Supplementary Information and
Notices of Ways and Means Motions Included

The Budget Plan 2001

Department of Finance Canada
Ministère des Finances Canada

Available from the

Distribution Centre
Department of Finance Canada
Room P-135, West Tower
300 Laurier Avenue West
Ottawa, Ontario K1A 0G5
Tel: (613) 943-8665
Fax: (613) 996-0901

and from participating bookstores.

Price: $26.75 including GST

This document is available free on the Internet
at http://www.fin.gc.ca/

Cette publication est également disponible en français.

Cat. No.: F1-23/2001-3E
ISBN 0-660-18690-X

Table of Contents

Annexes

1

Introduction and Overview

Budget 2001

Canadians today face a period of significant economic uncertainty.

For the first time in 25 years, we find ourselves in the midst of a global economic slowdown, which has been made worse by the September 11 terrorist attacks on the U.S.

Budget 2001 builds on the Government's long-term plan for a stronger economy and a more secure society, but it also responds to immediate economic and security concerns. It does this in four ways:

- first, it provides a timely boost to the economy at a time of global weakness and uncertainty and positions Canadians to take full advantage of the recovery expected next year;
- second, it acts to build personal and economic security by keeping Canadians safe, terrorists out and our borders open and efficient;
- third, it keeps the nation's finances healthy by balancing the budget this year and for the next two years; and
- fourth, it fully protects the $100-billion tax cut and the $23.4 billion in increased support for health care and early childhood development.

Global Economic Slowdown and Implications for Canada

Economic growth in all major economies slowed sharply in the first half of this year. A variety of factors contributed to the global slowdown, including higher interest rates and energy prices and a sharp decline in global high technology investment. The events of September 11 introduced a further shock to the global economy through disruptions in economic activity and sharp declines in confidence, particularly in the United States.

Forecasters have further downgraded their outlook for the U.S. economy, incorporating a recession now underway. Weakness in the U.S. economy is expected through the first half of 2002, followed by a rebound in the second half of the year.

This is affecting the Canadian economy, which has slowed considerably in response to weaker export demand from our largest trading partner. The Canadian economy contracted in the third quarter, and most private sector forecasters expect further weakness in the fourth quarter. They expect positive but modest growth in the first half of 2002, with growth picking up in the second half of the year.

There is considerable uncertainty in the global outlook. If U.S. consumer and business confidence erode further, global growth could remain weak and the recovery could be delayed.

Canada is better positioned than in the previous downturn of the early 1990s to weather difficult economic times because of:

– healthier finances through balanced budgets and debt repayment;
– the $100-billion tax cut, proportionately larger than in the U.S.;
– low and stable inflation;
– declining foreign debt; and
– historically low interest rates.

Canada's Fiscal Progress Through 2000-2001

The federal government recorded a budgetary surplus of $17.1 billion in 2000-01. This is the largest annual surplus since Confederation and the fourth consecutive annual surplus, following surpluses of $3.5 billion in 1997-98, $2.9 billion in 1998-99 and $12.3 billion in 1999-2000.

Net public debt has declined $35.8 billion from its peak of $583.2 billion in 1996-97 to stand at $547.4 billion. This debt paydown, coupled with Canada's strong economic growth, has resulted in a significant decline in the federal debt-to-GDP (gross domestic product) ratio, from its peak of 70.7 per cent in 1995-96 to 51.8 per cent in 2000-01. This decline in net public debt has resulted in ongoing savings in debt interest payments of about $2.5 billion each and every year.

Federal market debt – the debt issued on credit markets – has declined by over $30 billion from its peak of $476.9 billion in 1996-97 to $446.4 billion in 2000-01. The market debt-to-GDP ratio has declined to 42.3 per cent, down from its peak of 57.8 per cent in 1995-96.

The amount of every revenue dollar collected by the federal government that is used to pay interest on the public debt declined to 23.6 cents in 2000-01, down from 36 cents in 1995-96, and is now at its lowest level since 1981-82.

Federal program spending as a percentage of GDP has fallen from 16.4 per cent in 1993-94 to 11.3 per cent in 2000-01, its lowest level since 1948-49. More than two-thirds of the improvement in the budgetary balance since 1993-94 is attributable to the decline in program spending.

The aggregate provincial-territorial budget recorded a record surplus of $12 billion in 2000-01, the second consecutive surplus. Eight provinces and two territories reported budgetary surpluses in 2000-01.

On a total government basis, between 1992 and 2000 Canada achieved the largest improvement in its financial balance of all Group of Seven (G-7) countries. In 2000 Canada's surplus reached 3.2 per cent of GDP, compared to an average deficit of 0.1 per cent for the G-7 countries.

Private Sector Five-Year Economic and Fiscal Projections

The Department of Finance meets each fall with the chief economists of the major chartered banks and three private sector economic forecasting firms. The objective of this exercise is to agree on a set of economic assumptions for planning purposes, which the forecasting firms then use to develop fiscal projections of the budgetary balance for the current fiscal year and each of the next five years. However, because of the greater degree of uncertainty associated with longer-term projections, budget decisions are made on a rolling two-year horizon.

In the absence of any policy decisions proposed in this budget, the average private sector projections of the surplus for fiscal-planning purposes are $7.3 billion in 2001-02, $3.8 billion in 2002-03, $5.7 billion in both 2003-04 and 2004-05, $9.7 billion in 2005-06 and $14.3 billion in 2006-07.

These projections of the fiscal surplus reflect the effects of the slowdown in economic growth in both 2001 and 2002 and the rebound in the years thereafter. In addition, the agreements on health renewal and early childhood development reached by first ministers in September 2000 and the impact of the $100-billion Five-Year Tax Reduction Plan further restrain the surplus projections to 2004-05 – the year in which the tax reduction plan is fully implemented. Thereafter larger surpluses are projected.

These fiscal projections are based on the October 2001 survey of private sector economists. Subsequently private sector economists have adjusted their short-term economic forecasts to incorporate more current data, including the third-quarter National Accounts results for Canada and the U.S., which were released on November 30, 2001. These adjusted economic assumptions were used in deriving the rolling two-year budget fiscal forecasts in Chapter 7.

Enhancing Security for Canadians

The 2001 budget contains measures to enhance personal and economic security by: keeping Canadians safe, keeping terrorists out of Canada and keeping Canada's borders secure, open and efficient.

In total, the budget provides $7.7 billion over the next five years to enhance security for Canadians. This includes $6.5 billion for security, including air security and Canada's military. It also includes more than $1.2 billion for border initiatives aimed at strengthening border security, facilitating the flow of goods and people, and improving border infrastructure.

Security

Intelligence and Policing

The budget includes $1.6 billion over the next five years for intelligence and policing to:

- equip and deploy more intelligence officers and police officers;
- improve co-ordination and information sharing among law enforcement, intelligence and national security agencies;
- boost marine security through greater funding for coastal surveillance; and
- strengthen the role of the Financial Transactions and Reports Analysis Centre of Canada in cutting off terrorist financing.

Screening of Entrants to Canada

In total, $1 billion will be provided over the next five years to improve the screening of visitors, immigrants and refugee claimants entering Canada. These initiatives include:

- better and more accurate screening both at Canada's ports of entry and abroad; and
- faster and more thorough screening of refugee claimants.

Emergency Preparedness and Military Deployment

Budget 2001 provides more than $1.6 billion to:

- double the capacity of Joint Task Force Two – the Canadian Forces' elite anti-terrorist unit;
- support Canadian military participation in the international war on terrorism;
- fund military equipment purchases;
- improve laboratories and purchase specialized equipment to strengthen Canada's ability to respond to chemical, biological and nuclear threats; and
- improve the ability to protect Canada's critical infrastructure – such as water and energy utilities and transportation and communications systems.

A New Approach to Air Security

In total, $2.2 billion will be provided over the next five years to make air travel more secure in accordance with rigorous new national Transport Canada standards. To ensure that these standards are met, the Government will create a new federal air security authority.

New air security measures will include:

- armed undercover police officers on Canadian aircraft;
- better-trained personnel to screen passengers and carry-on baggage;
- new state-of-the-art explosive detection systems at Canada's airports;
- enhanced policing in airports;
- permanent modifications to aircraft cockpit doors to make them more secure; and
- enhanced security zones at airports, including handling facilities and on tarmacs.

These measures will be funded by a new Air Travellers Security Charge to be paid by air travellers starting April 1, 2002.

A Secure, Open and Efficient Border

More than $1.2 billion will be invested in border-related measures to address security concerns and enhance long-term economic prospects by making the Canada-U.S. border more open and efficient.

Border Security and Facilitation

Of the more than $1.2 billion dedicated to border-related measures, $646 million will be targeted to measures aimed at enhancing border security while facilitating the flow of goods and people between Canada and the United States. These include:

- new technology to help the Canada Customs and Revenue Agency facilitate the passage of goods and people at border-crossing points;
- new Canadian multi-agency Integrated Border Enforcement Teams to co-ordinate intelligence and enforcement efforts along the Canada-U.S. border;
- advanced information-sharing technology to help Customs officers screen travellers arriving at airports and other border-entry points;
- better equipment for detecting explosives, firearms and other dangers without delaying the flow of legitimate commerce or tourism; and
- new secure Internet-based technology to ease Customs compliance for small business.

Border Infrastructure

To help make the border more efficient, Budget 2001 also creates a new $600-million program to improve infrastructure – such as highways, commercial vehicle processing centres and technology – that supports major border crossings. This will be done in co-operation with public and private sector partners on both sides of the border.

Strategic Investments: Bridging to the Future

Budget 2001 addresses immediate needs through targeted, strategic investments that provide a stimulative boost to confidence in the economy. It does so as it advances, in a fiscally affordable way, the long-term plan the Government has put in place.

Investing in Health Initiatives

Because Canada's publicly funded health care system reflects the fundamental values shared by all Canadians, the budget:

- confirms that the $23.4 billion in funding to support health and early childhood development agreements reached by first ministers in September 2000 is fully protected;
- further strengthens the federal government's contribution to Canada's health care system by providing $95 million to the Canadian Institute for Health Information; and
- provides a $75-million increase to the annual budget of the Canadian Institutes of Health Research.

Investing in Skills, Learning and Research

Because the Government is committed to providing every opportunity for Canadians to upgrade their skills, and because research today is the source of new jobs tomorrow, the budget includes more than $1.1 billion over three years to support skills, learning and research by:

- increasing funding for sector councils;
- improving support for people with disabilities who pursue higher education;
- reducing waiting period provisions for apprentices in the employment insurance (EI) program, allowing an income tax deduction for apprentice vehicle mechanics' tools, and assisting mentoring and business support to young entrepreneurs;

- exempting from income tax, tuition assistance for adult basic education provided under certain government programs, and extending access to the education tax credit;
- helping offset indirect research costs at universities and research hospitals;
- supporting leading-edge technologies and expanding regional innovation initiatives across the country through increased funding to the National Research Council of Canada;
- providing additional funding to the Natural Sciences and Engineering Research Council and the Social Sciences and Humanities Research Council; and
- extending funding for Internet initiatives including SchoolNet, the Community Access Program and Government On-Line, and building CA*net 4, a new generation of Internet broadband network architecture.

In total, the Government's expenditures on science and technology are estimated at $7.4 billion in 2001-02, an increase of 25 per cent from the previous peak.

Investing in Strategic Infrastructure and the Environment

Because investments in infrastructure will both stimulate job creation and confidence in the short term and make the economy more productive and competitive in the long term, the budget announces targeted investments of nearly $3 billion that:

- create the Strategic Infrastructure Foundation, with a minimum federal commitment of $2 billion, to fund large strategic projects;
- confirm $680 million in funding for a capital grants program to alleviate the shortage of affordable rental housing;
- double funding to the Green Municipal Enabling Fund and the Green Municipal Investment Fund; and
- enhance incentives for renewable energy and energy efficiency projects.

Aboriginal Children

Because the well-being of Aboriginal children today will lead to stronger First Nations communities in the future, this budget provides $185 million over the next two years to:

- enhance programs such as child care and head start programs, which support early childhood development;
- intensify efforts to reduce the incidence of fetal alcohol syndrome and fetal alcohol effects on reserves; and
- provide increased funding to support children on reserves who have special needs at school.

Furthering International Assistance

Because Canada recognizes the importance of helping those most in need beyond its borders, the budget increases international assistance by $1 billion over three years. Among other things, the budget will:

- commit $500 million to a fund promoting sustainable development in Africa; and
- provide humanitarian emergency assistance in Afghanistan.

Financial Management in Uncertain Times

This budget projects balanced budgets or better for 2001-02 and for each of the next two fiscal years. The global economic outlook remains uncertain. However, even using the average of the four most pessimistic private sector forecasts, balanced budgets are still projected for each year of the budget plan.

Program spending is projected to increase by 9.4 per cent in 2001-02. Over three-quarters of this increase is due to higher cash transfers to the provinces and territories for health care, funding to enhance security, and higher EI and elderly benefits.

Budgetary revenues are projected to decline in 2001-02, reflecting the impact of the second year of the Government's tax reduction plan, the six-month deferral of monthly corporate tax instalment payments for small businesses, and the weakness in the economy.

The debt-to-GDP ratio is expected to fall to under 50 per cent in 2002-03, its lowest level in 17 years.

The unforeseen circumstances of both the global economic slowdown and the terrorist attacks of September 11th have created exceptional fiscal pressures. As a result, the Government will use the economic prudence and part of the Contingency Reserve for each year of the budget plan. The Contingency Reserve is set at $1.5 billion for 2001-02, rising to $2.0 billion in 2002-03 and $2.5 billion in 2003-04. It is the Government's intention to rebuild the normal Contingency Reserve and economic prudence as soon as possible.

In good economic times the Government paid down a substantial amount of debt – $35.8 billion in the last four years. Given the current economic weakness, it has decided not to pay down any debt this year. Any surplus at the end of fiscal year 2001-02 will be dedicated to the Strategic Infrastructure Foundation and the Africa Fund.

Summary of Spending and Revenue Initiatives Since the October 2000 Economic Statement

Table 1.1 presents the fiscal impact of the spending and revenue initiatives proposed in this budget. Table 1.2 presents the fiscal impact of the measures announced since the October 2000 Economic Statement but before the 2001 budget. Table 1.3 shows the total fiscal impact of all measures proposed since the October 2000 Economic Statement.

The cumulative cost of the measures over the three years from 2001-02 to 2003-04 amounts to $8.5 billion. Of this amount, $4.2 billion, or nearly half, is for measures directed at enhancing security for Canadians.

Table 1.1
Spending and Revenue Initiatives Proposed in the 2001 Budget

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Spending initiatives proposed in this budget			
Enhancing security for Canadians			
Security	1,067	1,217	1,236
Secure, open and more efficient Canada-U.S. border	72	306	260
Total	1,139	1,523	1496
Bridging to the future			
Investing in health	105	78	78
Investing in skills, learning and research	429	318	318
Strategic infrastucture and the environment	207	181	234
Strategic Infrastructure Foundation: minimum commitment of $2 billion			
Aboriginal children		90	95
International assistance	215		285
Africa Fund: commitment of $500 million			
Total	956	667	1,010
Departmental operations	569	361	198
Total spending initiatives	2,664	2,551	2,703
Revenue and cost recovery initiatives proposed in this budget			
Deferral of corporate income tax instalments for small businesses	2,000	-2,000	
Tax expenditures	10	40	60
Air Travellers Security Charge		-430	-445
Cost recovery		-50	-50
Total	2,010	-2,440	-435
Total spending, revenue and cost recovery initiatives	4,674	111	2,268

Table 1.2
Spending and Revenue Initiatives Announced Before the 2001 Budget

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Spending initiatives			
Improving the quality of life for Canadians and their children			
Community health and environment	173	180	167
Culture and branding Canada abroad	305	395	196
Crime prevention and drug strategy	30	30	30
Employment insurance benefits	35	89	89
Community safety and crime prevention	23	32	45
Total	565	726	526
Making Canada's economy more innovative			
Research and development			
Government On-line	120		
Providing essential public services			
Economic adjustment	183	103	120
Furthering international co-operation	25	37	26
Total	208	140	146
Total spending initiatives	894	866	672
Revenue initiatives			
Donations of certain publicly traded securities to charities		70	70
Tobacco tax increases	-275	-440	-440
Total	-275	-370	-370
Total spending and revenue initiatives	619	496	302

Table 1.3
Spending and Revenue Initiatives Proposed Since the October 2000 Economic Statement

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Spending initiatives			
Enhancing security for Canadians	1,139	1,523	1,496
Bridging to the future	1,076	667	1,010
Improving the quality of life for Canadians and their children	565	726	526
Providing essential public services	777	501	344
Total	3,557	3,417	3,375
Revenue and cost recovery initiatives			
Deferral of corporate income tax instalments for small businesses	2,000	-2,000	
Tax expenditures	10	105	120
Air Travellers Security Charge		-430	-445
Tobacco tax increases	-275	-440	-440
Cost recovery		-50	-50
Total	1,735	-2,815	-815
Total spending and revenue initiatives since the October 2000 economic statement	5,293	602	2,560

Note: Numbers may not add due to rounding.

Fiscal Outlook to 2003-04

Table 1.4 presents the fiscal outlook to 2003-04, taking into account the spending and revenue initiatives proposed since the October 2000 Economic Statement.

Table 1.4
Summary Statement of Transactions: Budget 2001

	2000-2001	2001-2002	2002-2003	2003-2004
	(billions of dollars)			
Budgetary transactions				
Budgetary revenues	178.6	171.3	174.7	180.7
Program spending	119.3	130.5	136.6	140.2
Operating balance	59.2	40.7	38.2	40.4
Public debt charges	42.1	39.2	36.3	38.1
Less: Contingency Reserve		1.5	2.0	2.5
Budgetary balance	17.1	0.0	0.0	0.0
Net public debt[1]	547.4	547.4	547.4	547.4
Non-budgetary transactions				
Loans, investments and advances	-1.7	-1.9	-1.9	-2.2
Pensions and other accounts	1.3	-1.7	0.0	2.6
Other	2.2	1.7	0.9	0.8
Total	1.8	-1.9	-1.0	1.2
Financial requirements/source	19.0	-1.9	-1.0	1.2
Per cent of GDP				
Budgetary revenues	16.9	15.8	15.9	15.5
Program spending	11.3	12.0	12.4	12.1
Public debt charges	4.0	3.6	3.3	3.3
Net public debt[1]	51.8	50.5	49.9	47.1

Note: Numbers may not add due to rounding.

[1] Assumes no incremental debt paydown.

2

Global Economic Slowdown and Implications for Canada

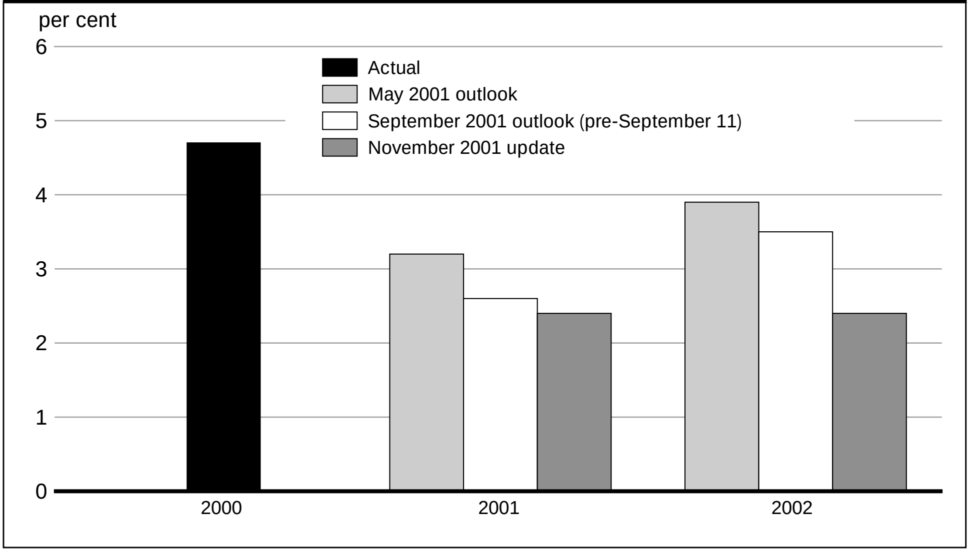
Highlights

- Economic growth in all major economies slowed sharply in the first half of this year.
- A variety of factors contributed to the global slowdown, including higher interest rates and energy prices and a sharp decline in global high technology investment.
- The events of September 11 introduced a further shock to the global economy through disruptions in economic activity and sharp declines in confidence, particularly in the United States.
- Forecasters have further downgraded their outlook for the U.S. economy, incorporating a recession now underway. Weakness in the U.S. economy is expected through the first half of 2002, followed by a rebound in the second half of the year.
- This is affecting the Canadian economy, which has slowed considerably in response to weaker export demand from our largest trading partner.
- The Canadian economy contracted in the third quarter, and most private sector forecasters expect further weakness in the fourth quarter. They expect positive but modest growth in the first half of 2002, with growth picking up in the second half of the year.
- There is considerable uncertainty to the global outlook. If U.S. consumer and business confidence erode further, global growth could remain weak and the recovery could be delayed.
- Canada is better positioned than in the previous downturn of the early 1990s to weather difficult economic times because of:
  - healthier finances through balanced budgets and debt repayment;
  - the $100-billion tax cut, proportionately larger than in the U.S.;
  - low and stable inflation;
  - declining foreign debt; and
  - historically low interest rates.

