on buildings and equipment; where being first to market with newer and better products, processes and services is critical; and where the thirst for talented, resourceful employees is insatiable.

This change has the potential to accomplish great things.

At lightning speed, it is already lifting the world's ability to generate prosperity and create vast new opportunities.

It holds out the promise of new jobs and higher wages. Of a better, more plentiful future.

At the same time, however, we can never forget that wealth for some is mirrored by inequality and insecurity for too many.

Who among us has not felt anxious about the extent and profound nature of the change we are experiencing? Who has not worried about its effect upon our own communities and our families?

For these reasons, Canadians want to know how, as a country, we propose to tackle the challenges that lie ahead. They want to know that their government has a plan and that there is a place for them in that plan.

It is against this background, it is within this context, that we should discuss the use of the surplus.

The economic framework required to take Canada into the 21st century is multifaceted. Let me focus today on four crucial elements.

First, we must build a solid foundation for economic growth by providing sound financial management.

Second, we must promote economic growth and a better quality of life by reducing taxes.

Third, we must recognize the need to make our economy more competitive by making it more innovative.

And fourth, we must recognize that providing security and opportunity for Canadians in the future means investing in their skills, in their knowledge and their capacity to learn.

None of these elements alone can give us the strong economy and the secure society we want.

But together, they provide the balance for a forward-looking plan to make Canada the place to be in the 21st century, as long as we remember one fundamental principle: while a plan for growth is important, so too we must ensure that such growth is shared widely.

Consequently, let us commit to take full advantage of this moment – to see to it that new growth permits us to better tackle old challenges.

That the gap between rich and poor is narrowed.

That urban Canada thrives.

That rural Canada prospers.

That every community becomes a potential location for new jobs and new hope.

For a nation such as ours – with a diverse population and our vast geography – this is where the true promise of the next century is to be found.

The fact is, the new economy makes all of this possible.

In summary, Mr. Chairman, the question before us is not simply how do we deal with the surplus, it is what do we do now to take the financial resources at our disposal and use them to bring together our human, our natural and our technological resources so as to take advantage, for the benefit of all Canadians, of the very exciting world opening up to us in the 21st century.

Building a Solid Foundation for Economic Growth: Providing Sound Financial Management

Let me turn first to the issue of providing sound financial management.

What must we do?

We must keep inflation low and stable.

That is why our agreement with the Bank of Canada is so important.

We must constantly review our regulatory framework to maintain a proper balance between reducing the regulatory burden of our businesses and promoting innovation on the one hand, and protecting the interests of the public and consumers on the other. This, for example, is the underlying philosophy of the reforms of the financial sector that the Government proposed last June.

And finally, we must continue to bring the debt burden down so that more of our dollars can be used to invest in the future, rather than paying for the consumption of the past.

Mr. Chairman, sound financial management is crucial to protect us from punishing cycles of boom and bust and the long-lasting problems they create.

Consider the devastating impact of the last two recessions.

Interest rates climbed to alarming levels. Business investment dropped by over $11 billion. And half a million jobs were destroyed.

It took five long years for business investment to recover after the recession in the early 1980s.

It took four long years to regain the jobs lost in the early 1990s.

We know that sound financial management will not put an end to business cycles – with their ups and their downs.

But we also know there have been times in the past, when we had poor financial policies in our country, that difficult situations turned into crises, that economic problems became dramatic compared to those of our main trading partners.

Mr. Chairman, being able, at long last, to look forward to a new era of surpluses is a historic achievement.

But does this mean our financial challenge has been fully met, our obligation to future generations fulfilled? The answer is no.

The fact is, for instance, our debt burden is far too high – indeed, it is the second highest in the G-7.

This is not some arid statistic – it has real and abiding consequences for all Canadians.

The single largest expenditure the federal government makes is to pay interest on our debt.

These payments – almost $42 billion a year – represent huge resources that cannot go to reducing taxes or investing in education, the environment, health care or child poverty. They hinder our ability to prepare for a better future. They leave future generations with a large bill that they played no part in racking up.

Quite simply, the debt burden must come down.

The best way to measure it is in relation to the economy that supports it. This is called the debt-to-GDP (gross domestic product) ratio. The lower the ratio, the more manageable the debt.

In 1995-96 the debt-to-GDP ratio peaked at 71.2 per cent. In 1996-97 – as a result of both our progress on the deficit and economic growth – the ratio fell meaningfully for the first time in more than 20 years. In 1998-99 it has fallen further, to 64.4 per cent.

As a result, the portion of our revenues going to pay interest on the debt has gone from 36 cents out of every dollar five years ago to 27 cents. That is major progress. But it is not good enough.

We must and we will ensure that the debt burden continues to fall – year in and year out.

That will happen in two ways. First, by paying down the absolute level of debt. Over the past two years, net public debt has declined by $6.4 billion, resulting in interest savings of more than $300 million each and every year. As well, market debt – the debt issued in financial markets – has fallen even further, with $16.4 billion of such debt being retired.

Second, and even more importantly, our debt ratio will be brought down by ensuring strong economic growth.

In other words, a strategy focused on growth is also the best strategy for reducing the debt burden.

So far, Mr. Chairman, in outlining the criteria for a successful economy of the 21st century, we have talked about sound financial management within Canada.

The fact is, however, sound financial management outside our borders is also of vital importance to the economic well-being of our citizens.

This was made evident by both the Mexican peso crisis five years ago and the recent Asian financial crisis.

In both cases, our country suffered the effects of a weakening dollar and a spike in interest rates. In the case of the Asian crisis, these effects were compounded by declining commodity prices.

The fact is, no country – no matter how powerful – is immune to economic and financial turmoil outside its borders.

Thus we clearly have an interest in improving the management not just of our own, but of the international financial system as well.

That is why Canada has taken a leadership role in reforming the international financial architecture. It is also why Canada pushed hard for the creation of the Group of Twenty (G-20), a new group that brings together G-7 countries and several key emerging economies, and whose objective is to reduce the likelihood of international financial crises and to reduce their severity if they do happen.

Improving Economic Growth and Quality of Life: Reducing the Tax Burden

Let me turn now to the question of taxation.

Mr. Chairman, for this government, the need for tax reduction is not a matter for debate.

It is not just one option among many.

It is not secondary.

It is not something to be considered only once the list of spending proposals is exhausted.

Tax reduction is essential to secure strong and sustained economic growth.

Indeed, there are many reasons for reducing taxes. Most are well-known and do not need repeating here. However, there is one I would like to mention because it is too frequently overlooked – it is quite simply that Canadians are entitled to keep more of the money they earn.

After all, they worked for it. It’s theirs.

Canadians had to pay more taxes when we were in deficit and the debt was increasing. They have a right to expect government to reduce their taxes now that the era of surpluses is here. In particular, they have a right to expect their disposable income to increase.

And this is, in fact, happening.

In the early 1990s, Canadians saw their real after-tax incomes shrink. Fortunately, that trend has ended. Real per capita after-tax incomes are now almost 3 per cent higher than they were three years ago. Our job now is to ensure their incomes grow even more.

Going forward, the principles of our plan to cut taxes are clear.

First, our approach to tax relief must be fair. Tax reduction must ultimately benefit all Canadians, but first it must benefit those who need it most – middle- and low-income earners, especially families with children.

Second, broad-based tax relief should focus initially on personal income taxes. That is where the burden is greatest – where Canadian taxes are most out of line with our history and with other countries.

Third, we must ensure that we have an internationally competitive business tax system.

And fourth, broad-based tax relief should not be financed with borrowed money.

To do so would not be to put money back into the pockets of Canadians.

It would be a promise to take more money out of their pockets in the future.

Mr. Chairman, we promised we would bring the deficit down – year by year. And we did.

Two years ago, when we balanced the books, we promised to bring in broad-based tax relief. And we have.

In 1998, tax reduction was focused at the lower end of the income scale.

In our 1999 budget, tax relief was provided to all Canadian taxpayers while, at the same time, middle- and low-income Canadians benefited proportionately more.

Together, the 1997, 1998 and 1999 budgets reduce the income tax burden of Canadians by some 10 per cent.

But, Mr. Chairman, these are only the first steps.

We must and we will cut taxes more.

In our next budget we will set out a multi-year tax reduction plan and we will explain how we intend to carry it out.

We will set out objectives and we will achieve them as quickly as possible.

That is how we eliminated the deficit. That is how we will continue to reduce taxes.

It is in the context of this plan for income tax relief that the issue of reductions in the employment insurance (EI) premium rate must also be addressed.

For the past five years – every year since we have taken office – EI premiums have been brought down. This is unprecedented – both in terms of the size of the reduction and its duration.

The Employment Insurance Commission has just set the rate at $2.40 for the year 2000, down from $2.55 this year.

Today, we are confirming that we accept the rate set by the Commission. And, Mr. Chairman, this reduction is reflected in the surplus figures outlined earlier in this presentation.

This means that employees and employers will save a further $1.2 billion next year – bringing total savings, compared to the rate which prevailed in 1994, to $5.2 billion.

Making Our Economy More Competitive by Making It More Innovative

Mr. Chairman, sound financial management and appropriate levels of taxation are prerequisites for success in the new global economy. But they are not the whole answer. More, much more, must be done.

The fact is, Canada is not the only country to restore sanity to its public finances. If we want to gain a competitive edge, we will need to find it elsewhere.

The question is, what are the choices that we can make today that in 20 years will be seen as having made a critical difference in making this the land of opportunity?

The answer is, those choices which make our economic culture one of innovation, our perspective that of the entrepreneur.

Mr. Chairman, the economies that will thrive over the next decade will be those that excel at innovation.

And with the second lowest level of research and development expenditures in the G-7, clearly our country needs to do a lot more.

The fact is that the greatest gains in productivity today – and the economic benefits that flow from them – are the result of research carried out years, if not decades, ago.

For instance, it is largely the newest of high technologies that are driving the U.S. economy – the strongest in the world this decade. However, as recent studies in that country have shown, much of the product and process innovation underpinning those new technologies is the result of investment in basic research done in the 1950s, 1960s and 1970s.

That is why we must accelerate our support for the kind of groundbreaking research that will provide the new ideas and methods that will generate economic growth in the Canada of the future.

That is why we must continually update our research facilities and create new opportunities for the best and brightest to pursue advanced studies and research right here at home.

That is why in 1997 we established the Canada Foundation for Innovation, which through partnerships will lead to over $3 billion in new world-class research facilities at our universities, colleges and research hospitals.

That is why in 1999 we proposed to create the Canadian Institutes of Health Research, which will enhance greatly the scope and reach of research in all disciplines that contribute to the better health of Canadians.

That is why we have increased to their highest level ever the budgets of the Government's granting councils, which provide financial support for researchers all over Canada.

That is why the Prime Minister has promised that up to 2,000 new research chairs will be created in Canadian universities. These funds will provide financial support for the world-class researchers of today and future generations to work in Canada and carry out the research that will pay off for decades to come.

But, Mr. Chairman, it is not just up to Canada's governments, scientists or engineers to create an innovative and competitive economy for the 21st century.

As a recent Conference Board study pointed out, the capacity of companies to innovate successfully is determined by the quality of their management and leadership.

The point is, all of us have a role to play in building an economy that can innovate and compete with the best in the world.

This includes everyone from the venture capitalists who provide the financing, to the researchers who generate the ideas, to the workers who turn these ideas into products and services, to the executives and managers who lead the development and marketing of those ideas, to the governments which create the right environment – the right social and economic framework.

The fact is, innovation doesn't just happen. It requires investment. It requires basic research. It requires infrastructure. It requires imagination. It requires creative management. It requires a sea change in much of our approach to the economy, and how that comes about must also be part of the national debate.

Providing Security and Opportunity for Canadians: Investing in Skills and Knowledge

Mr. Chairman, innovation is the foundation of the new wealth of nations.

But if we are to become a nation that excels at innovation, we must also become a nation that excels at education – at skills and knowledge.

These are the raw materials of today's global economy.

Our challenge is to translate them into the finished product of universal opportunity.

Skills provide Canadians the flexibility to adapt to a world in constant and unpredictable evolution. They are the key to higher incomes. They are at the core of a better quality of life. And more than ever, in today's modern economy, they provide the best way to widen the mainstream, strengthen the middle class and level the playing field between rich and poor.

In a real sense, good skills are an essential part of the social safety net of the future. They are not only about an economy's growth. They are about a society's health.

In the fall of 1997, a substantial part of my presentation to this Committee was about this very subject.

And in the 1998 budget – four months later – access to knowledge was our first post-deficit priority. That is where we launched the Canadian Opportunities Strategy, a seven-part plan to improve access to skills, training and higher education for all Canadians.

As a result of the Strategy, post-secondary students are now receiving substantial help from the Government of Canada to finance their studies; 100,000 scholarships will be awarded every year for the next 10 years; and students are receiving increased tax support for tuition and living expenses, as well as help in repaying debt after graduation, including a tax credit for interest on student loans.

Furthermore, as a result of the Canada Education Savings Grants (CESGs), also announced in the 1998 budget, the Government has since then put $500 million into the registered education savings accounts of children across the country.

Let me say a little more about the latter part of the strategy.

The 1998 budget created the CESG, a forward-looking initiative designed to help families save for their children's post-secondary education.

Canadians have responded overwhelmingly to that measure.

During the first 25 years of registered education savings plans (RESPs), $2.5 billion of savings were accumulated. In the short time since the CESG was introduced – only 21 months ago – private savings have doubled to $5 billion.

The fact is, thanks to the CESG, RESPs are becoming as essential and as valuable to saving for education as are registered retirement savings plans to retirement.

Looking forward, we believe we must build on the foundation laid in 1998.

We must continue to help Canadians build up their finances to learn.

But, Mr. Chairman, as well, we must help them build up their capacity to learn.

Knowledge joins the ambitions of the individual and the potential of the country. It is the meeting place between social and economic policy; the best guarantee of a well-paying job and the best assurance of individual security.

However, learning is no longer something we do at a certain age or in a certain place.

It is something we must do throughout our lives, no matter where we live and work.

I suspect we would all agree with that.

Where, however, our thinking must evolve is in recognizing that the effort must begin at the earliest of years.

The fact is, readiness to learn does not begin in school. It depends on the caring and nurturing environment provided to the smallest infant.

Dr. Fraser Mustard made this point in a recent report, and I quote:

"There is powerful new evidence from neuroscience that the early years of development from conception to age six, particularly for the first three years, set the base for competence and coping skills that will affect learning, behaviour and health throughout life."

Mr. Chairman, we must accelerate the development of ways of providing our children with the best possible start in life.

Helping Canadian families provide a supportive environment for their children is one of the best investments we can make.

The fact is, children equipped to learn become adults equipped to succeed.

That reality is one reason behind the new resources we have invested in the Community Action Program for Children, in Aboriginal Head Start and in the Canada Prenatal Nutrition Program.

It lies as well behind the new partnership established with the provinces to create the National Child Benefit System – whereby the federal government is providing some $7 billion in income support a year for middle- and low-income families.

It is why the Prime Minister announced that the Government will make a third major investment in the National Child Benefit by July 2001.

It is also why he announced that the Government will extend the time EI maternity and parental benefits are available.

Mr. Chairman, across the country there is a very strong consensus on the need to provide income support to families, to improve the services that children need and, especially, to focus on the very earliest years.

There is also a recognition of the value of governments working in partnership.

That consensus is reflected in the National Children's Agenda, launched last year by federal and provincial ministers, and which was the subject of a dialogue with Canadians across the land.

Our opportunity in the budgets that lie ahead will be to turn that agenda into action.

The obligation to do so stems from one straightforward fact: we may not know what the future will be, but we do know who the future will be. Our children.

Questions for Consultations With Canadians

Mr. Chairman, the framework we are proposing raises a number of issues and questions for Canadians to debate. In addition to discussing the framework itself, your committee can play an important role in seeking the views of Canadians on the following questions, among others.

On personal income taxes: What should the tax rates be? What should the amount of tax-free income be? What should the income thresholds be for various tax rates? And how soon can we get there? On business taxes: When should the process of tax reduction begin?

On EI: What is the appropriate timing for further reductions in premium rates in the context of other priorities?

On research and development: What are the best ways for the Government to encourage the private sector to invest more in this vital area for the future of our country?

On skills and knowledge: How can we make lifelong learning a reality accessible to all?

Conclusion

Mr. Chairman, long ago, Canadians made a defining decision.

It was that a strong economy and a secure society are flip sides of the same coin.

That is why, two years ago, we and the provinces acted to secure the future of the Canada Pension Plan – it will now be there when people need it.

That is why the largest investment we have made since taking office in 1993 was last year, and it was in health care.

The reason we were able to do this was because we had turned the corner in managing the finances of this nation.

I raise this in the context of the questions just put to you because, as you answer them, we must all be conscious that we must not return to the old ways of the old days – when every priority was declared equal; when every problem was met with yet another program; when government often over-reached, over-promised and under-performed.

Those days should be behind us forever.

We have come too far and accomplished too much to do otherwise.

Government should act only where it can make a difference.

After all, we are not here to spend the surplus. We are here to create better lives for Canadians.

With that in mind, Mr. Chairman, what must our goal be?

Quite simply, our goal must be to lead the world in the things that count.

It must be to foster a nation that will give every Canadian – young and old – every opportunity to realize their dreams.

A nation where not only our best and brightest want to remain. But where the freshest talents from around the globe are drawn to come.

How do we do that?

Well, one thing is for certain: success in the modern economy does not lie in luck. It requires knowing what the ingredients of a strong society are – and then creating them through partnership and investment.

Growing economies today are anchored in the creation of an environment where the capacity and the incentives are there to generate new ideas, to turn those ideas into new products and to take those products into new markets.

They are anchored in creating new waves of innovation and then riding them – in giving our economy the tools to grow and in giving all Canadians the means to share in the benefits of that growth.

That is the main message of this Economic Update.

But here, Mr. Chairman, I believe there is a further point to be made.

We bat around statistics – average rates of economic expansion, average income per capita – quantitative measures of every kind, all of varying degrees of reliability. Based on those statistics, we make comparisons with our own history and with other countries – and then declare ourselves winners or losers.

Well, statistics can illuminate. They can also blind.

The fact is, narrow economic indicators do not speak to child poverty. They do not speak to the quality of the air we breathe or the water we drink. They do not speak to the safety of our communities or the tragedy of the homeless.

Yet these are fundamentals that count for Canadians, for they are fundamentals that count for the future of our country.

They must also be part of the debate.

Mr. Chairman, a nation is not static. Economies are not static. People are not static.

Anchored by a set of core values, our greatest strength is our capacity to respond in new ways to the new challenges before us.

We must not let this period of worldwide innovation slip by unmet. We must turn this moment of opportunity into a sustained era of accomplishment.

So let there be no doubt.

We will strengthen our economy.

We will bring down taxes.

And we will recast the foundations of individual security.

But as well, we will do much more than that.

We will forge a culture of innovation.

We will build upon our traditional industries.

And we will build a society that nurtures its children like no other.

On the eve of the 21st century, that must be our ambition – that must be the Canada we seek to build.

Thank you.

Annexes

1

Canada's Recent Economic Developments and Prospects

Highlights

*"In Canada …
on almost every
economic measure that
matters, we have made
enormous strides."*

*"… the major
international economic
institutions … project
that Canada will record
this year and in the
year 2000, one of the
best rates of economic
growth among the
major industrial
countries."*

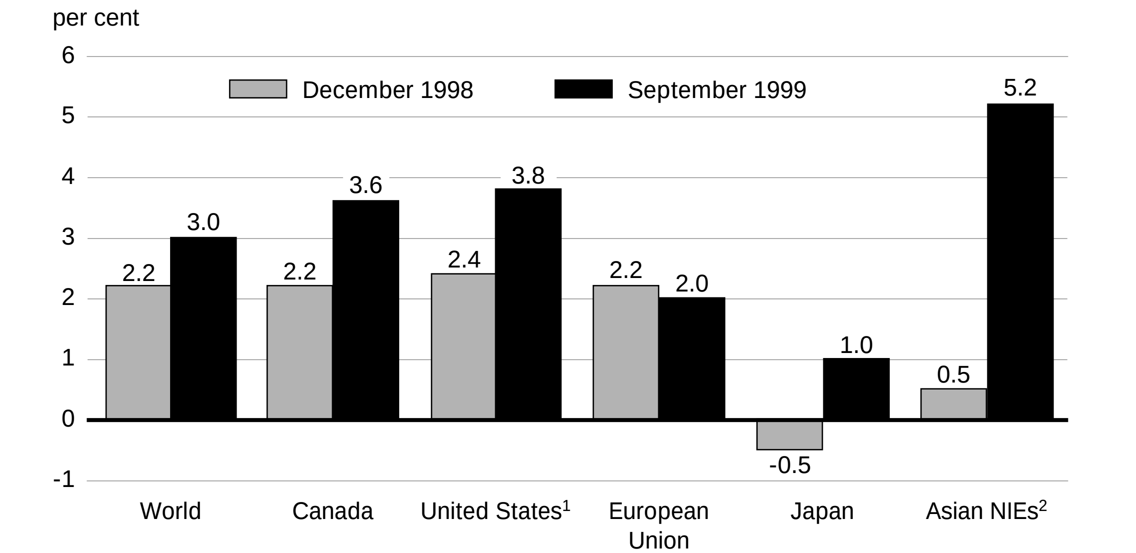
*"Even more importantly,
over the same period,
we are expected to lead*
all *G-7 nations in
job creation."*

The Honourable Paul Martin
Minister of Finance

- *The strength of the global economy has exceeded expectations since the 1999 budget. The recovery in Japan and other Asian economies arrived sooner than anticipated, while the U.S. has continued to post strong growth.*
- *The improved world economic conditions have helped commodity prices regain much of the ground lost during the Asian crisis, bolstering equity prices, profits and confidence.*
- *Canada's economic performance has also exceeded expectations since the 1999 budget due to improved world economic conditions and a surge in domestic demand.*
- *Domestic demand strength is now broadly based, with strong growth in consumption, residential investment and business investment so far this year.*
- *The current account has improved significantly so far in 1999, owing to the rebound in commodity prices and solid export growth.*
- *The unemployment rate fell to 7.5 per cent in September, its lowest level since June 1990.*
- *The strength in the Canadian economy reflects sound macroeconomic policies, including low inflation and healthy public finances, which have helped to keep interest rates near historic lows.*
- *As a result, international and private sector forecasters have revised up their forecasts for economic growth in Canada in 1999 and 2000.*
- *The average private sector growth forecast for real gross domestic product (GDP) has been upgraded to 3.6 per cent for 1999 (from 2.0 per cent at the time of the budget) and to 2.9 per cent for 2000 (from 2.5 per cent at the time of the budget).*
- *Moreover, the International Monetary Fund (IMF) expects Canada to be second in the Group of Seven (G-7) in real output growth and to lead in employment growth in 1999 and 2000.*

The global economy has rebounded faster than expected

Real GDP growth forecasts for 1999

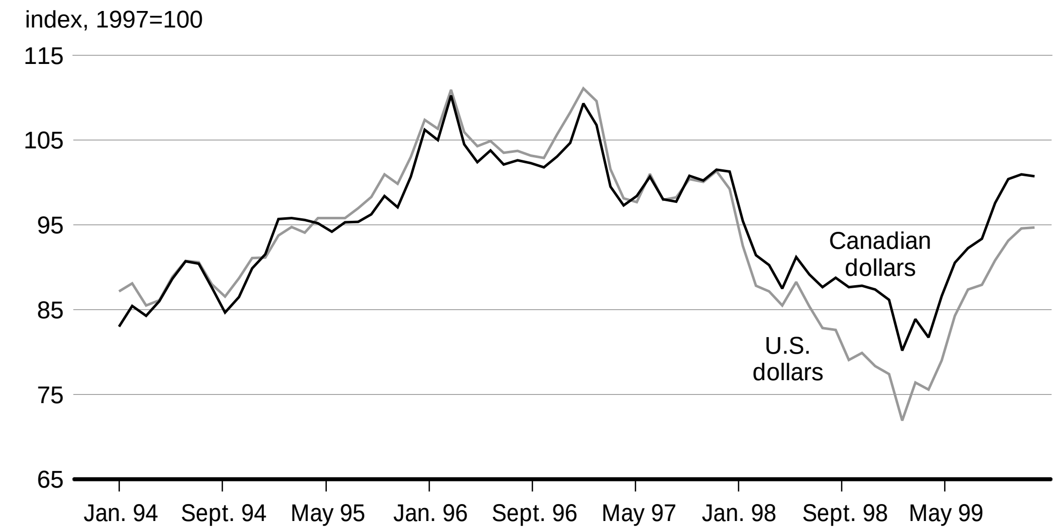


[1] *Blue Chip Economic Indicators*, January and October 1999.
[2] Newly industrialized economies. They include Hong Kong, South Korea, Singapore and Taiwan.
Source: IMF, *World Economic Outlook*, December 1998 and September 1999.

