Budget in Brief

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

February 27, 1995

Canada

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Department of Finance Canada
Ministère des Finances Canada

“There are times in the progress of a people when fundamental challenges must be faced, fundamental choices made – a new course charted. For Canada, this is one of those times.

Our resolve, our values, our very way of life as Canadians are being tested. The choice is clear.

We can take the path – too well-trodden – of minimal change, of least resistance, of leadership lost. Or we can set out on a new road of fundamental reform, of renewal – of hope restored.

Today, we have made our choice. Today, we take action.”

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Opportunity and Challenge

"This is a window of extraordinary opportunity. Thanks to the honest hard work of millions upon millions of Canadians, our economy is now stronger than it has been for years."

Canada is enjoying a period of strong economic growth and job creation.

Jobs and growth

In the past year, 433,000 jobs have been created.

In 1994, our economic growth was the highest of any G-7 country.

Productivity has surged. Canada's cost competitiveness is at its highest level in more than 40 years.

Our trade surplus is up. Canada's exports have never been higher.

Business confidence is greater than at any time since 1979.

"However, there are two clouds that loom over our country's horizon. One is the uncertainty that some would create over the future of Quebec. The second cloud is the debt and deficit. Dealing with that challenge is our purpose today."

1994-95 deficit $4.4 billion below target

The underlying deficit for this fiscal year, 1994-95, will be $35.3 billion – down $6.7 billion from last year – and $4.4 billion below the target set out in last year's budget. Even with certain one-time restructuring charges related to major reforms contained in the budget, the 1994-95 deficit will be under $38 billion – or about $1.8 billion below the $39.7 billion target.

However, higher than expected interest rates will mean billions of dollars in new debt charges which threaten future deficit targets.

Gaps and targets

Based on very prudent economic assumptions and including large contingency reserves, direct action is needed to avoid a $5.0 billion shortfall from the 1995-96 deficit target of $32.7 billion – and a $10.6 billion shortfall from the 1996-97 target of 3 per cent of GDP (Gross Domestic Product – the overall size of the economy).

Comparison of the economic assumptions with private sector forecasts

	1995	1996
Real output growth (%)		
Budget	3.8	2.5
Private sector average	3.9	2.9
Nominal GDP ($ billions)		
Budget	787	821
Private sector average	787	827
91-day Treasury bill rate (%)		
Budget	8.5	7.5
Private sector average	7.8	6.9
10-year government bond rate (%)		
Budget	9.7	9.0
Private sector average	9.0	8.4

Principles of the budget

> *"Canadians want their government to spend money and secure savings in ways that make sense, that reflect their values. To do that, it is essential that our effort be guided by clear principles."*

- Government must get its own house in order first and focus on cutting spending – not raising taxes.
- The priorities of the country must reflect the needs of the people. Canadians need an economic plan which promotes jobs and growth.
- The third principle is frugality – every dollar counts.
- Finally, we must be fair – among regions and among individual Canadians.

Securing the Deficit Targets

> *"We have said from the beginning that we would meet our targets – come what may. Therefore, those gaps must be closed. With this budget we are closing them."*

> *"We have always said that our 3-per-cent interim target was a station on the way, <u>not</u> our ultimate destination. <u>Interim</u> means <u>interim</u>."*

The budget closes the gaps and meets the targets. It achieves cumulative savings of $15.6 billion over the two fiscal years, 1995-96 and 1996-97.

In 1997-98, the measures in the budget will continue to pay off, with further savings of $13.3 billion.

The budget delivers cumulative savings of $29 billion over three fiscal years. This is the largest set of actions in any Canadian budget since postwar demobilization.

The savings come primarily from $25.3 billion of cumulative spending reductions – nearly $7 of spending cuts for every $1 of new tax revenue.

Fiscal actions lower debt by $29 billion

There will be a reduction in program spending from $120 billion in 1993-94 to under $108 billion by 1996-97.