Note: This chapter incorporates data available up to December 3, 2001.

The world economic outlook has weakened significantly

World Real Gross Domestic Product (GDP) Growth



Sources: IMF, *World Economic Outlook* (May 2001, September 2001 and November 2001 update).

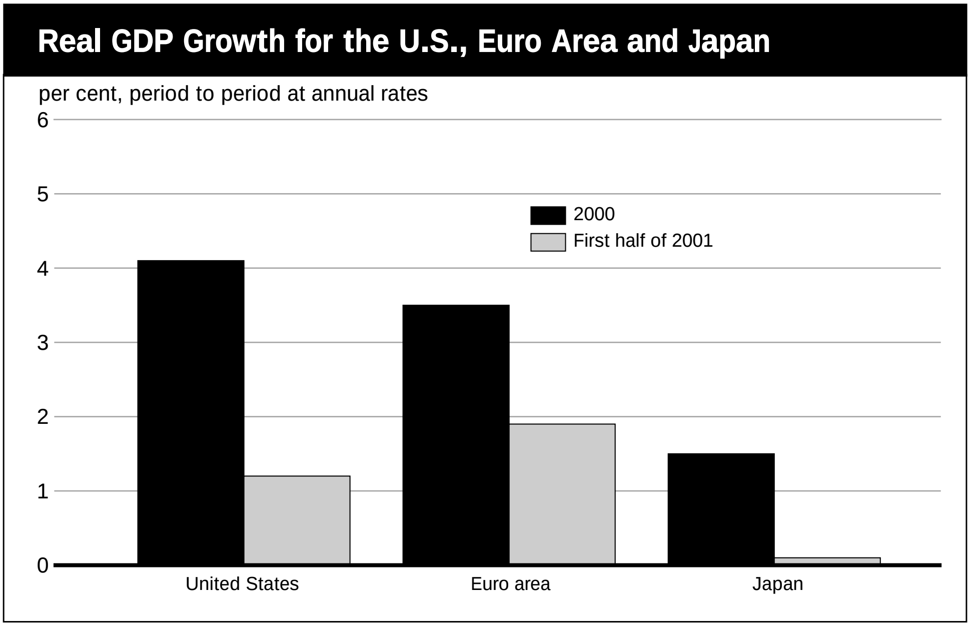
■ Last spring the International Monetary Fund (IMF) expected global economic growth to average 3.2 per cent in 2001 and 3.9 per cent in 2002. However, the global economic outlook has weakened significantly since then.

■ World economic conditions had begun to deteriorate before the terrorist attacks on the U.S. By early September the IMF expected global economic growth of 2.6 per cent in 2001 and 3.5 per cent in 2002 – a downward revision of about 0.5 per cent for both years.

■ The events of September 11 disrupted economic activity and affected confidence in all major economies, leading the IMF to further revise down its growth forecast, particularly for 2002. The IMF now expects the return to more robust growth to be delayed until mid-2002, leaving its forecast for world economic growth at just 2.4 per cent for both 2001 and 2002.

■ Although average growth is forecast to be the same in 2002 as in 2001, growth is expected to accelerate from a slow pace in early 2002 to a more robust pace by the second half of the year.

Growth was already slowing in all major economies prior to September 11, particularly in the U.S.



■ Even prior to the September 11 terrorist attacks on the U.S., all major economies were experiencing a slowdown in growth. This synchronized slowdown was fuelled by a number of factors, including:

- monetary tightening during 1999 and 2000;
- high energy prices in 2000; and
- a sharp downturn in business investment in information and communications technology (ICT) goods accompanied by a steep decline in technology-sector equity prices.

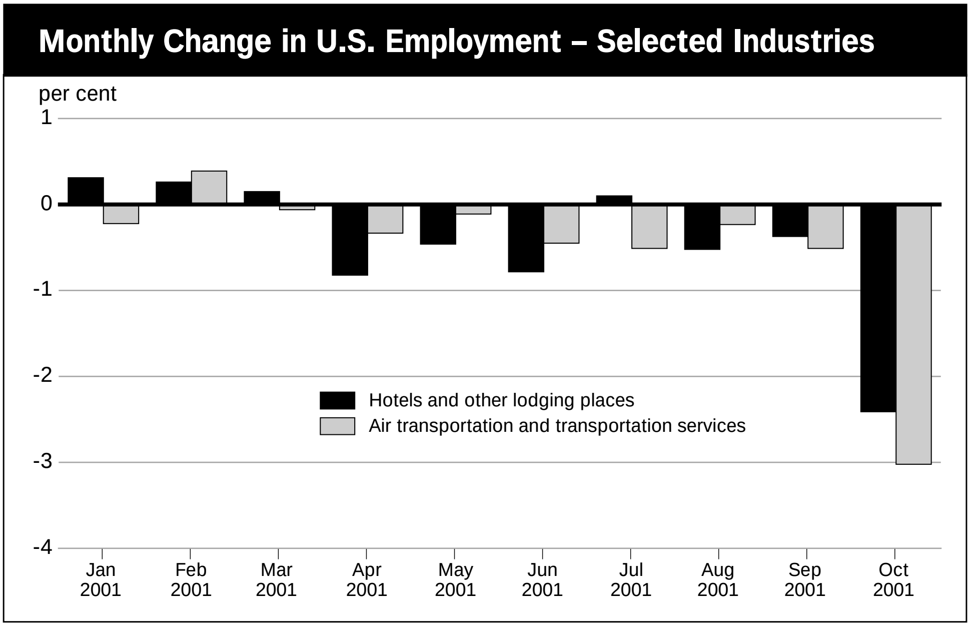
■ By the late 1990s both the U.S. and the euro area were experiencing growth that was widely viewed as unsustainably strong, fuelling fears of a resurgence of inflation. In response, monetary authorities began to increase interest rates in an attempt to engineer a soft landing for these economies.

■ Rapid growth in the major economies in the late 1990s also created strong global demand for energy, which outpaced supply. In response, energy prices rose sharply and remained at high levels for longer than expected.

■ The monetary tightening and high energy prices weakened global demand conditions. The slowdown was exacerbated by the sharp downturn in business investment in ICT goods. Indeed, the impact of the sharp decline in ICT investment was felt especially strongly in the U.S. – not surprisingly, as the U.S. is the world's largest producer and user of ICT goods.

■ In the first half of 2001 real U.S. business demand for ICT goods fell by 16 per cent (annual rate) – a sharp deterioration from average growth of over 20 per cent in 2000. This turnaround was responsible for over three-quarters of the overall slowdown in U.S. GDP growth from 2000 to the first half of 2001.

The terrorist attacks disrupted an already weakening U.S. economy…

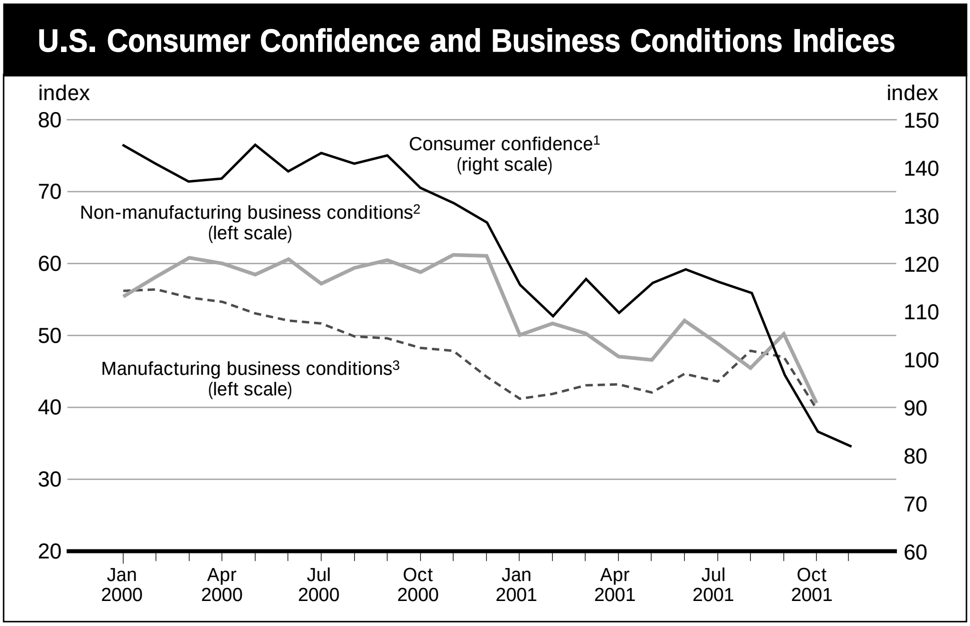


■ Although the economic slowdown has been global, it has been particularly pronounced in the U.S. In this context, September 11 represented a significant shock to already weakening U.S. economic conditions.

■ The impacts of the disruptions caused by the terrorist attacks appear to have been significant and widespread, affecting manufacturing output and shipments, international trade and consumer spending.

■ The immediate impacts of the attacks were most evident in declines in employment. In October, in the first monthly survey after the attacks, U.S. non-farm employment fell by 415,000, its sharpest monthly drop since May 1980, with close to one-quarter of these job losses in the accommodation and air transportation industries.

…and further weakened U.S. consumer and business confidence



[1] Conference Board's Index of Consumer Confidence.
[2] Non-Manufacturing Business Activity Index of the National Association of Purchasing Management.
[3] Purchasing Managers' Index (Manufacturing Industries) of the National Association of Purchasing Management.

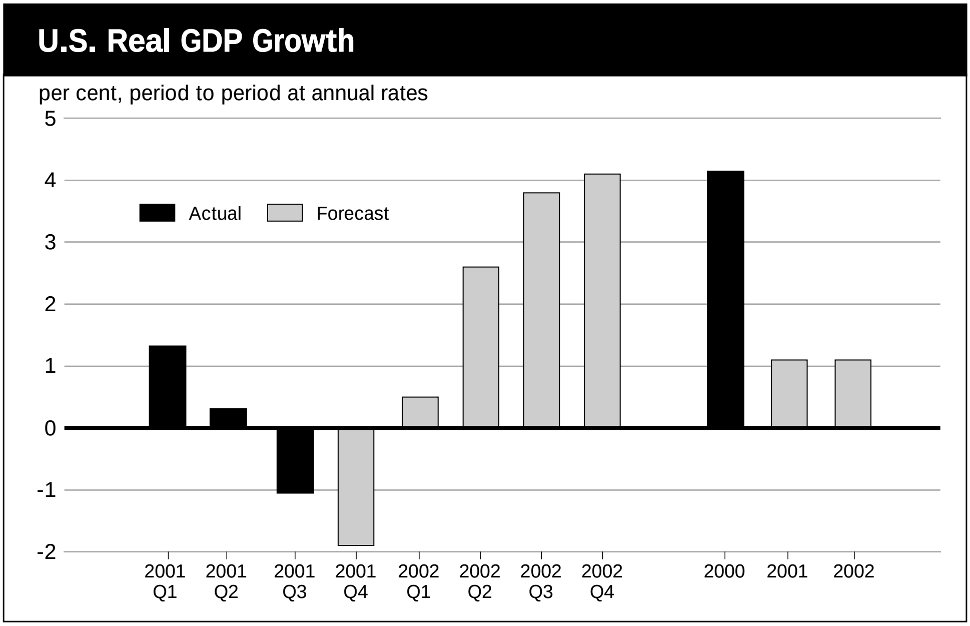
■ The immediate disruptions in specific sectors of activity were accompanied by sharp declines in both business and consumer confidence.

■ U.S. consumer confidence declined 14.9 per cent in September and a further 12.1 per cent in October – its largest decline over any two-month period since the invasion of Iraq in early 1991.

■ The decline in confidence was reflected in the decline in consumer spending in September, the steepest monthly decline in nearly 15 years. While consumer spending rebounded sharply in October, this largely reflected unusually attractive car dealer sales incentives. Falling confidence still suggests potential weakness in consumer spending looking ahead, although there is considerable uncertainty about the outlook.

■ Business confidence also fell sharply in the wake of the terrorist attacks. For example, the National Association of Purchasing Management indices for both manufacturing and non-manufacturing business activity declined sharply in October. These indices reveal widespread declines in both current and expected economic activity.

U.S. private sector forecasters expect a recovery beginning by mid-2002



Source: *Blue Chip Economic Indicators*, November 2001.

■ Interruptions in economic activity in September compounded the existing slowdown, pushing real GDP growth down to -1.1 per cent in the third quarter.

■ And with the deterioration in both consumer and business confidence, private sector forecasters now expect that the U.S. economy will contract further in the fourth quarter of 2001 (-1.9 per cent), leaving real GDP in the fourth quarter 0.3 per cent below its level at the end of 2000.

■ On average, forecasters anticipate that the U.S. economy will return to positive although modest growth in the first half of 2002. Growth is expected to accelerate to the 4-per-cent range in the second half of the year, fuelled by:

– the lagged effects of this year's interest rate cuts;

– U.S. fiscal stimulus enacted both before and after September 11; and

– the benefits to consumers and businesses of the recent sharp decline in energy prices.

■ Given the uncertainty in the aftermath of the events of September 11, the major risk to the forecast is the possibility that consumer and business confidence will recover more slowly than anticipated.

The weak first half of 2002 is expected to constrain U.S. growth to 1.1 per cent next year

Table 2.1
U.S. Forecast Summary

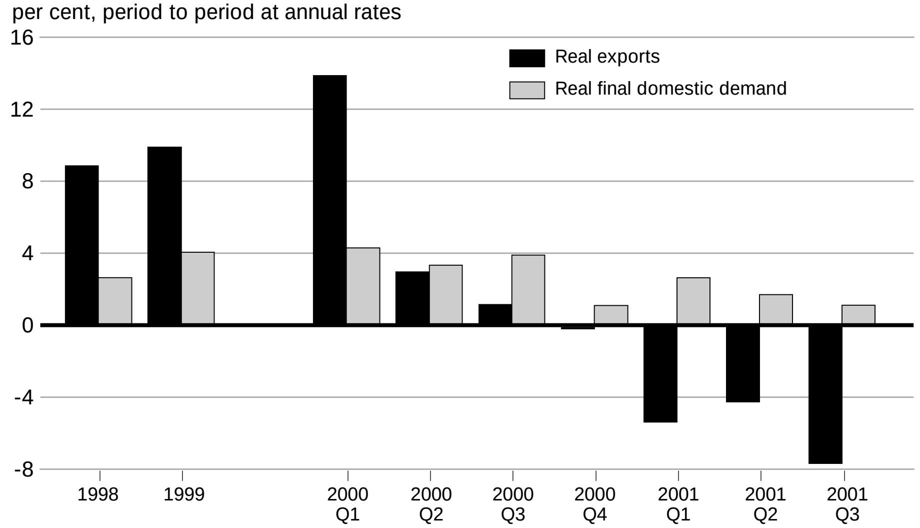
	2001	2002
	(per cent)	
Real GDP growth		
October 2000 *Economic Statement and Budget Update*	3.5	n/a
May 2001 *Economic Update*	1.8	3.2
December 2001 budget	1.1	1.1
CPI inflation		
October 2000 *Economic Statement and Budget Update*	2.7	n/a
May 2001 *Economic Update*	2.9	2.4
December 2001 budget	2.9	2.0
3-month Treasury bill rate		
October 2000 *Economic Statement and Budget Update*	6.2	n/a
May 2001 *Economic Update*	4.3	4.5
December 2001 budget	3.4	2.3
10-year government bond yield		
October 2000 *Economic Statement and Budget Update*	6.1	n/a
May 2001 *Economic Update*	5.0	5.3
December 2001 budget	4.9	4.6

Sources: September 2000, April 2001 and November 2001 *Blue Chip Economic Indicators*.

- Private sector forecasters now expect U.S. real GDP growth to be 1.1 per cent in both 2001 and 2002. As is the case with the global outlook, however, the relatively slow pace of average growth in 2002 expected for the U.S. economy reflects the expectation of weak growth in the first half of the year combined with a return to robust growth in the second half of 2002.
- These forecasts are substantially lower than those earlier this year and at the time of the October 2000 *Economic Statement and Budget Update*.
- In line with lower growth expectations and energy prices, U.S. inflation is expected to decline to 2 per cent in 2002 from nearly 3 per cent this year.
- Reflecting the weaker forecasts for U.S. growth and the actions taken by the Federal Reserve Board since the beginning of the year, forecasters have sharply lowered their expectations for interest rates for next year.

Weakness in the U.S. economy has significantly affected Canadian exports

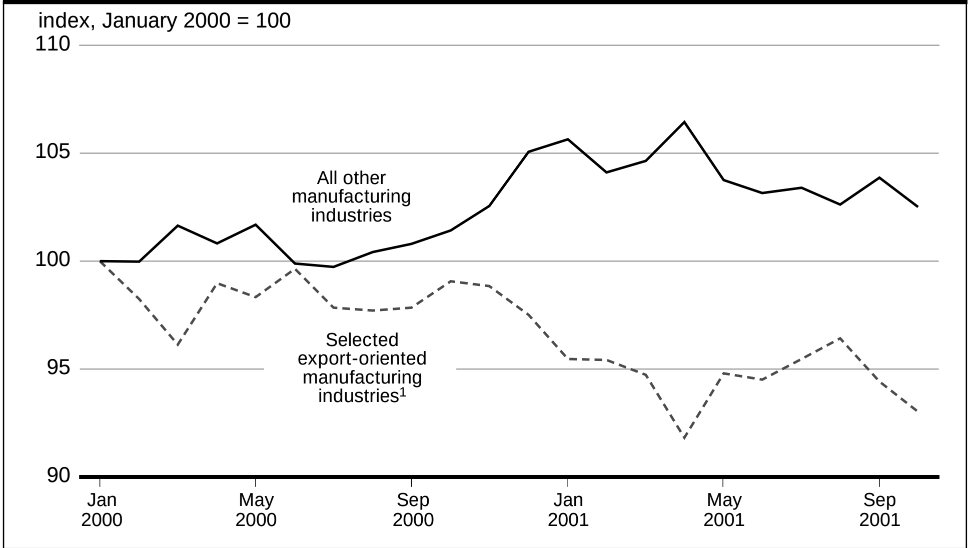
Canadian Real Export Growth and Real Final Domestic Demand Growth



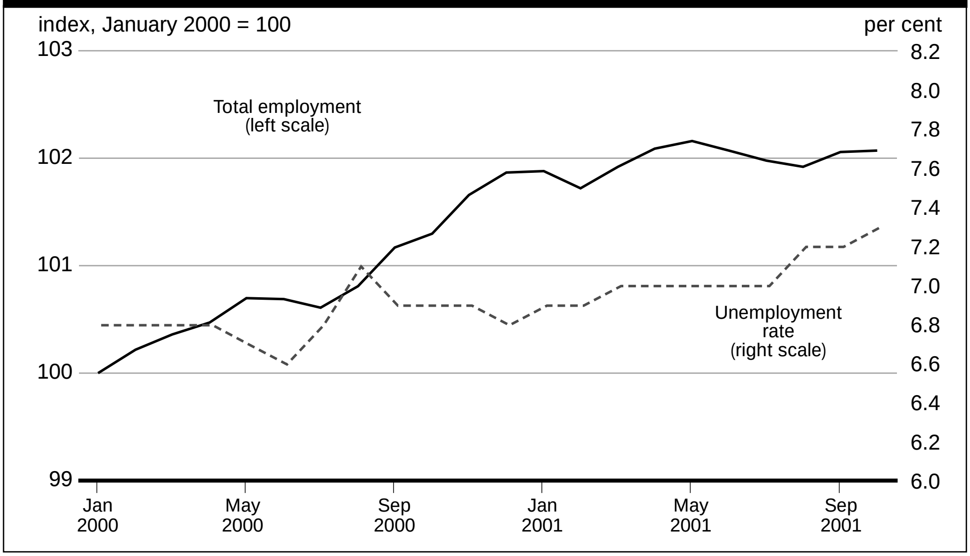
- Given our close trade ties, the downturn in the U.S. economy has had a negative impact on the Canadian economy.
- Real export growth had been a substantial contributor to overall GDP growth in Canada through 1998, 1999 and the early part of 2000. However, it slowed sharply in mid-2000, before posting three consecutive steep quarterly declines starting in the first quarter of 2001. By the third quarter of this year real exports had declined 4.4 per cent from their level at the end of last year, which has contributed significantly to the growth slowdown in 2001.
- In contrast, final domestic Canadian demand continued to grow over the period, albeit at a slower pace than in much of 2000.
- By the third quarter of 2001 real final domestic demand growth had eased to 1.1 per cent, in large part due to a sharp decline in consumer spending on goods which occurred immediately following the terrorist attacks of September 11.