- The strength of the global economy has exceeded the expectations of international agencies and private sector forecasters at the time of the 1999 budget, as the turbulence originating in Asia in early 1997 exerted less economic drag than forecast.
- The economic recovery in Japan and other Asian economies in 1999 came much earlier than expected at the time of the budget, although its strength and durability remain somewhat fragile.
- In Europe, gains in real GDP have remained modest.
- The U.S. economy, which supported world growth in the midst of the Asian crisis, continued to post one of the strongest growth rates of major industrialized countries over the first half of 1999, with little sign of rising inflation pressures. Although growth did slow in the second quarter of 1999, this was mainly the result of an unexpected decline in inventory investment.
- This excellent performance reflects in large part strong productivity growth since late 1995, due mainly to an explosion of productivity in the computer industry. Although U.S. productivity growth paused in the second quarter of this year, many analysts have revised up their estimates of how quickly the U.S. economy can grow without creating inflation pressures.
- Nevertheless, concerns remain about potential upward pressures on inflation and interest rates due to the unexpectedly strong momentum and potential structural imbalances in the U.S. economy, together with a stronger performance in the rest of the world.

Positive global developments have boosted commodity prices

Commodity prices

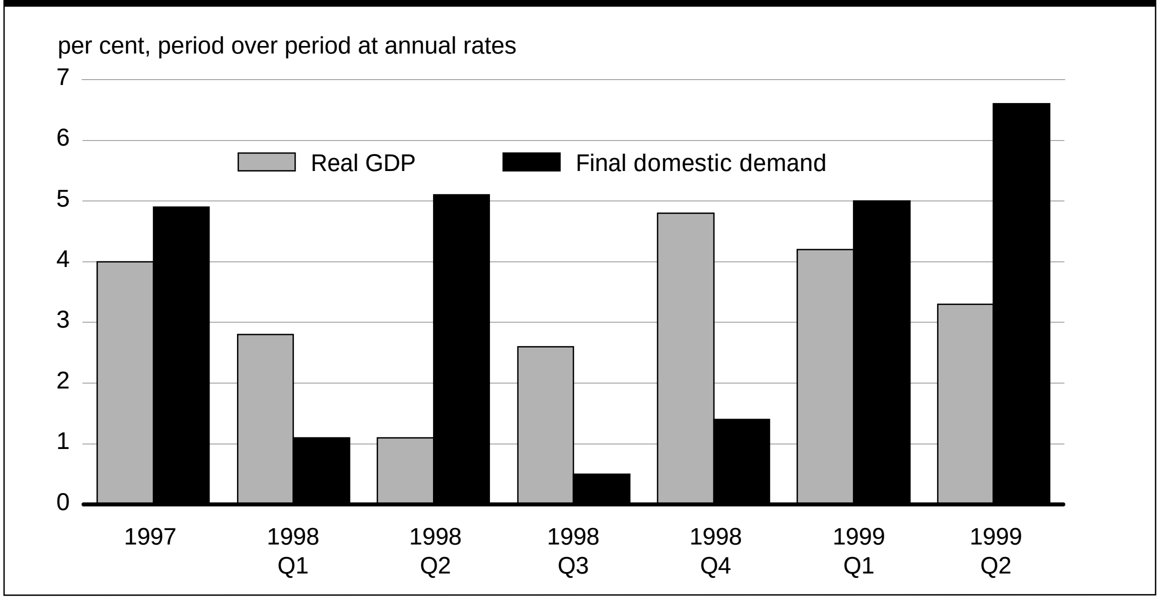


Source: Department of Finance's commodity price index.

- Improved economic conditions in Asia and the strong U.S. economy, as well as favourable supply conditions, have led to a solid recovery in commodity prices.
- In mid-October, commodity prices in U.S. dollars were more than 30 per cent above their recent trough, reversing about 85 per cent of the drop that had occurred after the onset of the Asian crisis in July 1997. In Canadian dollars, commodity prices returned to their early 1997 levels.
- The recovery in commodity prices is largely due to rising energy prices, particularly oil and natural gas prices. However, prices of other commodities, such as base metals, pulp and some agricultural commodities, have also posted gains.

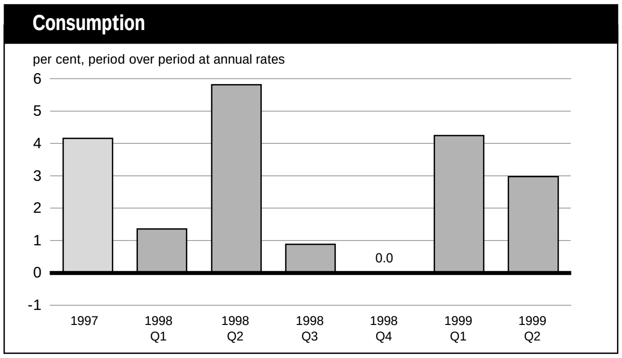
Canadian economic growth has also exceeded expectations

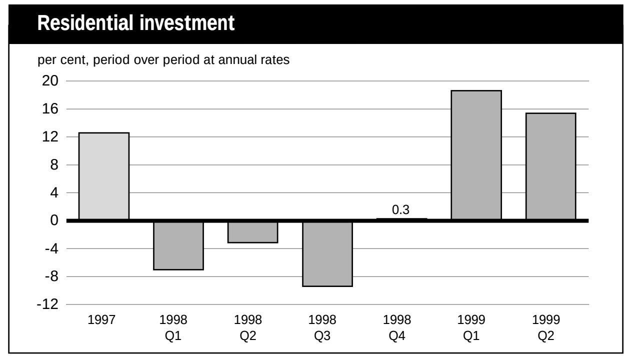
Real GDP and final domestic demand growth

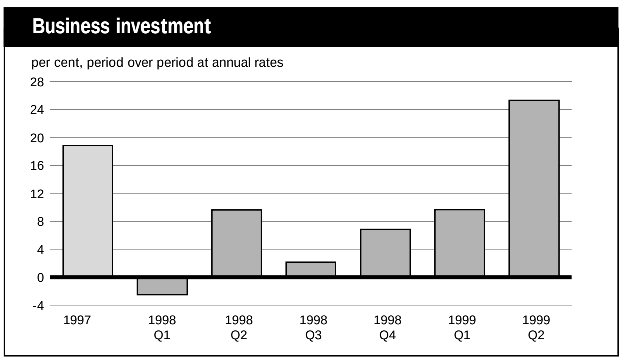


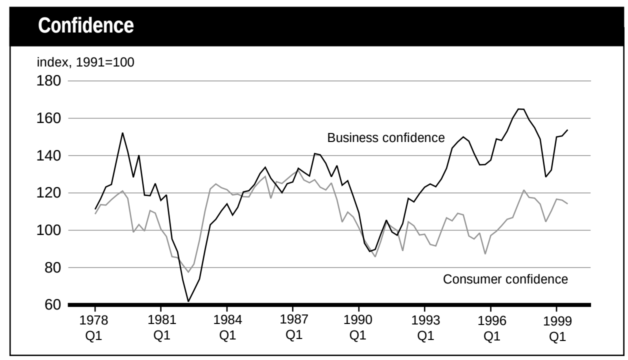
- Canada's economic performance has also exceeded expectations since the 1999 budget, in part due to improved world economic conditions, which have bolstered equity prices, confidence and corporate profits.
- Real GDP growth has been particularly strong, averaging 4.1 per cent from the fourth quarter of 1998 to the second quarter of 1999. This is almost double the average rate of growth during the first three quarters of 1998.
- In 1998, strong demand for our exports, mainly from the U.S., fuelled the Canadian economy. Although exports remained solid, final domestic demand has improved markedly, re-emerging as a major driver of growth so far in 1999.
- This rebalancing of growth, combined with continued low inflation and restored government finances, puts Canadian economic growth on a more sustainable footing.

Domestic demand strength is broadly based



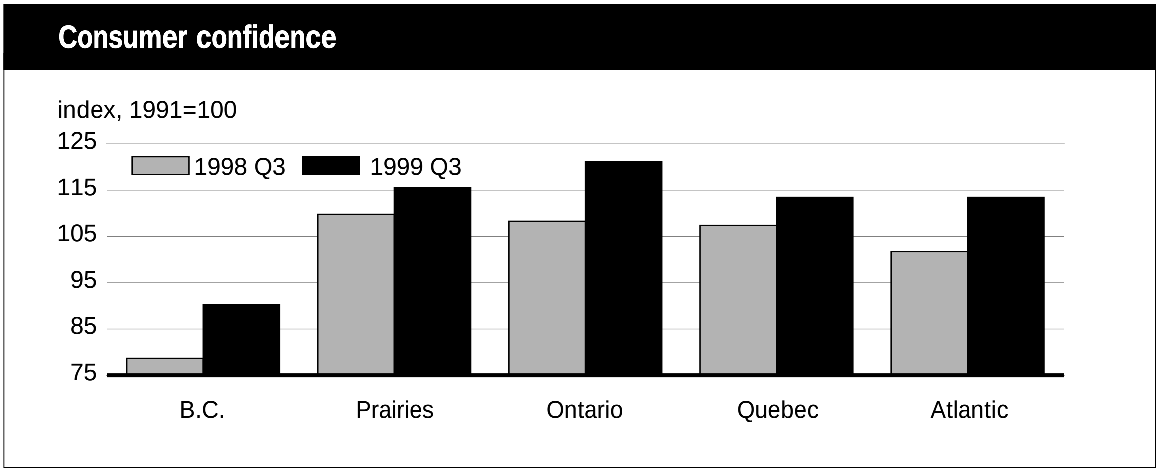


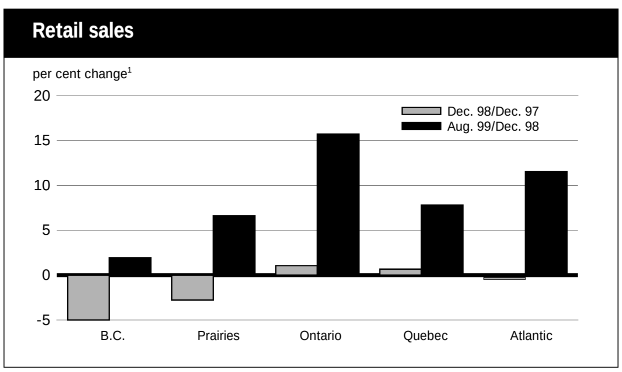


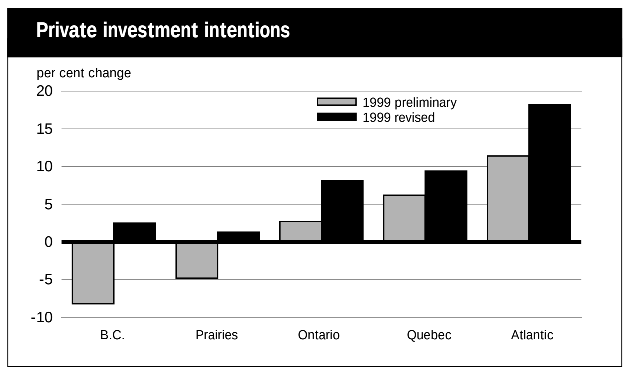


- Domestic demand growth has been widespread, with strong growth in consumption and investment:
  - Growth in consumer spending, which had slowed to a halt at the end of 1998, rebounded strongly over the first half of 1999 as consumer confidence improved and disposable income growth strengthened.
  - Renewed consumer confidence and healthy labour market conditions have boosted residential investment so far in 1999. In fact, growth in spending on new construction averaged 15.7 per cent over the period, while home resales hit their highest level in 2½ years in the second quarter of 1999.
  - Growth in business investment, which was hard hit by the Asian crisis, has also rebounded. The investment surge reflects a firming in business confidence and corporate profits over the year, as well as Canadian firms upgrading hardware to be year 2000 compliant.
- Strong inventory investment also contributed to domestic demand growth, as Canadian firms added about $5 billion to inventories in the first half of 1999. As a result, inventory investment may slow in the second half of the year.

Domestic demand has also strengthened from coast to coast



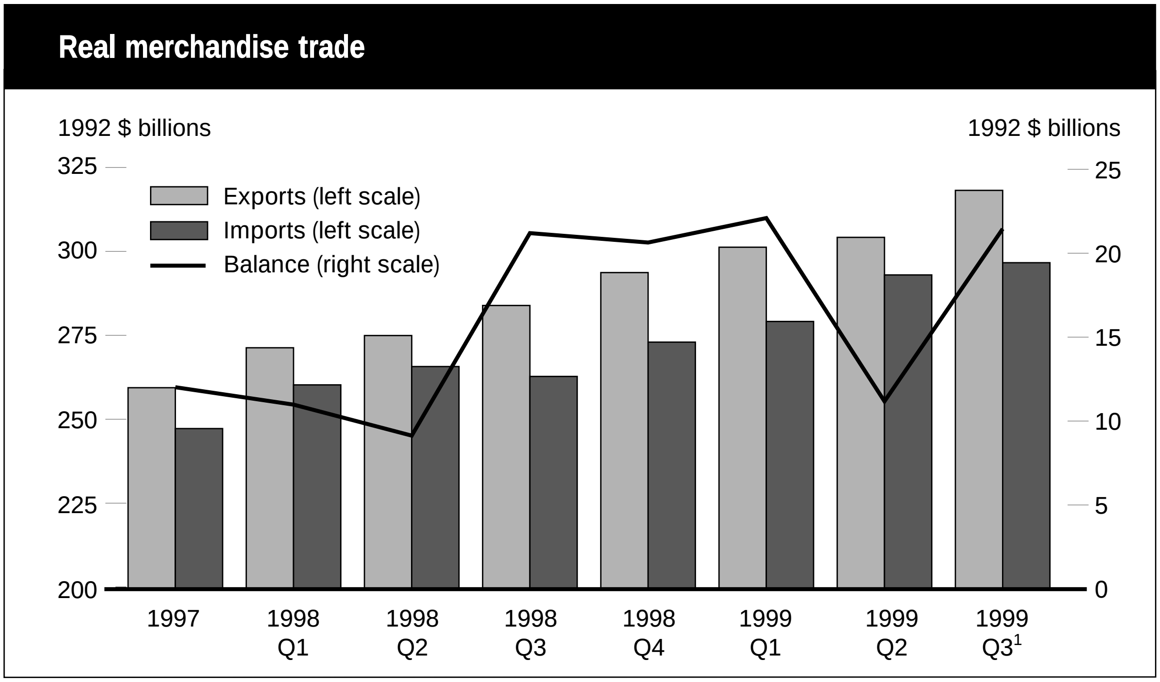




[1] Seasonally adjusted at annual rates.

- Domestic demand growth has also been widespread across the regions of the country, reflecting in part the renewed confidence. In fact, consumer confidence has rebounded strongly from its trough in the third quarter of 1998 in all regions.
- Consumer spending has strengthened considerably across Canada so far this year, with retail sales showing particular strength in Ontario, Quebec and the Atlantic region. In British Columbia and the Prairie provinces growth has rebounded from last year’s decline.
- Business investment has also strengthened, with private investment intentions up in all regions since the beginning of the year, particularly in the Atlantic region, the Prairies and British Columbia.
- Low grain prices have continued to adversely affect the Prairie provinces so far this year but are expected to strengthen.

Export growth remains strong

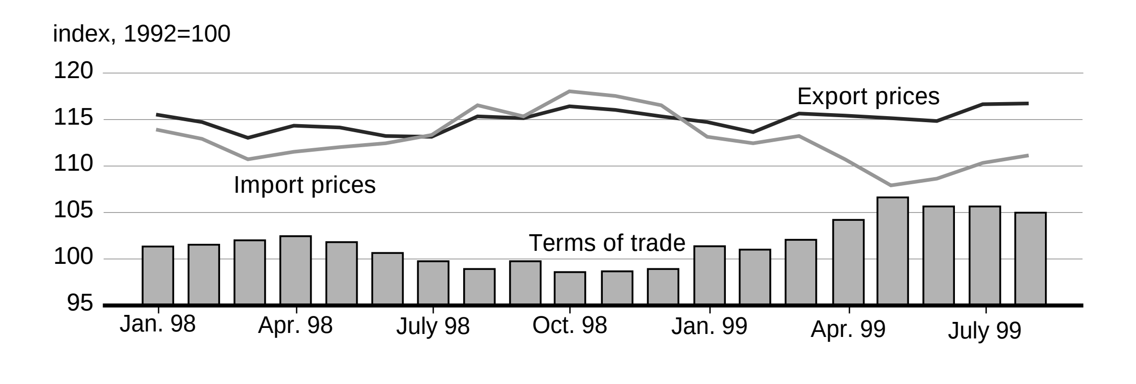


[1] Estimates based on the average of July and August

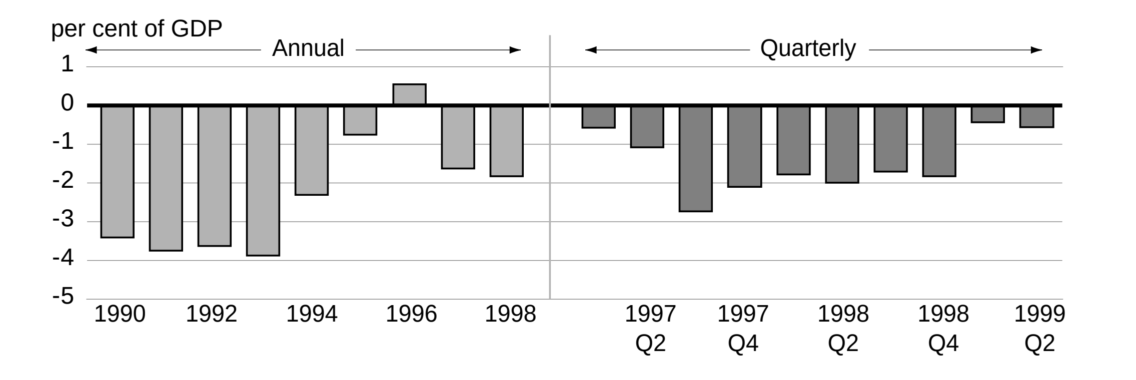
- The strong increase in domestic demand, particularly in areas with high import propensities such as machinery and equipment, has translated into a surge in merchandise imports. Since the third quarter of 1998, merchandise import growth has averaged 12.8 per cent.
- Strengthening world demand and strong growth in the U.S. have continued to support exports. Although growth in exports of merchandise slowed in the second quarter, exports rebounded strongly in July and August and are now 12.0 per cent above their level one year ago.
- The real merchandise trade surplus averaged over $20 billion in July and August, following a temporary decline in the second quarter that was largely due to a surge in imports.

The current account is improving

Export and import prices and the terms of trade for merchandise



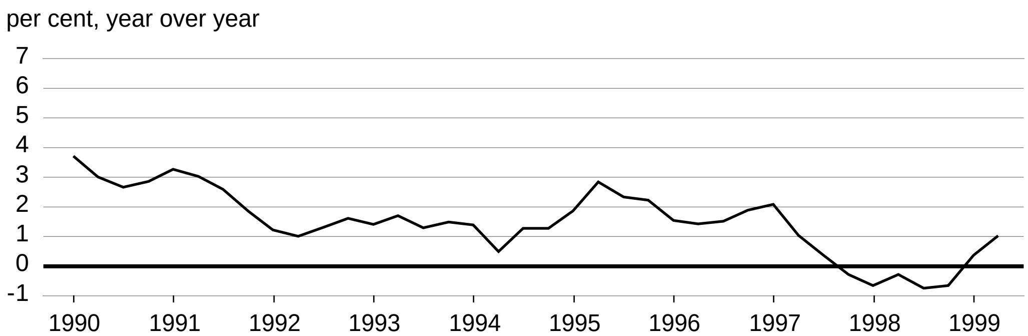
Current account balance



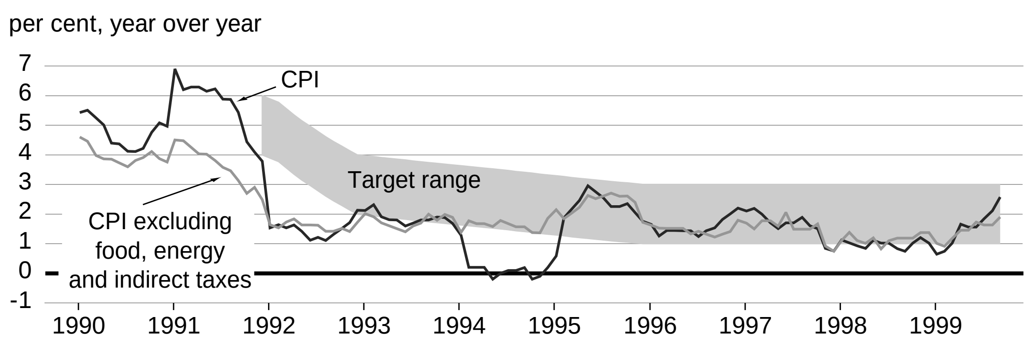
- An improvement in the price of Canada's exports relative to its imports (the terms of trade) more than offset the deterioration of the real trade balance in the first half of 1999, leading to a significant improvement in the current account since the end of last year.
  - Export prices have been supported by stronger world growth and higher commodity prices.
  - Import prices have fallen due to a shift towards goods that are experiencing lower inflation, such as computers, and a more favourable exchange rate.
- As a result, the current account deficit improved from $16.5 billion (1.8 per cent of GDP) in the fourth quarter of 1998 to $5.2 billion (0.6 per cent of GDP) in the second quarter of 1999.
- Moreover, the sharp rise in the real merchandise trade balance, combined with the relatively unchanged terms of trade so far in the third quarter, augur well for a further improvement in the current account.