The budgets of government departments are being reduced dramatically, in several cases halved over the next three years.

The budget proposes a small number of tax measures to increase fairness and tighten the tax system and to help meet deficit targets. **Personal income tax rates are not being raised.**

Impact of budget measures

	1995-96	1996-97	1997-98	3-year[1] impact
		(billions of dollars)		
Expenditure reductions				
Program review	3.9	5.9	7.2	16.9
Other	0.2	3.5	4.7	8.4
Total	4.1	9.3	11.9	25.3
Revenue measures				
Increase fairness and tighten tax system	0.1	0.4	0.6	1.1
Tax increases	0.9	0.9	0.8	2.6
Total	0.9	1.3	1.4	3.7
Total direct impact of fiscal actions	5.0	10.6	13.3	29.0
Ratio of expenditure reductions/ tax revenue increases	4.4:1	7.3:1	8.3:1	6.9:1

[1] Three-year cumulative impact of deficit reductions shows the reduction in net debt, by the end of the 1997-98 fiscal year, arising from fiscal actions.

Numbers may not add due to rounding.

Implications of Budget Measures

> *"We will continue to set firm, short-term deficit goals – rolling two-year targets, until the deficit is erased."*

> *"We seek not only to attack the deficit. We are also committed to putting Canada's debt ratio on a permanent downward track."*

Actions taken in the budget will bring the 1995-96 deficit down to $32.7 billion and the 1996-97 deficit to $24.3 billion – meeting the 3-per-cent target under very prudent economic assumptions.

The financial requirements – a measure of what the government must borrow on debt markets – will decline sharply from $29.8 billion in 1993-94 to $13.7 billion in 1996-97. This represents 1.7 per cent of the GDP, the lowest borrowing requirement since 1973-74.

Using this measure, Canada is projected to do better in 1996-97 than the national government of any other G-7 country.

As a share of GDP, program spending will fall rapidly reaching 13.1 per cent in 1996-97 – the lowest ratio since 1950-51.

By 1996-97, the Canadian economy will finally be growing faster than the debt, and the debt-to-GDP ratio will begin to decline. The ratio will continue to fall after that in response to the permanent spending reductions in the budget.

Deficit in 1997-98 will continue to fall

The deficit could turn out better than forecast.

A substantial contingency reserve has been included – $2.5 billion in 1995-96 and $3 billion in 1996-97. If it isn't needed to protect the fiscal position, it will not be spent. It will go to reducing the deficit even further.

If the economy performs as private sector forecasters expect, then the deficit could be below $19 billion in 1996-97 – $5.5 billion below the budget forecast. This would mean a decline in the current 1994-95 debt-to-GDP ratio of 73.2 per cent to under 72 per cent in 1996-97.

Summary statement of transactions: Fiscal outlook with budget measures

	1993-94	1994-95	1995-96	1996-97
		(billions of dollars)		
Budgetary transactions				
Budgetary revenues	116.0	125.0	133.2	137.4
Program spending	-120.0	-118.3	-114.0	-107.9
Operating balance	-4.0	6.7	19.2	29.4
Public debt charges	-38.0	-42.0	-49.5	-50.7
Underlying deficit	-42.0	-35.3	-30.2	-21.3
Restructuring charges		-2.6		
Contingency reserve			-2.5	-3.0
Deficit	-42.0	-37.9	-32.7	-24.3
Non-budgetary transactions	12.2	11.9	7.8	10.6
Financial requirements (excl. foreign exchange transactions)	-29.8	-26.0	-24.9	-13.7
Net public debt	508.2	546.1	578.8	603.1
Gross domestic product	711.7	746.4	787.1	821.3
Percentage of GDP				
Budgetary revenues	16.3	16.7	16.9	16.7
Program spending[1]	16.9	16.2	14.5	13.1
Public debt charges	5.3	5.6	6.3	6.2
Deficit	-5.9	-5.1	-4.2	-3.0
Financial requirements	-4.2	-3.5	-3.2	-1.7
Net public debt	71.4	73.2	73.5	73.4

[1] Includes restructuring charges.