Labour market conditions have weakened in Canada, particularly in export-oriented manufacturing industries

Manufacturing Sector Employment



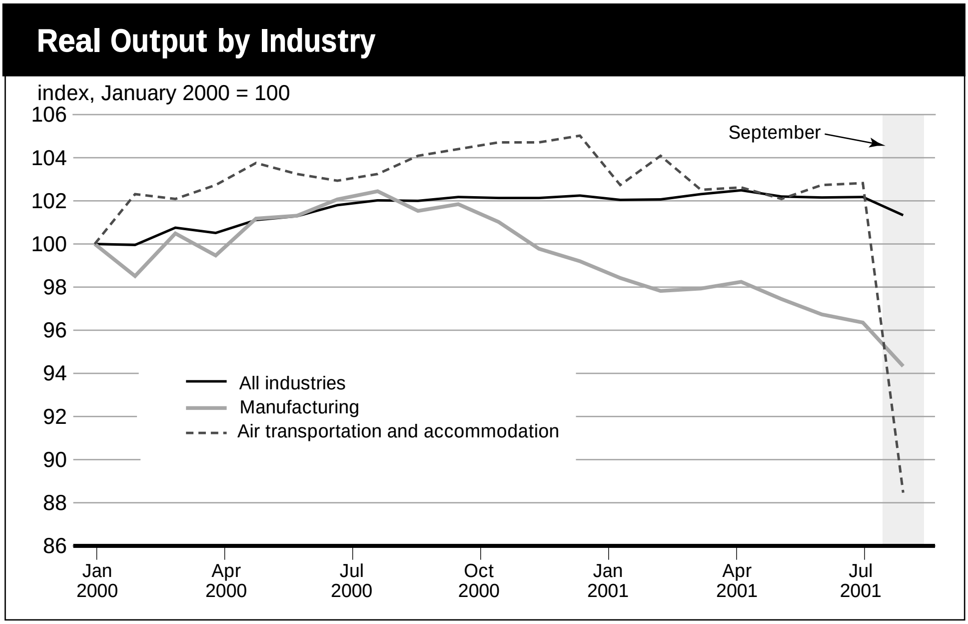
Employment and Unemployment Rate



[1] Includes manufacturers of computers and electronic products, automotive products, electrical equipment, appliances and components, paper and wood products, and primary metal products.

- In tandem with weakening export demand from a slowing U.S. economy, signs of weakness began to appear in labour markets in Canada early this year – particularly in export-oriented manufacturing industries. Total employment has remained virtually unchanged and the unemployment rate has risen modestly this year.
- In the aftermath of the September 11 terrorist attacks, the unemployment rate rose and employment in manufacturing industries declined. At the same time, average hours worked per employee declined sharply, indicating the possibility of further declines in employment in the months ahead.

September 11 disruptions impacted on Canadian output



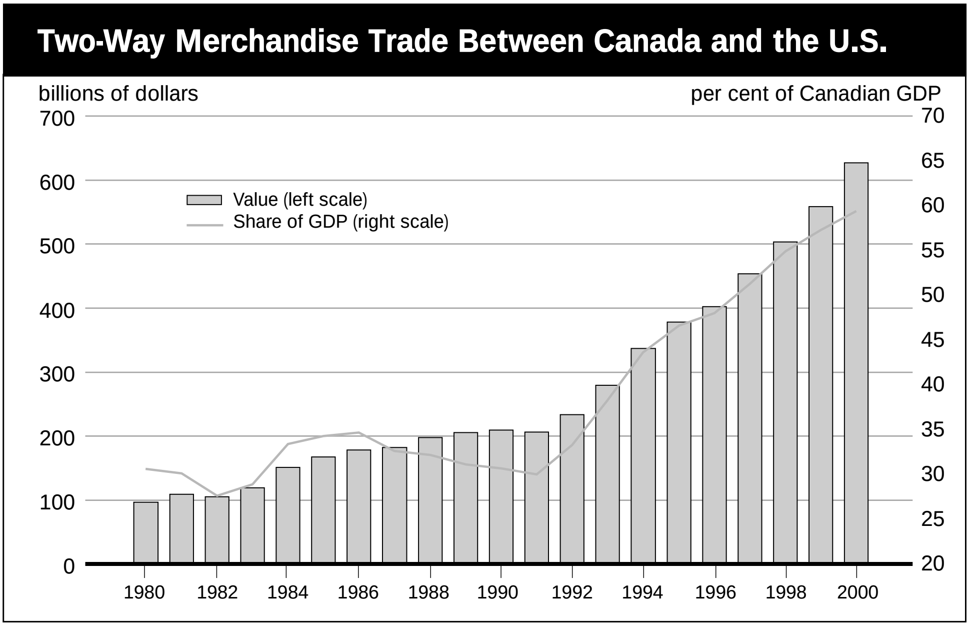
■ The immediate disruptions in economic activity were also apparent in industry output, which declined by 0.8 per cent in September – its sharpest monthly decline in fifteen years.

■ As in the United States, air travel and accommodation and related service industries were significantly affected in Canada in September, falling 19.1 per cent and 10.9 per cent, respectively. Significant declines were also reported in retail trade industries, which faced a sharp decline in consumer spending in the days following the terrorist attacks. As well, production of motor vehicles and parts dropped sharply in the month, in part reflecting delays at the Canada/U.S. border and supply shortages.

■ While these industries account for just over 8 per cent of aggregate output in the economy, they contributed close to one-half of the overall decline in September.

■ The overall Canadian manufacturing sector, which had already slowed significantly in response to the existing slowdown in the U.S., fell a further 2.1 per cent as a result of the September 11 disruption.

A smoothly functioning Canada-U.S. border has become increasingly important to the Canadian economy



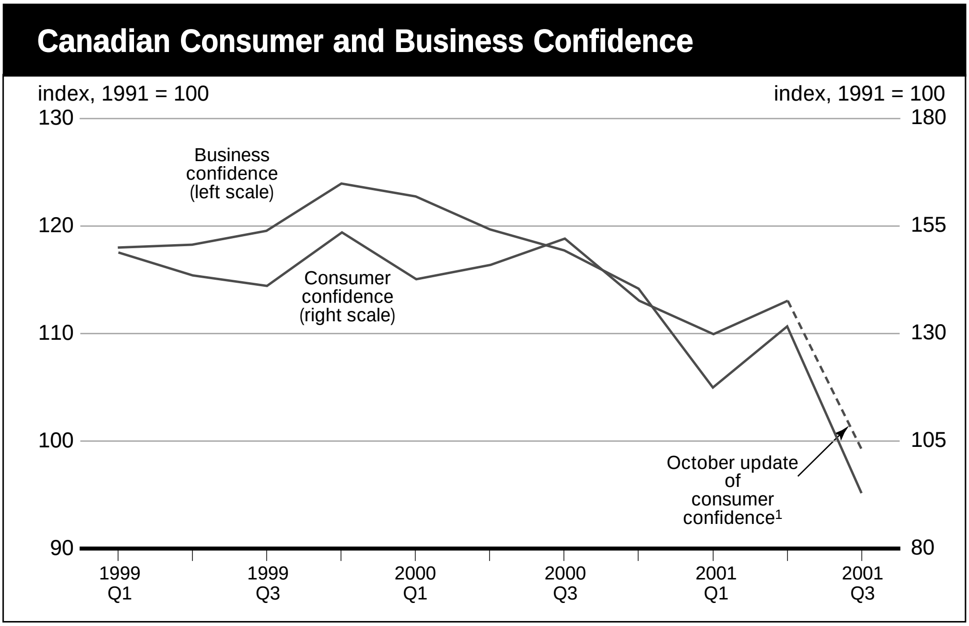
■ A well-functioning Canada-U.S. border is critical to the Canadian economy, and to the manufacturing sector in particular. In fact, two-way merchandise trade between the two economies rose from about $100 billion in 1980 to over $600 billion in 2000, while its share of Canadian GDP almost doubled to close to 60 per cent during the same period. Including trade in services, two-way trade between Canada and the U.S. now totals close to $2 billion per day – by far the largest two-way trade between any two countries.

■ A smooth flow of goods across the border is also important for the U.S. economy as Canada is the largest export market for the U.S., receiving about 25 per cent of its exports.

■ Since September 11 concern has arisen about predictable and efficient access at the Canada-U.S. border.

■ Uncertainty regarding delays translates into real costs for Canadian and U.S. producers, particularly in the manufacturing sector, where just-in-time inventory systems mean that a significant share of inputs and final products are in transit at any one time. Unless addressed, unpredictable border delays would hinder production, export growth and investment.

Business and consumer confidence have declined



[1] The October update of consumer confidence was not adjusted for normal seasonal variations in the index.

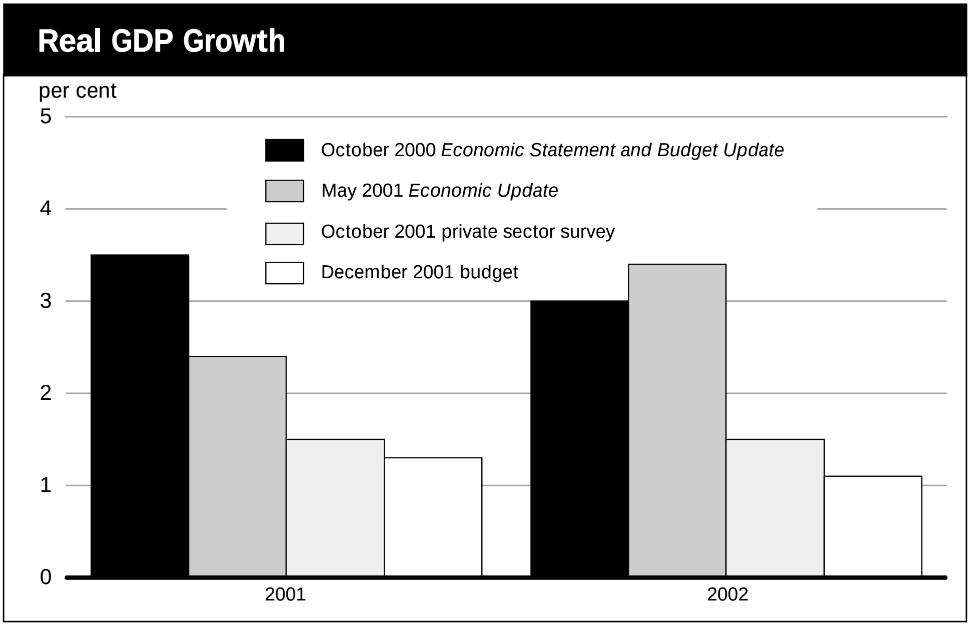
Source: The Conference Board of Canada.

■ Slower employment growth, concerns over the timing of a rebound in the U.S. economy, and uncertainty about the near-term economic outlook have reduced consumer and business confidence in Canada.

■ As in the U.S., there has been a significant weakening of consumer confidence in Canada. The most recent data, based on a special survey conducted by The Conference Board of Canada in early October, showed a sharp drop in consumer confidence from the quarterly survey of early September.

■ The impact on business confidence has also been sharply negative, as the measure showed its steepest quarterly decline on record since 1977. Business confidence had been declining significantly from its recent peak in late 1999 in tandem with weakening economic conditions.

The private sector outlook for 2001 and 2002 has been revised down sharply



Sources: September 2000, March 2001 and October 2001 Department of Finance surveys of private sector forecasters; December 2001 consultation with private sector forecasters.

■ The Department of Finance conducted its regular survey of Canadian private sector economists in early October, which is the basis for the five-year status quo fiscal projections provided in Chapter 4. Since the October survey new data showed larger than expected GDP contractions in the third quarter of 0.8 per cent in Canada and 1.1 per cent in the United States. In light of these data, the Department of Finance again consulted private sector economists in early December to obtain an update of their October view. This updated outlook is used in this budget for two-year fiscal-planning projections provided in Chapter 7 (see Table 2.2).

■ Private sector forecasters expect real GDP to decline further in the fourth quarter, implying growth of 1.3 per cent in 2001 and 1.1 per cent in 2002, a substantial downward revision from October 2000. As in the U.S., they expect positive but modest growth in the first half of 2002, with a solid rebound in the second half of the year. This reflects the impact of lower interest rates, fiscal stimulus from federal and provincial tax cuts, and the expected recovery of the U.S. economy. Growth for 2003 is expected to be a robust 3.9 per cent.

- The adjusted forecast also indicates GDP inflation of 1.3 per cent in 2001 and 0.2 per cent in 2002. Together with changes to forecast real GDP growth, these changes result in expected nominal GDP growth of 2.6 per cent in 2001 and 1.3 per cent in 2002.

- Reflecting a weaker economy and substantial interest rate reductions this year, private sector forecasters expect short-term interest rates of 2.4 per cent in 2002 and 4.0 per cent in 2003. Current private sector expectations for 10-year government bonds are at 5.5 per cent in 2002 and 5.9 per cent in 2003.

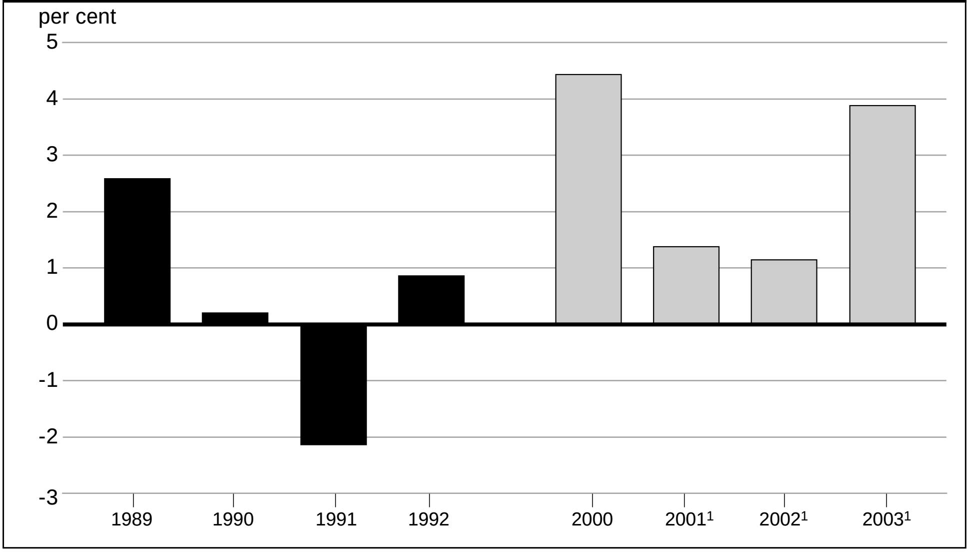
Table 2.2
Evolution of the Average Private Sector Forecasts for Canada

	2001	2002	2003
		(per cent)	
Real GDP growth			
October 2000 *Economic Statement and Budget Update*	3.5	3.0	3.0
May 2001 *Economic Update*	2.4	3.4	3.4
October 2001 private sector survey	1.5	1.5	3.9
December 2001 budget	1.3	1.1	3.9
GDP inflation			
October 2000 *Economic Statement and Budget Update*	2.0	1.5	1.9
May 2001 *Economic Update*	1.8	1.7	2.0
October 2001 private sector survey	2.6	1.6	1.9
December 2001 budget	1.3	0.2	1.9
Nominal GDP growth			
October 2000 *Economic Statement and Budget Update*	5.5	4.6	5.0
May 2001 *Economic Update*	4.2	5.1	5.4
October 2001 private sector survey	4.1	3.1	5.9
December 2001 budget	2.6	1.3	5.9
3-month Treasury bill rate			
October 2000 *Economic Statement and Budget Update*	5.8	5.5	5.4
May 2001 *Economic Update*	4.6	4.7	5.4
October 2001 private sector survey	4.0	3.2	4.7
December 2001 budget	3.8	2.4	4.0
10-year government bond yield			
October 2000 *Economic Statement and Budget Update*	5.9	5.8	5.9
May 2001 *Economic Update*	5.3	5.6	5.8
October 2001 private sector survey	5.5	5.5	5.9
December 2001 budget	5.5	5.5	5.9

Sources: September 2000, March 2001 and October 2001 Department of Finance surveys of private sector forecasters; December 2001 consultation with private sector forecasters.

The Canadian economy is better positioned to weather the current global slowdown than it has been in decades

Real GDP Growth



[1] Outlook: Department of Finance consultation with private sector forecasters, December 2001.

■ Canada is not immune to the current global economic slowdown, in particular the slowdown of the U.S. economy. However, Canada is better positioned to cope with negative external economic conditions than was the case in the previous downturn of the early 1990s.

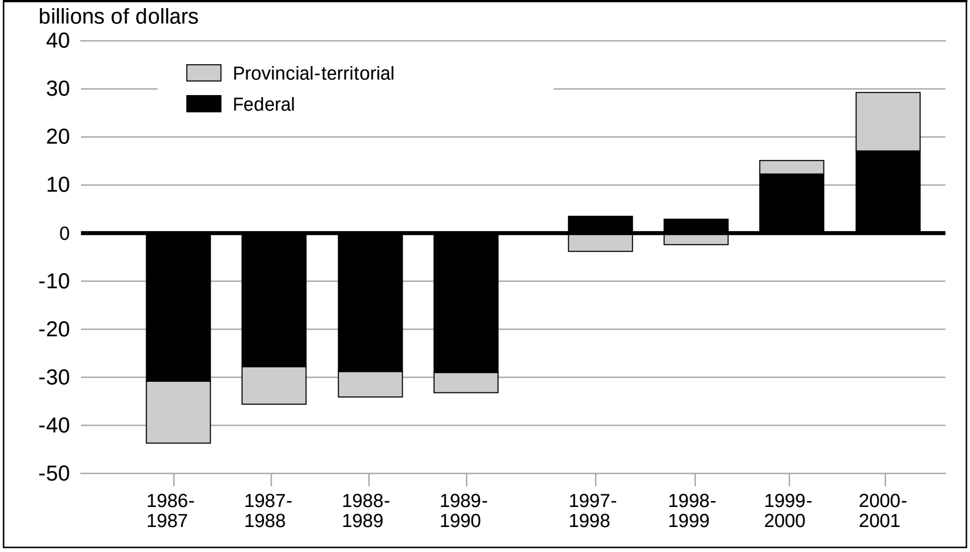
■ At that time economic growth declined significantly and remained weak for an extended period. This reflected several factors, including high and rising government deficits, entrenched expectations of high inflation, which kept interest rates high, and rising levels of foreign indebtedness.

■ Today this situation has improved markedly, which is reflected in the expectation by private sector forecasters of only a modest slowdown in growth. This expectation represents an acknowledgement of the following differences from the early 1990s:

- a return to fiscal balance has allowed the largest reduction of taxes in Canadian history;
- a solid track record of successfully lowering inflation has eliminated the fear of a return to a high inflation environment;
- there have been large interest rate cuts; and
- Canada's current account balance and net foreign debt positions have improved significantly.

The fiscal positions of the federal and provincial-territorial governments have improved significantly

Federal and Provincial-Territorial Budgetary Balances
(Public Accounts Basis)



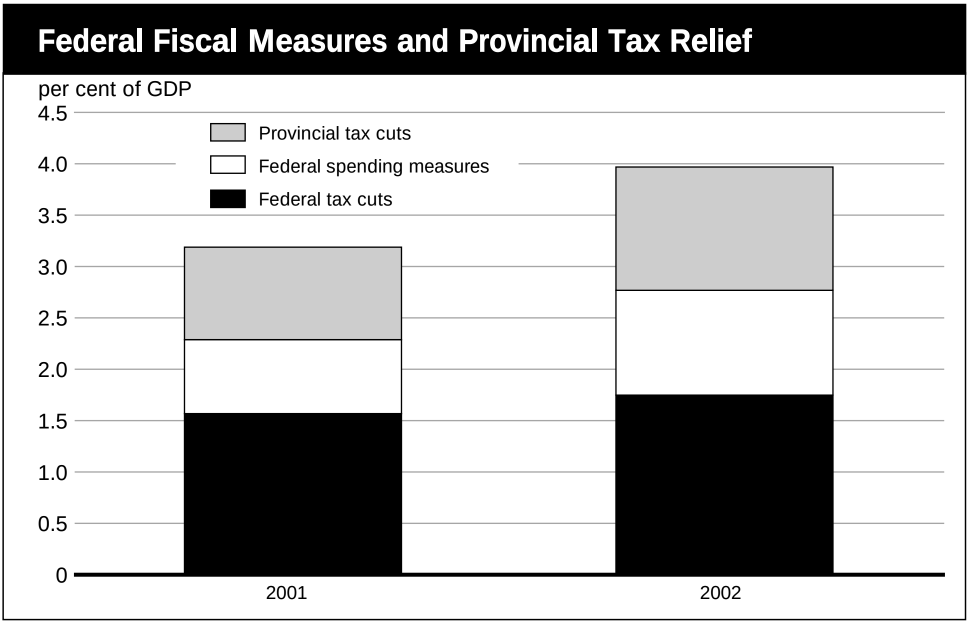
■ The most important difference between the current economic situation and that of the early 1990s is the dramatic turnaround in government finances in recent years.

■ Prior to the slowdown of the early 1990s, governments ran substantial deficits. This placed constraints on the ability of fiscal and monetary policy to offset economic weakness. High government debt also left the Canadian economy far more vulnerable to external shocks.

■ In fact, in the four years leading up to the recession of the early 1990s, the total federal-provincial-territorial government deficit was over $30 billion. In 2000-01 the federal and provincial-territorial governments recorded an aggregate budgetary surplus reaching almost $30 billion.

■ As a result, governments are now in a position to play an effective role in stabilizing the economy without a return to the vicious circle of deficits and higher interest rates.