Core inflation remains low

GDP inflation

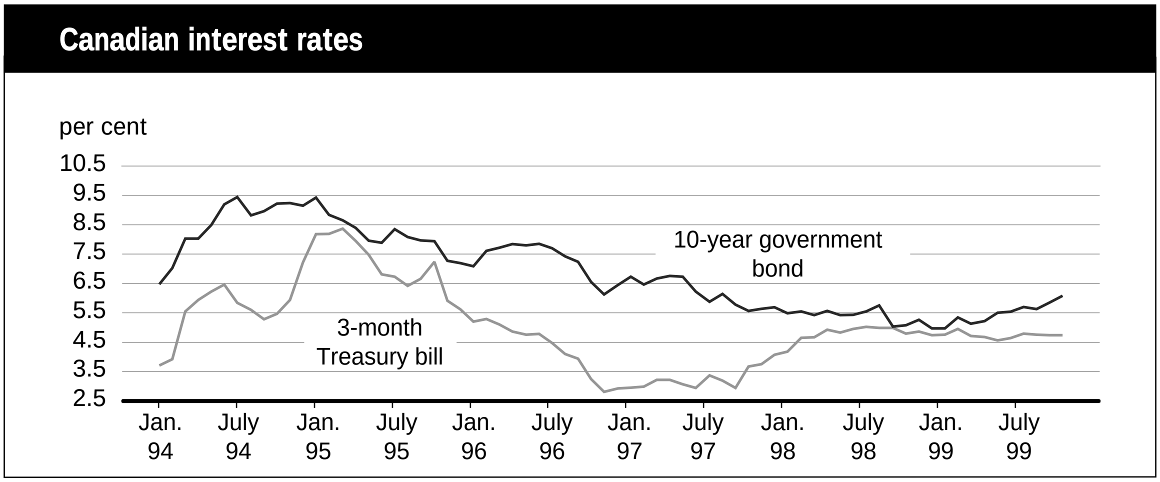


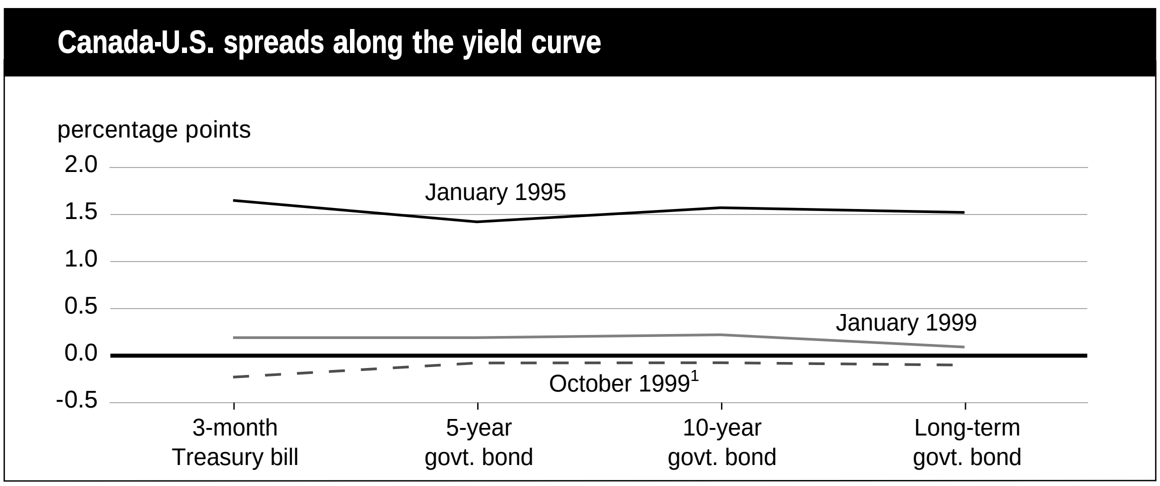
CPI inflation



- The improvement in our terms of trade has also boosted the aggregate price of Canada's GDP. On a quarter-over-quarter basis, the aggregate price of Canada's production increased an average 3.2 per cent (annual rate) over the first half of 1999.
- Consumer price inflation – the broadest measure of prices of goods and services purchased by Canadians – recently rose above the mid-point of the target band of 1 to 3 per cent established jointly by the Government and the Bank of Canada.
- However, the increase in consumer price inflation was mainly due to higher energy prices. Moreover, core inflation remains below the mid-point of the inflation target band.

Interest rates have edged up but remain low by historical and international standards



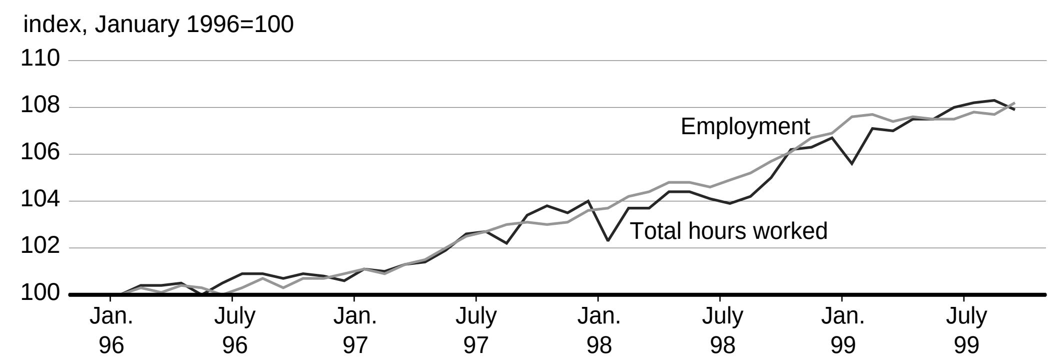


[1] Average of first two Wednesdays of October.

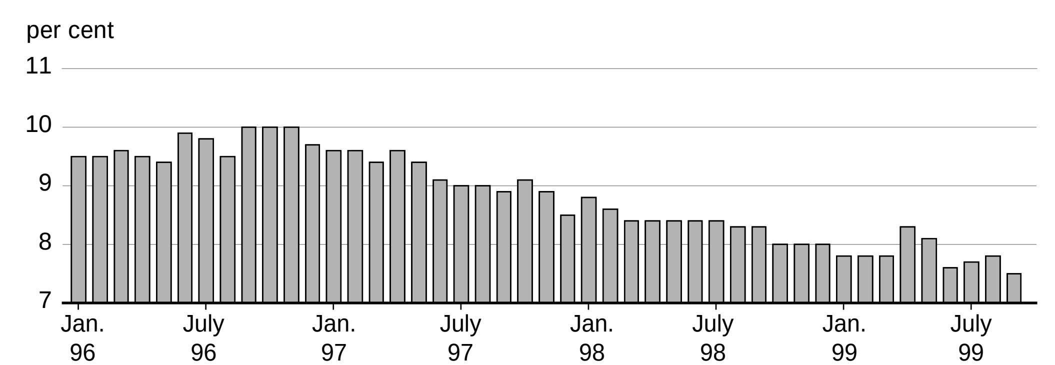
- The stronger-than-expected global economic performance, particularly in the U.S., has led to a drifting up in U.S. interest rates since the beginning of the year. Canadian interest rates, however, remain well below levels reached in the mid-1990s.
- Canadian interest rate increases since the beginning of the year have been more modest, consistent with our low inflation performance. Both short- and long-term rates, which had drifted above U.S. rates when the Asian crisis began, moved below U.S. rates in the spring of this year.

Labour market conditions remain healthy

Total employment and hours



Unemployment rate



- Employment growth has remained solid in 1999, with 173,200 jobs created over the first 9 months of the year for a total of 626,500 since the beginning of 1998.
- Although total employment growth has slowed somewhat from its exceptionally strong pace last year, growth in full-time employment has been stronger – up 1.9 per cent over the first 9 months of 1999 compared to 1.4 per cent over the same period in 1998. As a result, the number of hours worked since the beginning of the year has grown at roughly the same rate as over the same period in 1998.
- Moreover, jobs have been created across the country, with employment up in every province since the beginning of the year.
- Continued job growth pushed the unemployment rate down from 8.0 per cent at the end of 1998 to 7.5 per cent in September – the lowest rate since June 1990.

The external environment is expected to remain favourable to growth in Canada

Global outlook for real GDP growth

	1998	1999	2000
		(per cent)	
World	2.5	3.0	3.5
Japan	-2.8	1.0	1.5
Germany	2.3	1.4	2.5
France	3.2	2.5	3.0
United Kingdom	2.2	1.1	2.4
Italy	1.3	1.2	2.4

Source: IMF, *World Economic Outlook*, September 1999.

- Global economic prospects have improved significantly since the beginning of the year. The IMF has revised its forecast of global growth for 1999 from 2.2 per cent (December 1998 forecast) to 3.0 per cent (September 1999 forecast). Global growth is forecast to strengthen to 3.5 per cent in 2000.
- These upward revisions are due in part to the faster-than-expected recovery in a number of Asian economies, particularly Japan. The strength and durability of these recoveries, however, remain highly uncertain.
- Europe is expected to continue to post modest growth with low inflation over the short term.

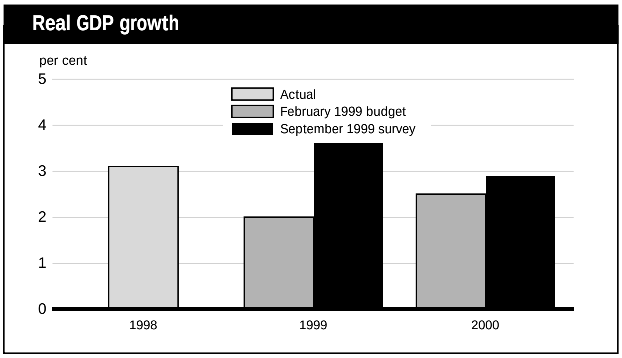
U.S. economic outlook

	1998	1999	2000
		(per cent)	
Real GDP	3.9	3.8	2.8
CPI	1.6	2.1	2.4
3-month Treasury bill rate	4.8	4.7	5.0
10-year government bond rate	5.3	5.6	5.9

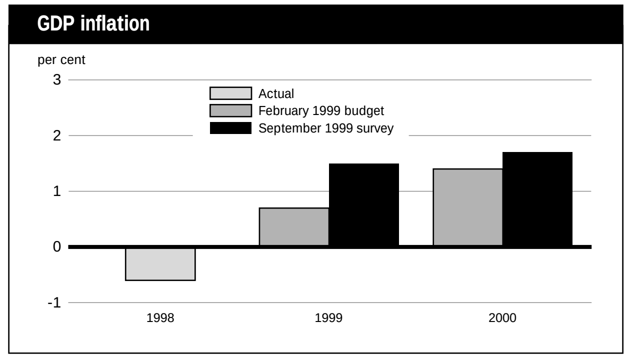
Source: *Blue Chip Economic Indicators*, October 1999.

- The strength of domestic demand in the United States continued to exceed expectations in the first half of 1999, resulting in substantial upward revisions to private sector growth forecasts. Real U.S. GDP growth is now expected to be almost 4 per cent in 1999 for the third successive year and to moderate to a more sustainable pace of 2.8 per cent in 2000.
- Despite much higher growth forecasts, expectations for consumer price inflation are virtually unchanged from earlier this year.
- Interest rate forecasts have been revised upwards, however, largely reflecting unanticipated increases so far this year.
- These expectations are consistent with the U.S. economy achieving a soft landing without further increases in market interest rates from current levels.

Canada's economic prospects for 1999 and 2000 have improved since the budget



Source: Department of Finance survey of private sector forecasters.



Source: Department of Finance survey of private sector forecasters.

Growth forecasts have been revised up

- The average private sector forecast for real GDP has been upgraded to 3.6 per cent for 1999 (from 2.0 per cent in the budget) and to 2.9 per cent for 2000 (from 2.5 per cent in the budget). This is consistent with the continuing strength of the U.S. expansion and robust Canadian domestic demand so far in 1999, and an easing in U.S. growth in 2000.
- The average forecast for GDP inflation is now 1.5 per cent for 1999, over double the rate expected in the budget. GDP inflation expectations for 2000 are also higher, up from 1.4 per cent in the budget to 1.7 per cent in September.
- Together, these changes result in upward revisions to nominal GDP forecasts in both 1999 and 2000. Nominal GDP projections are now $21 billion higher in 1999 and $28 billion higher in 2000 than private sector forecasters expected at the time of the budget.

Interest rate expectations are also up

- Substantial upward revisions to growth forecasts have been accompanied by more modest upward revisions to Canadian interest rate expectations.
- Short- and long-term interest rates are now forecast to average around 50 basis points higher in 1999 and 2000 than expected in the budget, mainly due to increases that have already taken place this year.
- These forecasts imply only modest increases in Canadian rates over the forecast horizon relative to current levels.

Evolution of the average private sector forecast for Canada[1]

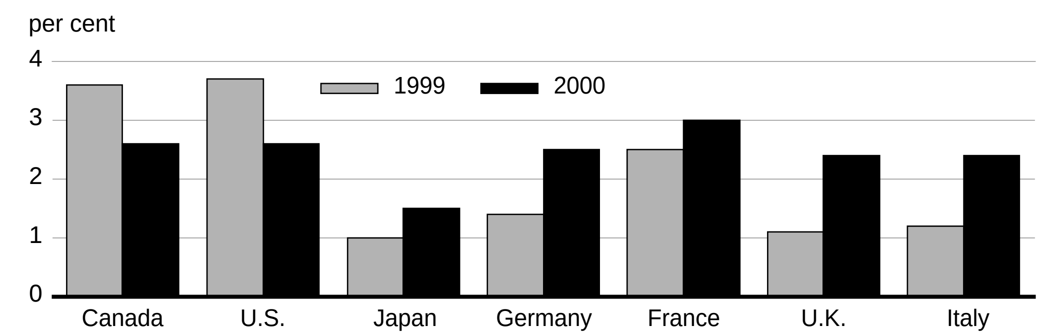
	1999	2000
	(per cent, unless otherwise indicated)	
Real GDP growth		
February 1999 budget	2.0	2.5
September 1999 survey	3.6	2.9
Difference	*1.6*	*0.4*
GDP inflation		
February 1999 budget	0.7	1.4
September 1999 survey	1.5	1.7
Difference	*0.8*	*0.3*
Nominal GDP growth		
February 1999 budget	2.7	3.9
September 1999 survey	5.1	4.6
Difference	*2.4*	*0.7*
Nominal GDP level ($ billions)		
February 1999 budget[2]	920	956
September 1999 survey	941	984
Difference	*21*	*28*
Employment growth		
February 1999 budget	1.9	1.6
September 1999 survey	2.5	1.7
Difference	*0.6*	*0.1*
Unemployment rate		
February 1999 budget	8.2	8.1
September 1999 survey	7.9	7.6
Difference	*-0.3*	*-0.5*
CPI inflation		
February 1999 budget	1.4	1.6
September 1999 survey	1.6	1.9
Difference	*0.2*	*0.3*
91-day Treasury bill rate		
February 1999 budget	4.4	4.5
September 1999 survey	4.8	5.1
Difference	*0.4*	*0.6*
10-year government bond yield		
February 1999 budget	5.1	5.4
September 1999 survey	5.6	5.8
Difference	*0.5*	*0.4*

[1] Average of 21 responses in September.

[2] Nominal GDP levels have been adjusted to reflect June 1999 revisions to Canada's National Income and Expenditure Accounts.

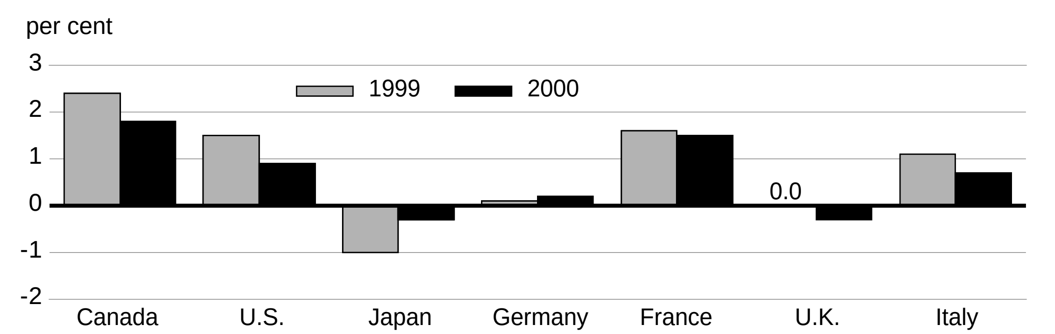
Canada is expected to be near the top of the G-7 in growth and to lead in job creation in 1999 and 2000

IMF forecasts for G-7 real GDP growth for 1999 and 2000



Source: IMF, *World Economic Outlook*, September 1999.

IMF forecasts for G-7 employment growth for 1999 and 2000



Source: IMF, *World Economic Outlook*, September 1999.

- Major international organizations are very positive about Canada's prospects for real GDP and employment growth.
  - In its September forecast, the IMF expects Canada's real GDP growth to be second among the G-7 countries in both 1999 and 2000.
  - And the IMF expects Canada to be well ahead of the other G-7 countries in terms of the pace of employment growth in both these years.

2

The Restoration of Fiscal Health in Canada

Highlights

"Thanks to the efforts of Canadians, this country is in the process of achieving a financial turnaround of historic proportions."

"In the space of only four years, the deficit was eliminated."

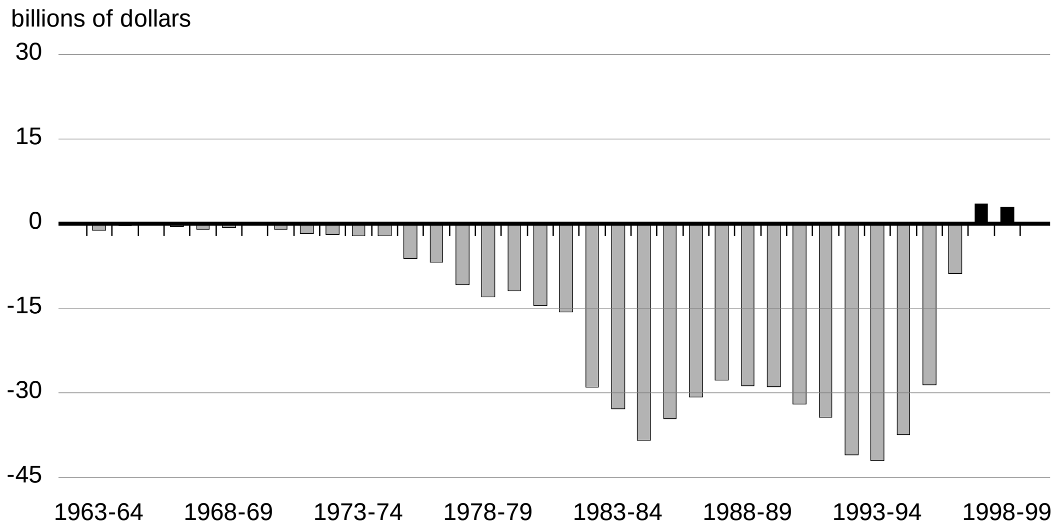
"… clearly, Canada has entered a new era, one of financial surplus. And clearly, a great debate is now underway as to how these surpluses should be used."

The Honourable Paul Martin
Minister of Finance

- *The federal government recorded its second consecutive budgetary surplus in 1998-99, the first back-to-back surpluses since 1951-52.*
- *Fiscal progress since 1993-94 has been due to a reduction in program spending and a growing economy.*
- *Federal program spending as a percentage of gross domestic product (GDP) has fallen to 12.4 per cent, its lowest level since 1949-50.*
- *The federal debt-to-GDP ratio declined to 64.4 per cent in 1998-99 from its peak of 71.2 per cent in 1995-96. This marks the third consecutive annual decline in the debt-to-GDP ratio.*
- *Federal market debt has declined $16.4 billion in the past two years.*
- *The amount of every dollar of revenue collected by the federal government that is used to pay interest on the public debt declined to 27 cents in 1998-99 from 36 cents in 1995-96. However, this amount is still twice as high as that of the provincial and territorial governments.*
- *Seven provinces and one territory achieved a balanced budget or surplus in 1998-99.*
- *On a total government basis, between 1992 and 1998, Canada achieved the largest improvement in its financial balance of all the Group of Seven (G-7) countries.*
- *In this period, Canada also recorded the largest reduction in program spending in the G-7.*
- *Canada's fiscal challenge now is to continue to reduce its debt-to-GDP ratio, which remains high by historical and international standards.*

A new era of budget surpluses

Federal budgetary balance
(Public Accounts basis)



- After recording uninterrupted deficits from 1970-71 to 1996-97, the federal government posted a surplus of $3.5 billion in 1997-98. This has been followed up with a surplus of $2.9 billion in 1998-99
- This marks the first back-to-back surpluses in nearly half a century. This achievement – remarkable in itself – is all the more impressive in light of the $42-billion deficit recorded in 1993-94.

Commitment to balanced budget or better met again in 1998-99

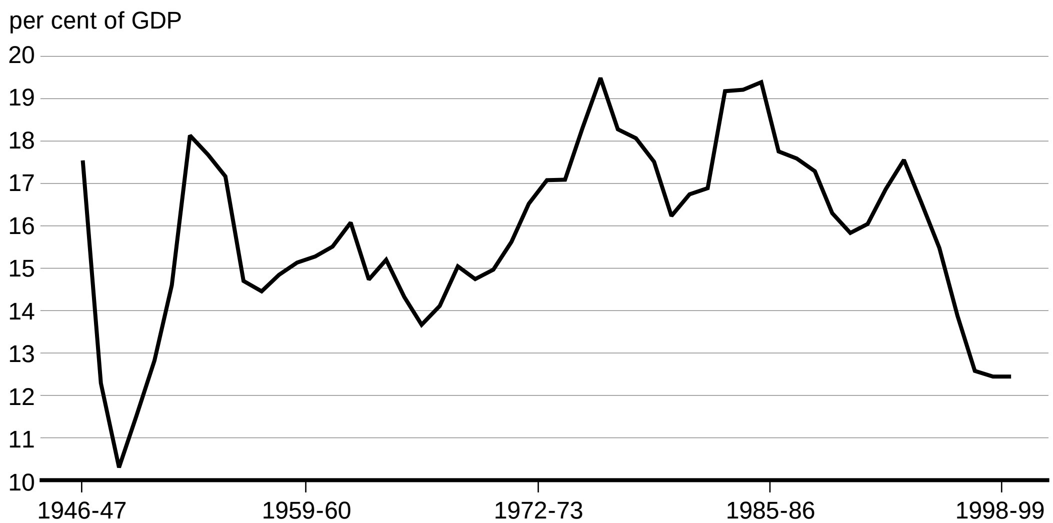
Comparison of 1998-99 outcomes to the 1999 budget estimates

	1999 budget estimate	1998-99 outcome	Difference
		(billions of dollars)	
Revenues	156.5	155.7	-0.8
Program spending	112.1	111.4	-0.7
Public debt charges	41.4	41.4	0.0
Contingency Reserve	3.0		-3.0
Budgetary balance	0.0	2.9	2.9

- The federal government's budgetary target for 1998-99, as set out in the 1999 budget, was a balanced budget.
- However, under the Debt Repayment Plan, this target included a $3-billion Contingency Reserve.
- Budget revenues were $0.8 billion lower than estimated in the 1999 budget. Most of this shortfall was attributable to transfers from personal income tax revenues to the Provincial Taxation Agreements Account, reflecting underpayments with respect to the 1997 and 1998 taxation years, and to lower corporate income tax revenues, reflecting weakness in corporate profits in 1998.
- However, program spending – total expenditures less public debt charges – was $0.7 billion lower than estimated in the 1999 budget, primarily reflecting lower direct program spending (total program spending less major transfers to persons and other levels of government).
- Public debt charges were identical to the budget estimate.
- As a result, virtually all of the Contingency Reserve went to the bottom line, resulting in a budgetary surplus of $2.9 billion.
- Net public debt has now been paid down by a total of $6.4 billion over two years.

Program spending has declined as a share of GDP

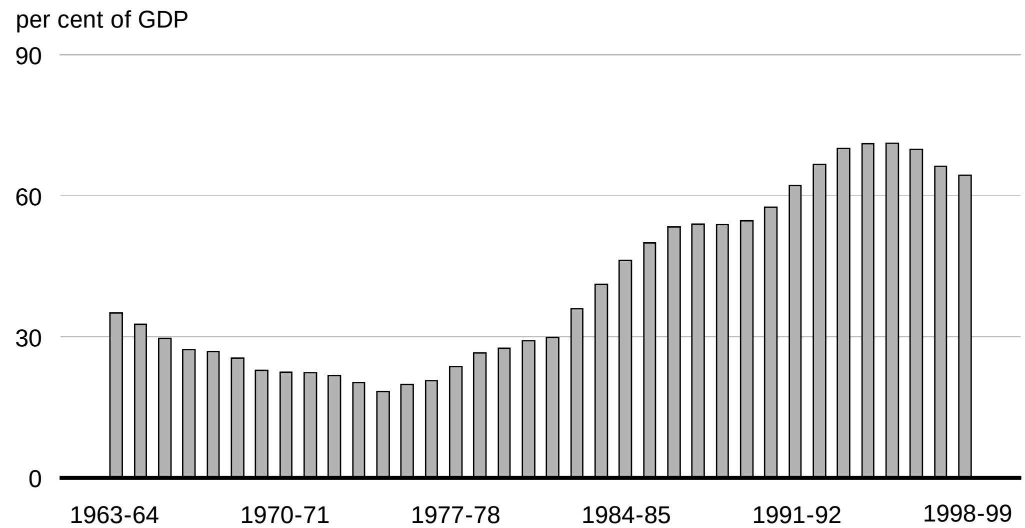
Federal program spending as a percentage of GDP
(Public Accounts basis)



- The reforms to federal program spending undertaken since 1993-94, coupled with strong economic growth, have reduced program spending as a percentage of GDP to 12.4 per cent. This is the lowest ratio of program spending to GDP since the Second World War demobilization.
- Since 1993-94, the ratio has declined 4.2 percentage points. This decline was primarily the result of a fundamental review of all federal government programs, beginning with the 1994 budget and followed up in the 1995 and 1996 budgets. This review was conducted in two parts: most components of direct program spending (total program spending less major transfers to persons and other levels of government) were subject to the Program Review exercises, while employment insurance benefits and major transfers to other levels of government were reviewed separately to ensure that they would be sustained over the long term.
- The reduction in program spending has accounted for most of the fiscal turnaround, as a percentage of GDP, since 1993-94. The improvement in the Government's financial position has enabled it to make a number of significant investments in the 1998 and 1999 budgets. Over three quarters of these investments reflect two of the highest priorities of Canadians – increased funding for health care and access to knowledge and education.