Notes: (-) indicates a net requirement for funds.
(+) indicates a source of funds.

Numbers may not add due to rounding.

Plan for Action

> *"Durable fiscal progress, building towards budget balance – that can only happen if we redesign the very role and structure of government itself."*
>
> *"If we secure that reform, it will continue to pay off – to live on – in 1997-98 and every year thereafter."*

The primary objective of the government is to sustain growth and job creation. That can only be achieved in a healthy fiscal environment. The budget is aimed not only at creating such an environment, but also at changing the way government operates.

The budget fundamentally reforms what government **does** and ***how*** it does it.

In many cases, that means ***smaller*** government. In all cases it means ***smarter*** government.

To that end, the following actions will be taken as a result of the budget:

■ reform of government programs and procedures to eliminate waste and abuse and ensure value for Canadian taxpayers;

■ delivery of a new vision of the federal government's role in the economy that includes substantial reductions in business subsidies;

■ setting parameters within which labour market programs will be redesigned to put Canadians back to work;

■ reform of the major federal transfers to the provinces (other than Equalization) to better reflect responsibilities and fiscal requirements; and

■ a small number of tax measures that remove preferences, increase fairness and ensure deficit targets are met.

Getting Government Right

> *"If our purpose is to get the economy right – and it is – then the best thing we can do is to get the government right – and this budget does."*

Program Review

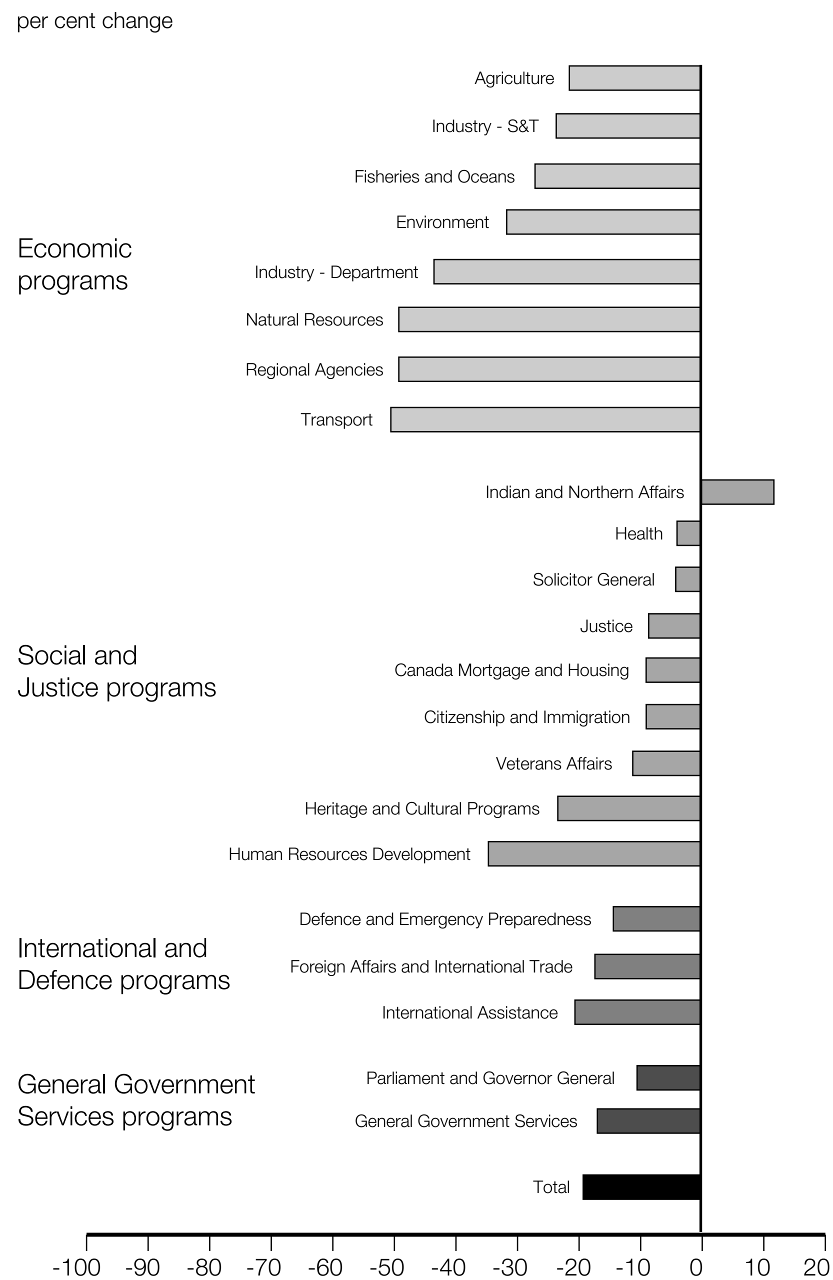
Program Review was a year-long, top-to-bottom review of all departmental programs, covering about $52 billion in spending.