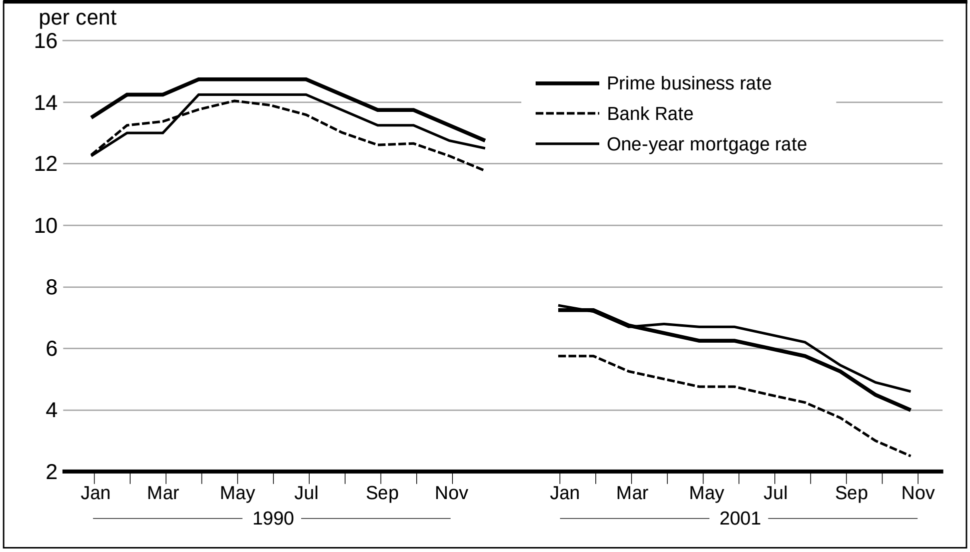
This has provided room for timely supportive fiscal measures



- The improvement in the federal government's fiscal position has allowed it to introduce the largest tax reduction package in Canadian history, which is providing a substantial, and timely, boost to domestic demand.
- Indeed, reductions in federal taxes amount to over $17 billion in 2001, representing 1.6 per cent of GDP, rising to almost $20 billion in 2002, or 1.8 per cent of GDP. This represents a much larger share of GDP than U.S. federal tax cuts announced last spring – 0.4 per cent in 2001 and 0.7 per cent in 2002.
- In addition, the stimulative impact of new spending measures at the federal level undertaken since the 2000 budget, including the initiatives in this budget, total $8.9 billion in 2001 and $11.0 billion in 2002.
- These measures, combined with federal tax cuts, represent 2.4 per cent of GDP in 2001 and 2.8 per cent in 2002.
- When provincial tax cuts are added, the total amount of supportive fiscal measures is 3.3 per cent of GDP this year and 4.0 per cent in 2002.

Improved fiscal conditions and low inflation have improved monetary policy flexibility

Bank Rate, One-Year Mortgage Rate and Prime Business Rate



■ The elimination of government deficits, along with a 10-year record of setting and meeting low inflation targets, has meant that monetary policy has been able to react to the current weakening economic conditions, a marked departure from the situation existing prior to the recession of the early 1990s.

■ In early 1990, as signs of weakness began to appear in the Canadian economy, the combination of high inflation expectations and high fiscal deficits created conditions which prevented easier monetary policy. Indeed, interest rates continued to rise, further dampening economic growth.

■ In contrast, the current environment of low inflation and fiscal surpluses has allowed the Bank of Canada to lower interest rates nine times since the beginning of January, for a total of 350 basis points. Short-term interest rates are at their lowest level in more than 40 years.

Lower interest rates are translating into significant reductions in debt-servicing costs for households and businesses

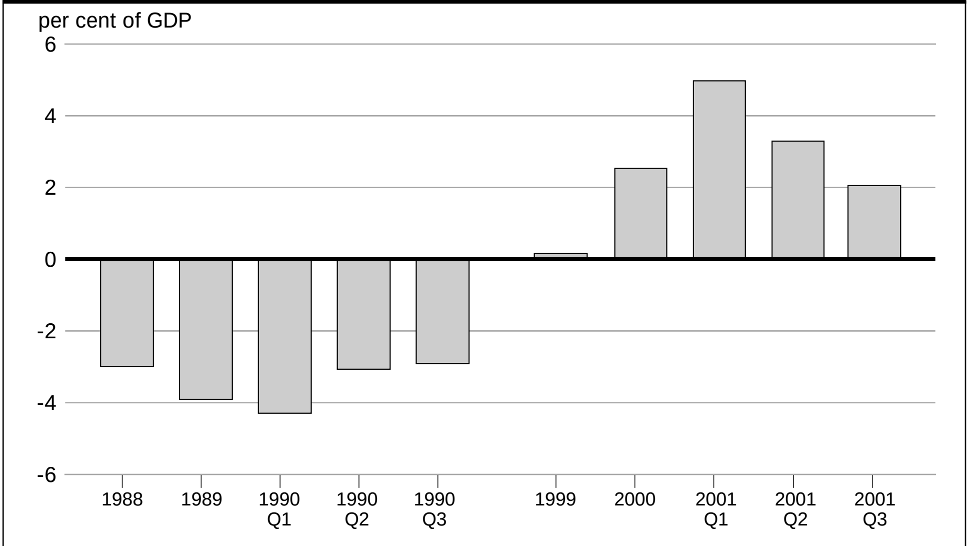
Table 2.3
Savings on Interest Payments Since December 2000

	One-year mortgage rate	Prime business rate
Rate – December 2000	7.70	7.50
Rate – December 3, 2001	4.60	4.00
Change in rate	-3.10	-3.50
Monthly payment – December 2000	$744.16	$1,562.50
Monthly payment – December 3, 2001	$559.05	$833.33
Change in monthly payment	-$185.11	-$729.16
Change in annual payment	-$2,221.32	-$8,750.00

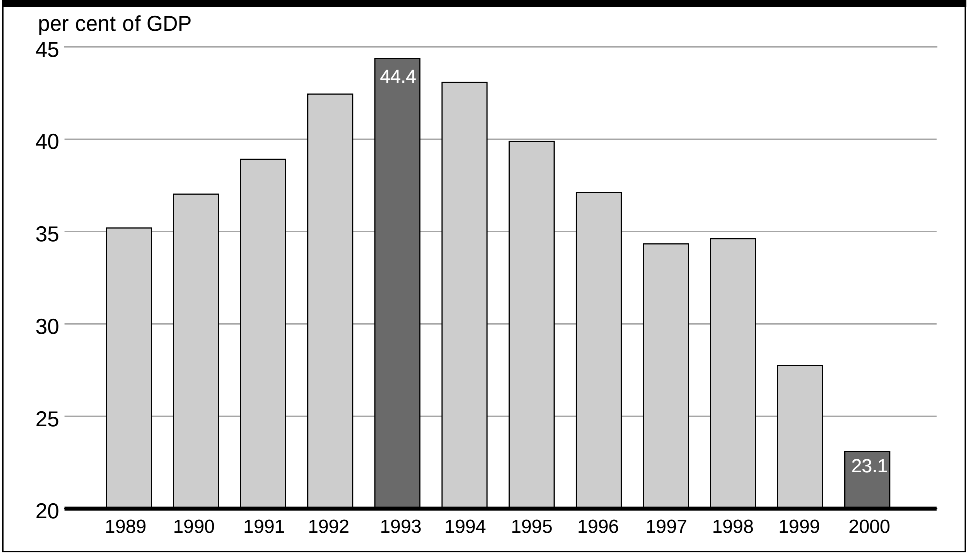
- Lower interest rates will help support domestic demand by sharply lowering the cost of borrowing for households and businesses.
- For instance, declines in mortgage rates since the beginning of this year have meant that a household that renegotiates a one-year mortgage of $100,000 will save more than $2,200 in annual payments compared to the end of last year.
- Similarly, declines in interest rates for businesses mean that annual payments on a small business loan of $250,000 tied to the prime rate would be $8,750 lower than they were at the end of last year.

Canada's current account and international investment positions are in their strongest positions in decades

Current Account Balance



Net Foreign Debt



- The turnaround in government fiscal positions has gone hand-in-hand with a significant improvement in Canada's current account balance.
- Since the first quarter of 2000 the current account balance has averaged 2.9 per cent of GDP – its highest level for any comparable period on record. In comparison, the current account was in a significant deficit position prior to the 1990 recession.
- The elimination of the current account deficit has pushed Canada's net foreign debt as a share of GDP down to its lowest level since the 1950s. Canada's net debt to foreigners stood at 23.1 per cent in 2000, a dramatic improvement from levels seen in the late 1980s and early 1990s.

3

Canada's Fiscal Progress Through 2000-2001

Highlights

- The federal government recorded a budgetary surplus of $17.1 billion in 2000-01. This is the largest annual surplus since Confederation and the fourth consecutive annual surplus, following surpluses of $3.5 billion in 1997-98, $2.9 billion in 1998-99 and $12.3 billion in 1999-2000.

- Net public debt has declined $35.8 billion from its peak of $583.2 billion in 1996-97 to stand at $547.4 billion. This debt paydown, coupled with Canada's strong economic growth, has resulted in a significant decline in the federal debt-to-GDP (gross domestic product) ratio, from its peak of 70.7 per cent in 1995-96 to 51.8 per cent in 2000-01.

- This decline in net public debt has resulted in ongoing savings in debt interest payments of about $2.5 billion each and every year.

- Federal market debt – the debt issued on credit markets – has declined by over $30 billion from its peak of $476.9 billion in 1996-97 to $446.4 billion in 2000-01. The market debt-to-GDP ratio has declined to 42.3 per cent, down from its peak of 57.8 per cent in 1995-96.

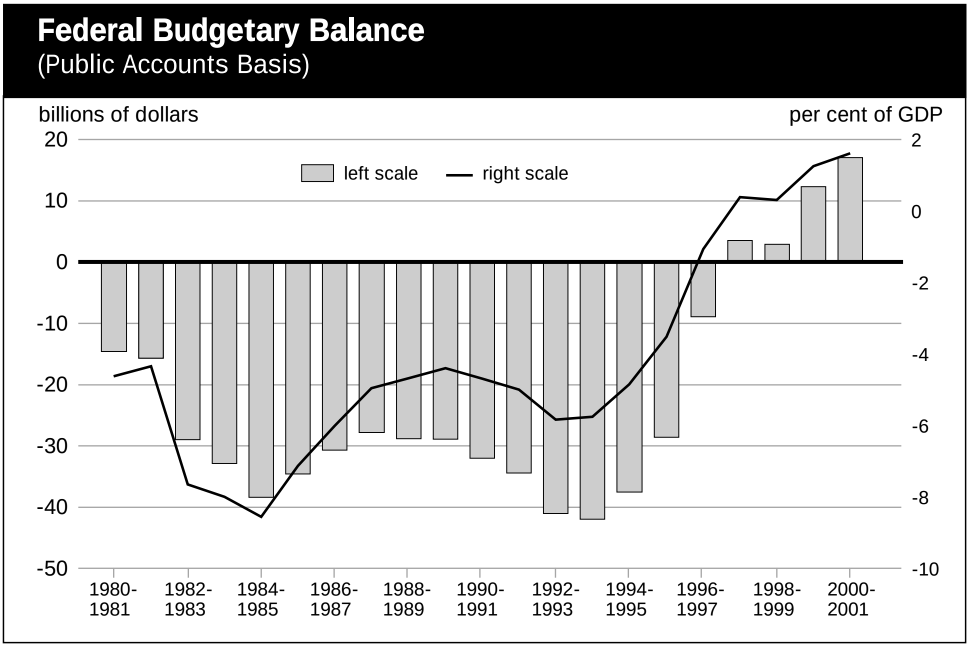
- The amount of every revenue dollar collected by the federal government that is used to pay interest on the public debt declined to 23.6 cents in 2000-01, down from 36 cents in 1995-96, and is now at its lowest level since 1981-82.

- Federal program spending as a percentage of GDP has fallen from 16.4 per cent in 1993-94 to 11.3 per cent in 2000-01, its lowest level since 1948-49. More than two-thirds of the improvement in the budgetary balance since 1993-94 is attributable to the decline in program spending.

- The aggregate provincial-territorial budget recorded a record surplus of $12 billion in 2000-01, the second consecutive surplus. Eight provinces and two territories reported budgetary surpluses in 2000-01.

- On a total government basis, between 1992 and 2000 Canada achieved the largest improvement in its financial balance of all Group of Seven (G-7) countries. In 2000 Canada's surplus reached 3.2 per cent of GDP, compared to an average deficit of 0.1 per cent for the G-7 countries.

Fourth consecutive budgetary surplus



Sources: Public Accounts of Canada and Statistics Canada.

- There was a record surplus of $17.1 billion in 2000-01. The federal government has now achieved four consecutive annual surpluses, including surpluses of $3.5 billion in 1997-98, $2.9 billion in 1998-99 and $12.3 billion in 1999-2000.
- As a percentage of GDP, the budgetary balance improved from a deficit of 5.8 per cent in 1993-94 to a surplus of 1.6 per cent in 2000-01, the largest surplus, as a percentage of GDP, since 1948-49.
- The four annual surpluses – totalling $35.8 billion since 1997-98 – have been applied to reducing the net public debt.
- This achievement reverses a trend of more than a quarter of a century of uninterrupted government deficits. Four consecutive surpluses have not been recorded since 1951-52.
- In a span of seven years the federal budget balance has improved by $59.1 billion, from a $42-billion deficit in 1993-94 to a $17.1-billion surplus in 2000-01.

Better than expected fiscal outcome for 2000-01 due to strong economic growth and lower spending

Table 3.1
Fiscal Outcome: Changes Between the October 2000 Economic Statement and Budget Update *and End of Fiscal Year 2000-01*

	(billions of dollars)
October 2000 Statement projected surplus	11.9
Impact of economic developments[1]	
Budgetary revenues	
Personal income tax	0.9
Corporate and other income tax	0.5
Excise taxes and duties	1.9
Non-tax revenues	1.7
Total revenues	4.9
Program spending	
Major transfers to persons	0.1
Major transfers to other levels of government	0.3
Direct program spending	2.6
Total program spending	3.0
Public debt charges	0.1
Net impact of economic developments	8.0
Policy decisions since October 2000 Statement affecting 2000-01	
Major transfers to other levels of government	
Lifting of equalization ceiling for 1999-2000	-0.8
Direct program spending	
Canada Foundation for Innovation	-0.8
Agricultural assistance	-0.5
Genome Canada	-0.1
Defence/other departmental operating expenditures	-0.7
Total spending measures	-2.7
Net change	5.2
Outcome for 2000-01	17.1

Note: Numbers may not add due to rounding.

[1] A positive number implies an improvement in the budgetary balance while a negative number implies a deterioration in the budgetary balance.

- The budgetary surplus of $17.1 billion in 2000-01 was $5.2 billion above the surplus of $11.9 billion estimated in the October 2000 *Economic Statement and Budget Update.*
- This improvement was attributable to the impact of a better than expected economic performance on budgetary revenues and program spending, offset somewhat by the introduction of new policy initiatives.
- Budgetary revenues were $4.9 billion higher than estimated in the October 2000 *Economic Statement and Budget Update*, primarily reflecting the impact of stronger than expected economic growth in 2000.
- All of the major revenue components, with the exception of employment insurance premium revenues (which were unchanged), were higher. Personal income tax revenues were up $0.9 billion, corporate and other income tax revenues were up $0.5 billion, excise taxes and duties were up $1.9 billion and non-tax revenues were up $1.7 billion. The increase in excise taxes and duties primarily reflected much higher than estimated customs import duties, while higher revenues from exchange account transactions was the major factor accounting for the increase in non-tax revenues.
- On a net basis, program spending was $0.4 billion lower than estimated in the October 2000 *Economic Statement and Budget Update.*
- However, underlying spending was $3.0 billion lower, primarily due to lower than expected direct program spending (subsidies and other transfers, expenditures related to Crown corporations, defence spending and operating and capital expenditures of non-defence departments and agencies). This reflected higher net gains from enterprise Crown corporations and higher lapses on appropriated spending.
- New spending initiatives after the October 2000 Statement totalled $2.7 billion. These included the impact of lifting the equalization ceiling for 1999-2000 ($0.8 billion), and of increased funding for the Canada Foundation for Innovation ($0.8 billion), agriculture ($0.5 billion), Genome Canada ($0.1 billion), and defence and other departments ($0.7 billion) to manage increased pressures.

Fiscal progress from 1993-94 to 2000-01

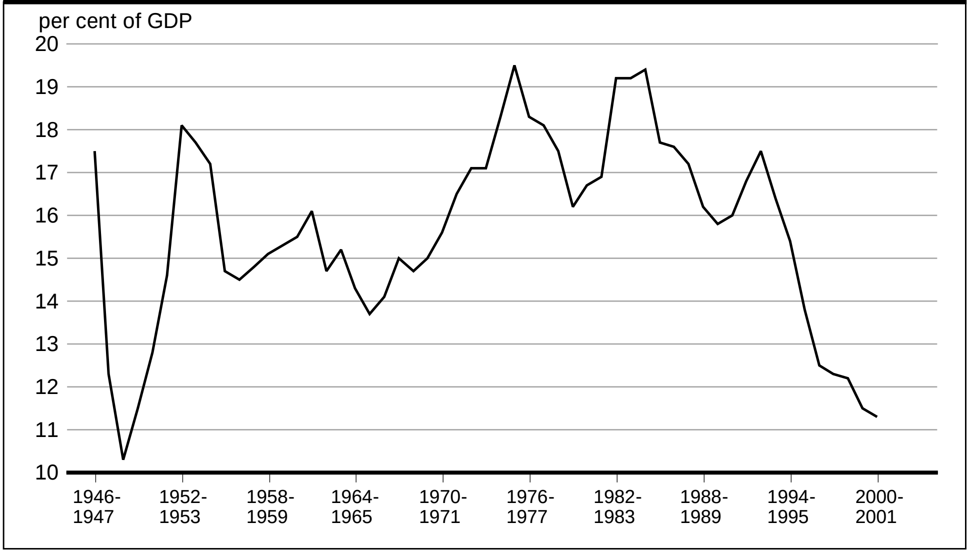
Table 3.2
Change in the Federal Budgetary Balance Relative to the Size of the Economy

	1993-94	2000-01	Change	Contribution
		(per cent of GDP)		(per cent)
Budgetary revenues	15.9	16.9	1.0	13.5
Program spending	16.4	11.3	-5.1	70.0
Public debt charges	5.2	4.0	-1.2	16.5
Budgetary balance	-5.8	1.6	7.4	100.0

- The contribution of revenue increases and expenditure reductions to the improvement in the budgetary balance is best illustrated by looking at the evolution of budgetary revenues, program spending and public debt charges, and the resulting budgetary balance, as a share of the economy.
- Between 1993-94 and 2000-01 the budgetary balance went from a deficit of 5.8 per cent of GDP to a surplus of 1.6 per cent – a turnaround of 7.4 percentage points.
- More than two-thirds of the improvement in the budgetary balance was attributable to the decline in program spending. This primarily reflected the impact of discretionary actions taken since 1993.
- Less than 15 per cent of this improvement was attributable to the increase in the revenue yield (revenues as a percentage of GDP). This increase was due primarily to the impact of one-time factors, which depressed revenues in 1993-94, the interaction of the tax system with rising incomes, and the exclusion from nominal GDP of certain components of income subject to taxation (for example, capital gains and income from pension plans).
- Reductions in the stock of interest-bearing debt, a decline in the average effective interest rate on that debt, and a change in the accounting for interest costs related to public sector pension plans resulted in a decline in public debt charges as a percentage of GDP. This accounted for more than 15 per cent of the improvement in the overall budgetary balance.

Program spending as a share of GDP at a 50-year low in 2000-01

Federal Program Spending as a Percentage of GDP
(Public Accounts Basis)



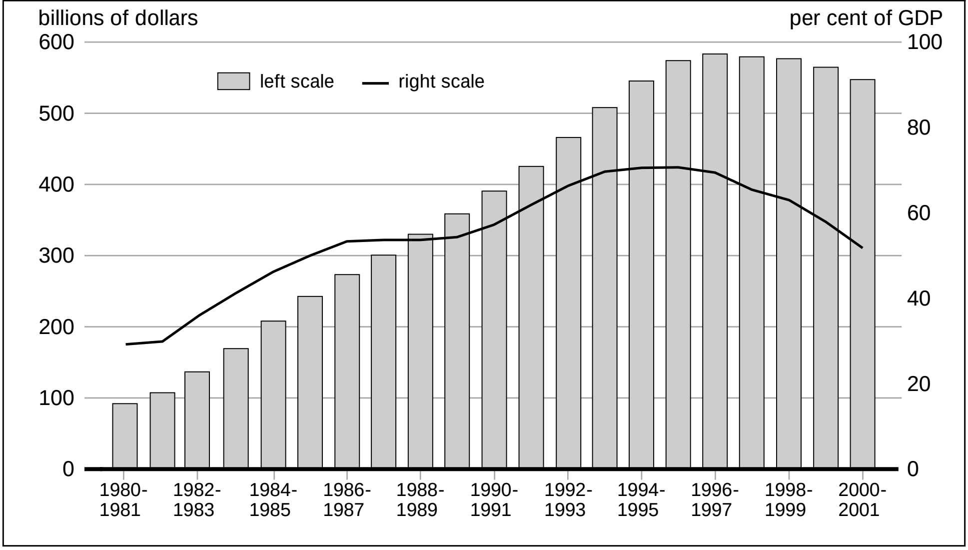
■ Program spending in 2000-01, at $119.3 billion, was $0.7 billion lower than the $120 billion recorded in 1993-94.

■ As a percentage of GDP, program spending declined to 11.3 per cent in 2000-01 – its lowest level since 1948-49 – and down more than 5 percentage points from its level in 1993-94.