The debt-to-GDP ratio is down for the third consecutive year

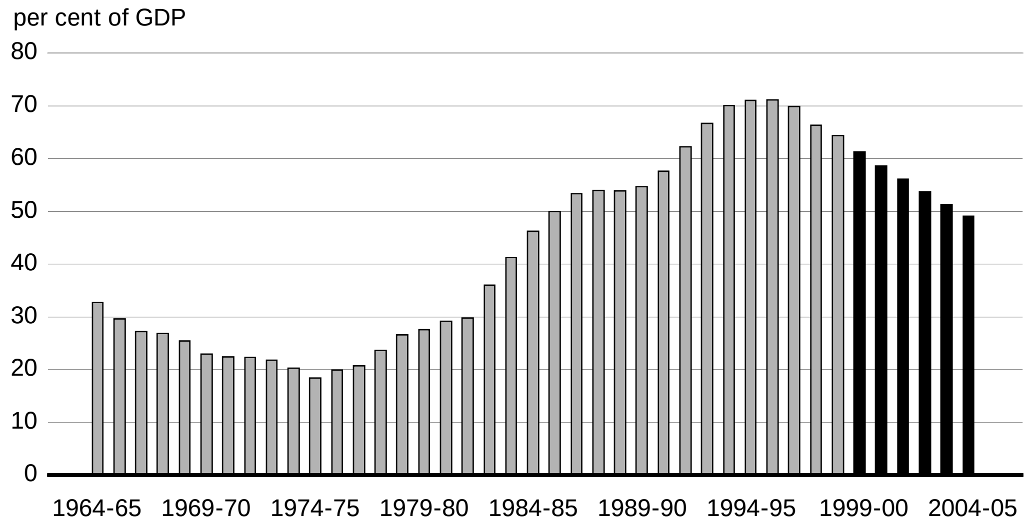
Federal debt-to-GDP ratio
(Public Accounts basis)



- The best indicator of the burden of debt is not the absolute level of debt but its relation to the size of the economy (the debt-to-GDP ratio). The debt-to-GDP ratio provides a measure of the ability of the economy to service the debt. Just as a household with a larger income can finance a larger mortgage, a country with a larger economy can service a larger debt.
- In 1998-99, the federal debt-to-GDP ratio fell to 64.4 per cent, a 1.9-percentage-point decline from its 1997-98 level.
- 1998-99 marked the third consecutive year in which the debt-to-GDP ratio declined. From its peak of 71.2 per cent in 1995-96, the debt-to-GDP ratio has now fallen 6.8 percentage points.

The debt-to-GDP ratio is on a permanent downward track

Federal debt-to-GDP ratio
(Public Accounts basis)



- Although declining, the federal debt-to-GDP ratio remains high by historical Canadian standards and in relation to other countries. Through its Debt Repayment Plan and sustained economic growth, the Government is committed to ensuring that the debt-to-GDP ratio continues to decline.
- Based on the medium-term private sector economic projections discussed in Annex 3 and an annual balanced budget, the debt-to-GDP ratio is projected to decline to under 50 per cent by 2004-05.
- A lower debt burden means that a smaller percentage of revenues goes to servicing the debt; it means more money is available to address the key priorities of Canadians, including tax reductions; it means that Canada is less vulnerable to worldwide interest rate shocks; and it means that the legacy left to future generations is one of sound social and economic programs, not one of high debt and high taxes.

Financial surplus of $11.5 billion in 1998-99

Federal budgetary surplus and financial surplus
(Public Accounts basis)

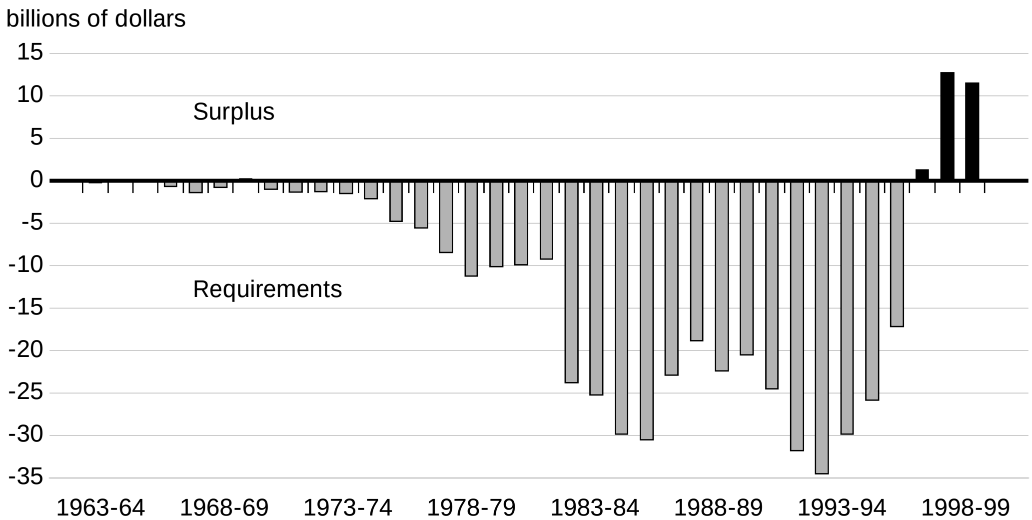
	1997-98	1998-99
	(billions of dollars)	
Budgetary surplus	3.5	2.9
Non-budgetary transactions		
Pension and other	3.8	7.0
Loans, investments and advances	2.0	0.5
Other transactions	3.4	1.1
Total	9.3	8.6
Financial surplus (excluding foreign exchange transactions)	12.7	11.5

Note: Numbers may not add due to rounding.

- Another important measure of the federal government's financial position is financial requirements/surplus, which measures the difference between cash received and cash disbursed.
- The adjustments required to convert the budgetary balance to financial requirements/surplus are included in non-budgetary transactions. The largest adjustment relates to the federal government employee pension accounts, which report the net flow of funds into these accounts. Other non-budgetary categories include the net change in the Government's loans, investments and advances (relating primarily to its enterprise Crown corporations and to sovereign governments). Other transactions primarily include the adjustments to convert the accrual figures included in the budgetary balance to a cash basis.
- The budgetary balance for 1998-99 was $2.9 billion. Adding non-budgetary transactions amounting to $8.6 billion, the financial surplus (excluding foreign exchange transactions) for 1998-99 was $11.5 billion, following a financial surplus of $12.7 billion in 1997-98.

Financial surplus for the third consecutive year

Federal government financial balance (excluding foreign exchange transactions)
(Public Accounts basis)



- 1998-99 marked the third consecutive year that the federal government recorded a financial surplus (excluding foreign exchange transactions).
- Moreover, the financial surpluses recorded in the past three years stand in sharp contrast to the large requirements observed from the mid 1970s through the mid 1990s.
- Financial requirements/surplus is a measure of the Government's financial position that is broadly comparable to the measures of budgetary balance used by other major industrialized countries, including the United States. On this basis, Canada, the United States and the United Kingdom were the only G-7 countries in surplus positions in 1998-99 (measured in terms of their respective fiscal years).

Market debt reduced by $16.4 billion in the past two years

Federal government financial assets and liabilities
(Public Accounts basis)

	1996-97	1998-99	Change: 1996-97 to 1998-99
		(billions of dollars)	
Interest-bearing debt			
Market debt	476.9	460.4	-16.4
Public sector pensions/other accounts	123.7	134.6	10.9
Total	600.6	595.0	-5.6
Current liabilities and allowances	40.1	45.3	5.2
Financial assets[1]	-57.5	-63.5	-6.0
Net public debt	583.2	576.8	-6.4

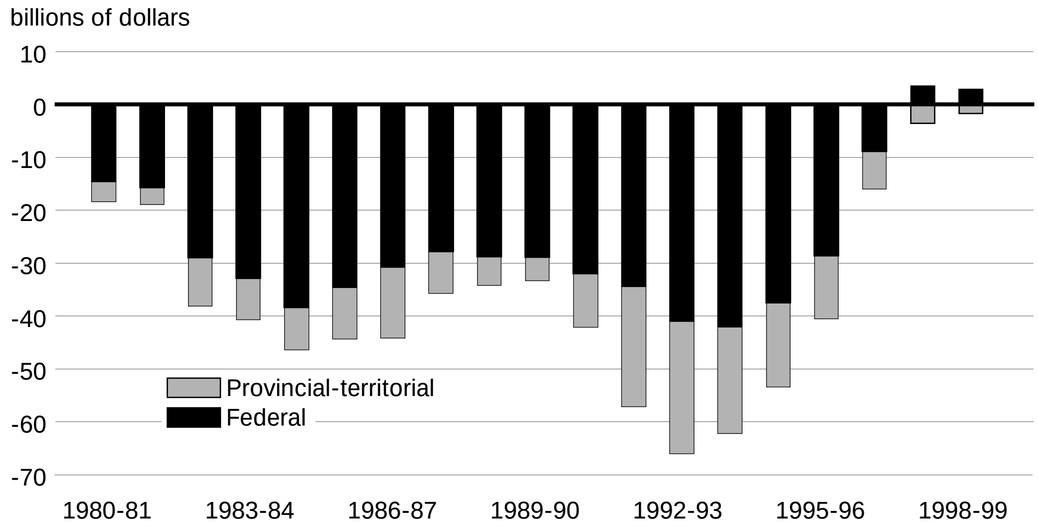
Note: Numbers may not add due to rounding.

[1] Financial assets are shown as a negative entry because they reduce the net debt.

- Net public debt consists of interest-bearing debt, current liabilities and allowances (primarily accounts payable) and financial assets (cash, accounts receivable, assets in the foreign exchange account, investment in Crown corporations and loans to other governments). Interest-bearing debt consists of market debt and the government's liabilities to federal employee pension plans and other accounts. In 1998-99, the federal government's net public debt was $576.8 billion, down $6.4 billion from the 1996-97 level.
- Market debt refers to debt issued on credit markets in the form of Government of Canada bonds, Canada Savings Bonds and Treasury bills. In 1998-99, the level of market debt declined $16.4 billion from the 1996-97 level, while public sector pensions and other accounts increased $10.9 billion.

The aggregate federal-provincial-territorial budget was in surplus in 1998-99

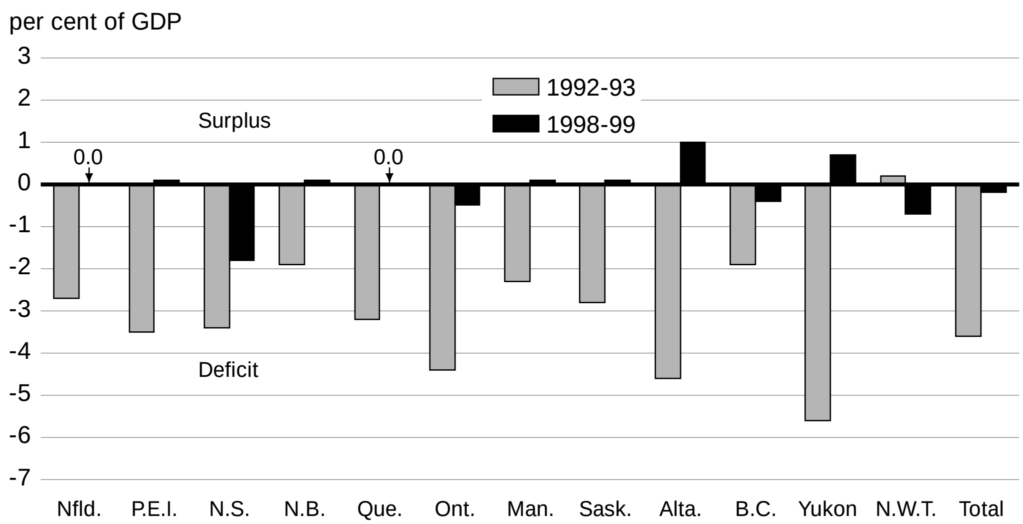
Total federal and provincial-territorial surplus / deficit (-)
(Public Accounts basis)



- The federal, provincial and territorial governments combined recorded a budget surplus of $1.2 billion in 1998-99. This represents a sharp improvement from a total federal-provincial-territorial government sector deficit of $66 billion in 1992-93.
- In 1997-98, the surplus at the federal level almost offset the aggregate provincial-territorial deficit. In 1998-99, however, the federal surplus was larger than the provincial-territorial deficit.
- The federal budget balance improved from a deficit of $42 billion in 1993-94 to a surplus of $2.9 billion in 1998-99.
- From its peak of $25 billion in 1992-93, the provincial-territorial deficit fell to $1.7 billion in 1998-99.

Most of the provinces and territories realized balanced budgets in 1998-99

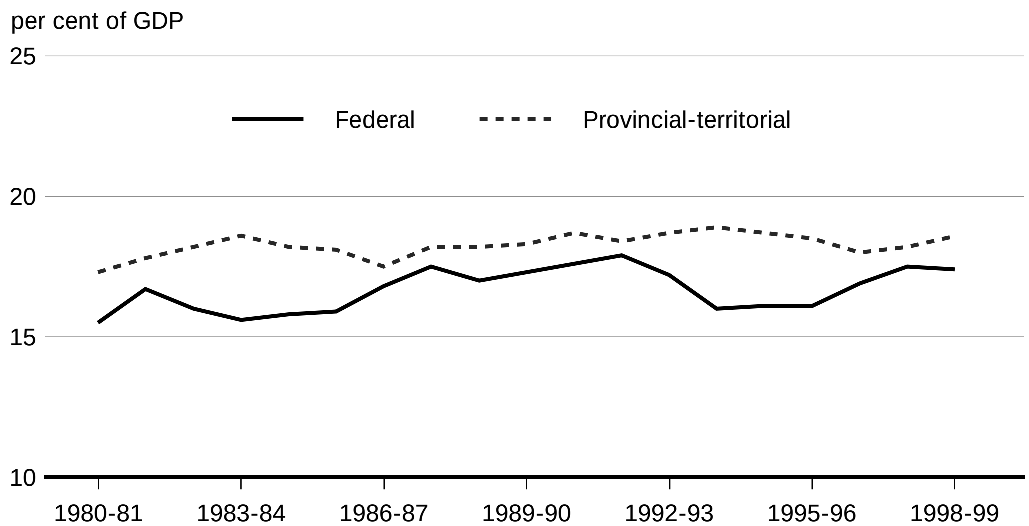
Provincial-territorial budgetary balances



- Seven provinces and one territory realized a balanced budget or surplus in 1998-99.
- This represents a substantial improvement from 1992-93, when all but one of the 12 provincial-territorial budgets (Northwest Territories) were in deficit.

Government revenues have been relatively stable as a share of GDP

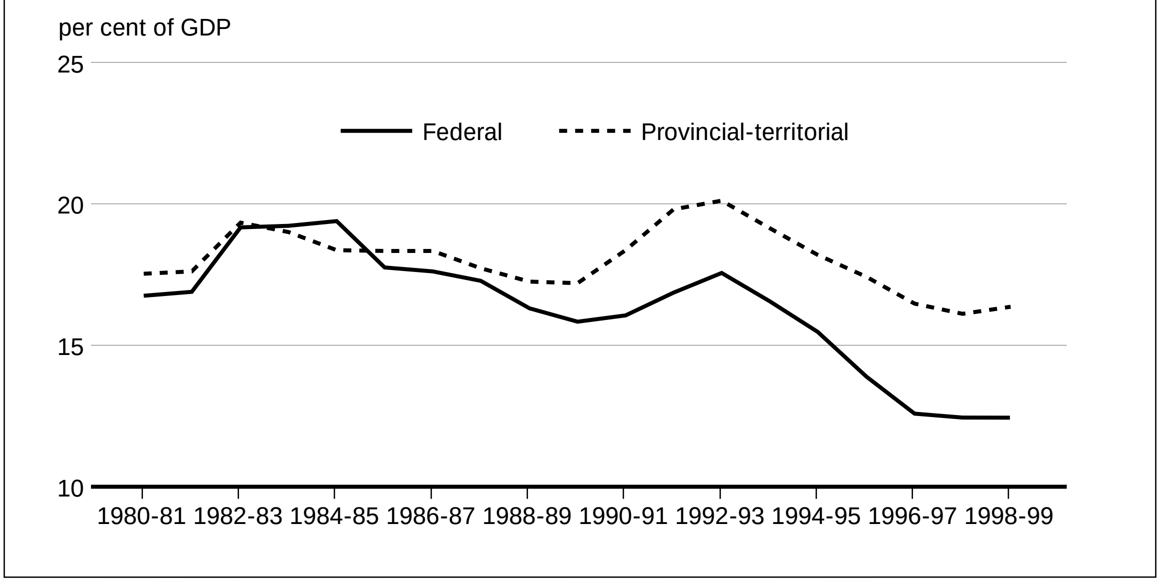
Federal and provincial-territorial revenues
(Public Accounts basis)



- The 1998-99 revenue-to-GDP ratio of both sectors is similar to the ratio in the early 1990s, i.e., before the fiscal consolidation effort.
- For the last 20 years, provincial-territorial revenues have consistently exceeded federal revenues.

Program spending has declined significantly as a share of GDP

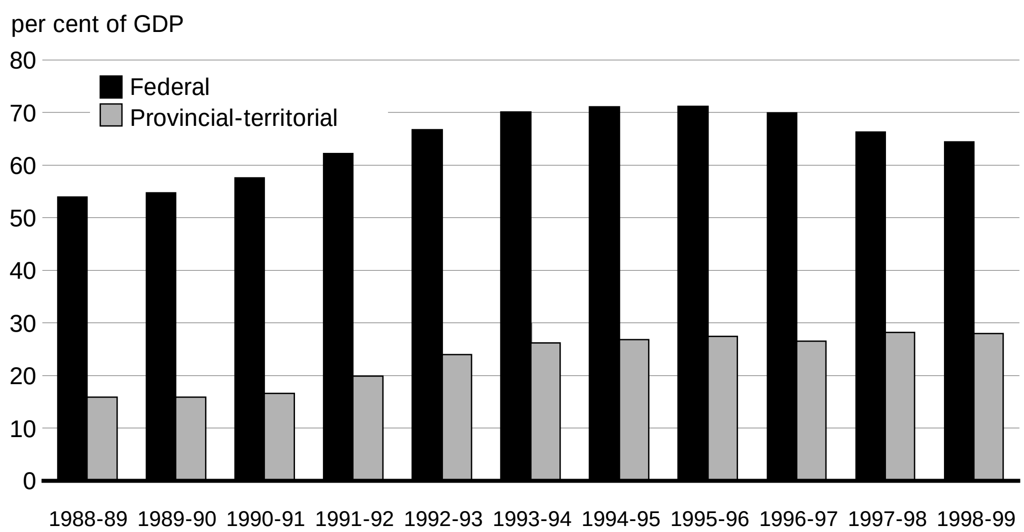
Federal and provincial-territorial program spending
(Public Accounts basis)



- At both levels of government, deficit reduction has been achieved primarily through program spending reductions.
- From 1992-93 to 1998-99, federal program spending as a per cent of GDP fell by 5.1 percentage points – from 17.5 per cent to 12.4 per cent. Provincial-territorial program spending as a share of GDP fell by 3.7 percentage points – from 20.1 per cent to 16.4 per cent.
- New federal and provincial-territorial budget initiatives, primarily in the areas of health and education, increased the absolute level of spending in 1998-99. However, as a per cent of GDP, program spending remained relatively flat that year.

The federal debt-to-GDP ratio is declining, but is still more than twice the provincial-territorial ratio

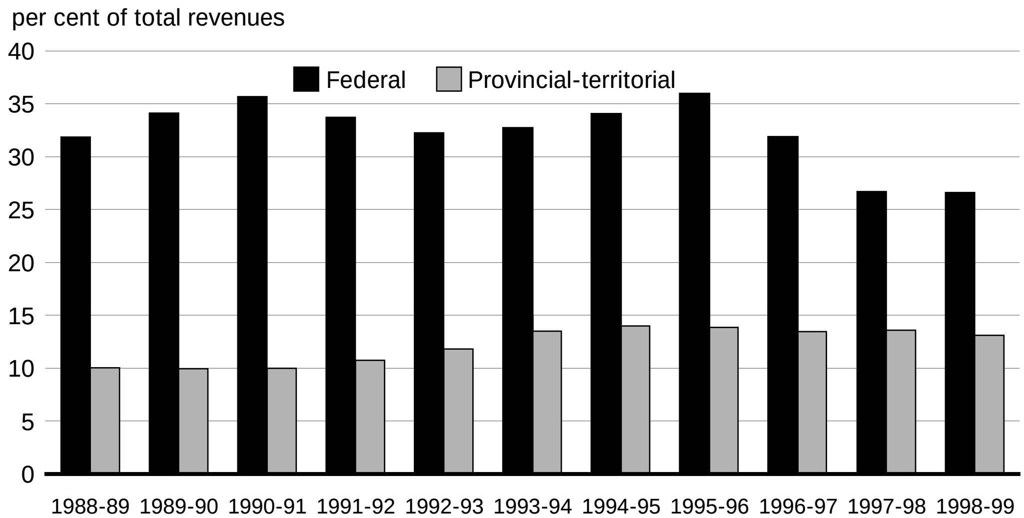
Federal and provincial-territorial net debt
(Public Accounts basis)



- Throughout the past decade, the federal debt burden has been more than twice as high as the provincial-territorial debt burden.
- In 1998-99, the federal debt-to-GDP ratio decreased substantially to 64.4 per cent from its peak of 71.2 per cent in 1995-96.
- The provincial-territorial ratio is estimated to have declined marginally in 1998-99 to 28.0 per cent of GDP.

Debt charges as a per cent of total revenues are significantly higher at the federal level

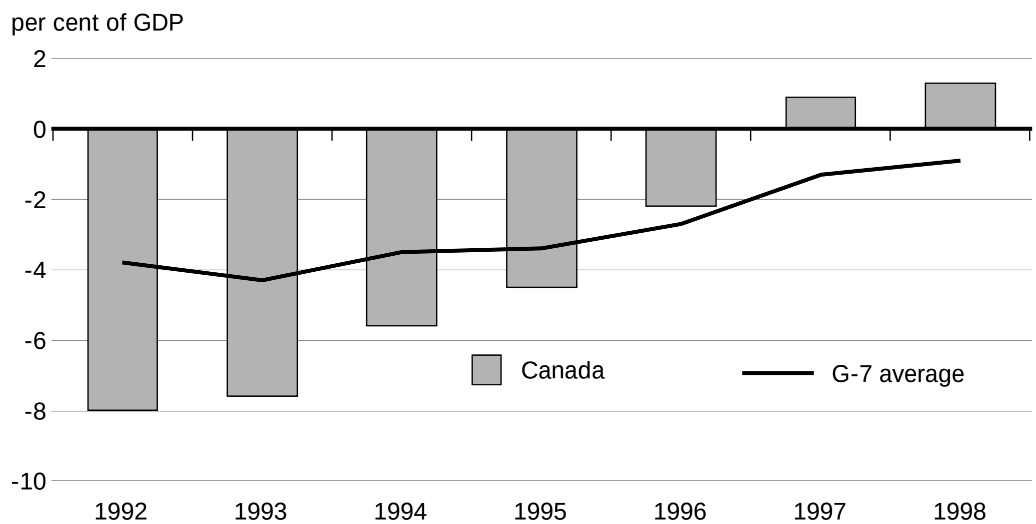
Federal and provincial-territorial debt charges
(Public Accounts basis)



- Because of its larger debt burden, the federal government faces much higher debt charges than the provincial-territorial sector.
- This means that the federal government spends a larger proportion of its revenues on debt charges than the provinces and territories.
- In 1995-96, the federal government spent 36 cents of every dollar of revenue on debt charges. Although significant progress has been made in reducing this burden, federal debt charges still consume 27 cents of every dollar of revenue, compared to about 13 cents for the provincial-territorial level.