Its main objective was to review all categories of federal government spending – except certain statutory programs such as Unemployment Insurance, Old Age Security and major transfers to the provinces – in order to bring about the most effective and cost-efficient way of delivering programs and services to Canadians.

The actions resulting from this review will substantially reduce expenditures over the next three years – $3.9 billion in 1995-96, $5.9 billion in 1996-97 and $7.2 billion in 1997-98. By 1997-98, spending subject to the Program Review will have declined almost 19 per cent relative to 1994-95.

Spending levels will be halved in some departments. The federal public service including defence is expected to decline by about 45,000 or 14 per cent by the time the actions in this budget are fully implemented.

Changes in federal departments spending 1997-98 relative to 1994-95



Highlights of Program Review

Some programs will be eliminated or substantially reduced:

- transportation subsidies under the *Western Grain Transportation Act*, the *Atlantic Region Freight Assistance Act* and the *Maritime Freight Rates Act* will be terminated;
- dairy subsidies will be reduced by 30 per cent over the next two years; and
- total spending on business subsidies will decline from $3.8 billion in 1994-95 to $1.5 billion by 1997-98 – by close to 60 per cent over the next three years.

Some programs will be redesigned or consolidated to become more efficient and cost-effective including:

- Regional Development – agencies will play new roles focusing on the needs of small- and medium-sized businesses;
- Canada Coast Guard and the Department of Fisheries and Oceans fleets will be integrated; and
- Departments of Health, Agriculture and Agri-Food, Fisheries and Oceans, and Industry will work together on measures to improve the food inspection system.

Some program activities will be devolved to other levels of government:

- authorities for freshwater habitat management and other related inland water responsibilities will be transferred to the provinces;
- recreational harbours will be divested to municipalities;
- Forest Resource Development Agreements and Mineral Development Agreements with the provinces will be discontinued; and
- airports will be transferred to local authorities.

Some activities will be commercialized or privatized including:

- remaining interest in Cameco Corporation and Petro-Canada;
- Canadian National (CN);
- Air Navigation System; and
- Canada Communication Group.

Cost recovery and user fees will be increased or imposed on certain services including:

- food and meat inspection, drug approval, fisheries inspection, marine services, customized weather forecasting;
- an immigration fee of $975 per adult immigrant; and
- consular and trade development services.

Better management of government:

- the Auditor General will report to Parliament more frequently – up to five times annually;
- a new Expenditure Management System will be implemented to ensure that programs are permanently subject to strict cost control and evaluation; and
- more productive and streamlined operations through innovative service delivery.

Unemployment Insurance Reform

> *"We need to move away from passive support – away from dependence – and move towards active assistance – towards independence."*
>
> *"A key job for unemployment insurance in the future must be to help Canadians stay off unemployment insurance."*

Building on measures in the 1994 budget, the Minister of Human Resources Development intends to table legislation this fall to make further changes to unemployment insurance. The changes will move current program funding into the areas of unemployment insurance which enhance the employability of Canadians, contribute to a healthy economy and encourage job creation.