■ The decline in program spending, as a percentage of GDP, since 1993-94 reflects reforms to program spending that were introduced in the mid-1990s as well as sustained economic growth. These reforms included structural changes to the employment insurance program, to major transfers to provinces (excluding equalization) and to direct program spending (discretionary spending by departments and agencies) as a result of the Program Review exercise.

The debt-to-GDP ratio declined for the fifth consecutive year

Federal Net Debt
(Public Accounts Basis)



Sources: Public Accounts of Canada and Statistics Canada.

- The debt-to-GDP ratio is generally recognized as the most appropriate measure of the debt burden, as it measures the debt relative to the ability of the Government and the nation's taxpayers to finance it.
- The debt-to-GDP ratio fell to 51.8 per cent in 2000-01, a decline of 18.9 percentage points from its peak of 70.7 per cent in 1995-96. The debt-to-GDP ratio is now at its lowest level since 1985-86.
- The debt-to-GDP ratio declined by 6.1 percentage points between 1999-2000 and 2000-01. This was the best single-year performance since 1951-52. Of this improvement, 4.4 points were due to economic growth while 1.7 points were due to the $17.1-billion debt repayment during the year – the largest absolute debt paydown in Canada's history.

Financial source of $19 billion in 2000-01

Table 3.3
Federal Budgetary Surplus and Financial Source

	1999-00	2000-01
	(billions of dollars)	
Budgetary surplus	12.3	17.1
Non-budgetary transactions		
Loans, investments and advances	-0.3	-1.7
Pension and other accounts	7.0	1.3
Other transactions	-4.4	2.2
Total	2.3	1.8
Financial source (excluding foreign exchange transactions)	14.6	19.0

Note: Numbers may not add due to rounding.

■ The budgetary balance is presented on a modified accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues only when the cash is received. The budgetary balance covers only those activities over which the Government has legislative control.

■ Another important measure of the federal government's financial position is the financial requirements/source, which measures the difference between cash received and cash disbursed.

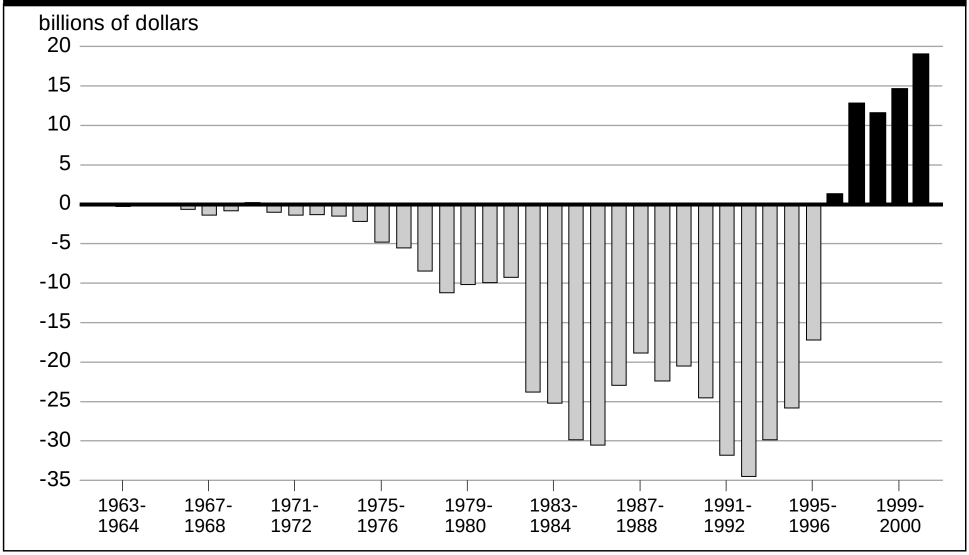
■ It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal government employee pension accounts and other accounts, changes in financial assets and liabilities, as well as the conversion from accrual to cash accounting. The net change in these activities is included as part of non-budgetary transactions.

■ Non-budgetary transactions produced a net source of funds of $1.8 billion in 2000-01, slightly less than that recorded in 1999-2000, although there were large differences among the components. The lower source in pension and other accounts primarily reflected the reforms of the federal government employees' pension plans, which became effective on April 1, 2000. Current contributions are now invested in financial markets, rather than being included as part of non-budgetary transactions. Other transactions provided a net source of funds, whereas in 1999-2000 a large requirement was recorded.

■ As a result, with a budgetary surplus of $17.1 billion and a net source of $1.8 billion from non-budgetary transactions, there was a financial source, excluding foreign exchange transactions, of $19.0 billion in 2000-01, up from a source of $14.6 billion in 1999-2000.

Financial source recorded for the fifth consecutive year in 2000-01

Financial Balance (Excluding Foreign Exchange Transactions)
(Public Accounts Basis)



■ Financial requirements/source 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.

■ Financial sources have now been recorded in each of the past five years. This is in contrast to the large financial requirements observed from the mid-1970s through the mid-1990s.

■ The financial source of $19.0 billion in 2000-01 was the largest in Canada's history.

Net public debt reduced by $35.8 billion over the last four years

Table 3.4
Federal Government Financial Assets and Liabilities

	1996-97	2000-01	Change
	(billions of dollars)		
Financial assets			
Cash and accounts receivable	13.9	19.2	5.2
Foreign exchange accounts	26.8	50.3	23.5
Net loans, investments and advances	16.7	16.0	-0.7
Total financial assets	57.5	85.5	28.0
Gross liabilities			
Interest-bearing debt			
Market debt			
Payable in Canadian dollars	453.8	413.2	-40.6
Payable in foreign currencies	23.0	33.2	10.1
Total	476.9	446.4	-30.4
Public sector pensions and other accounts	123.7	142.8	19.1
Total	600.6	589.2	-11.3
Other liabilities	40.1	43.6	3.5
Gross liabilities	640.7	632.9	-7.8
Net public debt	583.2	547.4	-35.8

Note: Numbers may not add due to rounding.

■ Net public debt consists of interest-bearing debt, other liabilities (primarily accounts payable) and financial assets (cash, accounts receivable, assets in the foreign exchange account, investment in Crown corporations and loans to other governments). It has declined by $35.8 billion since 1996-97, the last year the budget was in deficit.

■ Among the major components, financial assets increased by $28.0 billion over this period.

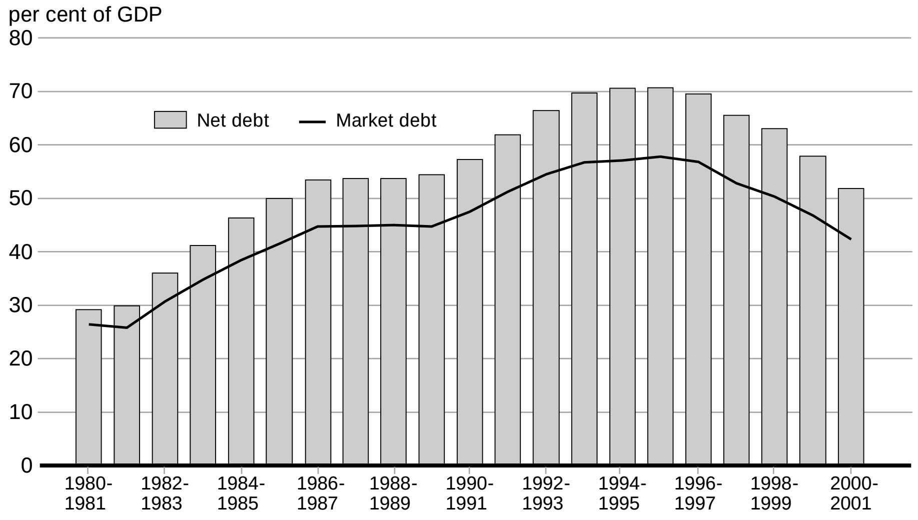
■ This increase is largely attributable to higher international reserves held in the Exchange Fund Account. The purpose of the Account is to aid in the control and protection of the external value of the Canadian dollar, which it does by acquiring or selling assets, as required.

■ The increase over the last four years reflects the Government's announcement in the 1995 and 1998 budgets that it would bring the level of Canada's international reserves more in line with that of other countries.

■ Net gains on financial assets are credited to budgetary revenues (return on investments), although borrowing costs associated with acquiring these assets are part of public debt charges.

The decline in net public debt mirrors the decline in market debt

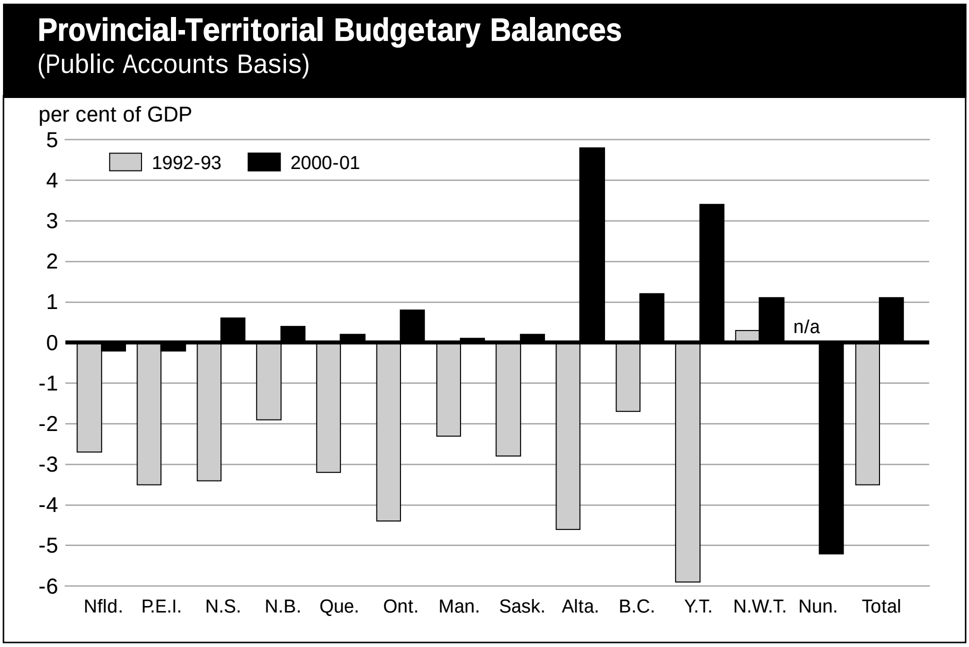
Federal Net Debt and Market Debt
(Public Accounts Basis)



Sources: Public Accounts of Canada and Statistics Canada.

- Gross liabilities include the Government's obligations with respect to interest-bearing debt and other liabilities, such as accounts payable. Interest-bearing debt consists of market debt and the Government's liabilities to federal employee pension plans and other accounts.
- Gross liabilities have declined by $7.8 billion since 1996-97, with interest-bearing debt down by $11.3 billion and other liabilities increasing by $3.5 billion.
- However, within interest-bearing debt there were large differences.
- Market debt, consisting of debt issued on credit markets in the form of Government of Canada bonds, Canada Savings Bonds and Treasury bills, for example, declined $30.4 billion between 1996-97 and 2000-01. Debt payable in Canadian dollars declined by $40.6 billion while debt payable in foreign currencies increased by $10.1 billion. The latter is used solely for exchange fund operations. The decline in net public debt as a per cent of GDP closely mirrors the decline in market debt.
- In contrast, liabilities to the federal government employees' pensions and other accounts increased by $19.1 billion.

A majority of the provinces and territories reported budgetary surpluses in 2000-01

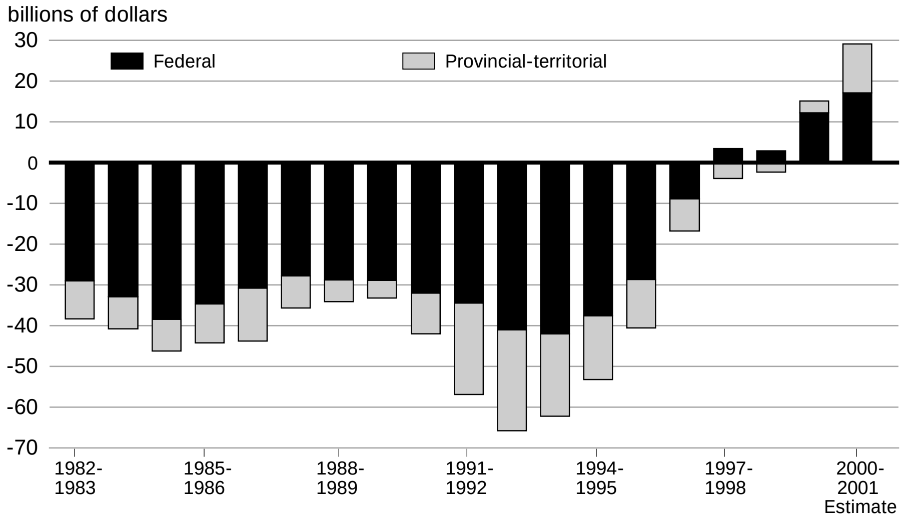


Source: Provincial Public Accounts, with the exception of P.E.I., Quebec, Yukon, Northwest Territories and Nunavut, which are based on the latest available data.

- Like the federal government, the provinces and territories have made substantial progress in restoring their fiscal health.
- Eight provinces and two territories are estimated to have recorded budgetary surpluses in 2000-01.
- This represents a substantial improvement from 1992-93, when all but one of the 12 provincial-territorial government budgets (Northwest Territories) were in deficit.
- The provincial-territorial government sector is estimated to have recorded a surplus of $12 billion in 2000-01, the second consecutive surplus after more than 30 years of uninterrupted deficits.

The aggregate federal-provincial-territorial government budget recorded a surplus for the third consecutive year in 2000-01

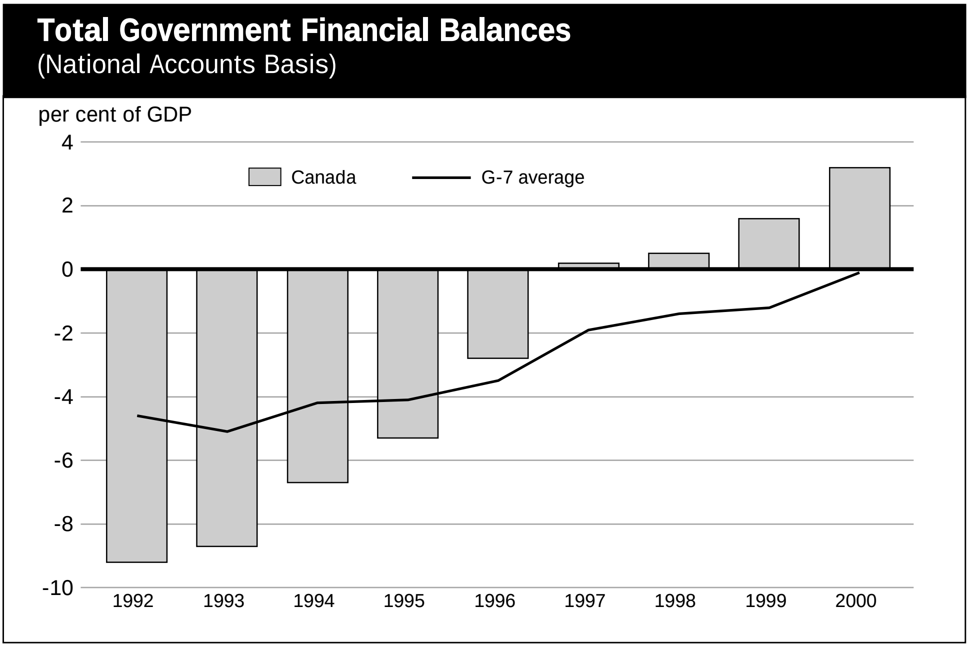
Federal and Provincial-Territorial Budgetary Balances
(Public Accounts Basis)



■ In 2000-01 federal-provincial-territorial governments are estimated to have recorded an aggregate surplus of $29.2 billion, the third consecutive surplus.

■ This represents a remarkable improvement from 1992-93, when the federal-provincial-territorial government sector posted a $65.8-billion deficit.

Canada's financial balance has improved significantly compared to the G-7 average



Source: *OECD Economic Outlook No. 70, Preliminary Edition* (November 2001), *OECD Economic Outlook No. 69* (June 2001).

- On a National Accounts basis, the measure commonly used to make comparisons across countries, Canada's total government[1] financial balance has improved substantially since the early 1990s.
- The total government deficit peaked at 9.2 per cent of GDP in 1992, compared to the G-7 average deficit-to-GDP ratio of 4.6 per cent that same year.
- By 1997, however, financial improvements at all levels of government enabled Canada's total government sector to post a surplus.
- In 2000 Canada's surplus reached 3.2 per cent of GDP, compared to an average deficit of 0.1 per cent in the G-7 countries.

[1] Includes federal, provincial-territorial and local governments as well as the Canada Pension Plan and Quebec Pension Plan.

4

Private Sector Five-Year Economic and Fiscal Projections

Highlights

- The Department of Finance meets each fall with the chief economists of the major chartered banks and three private sector economic forecasting firms. The objective of this exercise is to agree on a set of economic assumptions for planning purposes, which the forecasting firms then use to develop fiscal projections of the budgetary balance for the current fiscal year and each of the next five years.
- However, because of the greater degree of uncertainty associated with longer-term projections, budget decisions are made on a rolling two-year horizon.
- In the absence of any policy decisions proposed in this budget, the average private sector projections of the surplus for fiscal-planning purposes are $7.3 billion in 2001-02, $3.8 billion in 2002-03, $5.7 billion in both 2003-04 and 2004-05, $9.7 billion in 2005-06 and $14.3 billion in 2006-07.
- These projections of the fiscal surplus reflect the effects of the slowdown in economic growth in both 2001 and 2002 and the rebound in the years thereafter. In addition, the agreements on health renewal and early childhood development reached by first ministers in September 2000 and the impact of the $100-billion Five-Year Tax Reduction Plan further restrain the surplus projections to 2004-05 – the year in which the tax reduction plan is fully implemented. Thereafter larger surpluses are projected.
- These fiscal projections are based on the October 2001 survey of private sector economists. Subsequently private sector economists have adjusted their short-term economic forecasts to incorporate more current data, including the third-quarter National Accounts results for Canada and the U.S., which were released on November 30, 2001 (they are described in Chapter 2). These adjusted economic assumptions were used in deriving the rolling two-year budget fiscal forecasts in Chapter 7.

Introduction

- Earlier this fall the Department of Finance conducted its regular consultations with its economic advisory group, consisting of the chief economists of Canada's major chartered banks and leading economic forecasting firms.

- The objective of this exercise was to agree upon a set of economic assumptions for budget-planning purposes.

- The economic assumptions were based on a survey of 19 economic forecasters conducted in early October 2001. Based on their views of economic developments at that time, the advisory group agreed that the average of these economic forecasts constituted a reasonable basis to develop five-year fiscal projections, based on current tax and expenditure policies.

- The fiscal projections in this chapter are the average of the fiscal projections prepared by three economic forecasting firms, using the October 2001 survey of private sector economic forecasts. These fiscal projections have been adjusted to incorporate the fiscal impact of the policy initiatives announced before this budget, most of which were announced in the May 2001 *Economic Update*.

- These projections were prepared before the release of the third-quarter National Accounts for both Canada and the United States. As a result, private sector economists have revised their forecasts in light of the more recent economic data. The fiscal impact of the changed economic assumptions is reflected in the two-year budget projections contained in Chapter 7.

Assumptions Underlying Average of Private Sector Fiscal Projections

Table 4.1
Average of Private Sector Economic Forecasts: October 2001 Survey

	2001	2002	2003-2007
		(per cent)	
Real GDP	1.5	1.5	3.3
GDP inflation	2.6	1.6	1.9
Nominal GDP growth	4.1	3.1	5.3
3-month Treasury bill rate	4.0	3.2	5.1
10-year government bond rate	5.5	5.5	5.9

Note: Based on a survey conducted by the Department of Finance in early October.
The number of respondents declines from 19 in 2002 to 9 in 2006 and 2 in 2007.

■ As noted in Chapter 2, the average of private sector forecasts in the October 2001 survey projected economic growth of 1.5 per cent in both 2001 and 2002, down from 4.4 per cent in 2000. This slowdown in growth is accompanied by a fall in short-term interest rates.

■ Over the medium term, the private sector forecasters expect economic growth to rebound back to a healthy pace. The average of private sector forecasts for real gross domestic product (GDP) growth over the 2003 to 2007 period is 3.3 per cent.

■ GDP inflation is expected to average just under 2 per cent over the 2003 to 2007 period. As a result, nominal GDP growth is forecast to average 5.3 per cent over the same period.

■ The average of private sector forecasts calls for relatively flat interest rates between 2003 and 2007, along with consumer price inflation slightly below the mid-point of the official target band of 1 to 3 per cent.

■ Based on the October 2001 average of private sector economic forecasts, the three forecasting firms derived projections of the major components of the budgetary balance. These are based on the following assumptions:

- The projections include the impact of the $100-billion tax reduction plan as set out in the October 2000 *Economic Statement and Budget Update* and the $23.4-billion agreements on health renewal and early childhood development reached by first ministers in September 2000.
- The employment insurance (EI) premium rate assumptions are those used in the 2000 budget and the October 2000 *Economic Statement and Budget Update* – $2.20 (employee rate per $100 of insurable earnings) for 2002, $2.10 for 2003 and $2.00 thereafter.
- The 2000 budget assumptions for direct program spending – total program spending less major transfers to persons and major cash transfers to other levels of government – are used for 2001-02, adjusted for policy decisions announced in the October 2000 *Economic Statement and Budget Update*. Thereafter direct program spending is assumed to grow in line with the growth in the population and inflation.
- The projections of public debt charges assume that the Contingency Reserve is not required and is applied each year to reducing the net public debt.