Canada's budget balance has steadily improved compared to the G-7

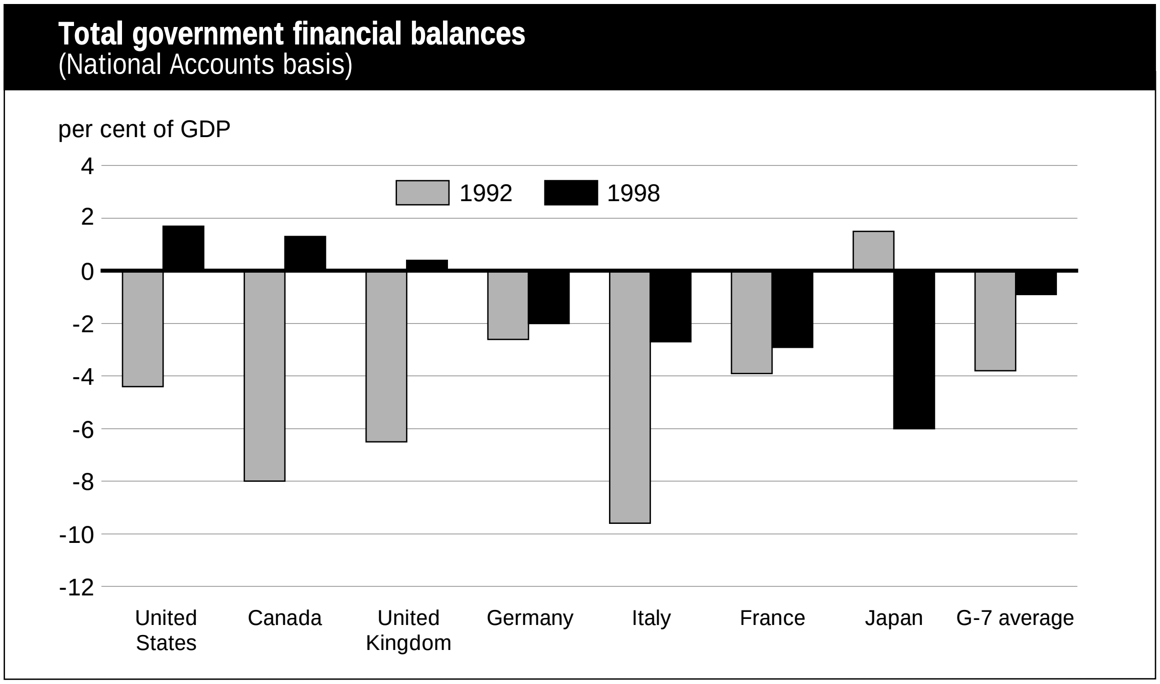
Total government financial balances
(National Accounts basis)



Source: *OECD Economic Outlook No. 65,* June 1999.

- On a National Accounts basis, a measure used by the Organization for Economic Co-operation and Development (OECD) to make comparisons across countries, Canada's overall budget balance has made steady improvements since 1992.
- In 1992, Canada's total government deficit (including federal, provincial and local governments, as well as the balances in the Canada Pension Plan and Quebec Pension Plan) amounted to 8 per cent of GDP, twice the G-7 average.
- In 1998, Canada had a surplus (for the second consecutive year) of almost 1.5 per cent of GDP compared to an average deficit of 1 per cent of GDP for the G-7 countries.

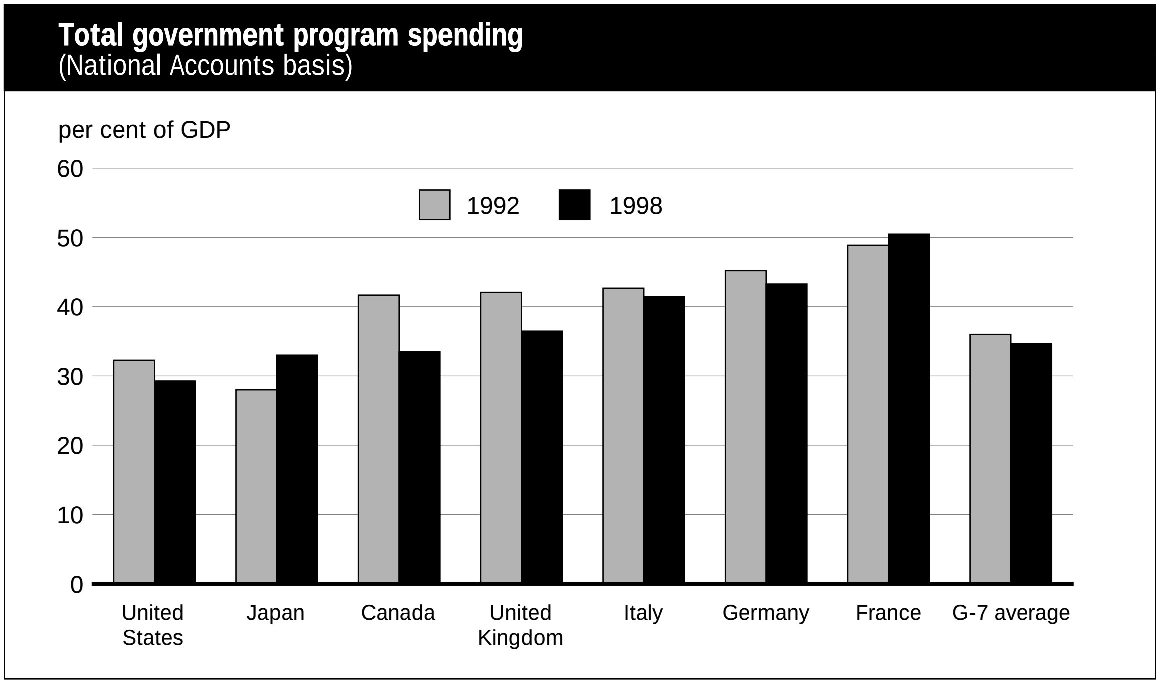
Canada has achieved the largest improvement in its financial balance of all the G-7 countries



Source: *OECD Economic Outlook No. 65,* June 1999.

- In 1992, Canada had the second highest total government deficit among the G-7 countries. However, in 1998, Canada was one of three G-7 countries to report a surplus, recording the second largest surplus after the United States.
- Looking at the change since 1992, the improvement in Canada's financial balance has been the best among the G-7 countries.

The reduction in Canada’s program spending as a share of GDP has been the largest of the G-7 countries

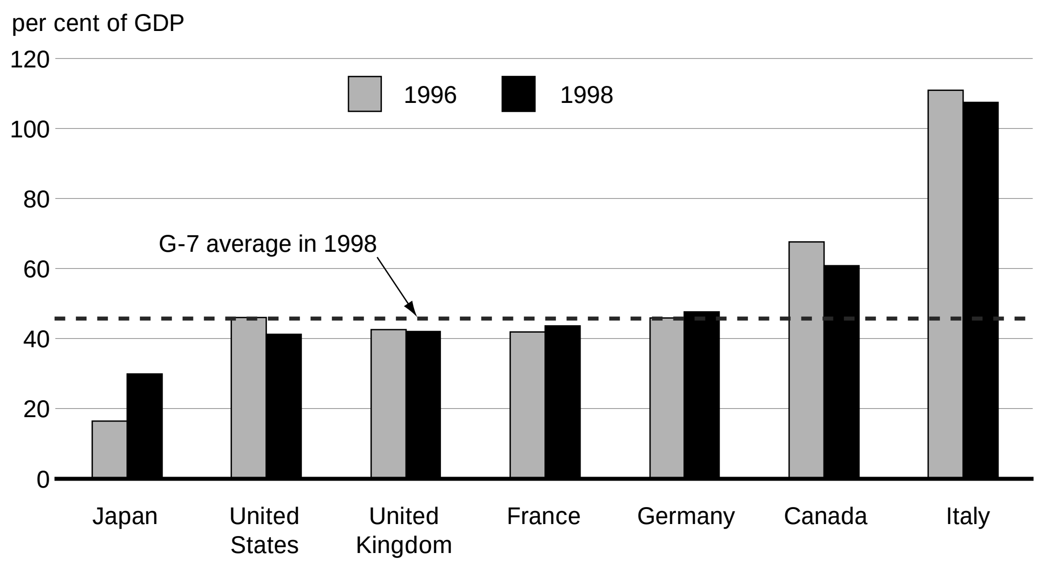


Source: *OECD Economic Outlook No. 65,* June 1999.

- The rapid turnaround in Canada’s fiscal position is attributable to a sharp reduction in program spending, i.e., all expenditures less gross debt charges.
- Between 1992 and 1998, Canada’s total government program spending in relation to the size of its economy fell by 8.3 percentage points.
- In fact, Canada’s program spending has fallen much faster than in any other G-7 country.

Canada's debt burden is falling but remains high

Total government net debt
(National Accounts basis)



Source: *OECD Economic Outlook No. 65,* June 1999.

- In the past few years, Canada has experienced the largest decline in the debt-to-GDP ratio in the G-7.
- But Canada's debt burden is still significantly above the G-7 average: it ranks second highest after Italy.

3

Canada's Medium-Term Economic and Fiscal Prospects

Highlights

"… in order to establish greater common ground, the Department of Finance, over the past several months, has conducted an unprecedented process of consultation with the chief economists of Canada's major chartered banks and four leading forecasting firms."

"… we now have the financial context for the debate that lies before us."

"… clearly, a great debate is now underway as to how these surpluses should be used."

"… as a parliament and as a people we should debate the use of the surplus over the longer term. … As a government, however, we will continue to take decisions only within a rolling two-year time horizon …"

The Honourable Paul Martin
Minister of Finance

- *The projections of the fiscal surplus are based on an unprecedented exercise with private sector economists. The objective was to agree upon a set of economic assumptions for planning purposes which the private sector forecasters would then use to develop projections of the fiscal surplus for each of the next five years.*
- *In addition, the private sector economists recommended, and the Government agrees, that:*
  - *the practice of setting aside $3 billion each year as a Contingency Reserve to guard against unforeseen developments will continue and that this reserve, if not needed, will be used to pay down the debt;*
  - *the fiscal projections will continue to include an extra degree of economic prudence to provide further assurance against going back into a deficit;*
  - *this prudence will be clearly and explicitly shown; and*
  - *for the purposes of public debate on policy options, a five-year rather than a two-year time horizon is now appropriate.*
- *However, because of the greater degree of uncertainty associated with longer-term projections, budget decisions will continue to be made on a rolling two-year time horizon.*
- *After subtracting the Contingency Reserve and economic prudence from the average private sector forecast of the surplus, in the absence of any new policy decisions, the surplus for budget planning purposes is $5.5 billion in 2000-01 and $8.5 billion in 2001-02, reaching $23.0 billion in 2004-05.*

Increasing transparency in budget planning

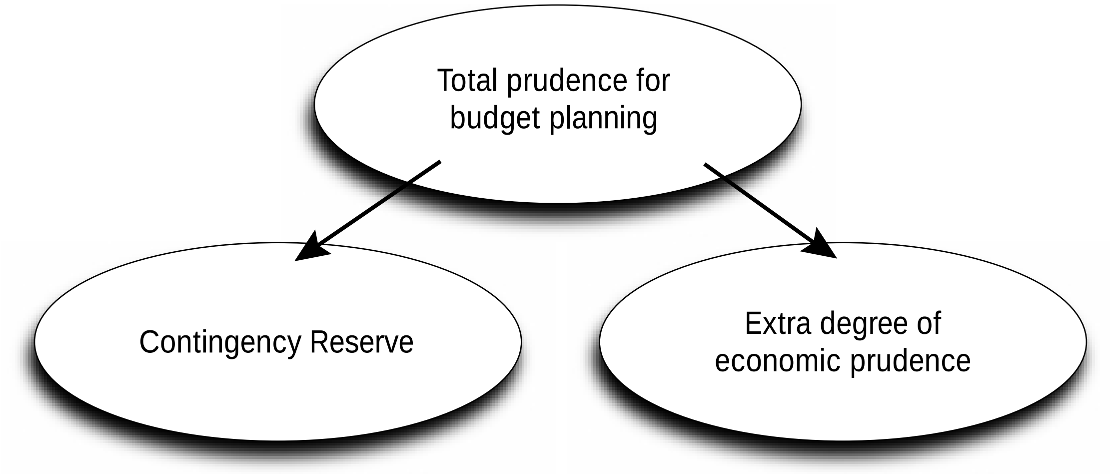
Planning process to date

- When the Government came into office in 1993, there was a lack of credibility in the federal government's budget plans. This was the result of too many years of optimistic forecasts and missed deficit targets.
- One of the first steps that the Government took to restore credibility in federal budget planning was to adopt a prudent approach to budget planning, which is now reflected in the Debt Repayment Plan. This consists of three key elements:
  - two-year budget plans based on prudent economic planning assumptions;
  - the inclusion in the budget plan of an annual Contingency Reserve; and
  - the use of the Contingency Reserve, when it is not needed, to pay down the public debt.
- This approach helped the Government better its fiscal targets each and every year since 1993-94. It resulted in a surplus of $3.5 billion in 1997-98, followed by a surplus of $2.9 billion in 1998-99.

New approach to budget consultations and planning

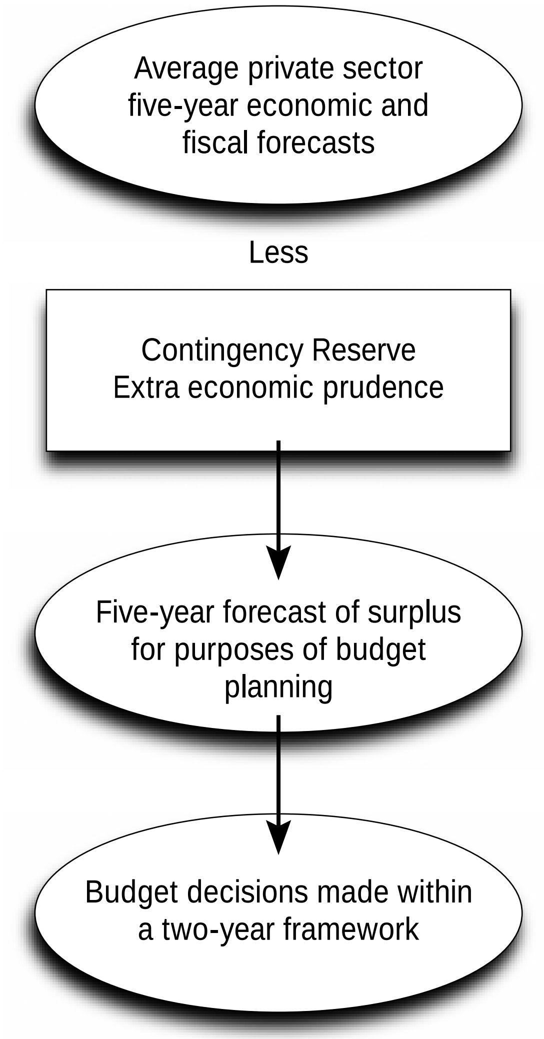
- Over the spring and fall of 1999, the Department of Finance conducted an unprecedented consultation process with the chief economists of Canada's major chartered banks and four leading economic forecasting firms.
- The purpose was to:
  - agree upon a set of economic assumptions for budget planning purposes; and
  - engage the four economic forecasting firms to use these assumptions to develop projections of the surplus for each of the next five years, based on current tax and spending policies.
- It was the view of the private sector economists that, for the purposes of public debate on policy options, a five-year time horizon was now appropriate.
- However, the economists agreed that great caution is warranted in the use of long-term projections as a basis for budget decisions. Therefore, budget decisions will continue to be made on a rolling two-year horizon.

Prudence remains an essential feature of budget planning



- The private sector economists recommended that the Government's prudent approach to budget planning be maintained. This includes:
  - continuing to use the average of private sector economic forecasts for budget planning purposes;
  - continuing the practice of setting aside an annual $3-billion Contingency Reserve. The Contingency Reserve is included primarily to cover risks arising from unavoidable inaccuracies in the models used to translate economic assumptions into detailed fiscal forecasts and unpredictable events. The Contingency Reserve also provides an extra measure of backup against adverse errors in the economic forecast. It is not a source of funding for new policy initiatives. If not needed, it will be used to pay down the public debt; and
  - continuing to add an extra degree of economic prudence to provide further assurance against falling back into a deficit.
- In the past, this extra degree of prudence was embedded in the revenue and spending projections. As a result, the exact dollar amount of this prudence was not explicitly identified, which made it difficult to judge the credibility of the key components of the fiscal projections.
- The private sector economists recommended, and the Government agrees, that this extra prudence be clearly and explicitly shown.

Summary: framework for fall update and budget



- In summary, for the purposes of public debate and for budget planning purposes, the Government will:
  - present the average private sector five-year projections of the fiscal surplus, which are based on a common set of economic assumptions;
  - include a $3-billion Contingency Reserve, which if not needed, will be applied to reducing the debt; and
  - include an extra degree of prudence, which will be shown explicitly.
- However, as in the past, budget decisions will continue to be made within a rolling two-year planning horizon, reflecting the difficulties in forecasting economic events over a longer period.

Economic assumptions

Average of private sector projections[1]

	1999	2000	2001	2002-2005
		(per cent)		
Real GDP growth	3.6	2.9	2.7	2.7
GDP inflation	1.5	1.7	1.9	1.8
Nominal GDP growth	5.1	4.6	4.6	4.5
CPI inflation	1.6	1.8	1.9	1.8
3-month Treasury bill rate	4.8	5.1	5.1	4.9
10-year government bond rate	5.6	5.8	5.8	5.6

[1] These averages are based on 21 forecasts in 1999 and 2000, 16 forecasts in 2001, 9 forecasts in 2004 and 5 forecasts in 2005.

- As detailed in Annex 1, the average private sector near-term outlook calls for a modest slowing in real GDP growth in tandem with slowing in the U.S. economy. Canadian interest rates are expected to increase only modestly over this period.
- Over the medium term, private sector forecasters, on average, expect economic growth in Canada to continue at a healthy pace. The average private sector forecast for real GDP growth over the 2001 to 2005 period is 2.7 per cent, only slightly below growth expected in 2000.
- GDP inflation is forecast to remain virtually unchanged at around 1.8 per cent over the same period. Nominal GDP growth is therefore expected to average 4.5 per cent between 2001 and 2005.
- Interest rates are also expected to remain relatively flat over the medium term, reflecting inflation expectations near the mid-point of the target band of 1 to 3 per cent jointly established by the Bank of Canada and the Government.
- While the average private sector forecast provides a reasonable basis for fiscal planning, there are risks to the outlook. Moreover, experience shows that the degree of uncertainty increases with the forecast horizon, in large part because the range of risks widens over time.

Extra economic prudence included in past budgets

	Year 1	Year 2
Average prudence: 1995-1997 budgets		
Nominal GDP growth (percentage points)	0.1	0.5
Three-month Treasury bill rate (basis points)	70	70
Ten-year government bond rate (basis points)	60	40
Fiscal impact (billions of dollars)	1.0	2.3
Prudence: 1998 budget		
Nominal GDP growth (percentage points)	0.6	1.0
Three-month Treasury bill rate (basis points)	80	100
Ten-year government bond rate (basis points)	50	100
Fiscal impact (billions of dollars)	1.4	3.7
Prudence: 1999 budget		
Nominal GDP growth (percentage points)	0.2	0.6
Three-month Treasury bill rate (basis points)	70	70
Ten-year government bond rate (basis points)	50	50
Fiscal impact (billions of dollars)	0.8	2.1

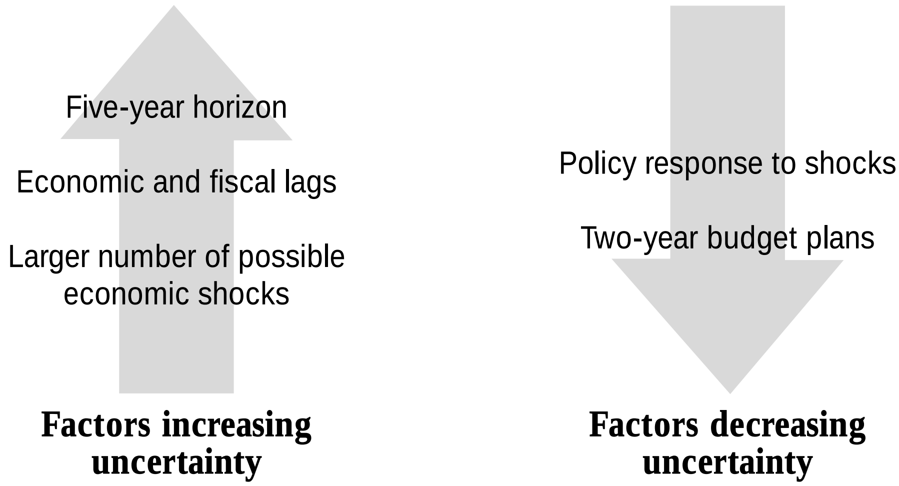
- Since the 1995 budget, the Government has incorporated both a Contingency Reserve and an extra amount of prudence in the economic assumptions used for fiscal planning. The extra prudence insured against the risk that the economic projections would not be realized.

- For the 1995, 1996 and 1997 budgets, short-term interest rates were assumed to be an average of 70 basis points higher than the average private sector forecast, while long-term rates were assumed to be 60 and 40 basis points higher in years 1 and 2, respectively. Nominal income growth was assumed to be 0.1 percentage point lower in the first year and 0.5 percentage points lower in the second year. The fiscal impact of the prudence factor built into the economic assumptions averaged $1.0 billion in the first year and $2.3 billion in the second year.

- The 1998 budget incorporated larger prudence factors because the weakness in commodity prices resulting from the Asian crisis had not been fully reflected in the private sector forecasts available at the time of the budget. The more prudent economic assumptions translated into extra prudence of $1.4 billion in the first year and $3.7 billion in the second year.

- The 1999 budget used more “normal” prudence – similar to that used in earlier budgets.