Canada's strong economic performance and unemployment insurance reform, which the government intends to have in place no later than July 1, 1996, will reduce the overall size of the program by a minimum of 10 per cent. This overall reform, combined with improvements in the administration of the unemployment insurance program, will secure savings of $700 million in 1996-97. Reform will be designed and carried out in a manner that eases the transitional impact of changes in provinces where there is a history of reliance on unemployment insurance.

With no increase in premium rates, the cumulative surplus in the Unemployment Insurance Account will be allowed to rise above $5 billion through to the end of 1996. This surplus will be maintained and will serve as a buffer to mitigate unemployment insurance premium rate increases during periods of slowing economic growth. The result of these measures will be a unemployment insurance program that does a much better job of investing in people, and lower, more stable unemployment insurance premium rates that encourage job creation.

A New Transfer to the Provinces

"We will never secure the sort of structural change that we need without reforming the system of transfers to the provinces."

"This budget sets out some key parameters, but as we go forward, we are committed to a co-operative approach."

The Canada Social Transfer

The government is giving one year notice that a new block grant to the provinces called the Canada Social Transfer (CST) will begin in 1996-97. It will continue the evolution away from cost-sharing in areas of provincial responsibility, which has been a source of entanglement and irritation in federal-provincial relations.

The major transfers to the provinces under the Canada Assistance Plan (CAP) and Established Programs Financing (EPF) will be replaced by the CST. As is currently the case with both EPF and CAP, the new transfer will be a combination of cash and tax points.

In 1996-97, CST funding will be set at $26.9 billion, a reduction of $2.5 billion compared with the projected transfer entitlement under the existing set of programs. In 1997-98, funding will be reduced further to $25.1 billion, a reduction of $4.5 billion, or about 3 per cent of total provincial government revenues.

Major transfer entitlements to provinces

	1993-94	1994-95	1995-96	1996-97	1997-98
			(millions of dollars)		
Current arrangements					
CAP	7,719	7,952	7,952		
EPF-PSE	6,108	6,177	6,251		
EPF-Health	15,128	15,299	15,483		
Total	28,955	29,428	29,686		
Canada Social Transfer				26,900	25,100
Equalization	8,034	8,332	8,870	9,270	9,618
Total major transfer entitlements of which:[1]	36,212	36,974	37,745	35,351	33,889
Tax point transfers[1]	11,290	11,729	12,572	13,248	13,968
Cash transfers	24,922	25,245	25,173	22,103	19,921
Change in entitlements from 1994-95 levels				1,623	3,085

[1] Equalization associated with EPF/CST tax points appears in both Equalization and EPF/CST entitlements. It has been subtracted from “Total major transfer entitlements” and “Tax point transfers” to avoid double counting.

The new transfer will free the provinces to pursue innovation by eliminating the restrictive cost-sharing feature of the Canada Assistance Plan.

The new transfer will not however be totally unconditional. The federal government will continue to enforce the Canada Health Act and the provinces will be required, as they are now under the rules of CAP, to provide social assistance without any minimum residency requirements.

The federal government, under the leadership of the Minister of Human Resources Development, will invite all provincial governments to work together on developing, through mutual consent, a set of shared principles and objectives that could underlie the new transfer.

Following consultations with the provinces, the ***Equalization program*** was renewed by Parliament for five years beginning in 1994-95. No changes are proposed in the budget. ***Territorial Formula Financing*** has not previously been subject to federal budgetary restraint. However, in view of the current fiscal situation, entitlements will be frozen in 1995-96 at 1994-95 levels and the 1996-97 Gross Expenditure Base in the formula will be reduced by 5 per cent for both the Northwest Territories and the Yukon.