Table 4.2
Status Quo Fiscal Outlook:
Changes Since October 2000 Economic Statement

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
			(billions of dollars)		
October 2000 Economic Statement					
Budgetary surplus:					
private sector average	15.2	14.9	16.5	17.3	13.5
Less spending and tax initiatives in 2000 Statement					
Spending initiatives	1.8	0.1	0.1	0.1	0.1
Tax relief	1.5	6.7	8.7	9.4	6.7
Total	3.3	6.8	8.9	9.6	6.8
October 2000 Statement: budgetary surplus	11.9	8.3	7.6	7.7	6.7
Spending and tax initiatives announced before 2001 budget	-2.1	-0.6	-0.5	-0.3	-0.2
Impact of economic developments	7.3	-0.4	-3.3	-1.7	-0.8
October 2001 private sector survey					
Status quo budgetary surplus:					
private sector average	17.1	7.3	3.8	5.7	5.7

Note: Numbers may not add due to rounding.

- In the October 2000 *Economic Statement and Budget Update*, the private sector average budgetary surplus was projected at $15.2 billion for 2000-01, $14.9 billion for 2001-02, $16.5 billion for 2002-03, $17.3 billion for 2003-04 and $13.5 billion for 2004-05.
- The acceleration and enhancement of the tax reduction plan, coupled with the spending initiatives announced in the October 2000 *Economic Statement and Budget Update*, reduce these surpluses to $11.9 billion for 2000-01, $8.3 billion for 2001-02, $7.6 billion for 2002-03, $7.7 billion for 2003-04 and $6.7 billion for 2004-05. The lower surplus estimate for 2004-05 reflects the fact that the tax reduction plan is fully in place in that year.
- Prior to the 2001 budget a number of policy initiatives were announced, most of which were listed in the May 2001 *Economic Update.* The net impact of these initiatives amounts to $2.1 billion in 2000-01, $0.6 billion in 2001-02, $0.5 billion in 2002-03 and about $0.3 billion each year thereafter.
- As indicated in the 2000-01 *Annual Financial Report of the Government of Canada*, the final budgetary surplus for 2000-01 was $17.1 billion, compared to an October 2000 *Economic Statement and Budget Update* estimated surplus of $11.9 billion. Most of this better than expected outcome is attributable to higher than expected budgetary revenues, which were $4.9 billion higher than estimated in the October 2000 Economic Statement. Part of the better than expected outcome for 2000-01 is expected to carry forward into 2001-02 and later years, partially offsetting the adverse impact of the changes in the economic outlook. This is supported by the monthly financial results to the end of October 2001.
- The private sector projections of the budgetary surplus, based on the October 2001 survey of private sector economic forecasts, and before adjusting for the Contingency Reserve, economic prudence and the policy initiatives announced in this budget, amount to $7.3 billion for 2001-02, falling to $3.8 billion in 2002-03 and rising to $5.7 billion in both 2003-04 and 2004-05.

Table 4.3
Spending and Tax Initiatives Announced Since the October 2000 Economic Statement and Before the 2001 Budget

	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	Total
	(millions of dollars)						
Improving the quality of life for Canadians and their children							
Community health and environment							
Tobacco strategy	70	95	95	110	110	110	590
Health commissioner[1]	7	8					15
Addressing environmental challenges[1]	77	44	42	41	8	8	220
Labrador Innu Healing Strategy[2]	19	33	30				81
Culture and branding Canada abroad							
Cultural initiatives	114	167	175	106			562
Amateur sports	10	10	10				30
CBC[3]	60	60					120
Canadian Television and Cable Production Fund[3]	100	100					200
Revitalizing Canada's Capital	21	58	11	40	16	2	148
Crime prevention and drug strategy	30	30	30	30	30	30	180
Employment insurance benefits[2]	35	89	89	89	89	89	480
Donations of certain publicly traded securities to charities[2,4]		70	70	75	75	75	365
Community safety and crime prevention[2]	23	32	45	45	45	45	235
Total	565	796	596	537	372	359	3,226
Making Canada's economy more innovative							
Research and development							
Government On-Line	120						120
Providing essential public services							
Economic adjustment							
Shipbuilding[2]	1	46	43	30	30		150
Airline assistance[2]	160						160
Toronto waterfront[1]	2	55	75	100	150	120	502
Canadian Tourism Commission[1]	20						20
Asia wood product market development[2]	0	2	2	1			4
Furthering international co-operation[2]	25	37	26				88
Total	208	140	146	131	180	120	924
Total	894	936	742	668	552	479	4,270
Less: Tobacco tax increases							
April 2001 increase[4]	200	200	200	200	200	200	1,200
November 2001 increase[2, 4]	75	240	240	240	240	240	1,275
Total	275	440	440	440	440	440	2,475
Net fiscal impact	619	496	302	228	112	39	1,795

[1] Revised from May 2001 *Economic Update.*
[2] Not included in May 2001 *Economic Update.*
[3] This budget extends funding for one more year.
[4] Tax measure.

- In the May 2001 *Economic Update* a number of initiatives announced since the October 2000 *Economic Statement and Budget Update* were identified. These included: the Tobacco Control Strategy, major investments in Canadian culture, support for Olympic bids and amateur sports, incremental funding for Government On-Line, new funding to fight organized crime, investments in a number of environmental initiatives, and funding to launch the Commission on the Future of Health Care in Canada and revitalize Canada's capital.

- Since the May 2001 *Economic Update* a number of additional initiatives have been announced. These include: funding for the Labrador Innu Healing Strategy, enhancements to EI benefits, making permanent the 1997 budget measure providing special tax assistance for donations of publicly traded securities to public charities, funding to support community crime prevention initiatives and assistance to airlines. In addition, incremental funding to the CBC and the Canadian Television and Cable Production Fund has been extended for one more year.

- Tobacco tax increases came into effect on April 6th and November 1st of 2001 and are expected to increase federal excise taxes and duties by $440 million per year on a full-year basis.

- As a result, the net impact of the policy initiatives announced before this budget amounts to $619 million in 2001-02, $496 million in 2002-03, falling to $39 million by 2006-07.

Table 4.4
October 2001 Status Quo Fiscal Outlook
Summary Statement of Transactions:
Average of Private Sector Fiscal Projections

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
				(billions of dollars)			
Budgetary transactions							
Budgetary revenues	178.6	174.8	175.6	182.5	188.0	196.9	206.5
Program spending	119.3	128.0	134.1	137.6	142.2	147.5	152.6
Operating balance	59.2	46.8	41.4	44.9	45.7	49.4	54.0
Public debt charges	42.1	39.5	37.7	39.2	40.0	39.8	39.7
Budgetary surplus	17.1	7.3	3.8	5.7	5.7	9.7	14.3
Net public debt							
Balanced budget (no debt repayment)	547.4	547.4	547.4	547.4	547.4	547.4	547.4
Per cent of GDP							
Budgetary revenues	16.9	15.9	15.5	15.2	14.8	14.8	14.7
Program spending	11.3	11.6	11.8	11.5	11.2	11.1	10.9
Public debt charges	4.0	3.6	3.3	3.3	3.2	3.0	2.8
Budgetary surplus	1.6	0.7	0.3	0.5	0.5	0.7	1.0
Net public debt							
Balanced budget (no debt repayment)	51.8	49.8	48.3	45.6	43.2	41.0	39.1

Note: Numbers may not add due to rounding.

Average of October 2001 Private Sector Projections

- Table 4.4 sets out the fiscal projections based on the October 2001 survey of private sector economic forecasts to 2006-07. They do not include the impact of changes to the economic outlook since that survey. In addition, they are not adjusted for either economic prudence or the Contingency Reserve and do not include the impact of policy initiatives proposed in this budget.

- On a status quo basis, a budgetary surplus of $7.3 billion is estimated for 2001-02. The impact of the slowdown in the economy reduces the surplus to $3.8 billion in 2002-03. Thereafter, given the projected rebound in economic growth, the surplus increases to $5.7 billion in 2003-04. It is not projected to increase in 2004-05, as this is the year in which the tax reduction plan is fully implemented. Thereafter the surplus rises to $9.7 billion in 2005-06 and $14.3 billion in 2006-07.

- The revenue-to-GDP ratio falls from 16.9 per cent in 2000-01 to 14.8 per cent in 2004-05. The major factor contributing to this decline is the implementation of the tax reduction plan. The revenue ratio remains stable thereafter.

- The program spending-to-GDP ratio increases in both 2001-02 and 2002-03, primarily reflecting the impact of a slowing economy, the fiscal costs of the agreements on health renewal and early childhood development, and changes to the EI program. Thereafter it falls to under 11 per cent by 2006-07.

- Assuming no debt payment over the planning period, the net debt-to-GDP ratio falls to under 40 per cent by 2006-07 – a decline of over 30 percentage points from its peak of 70.7 per cent in 1995-96.

Table 4.5
October 2001 Status Quo Fiscal Outlook
Budgetary Revenues: Average of Private Sector Projections

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
	(billions of dollars)						
Income tax							
Personal income tax	82.3	80.8	80.5	84.6	87.9	93.0	98.5
Corporate income tax	28.2	26.5	26.0	26.2	26.0	26.8	27.7
Other income tax	4.3	4.0	4.1	4.2	4.4	4.5	4.7
Total income tax	114.8	111.3	110.5	115.1	118.3	124.3	130.9
Employment insurance revenues	18.7	17.8	17.6	17.5	17.4	18.1	18.7
Excise taxes/duties							
Goods and services tax	25.0	25.8	27.1	28.9	30.7	32.5	34.4
Customs import duties	2.8	2.9	3.0	3.2	3.3	3.5	3.7
Other	8.3	8.6	8.9	9.2	9.5	9.8	10.1
Total	36.1	37.3	39.0	41.3	43.6	45.8	48.2
Total tax revenues	169.7	166.4	167.1	173.8	178.3	188.2	197.8
Non-tax revenues	8.9	8.4	8.5	8.6	8.7	8.7	8.8
Total budgetary revenues	178.6	174.8	175.6	182.5	188.0	196.9	206.5
Per cent of GDP							
Personal income tax	7.8	7.3	7.1	7.1	6.9	7.0	7.0
Corporate income tax	2.7	2.4	2.3	2.2	2.0	2.0	2.0
Employment insurance revenues	1.8	1.6	1.6	1.5	1.4	1.4	1.3
Goods and services tax	2.4	2.3	2.4	2.4	2.4	2.4	2.5
Other excise	1.1	1.1	1.1	1.0	1.0	1.0	1.0
Tax revenues	16.1	15.1	14.7	14.5	14.1	14.1	14.1
Non-tax revenues	0.8	0.8	0.7	0.7	0.7	0.7	0.6
Total	16.9	15.9	15.5	15.2	14.8	14.8	14.7

Average of October 2001 Private Sector Projections of Budgetary Revenues

■ The revenue projections in Table 4.5 do not include the impact of policy measures announced in this budget.

■ In the October 2000 *Economic Statement and Budget Update*, budgetary revenues, based on the average of private sector economic assumptions at that time, were expected to increase only marginally from 2000-01 to 2001-02, reflecting the impact of the tax cuts that came into effect in 2000 and 2001. These included:

- restoration of full indexation of the personal income tax system;
- reductions in personal income tax rates for all taxpayers;
- elimination of the deficit reduction surtax;
- increases in the Canada Child Tax Benefit;
- a reduction in the capital gains inclusion rate; and
- a reduction in the corporate income tax rate.

■ However, with the slowdown in economic growth in 2001, budgetary revenues are now expected to decline by $4 billion, in 2001-02.

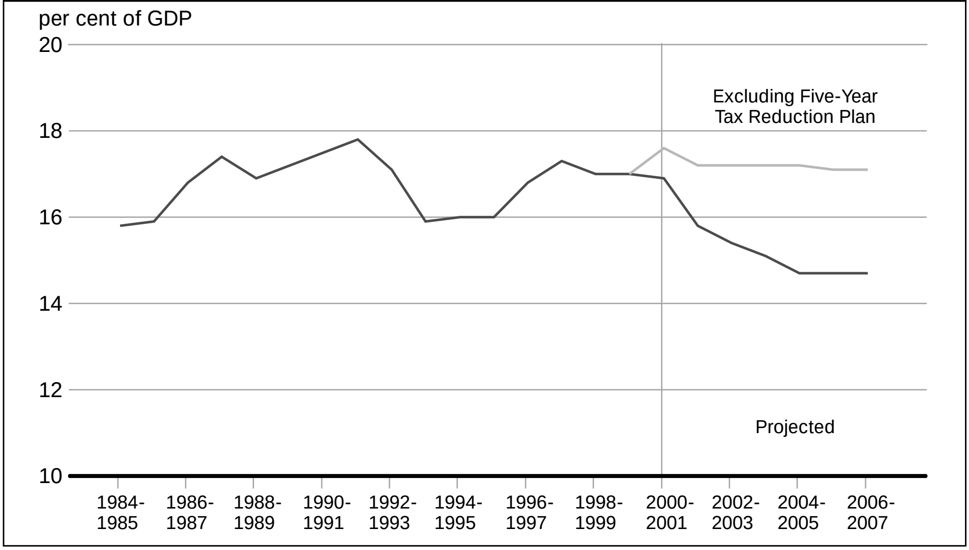
■ Only a slight increase in budgetary revenues is expected in 2002-03, reflecting the impact of continuing weak economic growth in 2002.

■ Thereafter the profile of revenues reflects the impact of sustained economic growth and the ongoing impact of the tax reduction plan. Beyond 2004-05 revenue growth is somewhat stronger, as the tax reduction plan is fully implemented.

■ Changes to the Employment Insurance Act give the Government the authority to set EI premium rates for 2002 and 2003. The employee rate for 2002 has been set at $2.20 per $100 of insurable earnings, unchanged from that assumed for planning purposes in the February 2000 budget and October 2000 *Economic Statement and Budget Update.* For planning purposes, the premium rates for 2003 and beyond are unchanged from what was assumed in the 2000 budget and October 2000 *Economic Statement and Budget Update.* However, in setting the rates for 2003, the Government will take into account the economic circumstances at that time.

Revenue Ratio Permanently Lowered Due to Tax Cuts

Federal Revenue-to-GDP Ratio



■ A more revealing picture of movements in tax revenue can be obtained by examining the "revenue ratio" – total federal revenues in relation to the total income in the economy (or GDP).

■ There is a cyclical element to the revenue ratio. It declines during economic downturns and tends to increase during recoveries, 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 1990-91 recession.

■ Looking forward, the revenue ratio is projected to be significantly lower than in the past. This is attributable to the ongoing impact of the tax reduction plan, which has lowered the ratio on a structural basis.

■ The revenue ratio is projected to decline from 16.9 per cent in 2000-01 to 14.8 per cent by 2004-05 – a level not seen since the early 1960s – and to stabilize thereafter.

Table 4.6
October 2001 Status Quo Fiscal Outlook
Program Spending: Average of Private Sector Projections

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
	(billions of dollars)						
Major transfers to persons							
Elderly benefits	24.3	25.3	26.4	27.3	28.4	29.4	30.6
Employment insurance benefits	11.4	14.1	15.7	15.3	15.1	15.8	16.5
Relief for Heating Expenses	1.5						
Total	37.2	39.3	42.1	42.6	43.5	45.3	47.1
Major transfers to other levels of government[1]							
Canada Health and Social Transfer	13.5	17.3	18.6	19.3	20.4	21.0	21.6
Medical Equipment Fund	1.0						
Fiscal arrangements	12.7	12.3	12.8	13.5	14.3	15.0	15.7
Alternative Payments for Standing Programs	-2.5	-2.4	-2.5	-2.6	-2.7	-2.8	-2.9
Total	24.7	27.2	28.9	30.2	32.0	33.2	34.4
Direct program spending	57.5	61.4	63.2	64.8	66.7	69.0	71.0
Total program spending	119.3	128.0	134.1	137.6	142.2	147.5	152.6
Per cent of GDP							
Major transfers to persons							
Elderly benefits	2.3	2.3	2.3	2.3	2.2	2.2	2.2
Employment insurance benefits	1.1	1.3	1.4	1.3	1.2	1.2	1.2
Total[2]	3.5	3.6	3.7	3.5	3.4	3.4	3.3
Major transfers to other levels of government							
Canada Health and Social Transfer	1.4	1.6	1.6	1.6	1.6	1.6	1.5
Fiscal arrangements	1.2	1.1	1.1	1.1	1.1	1.1	1.1
Alternative Payments for Standing Programs	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Total	2.3	2.5	2.5	2.5	2.5	2.5	2.5
Direct program spending	5.4	5.6	5.6	5.4	5.3	5.2	5.1
Total program spending	11.3	11.6	11.8	11.5	11.2	11.1	10.9

[1] For those years not covered by legislation, for planning purposes, it has been assumed that the current provisions are extended.

[2] Includes Relief for Heating Expenses.

Average of October 2001 Private Sector Projections of Program Spending

- The projections of program spending in Table 4.6 include the impact of the agreements on health renewal and early childhood development reached in September 2000, the February 2000 budget and September 2000 enhancements to EI benefits, as well as initiatives announced before this budget, primarily those contained in the May 2001 *Economic Update*. They do not include the initiatives proposed in this budget.

- Program spending is divided into three major components: major transfers to persons, major cash transfers to other levels of government and direct program spending.

- Based on the average of the projections provided by three forecasting firms, total program spending is estimated to increase from $119.3 billion in 2000-01 to $128.0 billion in 2001-02.

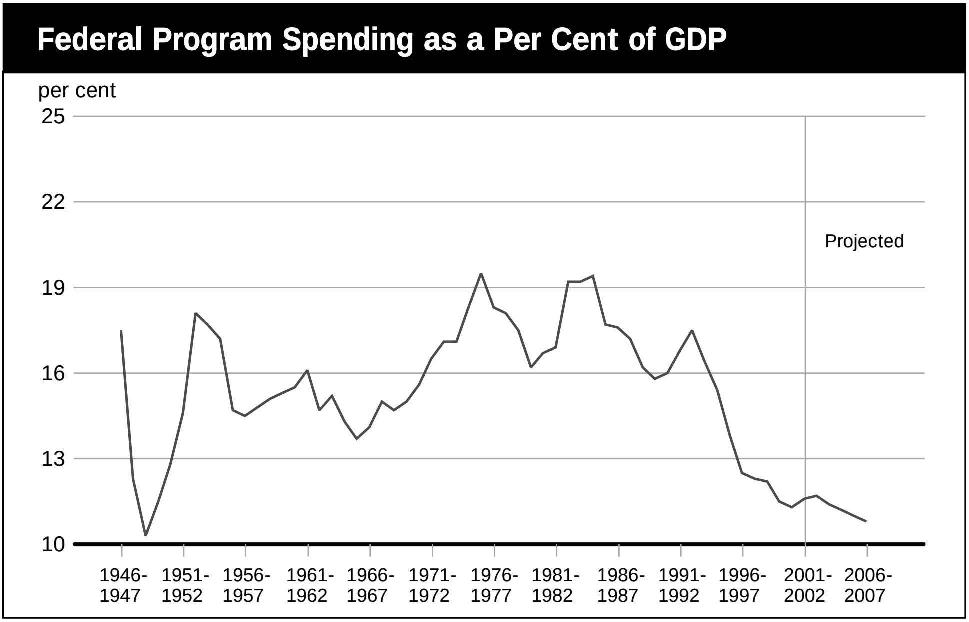
  – Nearly half of this increase is attributable to the impact of the September 2000 agreements on health renewal and early childhood development, which resulted in an increase of $3.8 billion in cash transfers under the Canada Health and Social Transfer.

  – EI benefits are expected to increase significantly by $2.7 billion, reflecting the impact of the slowdown on economic growth as well as the effect of program enhancements. In addition, elderly benefits are estimated to increase by $1 billion, reflecting increases in the number of people eligible for benefits and higher average benefits, which are indexed to inflation.

  – Direct program spending is expected to be up $3.9 billion, primarily reflecting developments that lowered spending in 2000-01 as well as the impact of policy initiatives announced before this budget.

  – Partially offsetting the impact of these factors are a number of one-time spending initiatives in 2000-01. These include the $1.5-billion Relief for Heating Expenses, $1.25-billion transfer to the Canada Foundation for Innovation, $1-billion payment to the Medical Equipment Fund and the liability of $0.8 billion related to the lifting of the equalization ceiling for 1999-2000.

Program Spending-to-GDP Ratio Continues to Decline



- Program spending as a share of GDP is expected to increase somewhat in both 2001-02 and 2002-03, reflecting the impact of higher cash transfers to the provinces and increased EI benefits, the latter reflecting both the impact of program enhancements as well as an increase in the number of people receiving benefits due to the slowdown in the economy.
- Beyond 2002-03 the ratio again declines as economic growth exceeds growth in program spending.