Extending economic prudence to the medium term



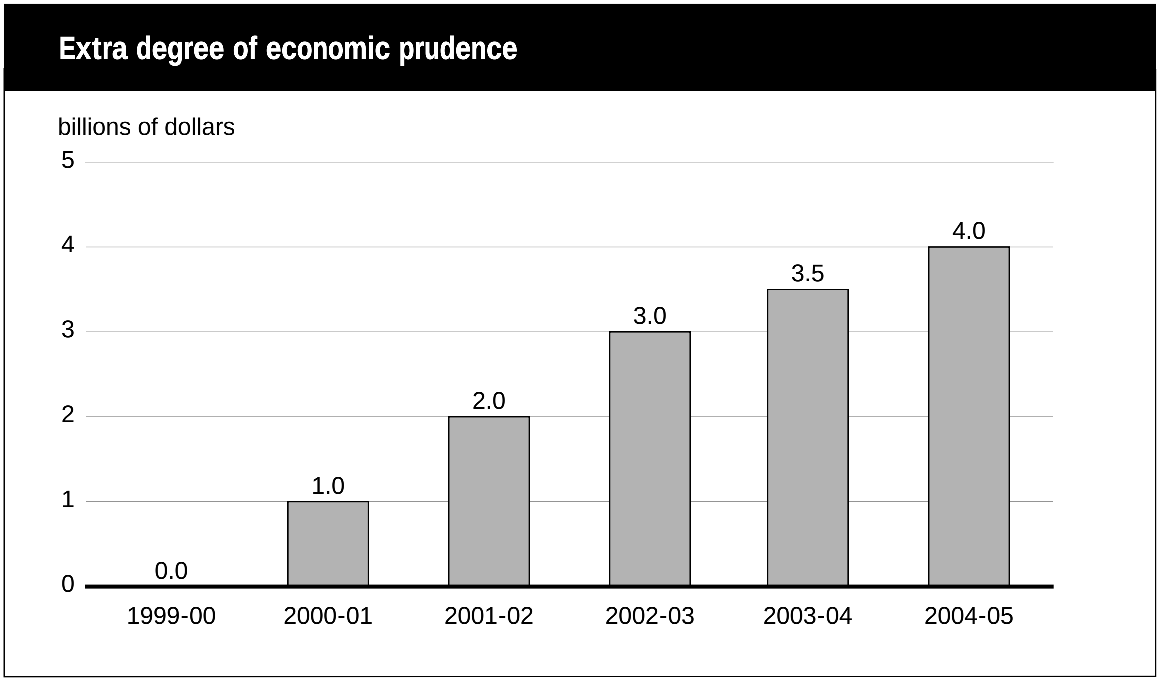
- Over the medium term, the average private sector forecast is consistent with most estimates of the current slack in the economy and Canada's non-inflationary growth potential.
- However, the medium-term outlook is subject to risks, which are inherently more difficult to identify than the near-term risks and are likely more important the further one looks beyond two years.
- Over the near term, the downside risks to the Canadian outlook arise from possible developments abroad, primarily in the U.S. While U.S. economic growth continues to exceed expectations, with no clear pickup in inflation, there is a risk that a significant increase in U.S. interest rates may eventually be necessary to avoid inflation pressures. This could also lead to a much sharper slowdown in U.S. activity.
- Uncertainty also remains regarding the strength and durability of the recovery in emerging economies and Asia. Renewed instability in these countries could have adverse effects on world demand and commodity prices.
- Furthermore, the full impact of unexpected changes in the economic environment take some time before they are felt on economic growth. And there is an additional lag before the full impacts on budgetary expenditures and revenues are felt.
- These factors suggest that the amount of extra prudence should increase over time.
- However, there are offsetting factors that limit the amount of prudence required, such as policy responses to unexpected shocks. In addition, the continued use of a two-year rolling fiscal planning horizon for budget decisions gives the Government the flexibility to make adjustments to offset impacts on the budgetary balance beyond the near term.

Sensitivity of the fiscal outlook to economic shocks

	Estimated change in fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
1-per-cent decrease in the level of nominal income				
Revenue decrease	1.5	1.6	1.7	1.7
Expenditure increase	0.6	0.6	0.7	0.7
Deterioration in budgetary balance	2.1	2.2	2.4	2.4
100-basis-point increase in all interest rates				
Revenue increase	0.3	0.3	0.4	0.4
Expenditure increase	1.2	1.9	2.3	2.7
Deterioration in budgetary balance	0.9	1.6	1.9	2.3

- One guide to evaluating the appropriate amount of economic prudence is the sensitivity of the budgetary balance to changes in important economic variables, such as nominal income and interest rates.
- For example, a decrease in the level of nominal income would lead to a decrease in federal government revenues through a contraction in various tax bases and an increase in spending, primarily due to higher employment insurance benefits. A 1-per-cent decrease in nominal GDP would have a negative impact of $2.1 billion in the first year, increasing to $2.4 billion by the third year.
- Alternatively, a sustained 100-basis-point increase in all interest rates would reduce the budgetary balance by $0.9 billion in the first year. The negative impact on the budgetary balance would increase every year as debt would be refinanced at the higher rates. This amount would reach $2.3 billion by the fourth year.

Extra degree of economic prudence for purposes of budget discussions



- Based on the above considerations, the Government has decided that the extra degree of economic prudence for planning purposes will be set at $1.0 billion in 2000-01, $2.0 billion in 2001-02, rising to $4 billion by 2004-05.
- The extra degree of economic prudence in the first two years is similar to that used in previous budgets (with the exception of the 1998 budget).
- The amounts set aside provide a reasonable buffer against the range of shocks that might occur over the five-year forecast period. For example, by year five, economic prudence would cover about a 1-per-cent decrease in the level of nominal income and a sustained 70-basis-point increase in interest rates.

Surplus for purposes of budget consultations and planning

Summary statement of transactions

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
			(billions of dollars)				
Budgetary transactions							
Revenues	155.7	158.0	164.5	172.5	180.0	188.0	197.0
Program spending	111.4	111.5	113.5	118.0	121.0	124.0	127.5
Operating balance	44.3	46.5	51.0	54.5	59.0	64.0	69.5
Public debt charges	41.4	41.5	41.5	41.0	40.5	40.0	39.5
Underlying budgetary balance (average of private sector)	2.9	5.0	9.5	13.5	18.5	24.0	30.0
Prudence							
Contingency Reserve		3.0	3.0	3.0	3.0	3.0	3.0
Economic			1.0	2.0	3.0	3.5	4.0
Total		3.0	4.0	5.0	6.0	6.5	7.0
Fiscal surplus for planning	2.9	2.0	5.5	8.5	12.5	17.5	23.0
Net public debt assuming:							
Balanced budget each year	576.8	576.8	576.8	576.8	576.8	576.8	576.8
Contingency Reserve applied to debt	576.8	573.8	570.8	567.8	564.8	561.8	558.8
Per cent of GDP							
Budgetary revenues	17.4	16.8	16.7	16.8	16.8	16.7	16.8
Program spending	12.4	11.8	11.5	11.5	11.3	11.0	10.9
Public debt charges	4.6	4.4	4.2	4.0	3.8	3.6	3.4
Total expenditures	17.1	16.3	15.7	15.4	15.0	14.6	14.2
Planning surplus	0.3	0.2	0.6	0.8	1.2	1.6	2.0
Net public debt assuming:							
Balanced budget each year	64.4	61.3	58.6	56.1	53.7	51.3	49.1
Contingency Reserve applied to debt	64.4	61.0	58.0	55.2	52.6	50.0	47.6

- Based on the common set of economic planning assumptions, the four forecasting firms derived projections of the major components of the budgetary balance. The projections in the table for 1999-2000 to 2004-05 are the average of these four sets of projections. The figures for 1998-99 are the final audited figures for the year.

- These projections are based on a number of important assumptions. They are based on current tax and spending policies – no new policy initiatives are incorporated. The EI premium rate of $2.40 for 2000 is held constant throughout the projection period. Direct program spending – total program spending less major transfers to persons and major cash transfers to other levels of government, and excluding the impact of special one-time adjustments affecting 1999-2000 – is assumed to grow in line with the growth in the population and inflation. In addition, the projections of public debt charges assume that the Contigency Reserve is not required and is applied each year to reducing the net public debt. These are critical assumptions underlying the average private sector surplus projections.

- As discussed earlier, the private sector economists recommended that the Government continue its practice of including a $3-billion Contingency Reserve and an extra degree of economic prudence. These amounts must be subtracted from the average private sector projections of the surplus to arrive at the surplus for budget consultations and planning purposes.

- The average private sector surplus for 1999-2000 is $5.0 billion. Subtracting the Contingency Reserve, this leaves a planning surplus of $2.0 billion. Economic uncertainties, prior-year adjustments, end-of-year accounting adjustments, and potential liabilities could affect the final outcome for 1999-2000. Despite these uncertainties, the Government remains committed to its target of a balanced budget or better as stated in the 1999 budget.

- The surplus for planning purposes is projected at $5.5 billion in 2000-01 and $8.5 billion in 2001-02. These are the two years for which decisions would be made in the 2000 budget.

- Over the following three years, the surplus for purposes of budget planning is projected to rise from $12.5 billion to $23 billion.

Average private sector projections of budgetary revenues

Budgetary revenues: private sector average

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
	(billions of dollars)						
Income tax							
Personal income tax	72.5	74.8	78.2	82.7	87.8	93.0	98.5
Corporate income tax	21.6	21.7	23.6	24.7	25.4	26.4	27.2
Other	2.9	3.0	3.1	3.2	3.2	3.4	3.5
Total	97.0	99.6	104.9	110.6	116.4	122.8	129.2
Employment insurance revenues	19.4	18.8	18.3	18.9	19.2	19.5	20.0
Excise taxes/duties							
Goods and services tax	20.7	22.0	23.0	24.2	25.4	26.9	28.5
Customs import duties	2.4	2.3	2.4	2.5	2.6	2.6	2.7
Other	8.4	8.3	8.5	8.8	9.0	9.2	9.5
Total	31.4	32.6	33.8	35.5	37.0	38.7	40.7
Total tax revenues	147.7	151.0	157.0	165.0	172.6	181.0	189.9
Non-tax revenues	7.9	7.0	7.5	7.5	7.4	7.1	7.1
Total budgetary revenues	155.7	158.0	164.5	172.5	180.0	188.0	197.0

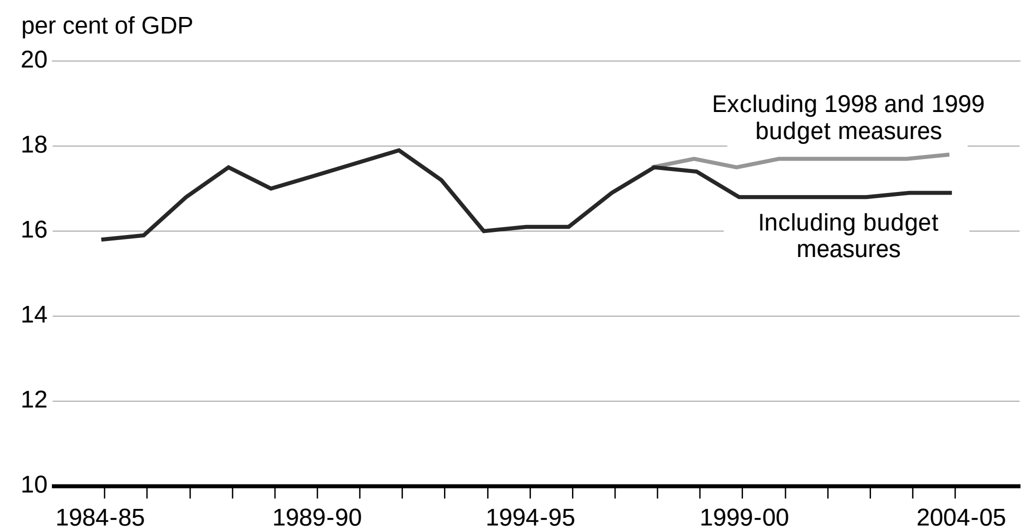
- Based on the average of the four forecasting firms, budgetary revenues are projected to increase by $2.3 billion in 1999-2000 to $158.0 billion. This small increase reflects the impact of economic growth dampened by the impact of personal income tax reductions announced in the 1998 and 1999 budgets and the reduction in EI premium rates effective January 1, 1999 from $2.70 to $2.55 (employee rate per $100 of insurable earnings).

- The growth in budgetary revenues in 2000-01 is again projected to be somewhat less than the growth in the economy, reflecting the impact of the 1999 budget tax reduction measures and a further decline in EI premium rates to $2.40 effective January 1, 2000.

- Based on existing policy, the growth in budgetary revenues beyond next year is projected to be in line with the growth in the economy.

Total budgetary revenue is expected to fall to 16.8 per cent of GDP in 1999-2000

Revenue-to-GDP ratio
(Public Accounts basis)



- The "revenue ratio" shows total federal revenues in relation to the total income in the economy (or GDP). It provides a measure of the federal tax burden.
- There is a cyclical element to the revenue ratio. During recessions, it declines and during recoveries it tends to increase, reflecting the progressive nature of the tax system and the cyclical nature of corporate profits. This was the primary factor underlying the increase in the revenue ratio between 1994-95 and 1997-98, as the economy recovered from the 1990-1991 recession.
- The tax relief provided in the 1998 and 1999 budgets is expected to bring the revenue-to-GDP ratio from 17.4 per cent in 1998-99 to 16.8 per cent in 1999-2000. Beyond 2000-01, the revenue-to-GDP ratio is expected to stabilize at 16.8 per cent, as growth in personal income tax revenues following the maturation of tax relief is offset by declines in the other revenue components.

Major components of budgetary revenue as a share of GDP

Budgetary revenues: private sector average

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
				(per cent of GDP)			
Personal income tax	8.1	8.0	8.0	8.0	8.2	8.3	8.4
Corporate income tax	2.4	2.3	2.4	2.4	2.4	2.4	2.3
Other income tax	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Employment insurance revenues	2.2	2.0	1.9	1.8	1.8	1.7	1.7
Goods and services tax	2.3	2.3	2.3	2.4	2.4	2.4	2.4
Customs import duties	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Other excise taxes/duties	0.9	0.9	0.9	0.9	0.8	0.8	0.8
Non-tax revenues	0.9	0.7	0.8	0.7	0.7	0.6	0.6
Total	17.4	16.8	16.7	16.8	16.8	16.7	16.8

- Based on the average of private sector forecasts, the personal income tax-to-GDP ratio is expected to decline to 8 per cent in 1999-2000 and remain at that level until 2001-02. This is attributable to the implementation of tax reductions announced in the 1998 and 1999 budgets. Once the personal income tax reductions mature, the personal income tax-to-GDP ratio is projected to increase, reflecting the progressivity of the tax system and the non-indexation of tax brackets and credits.
- In contrast to personal income tax revenue, the GDP shares of other components of tax revenue are projected to either be stable or decline. This leads to a generally constant revenue-to-GDP ratio beyond 1999-2000.

Average private sector projections of total program spending

Program spending: private sector average

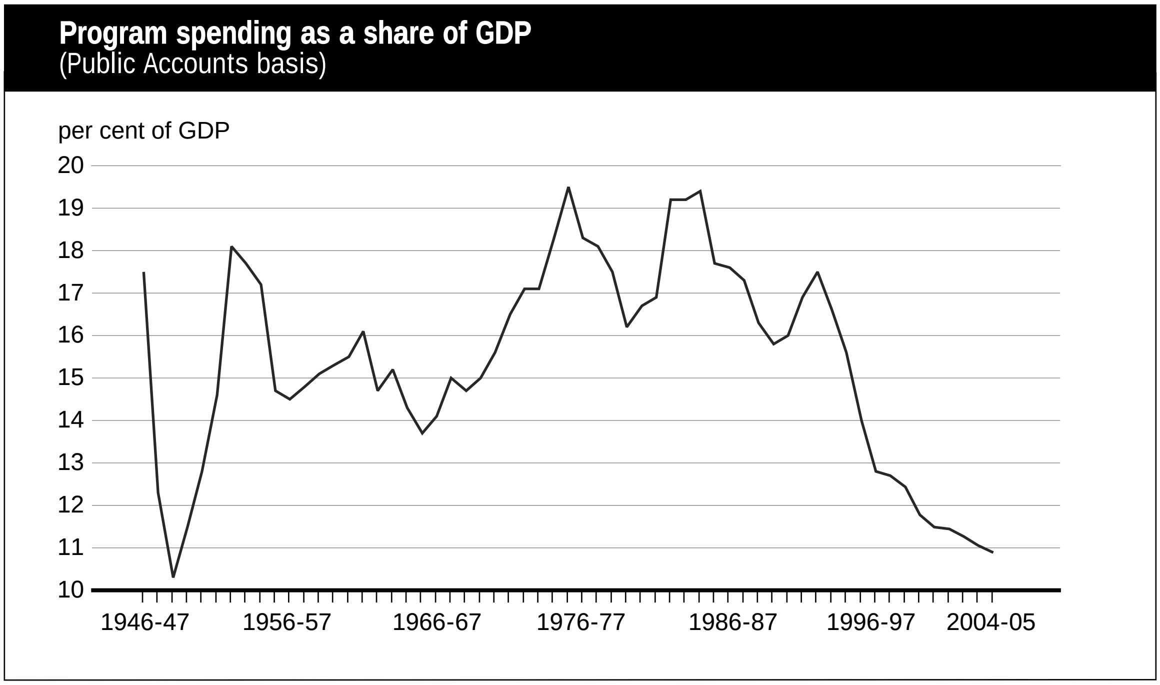
	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
	(billions of dollars)						
Major transfers to persons							
Elderly benefits	22.8	23.4	24.3	25.1	25.9	26.7	27.5
Employment insurance benefits	11.9	12.3	12.7	12.9	12.9	12.9	13.0
Total	34.7	35.8	37.0	38.0	38.8	39.6	40.5
Major cash transfers to other levels of government							
Canada Health and Social Transfer (CHST)[1]	12.5	12.5	13.5	14.5	15.0	15.0	15.0
CHST cash supplement	3.5						
Fiscal transfers	11.7	11.0	11.4	11.8	12.4	13.0	13.6
Alternative Payments for Standing Programs	-2.2	-2.3	-2.4	-2.5	-2.6	-2.7	-2.8
Total	25.5	21.2	22.5	24.0	24.8	25.3	25.8
Total major transfers	60.2	57.0	59.5	61.9	63.6	64.9	66.2
Direct program spending	51.2	54.5	54.0	56.0	57.5	59.1	61.3
Total program spending	111.4	111.5	113.5	118.0	121.0	124.0	127.5

[1] Cash transfer only. Total entitlements (both tax and cash) for CHST are:

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
	26.0	26.4	28.6	30.4	31.7	32.5	33.4

- Program spending is divided into three major components: major transfers to persons, major cash transfers to other levels of government and direct program spending.
- On average, the private sector forecasters project total program spending to increase from $111.5 billion in 1999-2000 to $127.5 billion in 2004-05.

Program spending as a share of GDP continues to decline



- Although the absolute level of program spending is projected to increase, this growth is considerably less than the projected growth in GDP. As a result, the program spending-to-GDP ratio continues to decline.
- From 17.5 per cent of GDP in 1992-93, program spending is expected to fall to just under 11 per cent by 2004-05.

Program spending grows in line with growth in the population and inflation

Change in program spending

	1999-00	2004-05	Change	Average annual growth
		(billions of dollars)		(per cent)
Major transfers to persons				
Elderly benefits	23.4	27.5	4.0	3.3
Employment insurance benefits	12.3	13.0	0.7	1.1
Total	35.8	40.5	4.7	2.5
Major cash transfers to other levels of government				
Canada Health and Social Transfer	12.5	15.0	2.5	3.7
Fiscal transfers	11.0	13.6	2.6	4.3
Alternative Payments for Standing Programs	-2.3	-2.8	-0.6	-4.0
Total	21.2	25.8	4.5	4.0
Total major transfers	57.0	66.2	9.2	3.0
Direct program spending	54.5	61.3	6.8	2.4
Total program spending	111.5	127.5	16.0	2.7

- Between 1999-2000 and 2004-05, total program spending is projected to increase at an average annual rate of 2.7 per cent. This is slightly below the combined growth in the population (1.2 per cent) and inflation (1.8 per cent), i.e. real per capita spending declines marginally on the basis of existing programs and policies.

- Direct program spending is assumed to increase by 2.4 per cent, on average, per year. However, as noted in the 1999 budget, the 1999-2000 estimate includes special one-time funding to address the Year 2000 computer problem in government departments. In addition, the 1999-2000 estimates include costs associated with Canada's international peacekeeping commitments in Kosovo and East Timor. Excluding these one-time adjustments, direct program spending over the 1999-2000 to 2004-05 period is assumed to grow in line with population and inflation.

- Many of the major cost drivers affecting individual components of program spending do not necessarily mirror the growth in population and inflation, as will be demonstrated in the following pages. The actual outcome, in the absence of any new policy initiatives, will primarily be dependent on economic and demographic factors affecting major transfers to persons and to other levels of government and whether the cost pressures on existing programs within direct program spending can be managed within the technical assumption of population growth plus inflation.

Major components of program spending as a share of GDP

Program spending: private sector average

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
	(per cent of GDP)						
Major transfers							
Elderly benefits	2.5	2.5	2.5	2.4	2.4	2.4	2.3
Employment insurance benefits	1.3	1.3	1.3	1.3	1.2	1.1	1.1
Major cash transfers to other levels of government	2.8	2.3	2.3	2.3	2.3	2.3	2.2
Total	6.7	6.1	6.0	6.0	5.9	5.8	5.6
Direct program spending	5.7	5.8	5.5	5.4	5.3	5.3	5.2
Total program spending	12.4	11.8	11.5	11.5	11.3	11.0	10.9

- Among the major components of program spending, the largest decline as a percentage of GDP is in direct program spending – total program spending less major transfers to persons and other levels of government. This primarily reflects the technical assumption used, as the growth in the population and inflation is less than the growth in the economy over this time period.
- Excluding the one-time CHST cash supplement in 1998-99, major cash transfers to other levels of government grow roughly in line with the economy.

Major transfers to persons

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
				(billions of dollars)			
Elderly benefits	22.8	23.4	24.3	25.1	25.9	26.7	27.5
Employment insurance benefits	11.9	12.3	12.7	12.9	12.9	12.9	13.0
Total	34.7	35.8	37.0	38.0	38.8	39.6	40.5

- Major transfers to persons consist of elderly benefits and EI benefits.
- Elderly benefits include Old Age Security pensions, the Guaranteed Income Supplement and the spouse's allowance.
  - Private sector forecasters expect elderly benefits to increase by 3.3 per cent per year on average, reflecting the growth in the elderly population and in average benefits, which are fully indexed to changes in consumer prices.
  - Growth in elderly benefits will be moderate until 2010-11, given the relatively small size of the generation born in the depression years of the 1930s and the World War II years. The full impact of the aging population on elderly benefits does not occur until 2019-2020, when the largest cohort of the "baby-boom" generation turns 65.
- There are three components of the EI benefit program: regular benefits which are primarily a function of the number of unemployed; special benefits, which include maternity, parental and sickness benefits; and employment benefits and support measures, primarily active labour market measures delivered either by the federal government or the provinces and territories.
  - The largest and most variable component, accounting for about two thirds of EI benefits, is regular benefits, reflecting labour market developments, in particular the number of unemployed. The other two components are relatively stable.
  - On average, private sector forecasters expect EI benefits to increase slightly through 2004-05. This largely reflects the assumption that the average level of EI benefits will rise with increases in average wages. Although maximum insurable earnings are assumed to remain capped at $39,000, not all beneficiaries will be at the maximum, so the average benefit should rise.

Major cash transfers to other levels of government

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
	(billions of dollars)						
Canada Health and Social Transfer (CHST)	12.5	12.5	13.5	14.5	15.0	15.0	15.0
CHST cash supplement	3.5						
Fiscal transfers	11.7	11.0	11.4	11.8	12.4	13.0	13.6
Alternative Payments for Standing Programs	-2.2	-2.3	-2.4	-2.5	-2.6	-2.7	-2.8
Total	25.5	21.2	22.5	24.0	24.8	25.3	25.8

- The major programs under which the federal government transfers funds to other levels of government are the Canada Health and Social Transfer (CHST) and fiscal transfers. The latter includes Equalization and Territorial Formula Financing, statutory subsidies and recoveries under the Youth Allowance Program. All major cash transfers to provinces and territories were put on a common five-year track in the 1999 budget, thus providing provinces and territories with predictable and stable funding.

- CHST cash transfers increase from $12.5 billion in 1999-2000 to $13.5 billion in 2000-01, to $14.5 billion in 2001-02 and to $15 billion in 2002-03. Under current legislation, cash transfers remain at $15 billion to 2003-04. For the purposes of this exercise, cash transfers are assumed to remain at $15 billion for 2004-05 as well.

- The largest component under fiscal transfers is Equalization. Under this program, the federal government transfers funds to provinces with below-average revenue-raising capacities in order that they have the ability to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Payments are made on the basis of a formula set out in legislation. The legislation also stipulates that the growth in entitlements cannot exceed the growth in GDP. This projection assumes that growth in Equalization will equal growth in GDP. However, the actual Equalization payment in any one year consists of the entitlement and an adjustment for revisions to prior years' entitlements.

- Fiscal transfers also include transfers to territories under Territorial Formula Financing. These transfers move generally in line with the growth in the economy.

- Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. The value of these tax points is netted against total entitlements, and accordingly from the cash transfers. These recoveries also move roughly in line with the growth in the economy.

Direct program spending: looking ahead

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
				(billions of dollars)			
Direct program spending	51.2	54.5	54.0	56.0	57.5	59.1	61.3

- As noted earlier, adjusting for special one-time factors which raise spending in 1999-2000, direct program spending is projected to increase at an average annual rate roughly in line with the growth in the population and inflation over the 1999-2000 to 2004-05 period.
- This is a technical assumption that was made for the purposes of developing a status quo estimate of the surplus for purposes of budget discussions.
- However, the 1994 budget restraint measures and the impact of the Program Review actions have left many key programs under strain. The cost-drivers affecting many of these programs are not reflective of the overall changes in the population and inflation.
- A major challenge over the next few years will be how best to manage these pressures.