The reduction in major transfers to the provinces is less than the cuts in other areas of federal program spending.

Protecting Canada's Seniors

> *"One of the greatest reforms ever provided by a Canadian government has been the provision of a decent support for elderly Canadians – who have given – and continue to give – so much to their families and to their country."*
>
> *"This government is absolutely committed to providing a fair and sustainable system of protection for Canada's seniors."*

The government is committed to take action to reform Canada's retirement income system on a fairer and sustainable basis. The first part of this system – tax assistance for private pensions – is being modified, as described in the next section. The second part – the Canada Pension Plan (CPP) – will be addressed this fall when Finance Ministers meet to review the financing of CPP, as part of its regular five-year review as mandated by law.

The third pillar of the pension income system – Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) – will be reviewed later this year. The Minister of Human Resources Development, in collaboration with the Minister of Finance, will release a paper which will outline other changes required to ensure a fair and sustainable public pension system for future generations of Canadians. The goal will be to legislate changes to take effect in 1997. Consultations with seniors, and with Canadians generally, will take place when the paper is released.

In the interim, the budget introduces two changes to the administration of the OAS benefit.

Effective July 1996, OAS payments will be calculated and paid out net of the high-income recovery amounts, based on income reported on the previous year's tax return. This will not affect the amount of benefits provided to seniors. The only change is that the OAS benefit will be reduced before it is sent out rather than being taxed back after individuals have already received their cheque.

Also effective July 1996, OAS recipients who are no longer resident in Canada will have to file a statement of their world-wide income in order to receive OAS benefits. Currently, non-residents with incomes above $53,215 escape the high-income recovery. They are treated more favourably than Canadian residents.

A Fairer Tax System: Sharing the Burden of Deficit Reduction

> *"There is not one, solitary Canadian who likes taxes. And certainly, they are far higher than any of us would like them to be."*
>
> *"But the issue of taxes is more than a matter of rates. It is a question of equity."*

The government is aware of the heavy tax burden already borne by Canadians and the cost imposed on the economy as a whole. Thus, the budget does ***not*** raise federal personal income tax rates. The tax measures are largely directed at removing preferences and increasing fairness and helping to meet deficit targets.

Impact of tax measures

	1995-96	1996-97	1997-98
	(millions of dollars)		
Measures to increase fairness and tighten the tax system			
Improving fairness in tax-assisted retirement saving	15	95	160
Strengthen Revenue Canada's ability to enforce the law	Prevents revenue losses		
Additional tax on investment income of private corporations	40	120	120
Eliminate deferral of tax on business income	–	170	300
Restrict SR&ED tax incentives	–	15	15
Family trusts	Prevents revenue losses		
Re-targeted film incentive	small	small	small
Subtotal	55	400	595
Increases in tax rates			
Corporate			
Large corporations tax	145	155	160
Corporate surtax	115	115	120
Temporary capital tax increase for large deposit-taking institutions	60	40	–
Excise			
Tobacco	65	65	65
Gasoline	500	500	500
Subtotal	885	875	845
Total	940	1275	1440

Improving Fairness in Tax-Assisted Retirement Savings

The principle underlying these changes is that tax assistance should be provided for contributions to registered savings plans based on earnings up to 2½ times the average wage, and no more.

Pensions and RRSPs: The dollar limit on deductible RRSP contributions will be reduced to $13,500 for 1996 and 1997. The limit then will be increased by $1,000 a year to reach $15,500 in 1999. The dollar limit on contributions to money-purchase pension plans will also be reduced to $13,500 in 1996 and then increased by $1,000 a year to reach $15,500 in 1998. The dollar limits on contributions to deferred profit sharing plans (DPSPs) will continue to be one half the contribution limits for money-purchase pension plans.

The maximum pension limit for defined-benefit pension plans will be frozen at its current level through 1998. The pension and DPSP limits will be indexed beginning in 1999 and the RRSP limit in 2000.