Table 4.7
October 2001 Status Quo Fiscal Outlook
Major Transfers to Persons

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
	(billions of dollars)						
Elderly benefits	24.3	25.3	26.4	27.3	28.4	29.4	30.6
Employment insurance benefits	11.4	14.1	15.7	15.3	15.1	15.8	16.5
Relief for Heating Expenses	1.5						
Total	37.2	39.3	42.1	42.6	43.5	45.3	47.1

■ Major transfers to persons consist of elderly and EI benefits. The Relief for Heating Expenses is included in 2000-01.

– Elderly benefits consist of Old Age Security pensions, the Guaranteed Income Supplement and the spouse's allowance.

– Growth in elderly benefits is largely determined by the growth in the elderly population and average benefits, which are fully indexed to quarterly 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 during World War II.

■ There are three components of the EI benefit program: regular benefits, which are primarily a function of the number of people unemployed and eligible to receive benefits; 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 provinces and territories. Certain provisions applying to special benefits will be modified to respond to issues arising from individual cases.

– The largest and most variable component, accounting for about two-thirds of EI benefits, is regular benefits. With the slowing in the economy and the accompanying increase in the number of unemployed, regular benefits are expected to increase significantly in both 2001-02 and 2002-03.

– The profile of EI benefits is also affected by the extension of and related changes to parental benefits and modifications to the intensity and clawback provisions.

Table 4.8
October 2001 Status Quo Fiscal Outlook
Major Transfers to Other Levels of Government

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
	(billions of dollars)						
Canada Health and Social Transfer[1]	13.5	17.3	18.6	19.3	20.4	21.0	21.6
Medical Equipment Fund	1.0						
Fiscal arrangements	12.7	12.3	12.8	13.5	14.3	15.0	15.7
Alternative Payments for Standing Programs	-2.5	-2.4	-2.5	-2.6	-2.7	-2.8	-2.9
Total	24.7	27.2	28.9	30.2	32.0	33.2	34.4

[1] Reflects profile of CHST cash as accounted for by the federal government. CHST entitlements consist of both cash and tax transfers. The tax transfer component is projected to grow every year in line with the growth of the Canadian economy.

■ 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 arrangements, which include equalization and Territorial Formula Financing.

– Under the agreements on health renewal and early childhood development reached by first ministers in September 2000, annual CHST cash transfers will increase from $13.5 billion in 2000-01, to $21 billion in 2005-06. For planning purposes, a continuation of the increase in 2005-06 is assumed for 2006-07.

– The largest component of fiscal transfers is equalization, whereby the federal government transfers funds to provinces with below-average revenue-raising capacities so that they can provide reasonably comparable levels of public services at reasonably comparable levels of taxation. The projection assumes that equalization transfers grow in line with the growth in nominal GDP. The final outcome for 2000-01 includes the liability related to the lifting of the equalization ceiling in 1999-2000.

Table 4.9
October 2001 Status Quo Fiscal Outlook
Direct Program Spending

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
				(billions of dollars)			
Direct program spending	57.5	61.4	63.2	64.8	66.7	69.0	71.0

- Direct program spending – total spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, defence spending, and operating and capital expenditures of non-defence departments and agencies.

- Many of these programs are quasi-statutory or demand-driven, such as support for Aboriginal people, veterans, correctional services, policing services and the justice system.

- There are also a number of programs that support economic growth and job creation or provide assistance to those in need. Such programs include student loan programs, the Canada Education Savings Grant, research and development (either through intramural activities or through transfers to universities, hospitals and the private sector), assistance to farmers and aid for developing countries.

- The projections for this component are consistent with those contained in the October 2000 *Economic Statement and Budget Update*, which were assumed to increase at an annual rate in line with the growth in the population and inflation. In addition to incorporating the effect of changes in the inflation outlook, adjustments were also made to include the impact of the policy initiatives announced in the October 2000 *Economic Statement and Budget Update*, as well as those announced before this budget.

5

Enhancing Security for Canadians

*"Canadians have been confronted with
a new kind of threat at home – and to protect ourselves,
we must respond in new kinds of ways."*

Finance Minister Paul Martin
2001 budget speech

Highlights

- The 2001 budget contains measures to enhance personal and economic security by:
  - keeping Canadians safe;
  - keeping terrorists out of Canada; and
  - keeping Canada's borders secure, open and efficient.
- In total, the budget provides $7.7 billion over the next five years to enhance security for Canadians.
  - This includes $6.5 billion for security, including air security and Canada's military.
  - It also includes more than $1.2 billion for border initiatives aimed at strengthening border security, facilitating the flow of goods and people, and improving border infrastructure.

1. Security

A. Intelligence and Policing

- The budget includes $1.6 billion over the next five years for intelligence and policing to:
  - equip and deploy more intelligence officers and police officers;
  - improve co-ordination and information sharing among law enforcement, intelligence and national security agencies;
  - boost marine security through greater funding for coastal surveillance; and
  - strengthen the role of the Financial Transactions and Reports Analysis Centre of Canada in cutting off terrorist financing.

B. Screening of Entrants to Canada

- $1 billion will be provided over the next five years to improve the screening of visitors, immigrants and refugee claimants entering Canada. These initiatives include:
  - better and more accurate screening both at Canada's border and abroad; and
  - faster and more thorough screening of refugee claimants.

C. Emergency Preparedness and Military Deployment

- Budget 2001 provides more than $1.6 billion to:
  - double the capacity of Joint Task Force Two – the Canadian Forces' elite anti-terrorist unit;
  - support Canadian military participation in the international war on terrorism;
  - fund military equipment purchases;
  - improve laboratories and purchase specialized equipment to strengthen Canada's ability to respond to chemical, biological and nuclear threats; and
  - improve the ability to protect Canada's critical infrastructure – such as water and energy utilities and transportation and communications systems.

2. A New Approach to Air Security

- $2.2 billion will be provided over the next five years to make air travel more secure in accordance with rigorous new national Transport Canada standards.
- To ensure that these standards are met, the Government will create a new federal air security authority.
- New air security measures will include:
  - armed undercover police officers on Canadian aircraft;
  - better-trained personnel to screen passengers and carry-on baggage;

- new state-of-the-art explosive detection systems at Canada's airports;
- enhanced policing in airports;
- permanent modifications to aircraft cockpit doors to make them more secure; and
- enhanced security zones at aircraft handling facilities and on tarmacs.

■ These measures will be funded by a new Air Travellers Security Charge to be paid by air travellers starting April 1, 2002.

3. A Secure, Open and Efficient Border

■ More than $1.2 billion will be invested in border-related measures to address security concerns and enhance long-term economic prospects by making the Canada-U.S. border more open and efficient.

A. Border Security and Facilitation

■ Of the more than $1.2 billion dedicated to border-related measures, $646 million will be targeted to measures aimed at enhancing border security while facilitating the flow of goods and people between Canada and the United States. These include:

- new technology to help the Canada Customs and Revenue Agency facilitate the passage of goods and people at border–crossing points;
- new Canadian multi-agency Integrated Border Enforcement Teams to co-ordinate intelligence and enforcement efforts along the Canada-U.S. border;

- advanced information-sharing technology to help Customs officers screen travellers arriving at airports and other border-entry points;
- better equipment for detecting explosives, firearms and other dangers without delaying the flow of legitimate commerce or tourism; and
- new secure Internet-based technology to ease Customs compliance for small business.

B. Border Infrastructure

■ To help make the border more efficient, Budget 2001 also creates:

- a new $600-million program to improve infrastructure – such as highways, commercial vehicle processing centres and technology – that supports major border crossings. This will be done in co-operation with public and private sector partners on both sides of the border.

Introduction

The legacy of September 11 is a sense of insecurity – both personal and economic. Key to rebuilding confidence is ensuring that people are safe, and that borders are secure, yet open and efficient.

The Government's response has been swift. The Prime Minister appointed the Ad Hoc Committee of Ministers on Public Security and Anti-Terrorism, which has overseen a number of initiatives, including:

- providing for initial actions in the security, law enforcement and intelligence areas;
- introducing legislation that takes aim at terrorism and enhances Canada's ability to identify, prosecute and punish terrorists; and
- moving expeditiously to cut off sources of financing for terrorists.

Budget 2001 builds on these initiatives through a comprehensive set of security measures designed to keep Canadians safe, keep terrorists out and keep our borders open. It provides a total of $7.7 billion over the next five years to enhance security for Canadians and make Canada's borders more secure, open and efficient.

These measures recognize that Canadians have been confronted with a new kind of threat – one that is aimed at undermining freedom and disrupting the economy. Responding to this threat is crucial to the security of individuals, not only in Canada but worldwide.

The global reinsurance industry has been greatly impacted by the events of September 11. The Government is monitoring the Canadian situation and is working with the insurance industry and other affected parties to determine what action may be required.

The budget includes $6.5 billion for security, emergency preparedness and the military. Also included in this amount is funding to a new federal authority, which will deliver enhanced security services at airports and on board flights according to rigorous new national standards set by Transport Canada.

Maintaining a secure yet open border with the U.S. is of particular importance to Canada. Indeed, the governments of both countries have agreed that security and openness go hand in hand, and have committed to work together to address their mutual security concerns and economic goals.

Two-way trade between Canada and the U.S. is the source of millions of jobs in both countries, accounting for close to $2 billion of commerce every day. Canadian and American factories depend on just-in-time delivery of parts, and Canadians need ready access to their U.S. customers. Tourism depends on making border crossings as quick and efficient as possible, and investors must be confident that the border will remain open.

The 2001 budget responds to this challenge through measures designed to create a more modern, sophisticated border, using state-of-the-art technology that stops individuals and shipments that pose a security risk while speeding legitimate traffic.

In total, this budget provides more than $1.2 billion over the next five years to fund these border measures, including a $600-million program to improve border infrastructure.

Table 5.1
Expenditures

	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	Total
				(millions)			
SECURITY[1]							
Intelligence and policing							
Equipping and deploying more intelligence and police officers	235	182	189	193	190	188	1,177
Improving co-ordination and information sharing	7	10	15	15	15	15	76
Enhanced marine security	5	12	13	10	10	10	60
Cutting off terrorist finances	10	15	10	10	10	10	63
Other initiatives	16	25	29	31	31	31	163
Contingency	–	10	20	20	20	25	95
Subtotal	273	253	276	279	275	278	1,634
Screening of entrants to Canada							
Better and more accurate screening	89	61	61	61	61	61	395
More resources for detentions, removals and refugee determination	30	42	42	32	32	32	210
Fraud-resistant documents	25	73	61	44	42	42	287
Contingency	–	10	20	20	30	30	110
Subtotal	143	186	184	157	165	165	1,001
Emergency preparedness and military deployment							
Supporting Canada's military	400	110	–	–	–	–	510
Expanded anti-terrorist capacity	44	15	15	15	15	15	119
Chemical, biological, radiological and nuclear threats	62	110	95	92	77	77	513
Emergency preparedness	30	71	74	74	75	75	396
Contingency	–	10	20	20	25	25	100
Subtotal	535	316	204	201	192	192	1,638
A NEW APPROACH TO AIR SECURITY	115	462	573	367	366	306	2,189
Total security initiatives	1,067	1,217	1,236	1,003	998	941	6,462

Table 5.1
Expenditures (cont'd)

	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	Total
				(millions)			
A SECURE, OPEN AND EFFICIENT BORDER							
Border security and facilitation							
Expediting pre-approved travellers	–	15	15	12	8	8	58
Better tools for risk assessment and detection	6	17	12	11	10	10	67
Better equipment for detecting dangerous shipments	3	52	15	14	12	12	107
Integrated Border Enforcement Teams	10	25	25	25	25	25	135
Better service to small business	–	5	5	2	2	2	14
Other initiatives	52	37	34	34	34	34	226
Contingency	–	5	5	10	10	10	40
Subtotal	72	156	110	107	101	101	646
Border infrastructure	–	150	150	150	100	50	600
Total border initiatives	72	306	260	257	201	151	1,246
Total	1,139	1,523	1,496	1,260	1,199	1,092	7,708
REVENUES							
Air Travellers Security Charge[2]	–	430	445	445	445	445	2,210
Other	–	50	50	30	25	25	180
Total revenues	–	480	495	475	470	470	2,390

Note: Totals may not add up due to rounding.

[1] This includes $1.2 billion for the Department of National Defence and its agencies.
[2] Figures include net goods and services tax (GST).

1. Security

Protecting citizens, their property and their way of life from external threats is a fundamental role of government. The new national security measures outlined below are designed to prevent terrorist attacks in Canada and prevent terrorists from using Canada as a staging area. The Government's plan is based on:

A. increased resources for intelligence and policing;

B. enhanced screening of arrivals to Canada; and

C. better emergency preparedness and support for Canada's military.

Security funding in this budget includes $1.2 billion for the Department of National Defence and its agencies.

A. Intelligence and Policing

Better intelligence and enhanced policing will help to detect terrorists in Canada so they can be prevented from acting on their intentions, prosecuted and dealt with – including removal from the country where mandated. Improved intelligence will also support other security measures by:

- providing more reliable data for screening entrants to Canada; and
- guiding the country's emergency response and preparedness efforts.

Over the next five years the cost of these intelligence and policing actions will total more than $1.6 billion.

This new funding builds on other recent initiatives such as those in the 2000 budget. The budget provided $1.1 billion over five years to the Royal Canadian Mounted Police (RCMP) to strengthen policing and security activities. In addition, during the last two years the Government provided more than $900 million over five years in a number of enforcement and intelligence areas.

Equipping and Deploying More Intelligence and Police Officers

Budget 2001 provides almost $1.2 billion over the next five years to the RCMP, the Canadian Security Intelligence Service (CSIS) and other security-related federal departments to train, equip and deploy more intelligence officers, front-line investigative personnel and other professional staff. CSIS will receive the biggest annual funding increase since its inception. This funding will also be used to upgrade technology and equipment for intelligence gathering and analysis.

These resources will strengthen the ability of Canada's security and intelligence agencies to provide timely and accurate information and analysis to support the fight against terrorism. This will improve Canada's ability to respond to national security threats.

Part of this funding will be provided to the RCMP to increase the number of investigators and better train them to deal with terrorism. The RCMP will upgrade key information management systems to make the collection, analysis and dissemination of intelligence more efficient and effective.

Improving Co-ordination and Information Sharing

The co-ordination of investigative and enforcement efforts among agencies is essential to the fight against terrorism. This budget provides $76 million over the next five years to strengthen inter-agency co-ordination on two fronts.

■ First, funding will be provided to the RCMP to establish Integrated National Security Enforcement Teams (INSETs), which will include representatives from federal enforcement and intelligence agencies, as well as provincial, municipal and international law enforcement partners.

- The INSETs will gather information to prevent, detect and prosecute criminal offences against Canada's national security. They will have an intelligence and enforcement component, and will focus on the criminal activity of individuals or groups linked to terrorists and their supporters. Using intelligence from CSIS or its own sources, the INSETs will investigate criminal activities, analyze intelligence and ensure that all information is shared among integrated partners.

■ Second, additional resources will be provided to the Canadian Public Safety Information Network. This network is a modern Canada-wide information system that enhances the timely and accurate sharing of information among criminal justice, enforcement and national security agencies.

Enhanced Marine Security

Canada is stepping up measures to protect its ports and other critical infrastructure from terrorist attacks and is increasing intelligence gathering to screen for potential terrorists as well as weapons and explosives. This budget provides $60 million over the next five years in support of these initiatives.

Funding in this budget will allow Fisheries and Oceans Canada to increase the scope and frequency of its surveillance flights over critical approaches to North America. This will enhance Canada's capacity to identify and address potential marine threats.

The Government will also provide resources to expand the Coast Guard's surveillance of Canada's waterways. Over the coming months Transport Canada will work with other organizations to identify further measures to improve marine security.

Cutting Off Terrorist Finances

Cutting off the financing that supports terrorism and denying terrorists access to the nation's financial system are a key element of the Government's anti-terrorist strategy. The Government recognizes that these initiatives must be part of a co-ordinated international effort to ensure terrorism cannot simply shop jurisdictions until it finds an accommodating home.

Canada has been a full partner in this effort. It has moved quickly to implement all UN Security Council Resolutions with respect to the freezing of terrorist assets and the prohibition of making funds available to terrorists.

In addition, as Chair of the G-20, Canada has worked to broaden the international commitment to strong countermeasures, as demonstrated by the Action Plan on Terrorist Financing agreed to at the November 2001 Meeting of G-20 Finance Ministers and Central Bank Governors in Ottawa.

Canada has also provided technical and financial assistance to other countries, especially developing nations, to aid in their efforts to prevent abuse of their financial systems. In early November the Caribbean Regional Technical Assistance Centre was established with the help of $8 million committed by Canada earlier this year.

To deprive terrorists of the funds needed to finance their activities, Bill C-36 strengthens the Government's ability to pursue those engaged in raising funds for terrorists and terrorist groups. The bill includes measures to make the financing of terrorism a criminal offence, strengthen the Government's authority to seize terrorist assets, and broaden Canada's existing anti-money laundering regime to combat terrorist financing.

Canada's anti-money laundering agency, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), was established to provide information to law enforcement authorities to assist in the investigation and prosecution of money laundering. In October 2001 the Government provided $10 million to FINTRAC to enable it to also address terrorist financing. This budget provides $53 million over the next five years to increase FINTRAC's capacity to fulfill these new responsibilities.

B. Screening of Entrants to Canada

Canada welcomes visitors, as well as immigrants and genuine refugees who want to live peacefully in their new country and contribute to its future. That will not change. Yet the Government recognizes that it must improve its ability to prevent potential security risks from entering or passing through the country.

This budget invests $1 billion over the next five years in several measures designed to improve the screening of the thousands of individuals – immigrants, refugee claimants, visitors – who arrive at Canada's borders or seek to go to Canada every day. The Government's objective is to ensure that this first line of defence is strong and secure. As a result, in situations involving refugee claimants, all of the processes that follow the initial screening will function more effectively.

This screening will start abroad with immigration control officers gathering intelligence and preventing those who should not be allowed into Canada from continuing their travel. It will continue at Canadian ports of entry, where there will be heightened vigilance, as well as faster and improved early security screening. Additional resources will be directed to the detention and removal of those who pose security risks to Canada.

Better and More Accurate Screening

Canadian immigration officers stationed abroad have a key role to play in the intelligence-gathering and enforcement process. In co-operation with CSIS and the RCMP, they help identify individuals linked to terrorism or organized crime and prevent them from obtaining documents that would facilitate travel to Canada. Immigration control officers also scrutinize documents of individuals at airports before they board a plane destined for Canada and prevent them from continuing if they should not be allowed entry into Canada.

This budget provides funding to significantly expand the number of immigration control officers abroad. This will better prevent potential security risks from attempting to enter Canada.

It is also critical that a strong screening system be in place at Canadian ports of entry to detect anyone posing a security threat. This budget therefore includes resources to allow for an increased number of immigration officers, who will perform more intense document verification for all individuals arriving in Canada. Up-front security screening of refugee claimants will also be intensified.

This budget provides a total of $395 million over five years for these screening initiatives.

More Resources for Detentions, Removals and Refugee Determination

To support enhanced screening activities, this budget increases resources to detain individuals who do not satisfy immigration officers of their identities, who pose security risks, or who try to enter the country illegally. In addition, further funding will be provided so that such persons, as well as those who are found not to be genuine refugees, can be removed promptly from Canada.

This budget also provides funding to shorten the length of time necessary to validate refugee claims. For claimants, this will avoid prolonged and uncertain stays in Canada while they are waiting for a hearing. Quicker determination of refugee claimants will enhance security by reducing the number of people making inappropriate claims in Canada and, therefore, the potential for would-be terrorists to exploit the refugee determination system.

Funding in this budget for these measures totals $210 million over the next five years.

Fraud-Resistant Documents

This budget provides $287 million over the next five years to improve the integrity of documentation provided to new immigrants to Canada and existing permanent residents who are not Canadian citizens. The new fraud-resistant Permanent Resident Card will come into effect as planned in June 2002. Further, state-of-the-art security features will be incorporated into the passport system.

To offset the cost of the card, the Minister of Citizenship and Immigration will make the necessary changes to regulations to increase immigrants’ application fees by $50. Current permanent residents may also obtain a card by paying a $50 fee. Development and implementation costs are funded in this budget.

These enhanced security measures will bolster confidence in these key personal documents at home and abroad.

C. Emergency Preparedness and Military Deployment

The security measures in this budget aim to minimize the potential for terrorism. However, the Government must ensure that, should a terrorist act occur, it has in place the means to act quickly and effectively to minimize the impact on the lives and property of Canadians. Enhancements in this area also position Canada better to respond to other types of emergencies, such as natural disasters.

This budget therefore commits substantial funding to enhance emergency response and preparedness. It allocates more than $1.6 billion over the next five years to improve the Government's ability to detect, prevent and respond to threats, and to fund Canada's military participation in the international coalition against terrorism.

Supporting Canada's Military

The Prime Minister has stated that Canada is firmly committed to fighting side-by-side with its allies against terrorism. Canada has announced a commitment of up to 2,000 members of the Canadian Forces in the operation known as Operation Apollo.

Budget 2001 provides an additional $210 million to fund Canada's participation in the international military campaign against terrorism, as well as a further $300 million for capital.

Incremental Defence Funding

The last two budgets increased defence funding to contribute to quality-of-life improvements for Canadian Forces personnel and provide more support to the Canadian Forces in pursuing their overall mandate. As a result of actions taken in the 1999 and 2000 budgets, the Department of National Defence (DND) will receive $3.9 billion in additional funding over the next five years.