4

Tax Relief:
Issues and Options

Highlights

"We must and we will cut taxes more."

"We will set out objectives and we will achieve them as quickly as possible. That is how we eliminated the deficit. That is how we will continue to reduce taxes."

"… Canadians are entitled to keep more of the money they earn. After all, they worked for it. It's theirs."

"Tax reduction is essential to secure strong and sustained economic growth."

The Honourable Paul Martin
Minister of Finance

- *Tax relief is a key element of the balanced use of the fiscal surplus, along with debt reduction and strategic investments in areas of national importance.*
- *Recent budget measures reduce average federal personal income taxes by about 10 per cent. For families with children, the personal income tax relief amounts to 16 per cent on average.*
- *In the 2000 budget, the Government will set out a multi-year plan to cut taxes further.*
- *Going forward, the principles underlying our plan are:*
  - *the approach to tax relief must be fair. Tax reduction must ultimately benefit all Canadians, but first it must benefit those who need it the most – middle- and low-income earners, especially families with children;*
  - *broad-based tax relief should focus initially on personal income taxes. That is where the burden is greatest – where Canadian taxes are most out of line with our history and with other countries;*
  - *the business tax system must be internationally competitive; and*
  - *broad-based tax relief should not be financed with borrowed money.*

Introduction

Real progress has been made over the past several years in dealing with Canada's major economic policy problems. The deficit has been eliminated and the debt burden is on a clear downward track. Targets for low inflation have been achieved. Structural reforms have been undertaken. Key investments have been made in strategic areas.

The fiscal improvement has enabled the Government to begin providing general tax relief – an integral element of the Government's strategy for sustained economic growth and an improved standard of living and quality of life for all Canadians.

While the Government has begun to reduce taxes, more needs to be done to lower the overall tax burden and to reform the structure of the tax system.

Tax Relief to Date

- **Targeted tax relief** was provided in all of this government's previous budgets. The details of this targeted tax relief are presented in the Appendix to this Annex.
- With the books in balance in 1997-98, the 1998 and 1999 federal budgets introduced **broad-based tax relief**. This tax relief is proportionally larger for low- and modest-income Canadians. It includes:
  - an increase of $675 in the amount that can be earned tax-free for all Canadians;
  - the elimination of the 3-per-cent general surtax; and
  - a $2-billion increase in the Canada Child Tax Benefit (CCTB) – for a total benefit of $7 billion annually.
- The actions taken in the 1998 and 1999 federal budgets have removed 600,000 low-income Canadians from the federal tax rolls.
- With the actions already taken, taxpayers will have their federal income taxes reduced on average by about 10 per cent.
  - When the measures are mature, total personal income tax relief provided in the 1997, 1998 and 1999 budgets amounts to $7.5 billion – a 9.8-per-cent reduction in the $76.9 billion paid in personal income taxes in 1999-2000 (Table 1).
  - For families with children, total personal income tax relief provided in the 1997, 1998 and 1999 budgets amounts to $4.1 billion – a 16-per-cent reduction in the $25.7 billion paid by that group in personal income taxes in 1999-2000 (Table 2).
  - High-income individuals receive proportionately less than the average personal income tax relief.

Table 1
Calculation of per cent reduction in federal personal income tax: 1999-2000[1]

Measures	Cost
	(billions of dollars)
1997 budget	
Increase in the Canada Child Tax Benefit (CCTB)	0.9
Tax fairness	0.3
Total	1.2
1998 budget	
$500 increase in the amount of income that can be earned tax-free, for low-income Canadians	0.3
Elimination of the 3-per-cent surtax for individuals with income up to about $50,000	1.3
Increase in the CCTB	0.9
Tax fairness	0.6
Total	3.1
1999 budget	
Extension of the amount that can be earned tax-free to all Canadians, and increase in this amount to $675	1.8
Elimination of the 3-per-cent surtax	1.1
Increase in the CCTB	0.3
Tax fairness	0.1
Total	3.2
Total personal income tax relief[2]	7.5
Personal income tax revenues before budget measures net of refundable credits (CCTB and the goods and services tax credit)[3]	76.9
Per cent reduction in federal personal income tax	9.8%

1 Numbers may not add due to rounding.
2 Costs at maturity are used in calculating the amount.
3 Relative to aggregate federal personal income taxes paid to the Government in fiscal year 1999-2000, net of refundable credits. These credits total $8.9 billion.

Table 2
Calculation of per cent reduction in federal personal income tax for families with children: 1999-2000[1]

Measures	Cost
	(billions of dollars)
1997 budget	
Increase in the Canada Child Tax Benefit (CCTB)	0.9
Tax fairness	0.1
Total	1.0
1998 budget	
$500 increase in the amount of income that can be earned tax-free, for low-income Canadians	0.1
Elimination of the 3-per-cent surtax for individuals with income up to about $50,000	0.6
Increase in the CCTB	0.9
Tax fairness	0.2
Total	1.8
1999 budget	
Extension of the amount that can be earned tax-free to all Canadians, and increase in this amount to $675	0.6
Elimination of the 3-per-cent surtax	0.5
Increase in the CCTB	0.3
Tax fairness	0.0
Total	1.3
Total personal income tax relief[2]	4.1
Personal income tax revenues before budget measures net of refundable credits (CCTB and the goods and services tax credit)[3]	25.7
Per cent reduction in federal personal income tax	16.0%

[1] Numbers may not add due to rounding.

[2] Costs at maturity are used in calculating the amount.

[3] Relative to aggregate federal personal income taxes paid by families with children to the Government in fiscal year 1999-2000, net of refundable credits. These credits total $7.0 billion for families with children.

Example of federal personal income tax relief

Federal personal income tax relief for a single individual with an annual income of $20,000[1]

	(dollars)
Pre-1997 budget net federal personal income tax	1,871
1998 budget tax reduction	
Increased tax-free income	0
3-per-cent surtax reduction	-63
Total	-63
1999 budget tax reduction	
Increased tax-free income	-115
3-per-cent surtax elimination	0
Total	-115
Total relief	-178
Post-1999 budget net federal personal income tax	1,693
Per cent reduction in net federal personal income tax	9.5%

[1] All income is from salaries and wages. The following tax credits are claimed: the basic personal credit ($7,131), and credits for Canada Pension Plan contributions (3.9 per cent of earnings from $3,500 to $38,000) and employment insurance premiums (2.40 per cent of earnings up to $39,000). No deductions (e.g., for registered retirement savings plan contributions) are claimed. Full-year impacts. Negative values indicate a reduction in taxes.

- Prior to the actions taken in the 1997 to 1999 budgets, a typical single individual earning $20,000 a year would have paid $1,871 in net federal personal income taxes.
- However, due to the elimination of the general surtax he/she pays $63 less in personal income taxes.
- Also, due to the increase in the amount of income that can be earned tax-free, the individual pays $115 less in personal income taxes.
- In total, the individual pays $178 less in net federal personal income taxes.
- Net federal personal income taxes paid are reduced from $1,871 to $1,693, a 9.5-per-cent reduction.

Example of federal personal income tax relief

Federal personal income tax relief for a one-earner couple with two children and an annual income of $40,000[1]

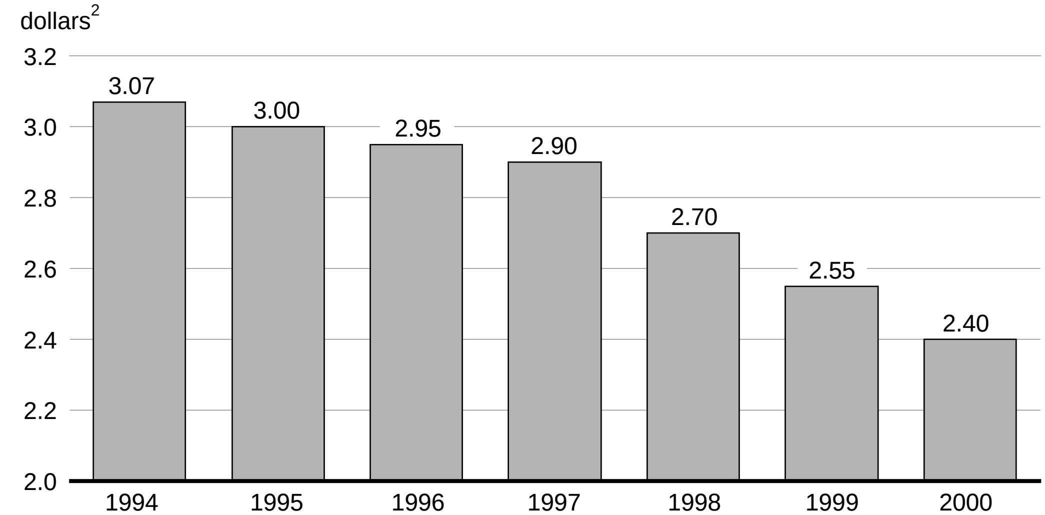
	(dollars)
Pre-1997 budget net federal personal income tax	3,949
1998 budget tax reduction	
Increased tax-free income	0
3-per-cent surtax reduction	-160
Total	-160
1999 budget tax reduction	
Increased tax-free income	-230
3-per-cent surtax elimination	0
Canada Child Tax Benefit (CCTB)	-184
Total	-414
Total relief	-574
Post-1999 budget net federal personal income tax	3,375
Per cent reduction in net federal personal income tax	14.5%

1 All income is from salaries and wages. The following tax credits are claimed: the basic personal credit ($7,131), the spousal credit ($6,055), and credits for Canada Pension Plan contributions (3.9 per cent of earnings from $3,500 to $38,000) and employment insurance premiums (2.40 per cent of earnings up to $39,000). No deductions (e.g., for registered retirement savings plan contributions) are claimed. Full-year impacts. Negative values indicate a reduction in taxes.

- Prior to the actions taken in the 1997 to 1999 budgets, a typical one-earner couple earning $40,000 a year with two children would have paid $3,949 in net federal personal income taxes.
- Following the 1998 budget, they pay $160 dollars less in federal personal income taxes. In addition, following the 1999 budget, they pay $230 less in federal personal income taxes and get an increase in their CCTB of $184.
- In total, they pay $574 less in net federal personal income taxes.
- Net federal personal income taxes are reduced from $3,949 to $3,375, a 14.5-per-cent reduction.

Employment insurance premium reductions

Employee EI premium rates[1]



[1] Employers' EI premium rates are 1.4 times the employee rate.
[2] Per $100 of insurable earnings up to the maximum ($39,000 for the year 2000).

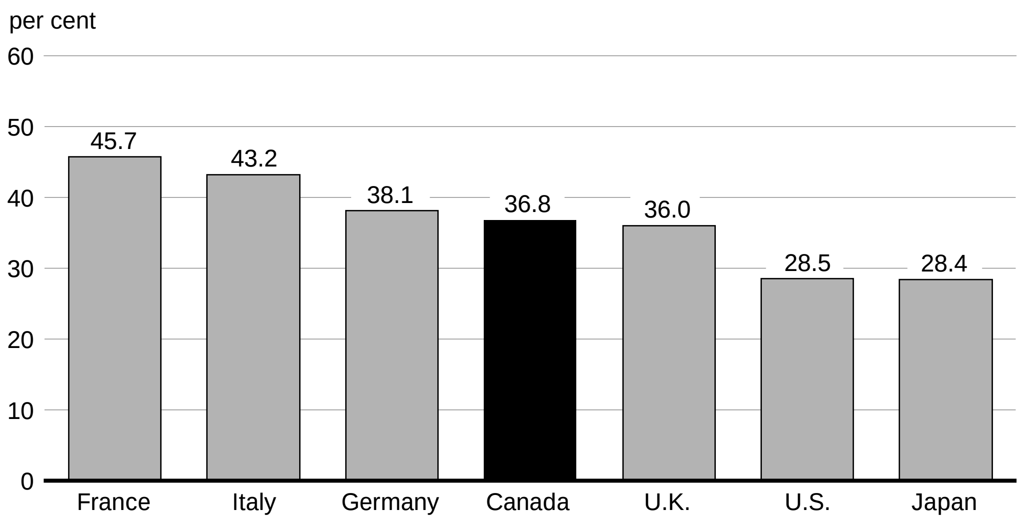
- **Employment insurance (EI) premiums have been reduced** each year since 1994, from $3.07 to the current level of $2.55 in 1999. The Canada Employment Insurance Commission has set the rate at $2.40 for the year 2000. The Government has accepted this rate.
- This means that employees and employers will save a further $1.2 billion next year – bringing total annual savings, compared to the rate which prevailed in 1994, to $5.2 billion.
- Details on specific EI-related actions since 1994 include:
  - the New Hires Program announced in November 1996 provided relief to small firms that created jobs in 1997 and 1998. The total relief provided was $465 million over two years;
  - an EI premium holiday was announced in 1998 to provide relief for all firms for the new hiring of young Canadians in 1999 and 2000. The total relief will be $200 million over the two years; and
  - the maximum insurable earnings (the base for the calculation of maximum EI premiums) was lowered from $43,940 to $39,000 in 1996 and then frozen at that level. This provided relief of $1.8 billion over three years.

Key International Comparisons

Although steps have been taken to provide tax relief, the task is not yet complete. This section presents key facts about the tax system that the Government will take into account as it develops its multi-year plan to reduce Canadians' taxes.

Canada's total tax burden is in the middle of the pack of G-7 countries

Total tax revenue[1] as a percentage of GDP, G-7 countries, 1996

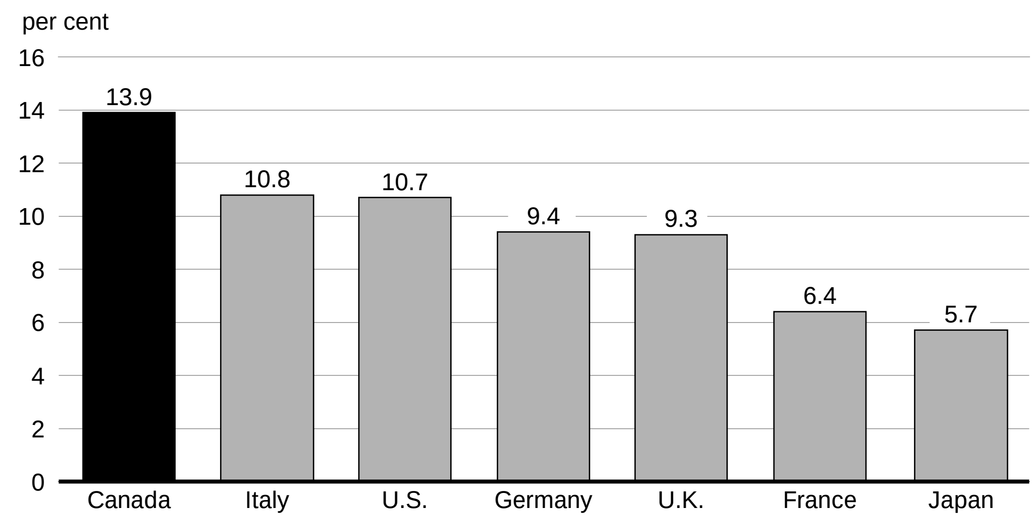


[1] Excludes non-tax revenue. The Canadian figure includes federal and provincial taxes.
Source: *OECD Revenue Statistics, 1965-1997.*

- Total tax revenues in Canada stood at 36.8 per cent of GDP in 1996 (the last year for which internationally comparable data are available), compared to 28.5 per cent in the United States and 28.4 per cent in Japan, Canada's two largest trading partners.
- However, compared to all Group of Seven (G-7) countries, Canada's overall tax burden is in the middle of the pack.

Canada's total personal income tax burden is the highest among G-7 countries

Personal income tax[1] as a percentage of GDP, G-7 countries, 1996

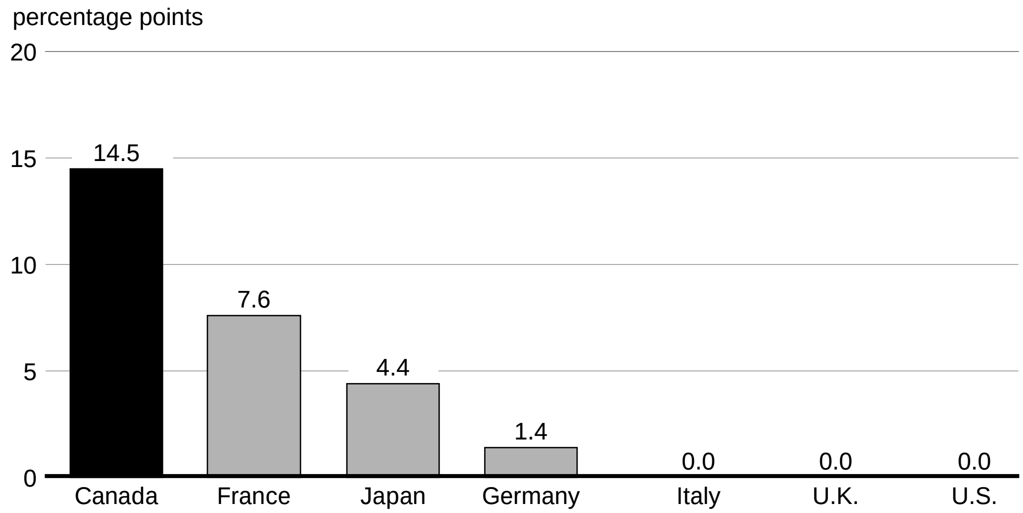


[1] The Canadian figure includes federal and provincial taxes.
Source: *OECD Revenue Statistics, 1965-1997.*

- Personal income tax in Canada stood at 13.9 per cent of GDP in 1996, compared to 10.7 per cent in the United States and 5.7 per cent in Japan.

The increase in the personal income tax rate from low to middle income in Canada is the largest among G-7 countries

Increase in effective marginal tax rates from low to middle income, G-7 countries [1]

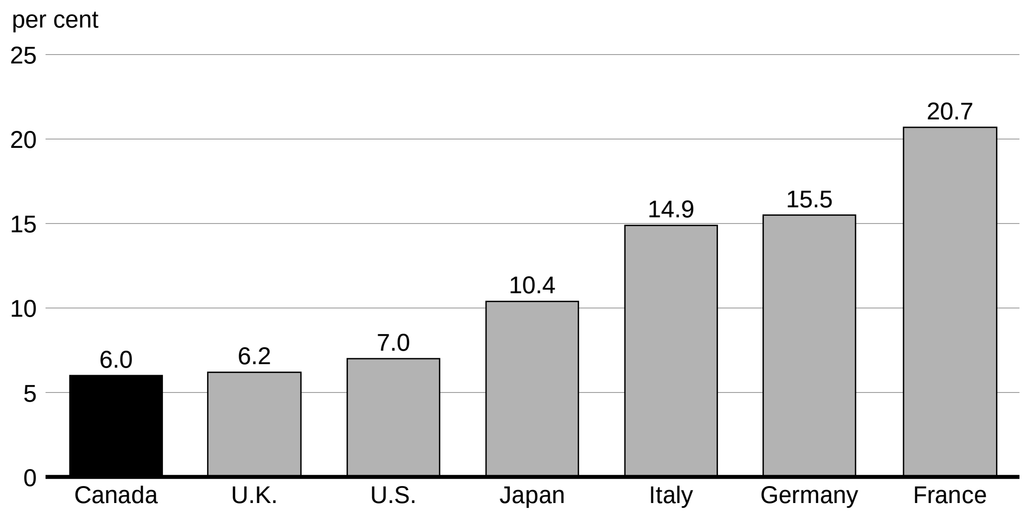


[1] This chart presents the difference between the effective marginal tax rate at 66 per cent and 100 per cent of the average production wage for a single individual in 1995. For example, the 14.5 figure for Canada is the difference between the marginal tax rates of 31.4 per cent (income level of $21,450) and 45.9 per cent (income level of $32,500). These tax rates include both the statutory tax rates and benefit reduction rates. The Canadian figure includes federal and provincial taxes.
Source: *OECD, Economic Surveys, Canada, 1997.*

- Many countries have tax structures where the tax rates rise with increases in income levels. Those with higher incomes pay progressively more taxes.
- The increase in the Canadian tax rate between low and middle income is the largest among G-7 countries, at 14.5 percentage points. France is a distant second, with three of the G-7 countries showing no tax rate increase between the two income groups.

Canada's total payroll and social security taxes are the lowest among G-7 countries

Payroll and social security taxes[1] as a percentage of GDP, G-7 countries, 1996

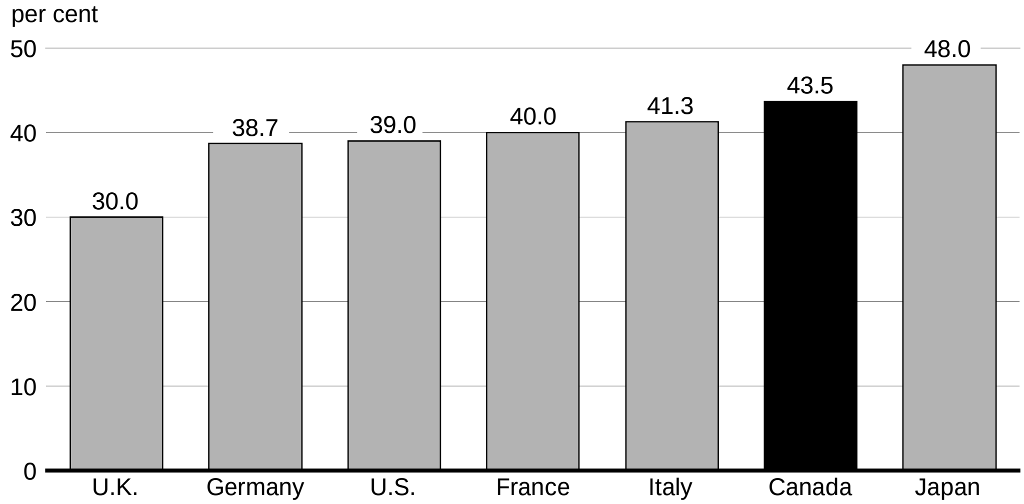


[1] The Canadian figure includes federal and provincial taxes.
Source: *OECD Revenue Statistics, 1965-1997.*

- Canada has the lowest payroll and social security taxes of all G-7 countries; France has the highest at 20.7 per cent of GDP.
- Canada's payroll tax burden stood at 6.0 per cent of GDP in 1996, compared to 7.0 per cent in the United States and 10.4 per cent in Japan.

Many G-7 countries are lowering their general corporate tax rate

Recently announced general corporate tax rates[1] in G-7 countries



[1] The Canadian tax rate of 43.5 per cent includes the 29.1-per-cent federal tax rate (28 per cent plus the 4-per-cent surtax) plus the average provincial tax rate of 14.4 per cent.

Sources: *KPMG Corporate Tax Rate Survey;* Ernst & Young International Tax Services; OECD Tax Database; Department of Finance calculations.

- Since 1996, all G-7 countries other than Canada and the United States have either reduced or are planning to reduce their general corporate tax rate. Other countries are also reducing their tax rates, including Switzerland (from 35.5 per cent to 25 per cent) and Australia (from 36 per cent to 30 per cent).

- Unlike most other countries, Canada varies its tax rate on corporations depending on both their size and activity. Canada has one of the lowest tax rates for small business (effective federal-provincial tax rate of 21 per cent), has comparable rates for the manufacturing and processing sector (effective tax rate of 35 per cent), but imposes the full general tax rate of 43.5 per cent on most other sectors, including the service and knowledge-based industries.