The government will investigate the possibility of modifying RRSP limits, without incurring additional revenue costs, to restore lost RRSP room to employees who leave pension plans before retirement.

RRSP Overcontribution Allowance: The overcontribution allowance of $8,000 will be reduced to $2,000 in 1996. A penalty tax of 1 per cent applies to excess contributions above the allowance.

Retiring Allowance Rollovers: The rollover of retiring allowances to RRSPs, currently permitted at up to $2,000 per year of service, will be phased out by reducing the limit to zero for years of service after 1995. The allowances for years of service up to, and including 1995, are not affected.

Locked-in RRSPs: Holders of locked-in RRSPs, currently limited to purchases of life annuities with those funds, will be allowed to purchase Life Income Funds through an amendment to the Pension Benefits Standards Act (PBSA).

Increasing Fairness and Tightening the Tax System

Strengthening Revenue Canada's Ability to Enforce the Law: To ensure that all Canadians pay their fair share of taxes and to reduce unfair competition for legitimate businesses, the budget strengthens Revenue Canada's ability to enforce the tax laws. Measures include: strengthening its auditing of large corporations, new reporting requirements for the construction industry and for foreign investments, and penalties for interference with the remittance of source deductions and GST.

Tax on Investment Income of Private Corporations: Effective July 1, 1995, a refundable tax will be levied on the investment income received by Canadian-controlled private corporations. This tax will reduce the current deferral advantage for investment income received by private corporations when the corporate tax rate applied to this income is lower than the marginal tax rate of the individual shareholder.

Deferral Advantages for Business and Professional Income: Effective for taxation years starting after 1994, individuals will be required to report their business and professional income on a calendar year basis. Currently, they have the option to choose any date as their year end for reporting such income. This can result in an initial delay in reporting income and a consequent delay in payment of tax on an ongoing basis. A ten year transition period will preclude a large one-time tax increase for many of these taxpayers.

Restrictions on SR&ED Tax Incentives: Pending the completion of a review of information technology R&D, all such R&D performed after February 27, 1995 by financial institutions will be excluded from the definition of Scientific Research and Experimental Development (SR&ED).

Family Trusts: The existing election to defer the application of the 21-year rule will be eliminated January 1, 1999. To restrict income splitting, the "preferred beneficiary election mechanism" will be repealed for taxation years of trusts commencing after 1995, except for elections in respect of persons with mental or physical disabilities.

Re-Targeted Film Incentive: Government assistance available to certified Canadian film productions will be re-targeted in order to maximize the benefit to such productions.

Corporate Tax Rate Increases

Large Corporations Tax (LCT) Rate: The rate of LCT will rise immediately from 0.2 per cent to 0.225 per cent of capital used in Canada in excess of $10 million, a tax increase of 12.5 per cent.

Corporate Surtax: The corporate surtax, currently levied at a rate of 3 per cent of basic federal corporate income tax, will be increased to 4 per cent – effective immediately.

Tax on Large Deposit-Taking Institutions: The capital tax imposed on banks and other large deposit-taking institutions will be temporarily increased. The tax will take effect immediately and will remain until October 31, 1996.

Excise Tax Increases

Tobacco Products: Moving towards re-establishing a uniform federal excise tax rate, the federal taxes on cigarettes sold for consumption in Quebec and Ontario – the two provinces that undertook the deepest reductions last year – were increased by 60 cents per carton of 200 cigarettes effective February 18, 1995.

Gasoline: Federal excise tax on leaded and unleaded gasoline will be increased by 1.5 cents per litre effective immediately.

Conclusion

"This government wants Canadians to be able to judge it not on its rhetoric, but on its results; not on more promises made, but on real progress secured.

This budget sets this country on a sure course of fiscal responsibility and government renewal.

Canadians can have confidence now in a country that has put the era of band-aid budgets behind it – and exercised the leadership necessary for a cure.

Canadians can have confidence now in Canada becoming one of the most attractive places in the world to invest, creating jobs."