The Canada Child Tax Benefit

- The Canada Child Tax Benefit (CCTB) delivers substantial benefits for families with children as part of the federal-provincial-territorial National Child Benefit (NCB) system.
- The CCTB is the main program through which the federal government recognizes the cost of raising children.
  - Income-testing is undertaken to maximize benefits to those most in need, given fiscal constraints.
  - The CCTB is provided to all families that meet the income criteria.
- The cost of the program is close to $7 billion annually.
  - It includes enrichments of $2 billion in recent budgets, with $1.7 billion for the NCB supplement, a component of the NCB system that targets low-income families, and $300 million for middle-income families.
- The CCTB provides benefits to over 3 million families with children.
  - About 1.5 million families earning under $29,590 receive the base benefit of $1,020 per child as well as all or a portion of the NCB supplement (the maximum amount for the first child is $955).
  - With income-testing, those earning over $29,590 do not get the full base benefit.
- Families with children who do not claim the child care expense deduction (i.e. normally families with children where a spouse is not working outside the home) receive a $213 supplement for each child under 7.
- The Government has committed to making a further significant investment in the NCB for low-income families with children by July 1, 2001.

The level of tax support for children under the Canada Child Tax Benefit falls quickly as income increases

Canada Child Tax Benefit (CCTB), July 2000

Family net income	Benefit for first child	Cumulative per cent of families with children[1]
($)	($)	(%)
10,000	1,975	7
20,000	1,975	24
30,000	1,010	36
40,000	760	49
50,000	510	61
60,000	260	72
70,000	10	80

[1] Shows the percentage of families with children up to the level of income shown.
All families, with children, in the income ranges shown in the table receive some amount of CCTB.
For example, 49 per cent of the total number of families with children have family income of $40,000 or less.

- The table above shows the amount of CCTB provided at different levels of family income.
- The amount of support provided declines as family income increases.
- No CCTB is provided at family income levels above $70,000 for a first child.
- One quarter of families with children receive full benefits.
- One half of families with children receive at least one third of the maximum benefit; 80 per cent of all families with children receive some benefit.

Options for Tax Relief

Areas for possible tax relief and their costs

To help ensure that Canadians have a better understanding of the difficult choices ahead, estimated costs of the most frequently cited options for federal tax relief are listed below. A broader range of options and their costs are listed in the table that follows.

Increasing the amount of income that can be earned tax-free
Personal amounts – the amounts used as the basis for calculating the basic personal, spousal and equivalent-to-spouse credits – ensure that no personal income tax is paid on a basic amount of income. They make the tax system fairer. These amounts also effectively increase the threshold at which the 17-per-cent tax rate applies. Progress was made in this area in the 1998 and 1999 budgets which, combined, increased these amounts by $675 to $7,131 for the basic personal amount and $6,055 for the spousal and equivalent-to-spouse amounts (an increase of 10.5 per cent and 12.5 per cent respectively). This increase more than offsets the effect of inflation on the value of income that can be earned tax-free since 1992.

- Increasing personal amounts (i.e., the threshold beyond which the 17-per-cent tax rate applies) by an additional $100 (an increase of 1.4 per cent in the basic personal amount and 1.7 per cent in the spousal and equivalent-to-spouse amounts) would cost $280 million per year.

Increasing income levels (thresholds) at which tax rates take effect
The federal tax system has three tax rates: a 17-per-cent rate that applies to taxable income up to $29,590; a 26-per-cent rate that applies to taxable income between $29,590 and $59,180; and a 29-per-cent rate that applies to taxable income above $59,180.

- Increasing the thresholds at which the 26-per-cent and 29-per-cent tax rates become effective by $1,000 and $2,000 respectively (an increase of 3.4 per cent each) would cost $690 million per year.

Fully indexing the tax system to offset the effect of inflation
Currently, the income levels at which the various tax rates come into effect are only indexed for inflation above 3 per cent growth in the consumer price index. The effect of inflation below 3 per cent on the tax system is commonly referred to as bracket creep. Indexation of the tax system would result in increases in the amount of income that can be earned tax-free, in income levels (thresholds) at which tax rates take effect and in various refundable and non-refundable credits such as the Canada Child Tax Benefit (CCTB).

- Restoring full indexation of the tax system would cost approximately $900 million in the first year, with the cost rising cumulatively in subsequent years (e.g. to $4.5 billion annually in the fifth year).

Reducing the middle tax rate

Taxable income between $29,590 and $59,180 is subject to a tax rate of 26 per cent.

- Each percentage point reduction in the 26-per-cent tax rate would cost $1.1 billion per year.

Changes in the 5-per-cent surtax

The 1998 and 1999 budgets eliminated the general 3-per-cent surtax that applied to all taxpayers. Incomes above approximately $65,000 continue to be subject to a surtax of 5 per cent on tax otherwise payable.

- Eliminating the 5-per-cent surtax would cost $650 million per year ($130 million per percentage point reduction per year).
- Raising the threshold at which the 5-per-cent surtax is applied from $65,000 to $72,500 would cost $100 million per year.
- Raising the threshold at which the 5-per-cent surtax is applied from $65,000 to $100,000 would cost $300 million per year.
- Raising the threshold at which the 5-per-cent surtax is applied from $65,000 to $125,000 would cost $460 million per year.

Canada Child Tax Benefit – increasing its base/reducing its phase-out rate

The CCTB is the main federal initiative that recognizes the cost of raising children. To target those most in need, benefits depend on family net income and the number of children. There are two main components of the CCTB: the base benefit, which is phased out for family net income over $29,590 at a rate of 2.5 per cent for a one-child family and 5.0 per cent for families with two or more children, and the National Child Benefit (NCB) supplement, which in most cases is phased out between net income of $20,921 and $29,590.

- Increasing the NCB supplement by $100 (an increase of 10.5 per cent for a first child) would cost $210 million per year. Families earning less than $20,921 in family net income would receive the full $100 increase while those with family net incomes between $20,921 and $29,590 would receive a smaller increase. For example, a family with one child and $25,000 in family net income would receive a benefit increase of about $50.
- Increasing the CCTB base amount by $100 (an increase of 9.8 per cent) would cost $600 million per year. About 40 per cent of the increase would go to families with less than $30,000 in net income and about 52 per cent to middle-income families earning between $30,000 and $70,000. In addition, the percentage of families with children receiving benefits would increase from 80 per cent to about 83 per cent.

- Reducing the phase-out rates for the CCTB base amount from 2.5 per cent and 5 per cent to 1.25 per cent and 2.5 per cent respectively would cost $1.2 billion per year. About 55 per cent of the increase would go to middle-income families, i.e., those with incomes between $30,000 and $70,000. The percentage of families with children receiving benefits would increase from 80 per cent to about 96 per cent.
- Increasing the $29,590 threshold for the CCTB by $1,000 would cost $110 million per year.[1] More than 90 per cent of the increase in benefits would go to modest- and middle-income families, i.e., those with incomes between $20,000 and $70,000.

Increasing the RPP/RRSP contribution limits

Currently, the maximum contribution limit for registered pension plans (RPPs) and registered retirement savings plans (RRSPs) is $13,500.

- Increasing the RPP/RRSP contribution limits by $1,000 would cost $200 million per year.

Reducing capital gains taxes

The capital gains inclusion rate is currently 75 per cent. This means that 75 per cent of capital gains realized must be included as income. This portion of realized capital gains is then taxed in the same way as other sources of income such as salaries and wages.

- Lowering the capital gains inclusion rate by 5 percentage points would reduce federal tax revenues by $175 million per year at maturity.
- However, the cost would increase more than proportionally for larger reductions in the inclusion rate. The more a source of income is favoured in the tax system, the greater will be the change in behaviour to increase that source of income. A 10-percentage-point reduction in the inclusion rate would cost $375 million per year at maturity. A 20-percentage-point reduction in the inclusion rate would cost $800 million per year at maturity.

Reducing federal corporate tax rates

The federal statutory tax rate varies depending on the type of income: 12 per cent for small business, 21 per cent for the manufacturing and processing sector, and 28 per cent for other sectors such as the service and knowledge-based industries.

- A one-percentage-point reduction in the general corporate tax rate on business income would cost $270 million per year. A one-percentage-point reduction in all corporate income tax rates would cost $750 million per year.

[1] Under this scenario, the benefit reduction rates for the NCB supplement would be reduced from 11.0 per cent to 9.9 per cent for the first child, from 19.7 per cent to 17.7 per cent for the second child, and from 27.6 per cent to 24.7 per cent for the third and subsequent children.

Fiscal cost of various tax and employment insurance premium rate reductions: full-year impact estimates for 2000

	Cost of change
	(millions of dollars)
Personal Income Tax	
$100 tax reduction for all taxpayers[1]	1,450
$100 increase in amounts used to establish selected credits	
Basic personal amount	240
Spousal/equivalent-to-spouse amount	40
Increase tax bracket thresholds	
$1,000 increase in second tax bracket threshold (currently $29,590)	600
$2,000 increase in third tax bracket threshold (currently $59,180)	90
Restore full indexation of tax parameters[2]	
Total impact:	
Year 1	900
Year 2	1,800
Year 3	2,700
Year 4	3,600
Year 5	4,500
Reduce marginal tax rates (per percentage point)[3]	
Lowest rate (17%)	1,930
Middle rate (26%)	1,050
High rate (29%)	550
1-percentage-point reduction in each rate	3,530
Federal 5% surtax	
Reduce high-income 5% surtax by 1 percentage point[4]	130
Increase income threshold from $65,000 to $72,500[5]	100
Increase income threshold from $65,000 to $100,000[5]	300
Increase income threshold from $65,000 to $125,000[5]	460
Elimination	650
Canada Child Tax Benefit (CCTB)	
$100 increase in the base benefit under the CCTB[6]	600
$100 increase in the benefit under the National Child Benefit (NCB) supplement	210
Increase the threshold for the CCTB	
$1,000 increase in the phase-out threshold for the CCTB base	70
$1,000 increase in the phase-out threshold for the NCB supplement	40
Reduce 2.5% and 5% CCTB base phase-out rates to 1.25% and 2.5%	1,200
$1,000 increase in RRSP/RPP contribution limits	200
Reduce capital gains inclusion rate[7]	
5 percentage points to 70%	175
10 percentage points to 65%	375
20 percentage points to 55%	800
$100 increase in GST credit for a family of four[8]	460

Fiscal cost of various tax and employment insurance premium rate reductions: full-year impact estimates for 2000 *(cont'd)*

	Cost of change
	(millions of dollars)
Employment Insurance Premiums	
10-cent reduction in employee rate/14-cent reduction in employer rate	
Employee 10-cent reduction[9]	320
Employer 14-cent reduction[9]	450
Total	770
Business Income Tax	
1-percentage-point reduction in rates	
All rates	750
Selected rates	
General rate on business income[10]	270
Manufacturing and processing rate	200
Small business rate	170
1-percentage-point reduction in the 4% surtax[11]	145
0.025-percentage-point reduction in the large corporations tax[12]	180
Sales Tax	
1-percentage-point reduction in GST[13]	3,000
1-cent-per-litre reduction in motor and aviation fuels	620
1-per-cent reduction in excise duties on:	
Spirits	5
Beer	5
Wine	1
Tobacco	20

1 Non-refundable.

2 Estimates assume 1.5-per-cent annual inflation. Impacts are cumulative.

3 The 17-per-cent rate is applicable to taxable incomes up to $29,590, the 26-per-cent rate is applicable to taxable incomes from $29,590 to $59,180, and the 29-per-cent rate is applicable to taxable incomes from $59,180 and up.

4 Currently applies on basic federal tax in excess of $12,500 on an income level of about $65,000.

5 Approximate income levels of $72,500, $100,000 and $125,000 translate into $15,000, $23,000 and $30,000 respectively in basic federal tax.

6 Current maximum value of the base benefit is $1,020.

7 Costs presented are mature impacts. Revenue costs would be smaller in the short term because of earlier realizations.

8 Current credit value of goods and services tax credit depends on family type: $199 for the filer and spouse or equivalent-to-spouse, and $105 for each child. The $100 increase is broken down as follows: $35 each for the filer and spouse, and $15 for each of two children.

9 Employers pay 1.4 times employee premium. Cost is gross of income tax impacts.

10 Excluding manufacturing and processing, resource and small business income.

11 On basic 28-per-cent federal corporate tax.

12 Current rate of 0.225 per cent.

13 No change to GST credit.

Appendix

Tax Actions to Date: General Tax Relief and Tax Fairness Measures (1994-1999)

General tax relief

1998

- Increased the amount of income that low-income Canadians can receive on a tax-free basis by $500.
- Eliminated the 3-per-cent general surtax for taxpayers with incomes up to about $50,000 and reduced the amount for those with incomes between $50,000 and $65,000.

1999

- Extended the $500 increase in the amount of income that can be received on a tax-free basis to all Canadians, and increased it for all Canadians by an additional $175, for a total of $675.
- Eliminated the 3-per-cent general surtax for all remaining taxpayers for whom the surtax was not removed in the 1998 budget.

Families and seniors

1996

- Introduced new tax treatment of child support payments, with payments non-deductible for the payer and non-taxable for the recipient.
- Announced two-step enrichment of the Working Income Supplement (WIS) of the Child Tax Benefit (CTB) of $250 million.
- Replaced the seven-year limit by an unlimited carry-forward of unused registered retirement savings plan (RRSP) room.

1997

- Announced a $6-billion Canada Child Tax Benefit (CCTB) by simplifying and enriching the current CTB, starting July 1998, with an $850-million supplement for low-income families.
- Enriched the WIS in July 1997 from the $125 million announced in the 1996 budget to $195 million and restructured from a per-family to a per-child basis.

1998

- Increased the limits to $7,000/$4,000 under the child care expense deduction.
- Enriched the supplement under the CCTB by another $425 million on July 1, 1999 and a further $425 million on July 1, 2000.
- Removed contributions to RRSPs and registered pension plans (RPPs) from the base for the alternative minimum tax.

1999

- Set the design for the $850-million increase in the CCTB supplement amount in the 1998 budget.
- Proposed to enrich the CCTB by $300 million in July 2000 to enhance benefits for modest- and middle-income families.
- Proposed to improve the responsiveness of the goods and services tax (GST) credit.
- Proposed to ensure that the maximum GST credit supplement is provided to low-income single-parent families.
- Proposed to allow greater flexibility to transfer RRSP proceeds to financially dependent children upon the death of the RRSP owner.

Education

1996

- Increased the amount used to establish the education credit from $80 to $100 per month.
- Raised the annual limit on the transfer of the tuition fee and education amounts to those who support students from $4,000 to $5,000.
- Increased the annual limit on contributions to registered education savings plans (RESPs) from $1,500 to $2,000, and the lifetime limit from $31,500 to $42,000.
- Broadened eligibility for the child care expense deduction to assist parents who undertake education or retraining.

1997

- Doubled the amount used to establish the education credit over two years to $200 per month.
- Made ancillary fees, such as health services and athletics, eligible for the tuition credit.
- Allowed a carry-forward of unused tuition and education credits.
- Increased annual contribution limits for RESPs from $2,000 to $4,000.
- Allowed transfers of RESP funds to an RRSP or to the contributor.

1998

- Provided a Canada Education Savings Grant of 20 per cent on annual contributions of up to $2,000, along with carry-forward flexibility.
- Introduced a tax credit for interest on student loans.
- Allowed RRSP withdrawals for lifelong learning.
- Enhanced tax support for part-time education through the education credit and the child care expense deduction.

Tax assistance for charities and public institutions

1994

- Lowered the threshold at which charitable donations begin to earn the 29-per-cent tax credit from $250 to $200.

1995

- Removed the income limit for tax credits on donations of ecologically sensitive lands.

1996

- Increased the limits on charitable donations eligible for tax credits from 20 per cent to 50 per cent of net income, and to 100 per cent of net income in the year of death and the preceding year.
- Expanded zero-rating of hospital beds to all health care facilities, including long-term care facilities.
- Allowed most charitable and public organizations to raise funds without collecting and remitting GST on sales.
- Extended GST relief on purchases of vehicle modifications necessary to serve individuals with disabilities.
- Provided a 100-per-cent GST rebate on books purchased by public libraries, educational institutions and other specified bodies.

1997

- Reduced the inclusion rate on capital gains arising from the donation of publicly listed securities from 75 per cent to 37.5 per cent.
- Changed the income limit for donations to 75 per cent.
- Included 25 per cent of capital cost allowance (CCA) recapture in the net income limit.
- Sanctioned a new method of valuation for easements of ecologically sensitive lands.
- Increased resources for Revenue Canada to enhance information and compliance from charities.
- Simplified GST accounting, reporting and remittance requirements for charities.

1998

- Increased tax-free allowances for emergency service volunteers.
- Allowed designated charities to treat certain services they supply to business customers as GST/harmonized sales tax (HST) taxable, thereby allowing charities to compete on an equal footing with other suppliers.
- Provided equivalent GST/HST treatment to charities operating authorized bottle return depots vis-à-vis commercial operators.

Persons with disabilities

1996
- Expanded zero-rating of orthopaedic and orthotic devices under the GST.
- Enriched the tax credit for infirm dependants.

1997
- Broadened the medical expense tax credit.
- Removed the limit on the attendant care deduction.
- Introduced a refundable medical expense credit for earners.
- Broadened the definition of preferred beneficiary for trusts benefiting people with disabilities.

1998
- Introduced a new tax credit for caregivers who care for related seniors and persons with disabilities.
- Extended the Home Buyers' Plan to persons with disabilities.
- Included training expenses for caregivers for the medical expense tax credit.
- Allowed certification for the disability tax credit by occupational therapists and psychologists.
- Exempted respite care services from the GST/HST.

1999
- Proposed to expand the medical expense credit to provide enhanced tax assistance for persons with disabilities.

Personal income tax measures to better target tax preferences

1994
- Eliminated the $100,000 lifetime capital gains exemption.
- Extended the base for the alternative minimum tax.
- Restricted the use of tax shelters.
- Extended the taxation of employer-paid life insurance premiums to the first $25,000 of coverage.
- Introduced income-testing of the age credit.

1995
- Eliminated tax advantages available through trusts.
- Reduced the overcontribution allowance for RRSPs from $8,000 to $2,000.
- Capped the money purchase RPP and RRSP dollar limits at $13,500 through 2002 and 2003 respectively.
- Eliminated the retiring allowance rollovers for years of service after 1995.
- Eliminated double claims of personal credits in the year of personal bankruptcy.

1996
- Announced new rules on taxpayer migration to ensure that gains that accrue while a taxpayer is a resident of Canada are subject to Canadian tax.
- Capped the maximum pension limit for defined benefit RPPs at $1,722 per year of service until 2005 (only affecting individuals earning over $75,000).
- Reduced the maximum age limit for deferring tax on savings in RRSPs and RPPs from age 71 to 69.
- Further constrained tax shelters relying on a mismatch of income and expenses.

1998
- Allowed deductibility of health and dental premiums for the self-employed.
- Expanded the remote worksite concept.
- Clarified the tax treatment of relocation expenses.
- Strengthened the integrity of the certified cultural property regime.
- Expanded rules regarding employee options to allow the acquisition of units of mutual fund trusts.

1999
- Proposed to prevent income splitting with minors.
- Proposed to address deficiencies in the rules governing the taxation of income earned through investments in foreign-based investment funds and transfers to non-resident trusts.
- Proposed special rules for the treatment of retroactive lump-sum payments.
- Proposed to provide more equitable treatment of income earned by communal organizations.

Business income tax measures to better target tax preferences

1994

- Eliminated, for large private corporations, both the small business deduction and the enhanced scientific research and experimental development (SR&ED) benefits.
- Reduced the deduction for business meals and entertainment expenses from 80 per cent to 50 per cent to better reflect the personal consumption element of these expenditures.
- Increased the rate of tax on corporate dividends received by private investment corporations.
- Implemented measures to ensure that the income of financial institutions is measured appropriately for tax purposes.
- Eliminated the preference for sole-purpose SR&ED performers.
- Reduced regional investment tax credits.
- Modified the basis upon which insurance companies may claim reserves for income tax purposes.
- Ensured corporations cannot avoid paying tax when selling assets through "purchase butterfly" transactions.
- Tightened the rules applicable to foreign affiliates.
- Tightened the rules applicable on forgiveness of debt.

1995

- Increased the large corporations tax (LCT) and corporate surtax.
- Introduced a temporary surcharge on banks and other large deposit-taking institutions.
- Eliminated the deferral of tax on unincorporated business income.
- Eliminated the deferral advantage for investment income earned by private holding companies.
- Replaced the film tax shelter mechanism for certified Canadian films with a tax credit.
- Tightened the rules relating to non-arm's-length contract SR&ED.
- Introduced a voluntary measure for construction industry reporting.
- Tightened the rules concerning superficial losses.

1996

- Extended the capital tax surcharge on large deposit-taking institutions.
- Reduced tax assistance for labour sponsored venture capital corporations (LSVCCs).
- Tightened the resource allowance rules.
- Repealed joint exploration corporation rules.
- Restricted eligibility of various expenses for flow-through share treatment.
- Enhanced incentives to invest in renewable energy.
- Limited SR&ED benefits for non-arm's-length salaries and wages.

Business income tax measures to better target tax preferences *(cont'd)*

1997
- Extended the capital tax surcharge on large deposit-taking institutions.
- Replaced tax shelters used to finance non-Canadian films with a tax credit.

1998
- Extended the capital tax surcharge on large deposit-taking institutions.
- Allowed deductibility of countervailing duties and anti-dumping charges.
- Allowed more time for year-end distributions for mutual fund trusts.
- Harmonized financial institution designation for LCT and other purposes.
- Allowed an earthquake reserve deduction.
- Prevented unintended benefits under the SR&ED regime.
- Improved a range of international taxation rules.

1999
- Proposed to extend the capital tax surcharge on large deposit-taking institutions.
- Proposed to ensure that electricity generating activities are taxed equitably.
- Proposed to clarify the tax status of non-resident funds that retain Canadian service providers.
- Proposed to update rules governing LSVCCs to ensure consistency with provincial programs, and address issues relating to corporate restructuring.
- Proposed improved capital cost allowances to encourage the productive use of flare gas.

Sales tax measures to better target tax preferences

1996-97

- Tightened the GST rules governing the claiming of input tax credits and rebates by large businesses and exempt entities.
- Reinforced the GST rules relating to trusts, estates and partnerships to ensure fair and consistent treatment of similar businesses that are organized differently.
- Refined the criteria for businesses to be treated for GST purposes as being in competition with financial institutions.
- Permitted warranty companies to recover GST paid on reimbursements to warranty holders.
- Extended the GST accommodation rebate for visitors to Canada to non-resident businesses.
- Expanded zero-rating and rebate provisions for exported goods and services.
- Tightened the GST real property rules to ensure that all builders of multiple-unit residential buildings are treated equitably.

1998

- Enhanced the GST/HST Visitor Rebate Program.
- Enhanced the alternate collection mechanism for direct sellers.

Simplifying tax administration and improving enforcement

1994-97

- Strengthened outreach and education programs.
- Enhanced easy-to-understand automatic telephone information systems.
- Met with special taxfiler groups such as senior citizens and immigrants to help them comply.
- Established a single Business Number for streamlining registration for GST remitters, employers, corporations and importers/exporters.
- Introduced a "Business Window" initiative to provide one-stop service for small businesses.
- Simplified payroll reporting for small businesses.
- Reduced compliance costs for small- and medium-sized businesses by co-ordinating GST, income tax and excise tax audits.
- Streamlined procedures to simplify and expedite Customs clearance.
- Implemented a new approach to large business audits including audit protocol.
- Reinforced measures to target the underground economy.
- Proposed earlier identification of abusive tax avoidance and tax shelter schemes.
- Continued to improve sophisticated risk models to identify areas of high risk and a sector approach to compliance for small- and medium-sized businesses.
- Introduced forgiveness of penalties on voluntary tax disclosures to encourage taxpayers to comply voluntarily.
- Included exchange of information provisions to help deal with tax havens.
- Proposed new rules requiring residents of Canada to file an information return when they own foreign assets in excess of $100,000 in value.
- Required adequate documentation of transactions relating to transfer pricing and introduced new penalty provisions related to Revenue Canada reassessments.
- Increased resources for Revenue Canada for transfer pricing audits.

1998

- Introduced mandatory reporting of federal and construction contracts.

1999

- Proposed to allow corporations to offset interest on corporate tax overpayments and underpayments.
- Proposed to provide for civil penalties for misrepresentations of tax matters by third parties.
- Proposed to improve tax administration by sharing limited information with provinces.
- Proposed measures that will reduce tobacco contraband.