Budget 2001 provides DND and its agencies with a total of $1.2 billion over the next five years. This includes $300 million this year to purchase needed capital, $210 million for Operation Apollo and more than $690 million under the security initiatives.

The $3.9 billion of new funding in the budgets of 1999 and 2000, together with the more than $1.2 billion of new funding in this budget, means that the Government will have increased DND funding by $5.1 billion over the next five years.

Incremental DND Funding Over the Next Five Years

Budget 1999	Budget 2000	Budget 2001	Grand total
	(millions of dollars)		
550	3,350	1,202	5,102

Expanded Anti-Terrorist Capacity

The Joint Task Force Two (JTF 2) of the Canadian Forces is a world-class elite unit trained to intervene in terrorist situations. In light of the international obligations that may be placed on the JTF 2 as part of Canada's commitment to its allies in the war on terrorism, this budget provides $119 million over the next five years to double the capacity of the unit. This will improve the JTF 2's ability to respond to incidents at home and abroad.

Chemical, Biological, Radiological and Nuclear Threats

Canada must have the infrastructure to respond to the use of unconventional weapons, whether they be chemical, biological, radiological or nuclear. As a result of this budget:

- funding will be increased to enhance the existing laboratory networks so that they will be able to detect and identify possible biochemical threats more quickly; and
- new protective equipment will be purchased and better training for emergency response teams will be provided to ensure that front-line responders are better prepared.

In total, this budget provides $513 million over the next five years in support of these initiatives.

Emergency Preparedness

Canada needs to strengthen its ability to respond to threats against critical infrastructure such as water and energy utilities and transportation and communications systems. Therefore, this budget includes funding to expand the capacity of the Office of Critical Infrastructure Protection and Emergency Preparedness (OCIPEP).

OCIPEP will work with other federal agencies such as the RCMP and CSIS. It will also work with all provincial and territorial governments, emergency measures organizations throughout Canada, and foreign organizations – particularly in the U.S. – to improve the overall level of infrastructure protection and emergency preparedness.

This budget provides $396 million over the next five years to fund these initiatives.

2. A New Approach to Air Security

Although Canada has one of the safest aviation systems in the world, the events of September 11 have had a significant impact on the security needs of air travellers. Budget 2001 is allocating $2.2 billion over the next five years to meet these new needs.

Rigorous new national standards for security in airports and on board flights are essential to protecting people. This budget will therefore provide Transport Canada with funds to strengthen its capacity to set regulations, review standards, and monitor and inspect all air security services.

A New Federal Authority for Air Security

To implement these standards, the Government will consolidate air security services under a single new federal authority, which will deliver improved security at Canadian airports and on board flights.

The new federal authority will be responsible for:

- providing pre-board screening of passengers and baggage at airports. Screening will be done by better-trained personnel using highly specialized equipment according to new, rigorous performance and training standards set by Transport Canada;
- policing at key locations in Canada’s airports;
- providing armed undercover police on domestic and international flights originating in Canada; and
- providing for the acquisition and operation of detection equipment that will search for traces of explosives on air passenger baggage in Canada.

Security Modifications for Aircraft

This budget provides funding to help Canadian air carriers undertake permanent modifications to aircraft cockpit doors. This initiative will address the heightened security standards required in the current environment. This assistance is over and above the $160 million in federal funding provided to Canadian air carriers for their direct losses stemming from the closure of Canada’s airspace following the events of September 11.

Enhanced Security Around Work Areas in Airports

The new federal authority will be responsible for screening passengers and their baggage. Since people other than passengers also have access to airport facilities, Transport Canada is also tightening access to aircraft by creating enhanced security zones at handling facilities and on airport tarmacs, and will work in co-operation with the Canada Customs and Revenue Agency (CCRA) on security procedures at Canada's airports.

Air Travellers Security Charge

To fund the new air security expenditures, the Government will introduce an Air Travellers Security Charge, effective April 1, 2002. The charge will be paid by air travellers – the primary users of these enhanced security measures. It will be collected by air carriers or their agents at the time of purchase of the airline tickets.

For travel within Canada, the total cost of the charge will be $12 for a one-way trip and $24 for a round trip. Over the next five years this charge will generate revenue that will be roughly equivalent to the new air security expenditures. The rate of the charge will be reviewed over time to maintain revenue in line with these expenditures.

Table 5.2
Air Travellers Security Charge

One-way travel within Canada:	$12
Round-trip travel within Canada:	$24
Travel to a destination in the continental U.S.:	$12[1]
Travel to a destination outside Canada and the continental U.S.:	$24

Notes: The above amounts include GST, where applicable.
Further details on the Air Travellers Security Charge are provided in Annex 8.

[1] The rate for travel to U.S. destinations takes into account that U.S. taxes also apply.

3. A Secure, Open and Efficient Border

The Government's security agenda involves much more than physical security for Canadians. A key element is rebuilding confidence through greater economic security, and there can be no more important measure than maintaining an open border with the U.S. The economic welfare of both countries depends on making the border more secure, open and efficient.

Every day close to $2 billion worth of goods and services crosses the Canada-U.S. border. The U.S. is the destination for over 80 per cent of Canada's exports and the source for about 70 per cent of Canada's imports. Canada provides 20 per cent of U.S. imports and is the single largest foreign market for U.S. goods and services, accounting for 25 per cent of its exports.

Given the magnitude of this two-way trade, both countries recognize that it is in their mutual interest to facilitate the flow of legitimate goods and people while ensuring that safety and security concerns are addressed.

During the G-20 Ottawa Ministerial in November 2001, renewed impetus was given to Canada-U.S. co-operation on finding better ways to manage the flow of goods and services across the border and on quickly resolving potential impediments to this flow. To co-ordinate this effort, both countries agreed to appoint senior officials.

This budget provides more than $1.2 billion to keep the border open, secure and efficient, including a $600-million program to improve border infrastructure.

A. Border Security and Facilitation

This budget provides $646 million over the next five years to enhance border operations. The CCRA will accelerate implementation of its new risk-based approach to border management. This involves facilitating the passage of pre-approved goods and travellers so that resources can be concentrated on other goods and travellers.

Expediting Pre-Approved Travellers

Many Canadians, particularly those who live in border cities, go to the U.S. frequently for business and pleasure. The Government recognizes the benefit of expediting such crossings.

The CCRA will therefore seek to partner with American authorities in expanding the Canada-U.S. NEXUS system, which speeds passage of pre-approved travellers at land border crossings. It will also implement the Expedited Passenger Processing System for frequent air travellers. The pre-approval processes for such programs are rigorous, involving background and security checks on all applicants prior to approval.

For both programs, the CCRA will improve the level of technology, using advanced systems to identify participants. These traveller pass programs will involve a service fee consistent with the Government's cost recovery policy.

This budget provides $58 million over the next five years in support of these initiatives.

Better Tools for Risk Assessment and Detection

Effective security requires the capacity to identify and intercept high-risk individuals before they attempt to enter the country. Currently Customs officers get their first opportunity to review air travellers coming to Canada only when they arrive at Customs.

The Advanced Passenger Information System/Passenger Name Record (API/PNR) will allow Customs officers access to air carriers' passenger reservation systems to obtain information on travellers for a risk assessment review before they arrive at Customs.

API/PNR received funding in Budget 2000 for an initial evaluation. Budget 2001 provides additional funding to implement the program on a Canada-wide basis.

Another key element of improving screening of people wishing to enter Canada is to provide front-line officers with better information on arriving travellers. The Integrated Primary Inspection Line system will link Customs' primary inspection lines to additional data and intelligence in real time. Like API/PNR, this system will help Customs officers determine whether travellers should be referred for further questioning or examination. This budget allocates funds to expand this program to all major ports of entry.

Additional funds will be allocated for the CCRA to develop an on-line case management and occurrence reporting system and a national repository for intelligence information. This initiative will facilitate sharing of intelligence data and the building of case profiles on individuals posing a threat to national security.

In total, this budget provides $67 million over the next five years in support of these initiatives.

Better Equipment for Detecting Dangerous Shipments

Smuggling is becoming more sophisticated, not only for guns and explosives, but also for drugs and other contraband – the sale of which might be used to finance terrorist activities.

This budget provides $107 million over the next five years to the CCRA for additional detection equipment such as X-ray machines and ion scanners. This will make it easier for Customs officers to intercept firearms and explosives, without delaying legitimate commerce or tourism.

The CCRA will also work with other government departments to control shipments that affect Canada's health, safety and security by improving the exchange of electronic information.

Integrated Border Enforcement Teams

Maintaining an open Canada-U.S. border requires numerous agencies to work together to share intelligence and co-ordinate enforcement activities. This budget therefore includes additional funding of $135 million over five years to establish new multi-agency Integrated Border Enforcement Teams.

Led by the RCMP on the Canadian side, Integrated Border Enforcement Teams will consist of other federal enforcement agencies, including the CCRA, Citizenship and Immigration Canada, and provincial and municipal police forces. These teams will work in co-operation with enforcement personnel from key U.S. federal, state and local agencies. Teams will help border inspection agencies with intelligence gathering and investigations, both at and between high-volume land and marine border crossings.

Better Service to Small Business

Many of the Government's trade facilitation programs focus on streamlining the importation process for low-risk importers. However, such broad-based programs may not meet the needs of small business importers.

The CCRA will introduce the following two new programs targeted to meet the unique needs of small commercial importers:

- The Internet One-Step Process will provide a secure Internet environment in which importers may complete and submit standard import documents electronically. On-line options for the payment of any applicable duties and taxes will also be developed. Importers who use this new program will still have to present their goods at Customs and provide any necessary additional documents, such as import permits.

- Customs Small Business Desks will assist small commercial importers by offering personalized assistance on all aspects of the importation process, including the new Internet One-Step Process.

Together, these programs will make it easier for small businesses to bring their goods across the border into Canada. This budget provides $14 million over the next five years in support of these programs.

B. Border Infrastructure

Trade flows with the U.S. have increased some 150 per cent since 1988. Robust growth in commercial traffic is now taxing the capacity of some of Canada’s busiest border crossings. Continued growth in trade will therefore require further investment in border-related infrastructure.

To this end, Budget 2001 provides $600 million over the next five years towards a new border infrastructure program. Projects supported by this program could include:

- new or improved highway access for border crossings;
- processing centres for commercial vehicles to speed up clearance times; and
- “soft infrastructure” such as intelligent transportation systems, which facilitate the electronic exchange of information between government agencies and trucks and trains crossing the border.

Under this program, the Government will seek to partner with the provinces, municipalities and private sector. The federal government also intends to work with the United States to ensure a co-ordinated approach towards border infrastructure.

By financing improvements to the infrastructure of existing and new crossings, this border infrastructure program will result in greater security and faster transit times for people and goods crossing the Canada-U.S. border.

6

Strategic Investments: Bridging to the Future

"Our economic success, our ability to create jobs, will be determined, first and foremost, by the degree to which we demonstrate an understanding of the great currents that are shaping the world of tomorrow."

Finance Minister Paul Martin
2001 budget speech

Highlights

Budget 2001 addresses immediate needs through targeted, strategic investments that provide a stimulative boost to confidence in the economy. It does so as it advances, in a fiscally affordable way, the long-term plan the Government has put in place.

1. *Investing in Health Initiatives*

Because Canada's publicly funded health care system reflects the fundamental values shared by all Canadians, the budget:

- confirms that the $23.4 billion in funding to support health and early childhood development agreements reached by first ministers in September 2000 is fully protected;
- further strengthens the federal government's contribution to Canada's health care system by providing $95 million to the Canadian Institute for Health Information; and
- provides a $75-million increase to the annual budget of the Canadian Institutes of Health Research.

2. *Investing in Skills, Learning and Research*

Because the Government is committed to providing every opportunity for Canadians to upgrade their skills, and because research today is the source of new jobs tomorrow, the budget includes more than $1.1 billion over three years to support skills, learning and research by:

- increasing funding for sector councils;
- improving support for people with disabilities who pursue higher education;

- reducing waiting period provisions for apprentices in the employment insurance program, allowing an income tax deduction for apprentice vehicle mechanics' tools, and assisting mentoring and business support to young entrepreneurs;
- exempting from income tax tuition assistance for adult basic education provided under certain government programs and extending access to the education tax credit;
- helping offset indirect research costs at universities and research hospitals;
- supporting leading-edge technologies and expanding regional innovation initiatives across the country through increased funding to the National Research Council of Canada;
- providing additional funding to the Natural Sciences and Engineering Research Council and the Social Sciences and Humanities Research Council; and
- extending funding for Internet initiatives including SchoolNet, the Community Access Program and Government On-Line, and building CA*net 4, a new generation of Internet broadband network architecture.

In total, the Government's expenditures on science and technology are estimated at $7.4 billion in 2001-02, an increase of 25 per cent from the previous peak.

3. *Investing in Strategic Infrastructure and the Environment*

Because investments in infrastructure will both stimulate job creation and confidence in the short term and make the economy more productive and competitive in the long term, the budget announces targeted investments of nearly $3 billion that:

- create the Strategic Infrastructure Foundation, with a minimum federal commitment of $2 billion, to fund large strategic projects;
- confirm $680 million in funding for a capital grants program to alleviate the shortage of affordable rental housing;
- double funding to the Green Municipal Enabling Fund and the Green Municipal Investment Fund;
- enhance incentives for renewable energy and energy efficiency projects.

4. *Aboriginal Children*

Because the well-being of Aboriginal children today will lead to stronger First Nations communities in the future, this budget provides $185 million over the next two years to:

- enhance programs such as child care and head start programs, which support early childhood development;
- intensify efforts to reduce the incidence of fetal alcohol syndrome and fetal alcohol effects on reserves; and
- provide increased funding to support children on reserves who have special needs at school.

5. *Furthering International Assistance*

Because Canada recognizes the importance of helping those most in need beyond its borders, the budget increases international assistance by $1 billion over three years. Among other things, the budget will:

- commit $500 million to a fund promoting sustainable development in Africa; and
- provide humanitarian emergency assistance in Afghanistan.

Introduction

The Government's overarching goals are to build a strong economy and secure society and to improve the quality of life for Canadians. The strategic investments in this budget help achieve these objectives by dealing with the needs of today. At the same time, they serve as a bridge to a better tomorrow.

This budget does so with investments that are consistent with the Government's long-term plan. By investing responsibly now in key initiatives, the Government is achieving two important goals. It is helping to support Canadians and the Canadian economy through the current period of economic weakness and uncertainty, while meeting its ongoing commitment to a more innovative economy and inclusive society.

In each case, decisions are based on these two criteria. First, the investment must be consistent with advancing the Government's long-term agenda. Second, it must fit within its prudent fiscal framework and, where possible, provide stimulus during a period of economic weakness and uncertainty and position Canada to take advantage of the economic recovery.

The economic stimulus in this budget is both significant and timely. When coupled with other spending initiatives coming on stream this year, the total impact is $9 billion this year, growing to $11 billion next year. This is in addition to the stimulus provided by the large tax cuts announced in October 2000 and the substantial decline in interest rates this year.

By investing in strategic infrastructure, in skills, learning and research, and in health, Aboriginal children, the environment and international assistance, the 2001 budget reflects the Government's long-term vision while providing important support now for the economy.

It represents another important building block in the Government's balanced agenda of jobs, growth and opportunity.

Investing in Health Initiatives

Canada's publicly funded health care system reflects the fundamental values shared by all Canadians. It gives Canadians the security of knowing that they have access to high-quality care when they need it.

Confirming Increased Funding for Health Care

In September 2000 a historic agreement was reached by first ministers on a shared approach and action plan for renewing health care services and reporting to Canadians on progress made. Agreement was also reached on increased support for early childhood development.

This budget confirms that the federal funding of $23.4 billion in support of these agreements is fully protected. This includes $21.1 billion in transfers to the provinces and territories through the Canada Health and Social Transfer (CHST) and $2.3 billion in targeted health funds for medical equipment, new information technologies and primary care reform.

The CHST is the main program through which the federal government supports health care. In 2001-02 CHST cash will increase by $2.8 billion, bringing the cash total to $18.3 billion. In 2002-03 CHST cash will grow to $19.1 billion, a $3.6-billion increase over 2000-01. By 2005-06 CHST cash will reach $21.0 billion – a $5.5-billion or 35-per-cent increase over 2000-01 levels.

Providing Growing, Stable and Predictable Funding for the Provinces and Territories

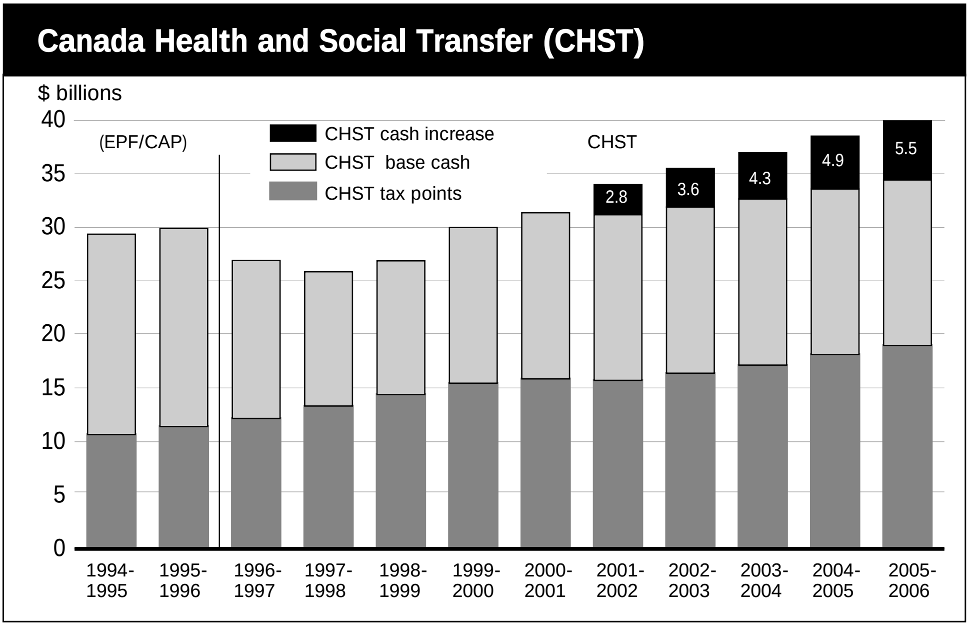
Table 6.1
Funding Commitments of the Government of Canada to Accompany the Agreements on Health Renewal and Early Childhood Development

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	Total
			(billions of dollars)				
Canada Health and Social Transfer							
Base cash[1]	15.5	15.5	15.5	15.5	15.5	15.5	–
General cash increase	–	2.5	3.2	3.8	4.4	5.0	18.9
Early childhood development		0.3	0.4	0.5	0.5	0.5	2.2
Total CHST cash	15.5	18.3	19.1	19.8	20.4	21.0	–
Medical Equipment Fund	0.5	0.5	–	–	–	–	1.0
Health information technology	0.5	–	–	–	–	–	0.5
Health Transition Fund for Primary Care	–	0.2	0.2	0.2	0.2	–	0.8
Total cash[2]	16.5	19.0	19.3	20.0	20.6	21.0	–
Total cash increase							23.4

[1] Base CHST cash includes the CHST supplements in Budget 1999 ($3.5 billion) and Budget 2000 ($2.5 billion).

[2] Sum of total CHST cash transfers and funding for non-CHST measures.

At the same time, the tax transfer component of the CHST, which grows in line with the growth in the economy, provides increasing support to the provinces and territories, as illustrated in the chart below, growing from $16.5 billion in 2000-01 to $18.8 billion in 2005-06. Together with the increases in CHST cash, total CHST will reach close to $40 billion in 2005-06, compared to approximately $32 billion last year.



Notes: Established Programs Financing (EPF) and Canada Assistance Plan (CAP) transfers to the provinces were replaced by the CHST in 1996. CHST base cash includes both the CHST supplements of Budget 1999 ($3.5 billion) and Budget 2000 ($2.5 billion). The CHST cash increase is the funding provided in September 2000 in support of agreements on health renewal and early childhood development.

New Health Investments

Budget 2001 further strengthens the federal government’s contribution to Canada’s health care system and the health of Canadians by investing substantial additional funds in health information systems and health-related research and innovation.

The Canadian Institute for Health Information

The Canadian Institute for Health Information (CIHI), established in 1994, is playing an increasingly central role in providing Canadians, health care providers and policy-makers with information on the health of Canadians and the health care system.

The 1999 budget provided $95 million to the CIHI to support it over four years. This budget renews the $95 million for an additional four years, to be used in conjunction with Statistics Canada, to continue to provide quality and timely health information. This will include developing common health indicators so that nationwide, comparable information is available.

In addition, this budget provides $5 million over two years to Health Canada so that it can produce health data on First Nations' people on reserve. This information is important to understanding health trends and emerging issues.

Canadian Institutes of Health Research

In Budget 1999 the Government announced the creation of the Canadian Institutes of Health Research (CIHR) through a combination of existing resources for health research and an incremental annual investment of $175 million. Already, the CIHR has established 13 Institutes across the full spectrum of health research, including the Institute of Cancer Research, the Institute of Nutrition, Metabolism and Diabetes, the Institute of Gender and Health, the Institute of Healthy Aging, the Institute of Neurosciences, Mental Health and Addiction, and the Institute of Aboriginal Peoples' Health.

All the Institutes embody an innovative and integrative approach to health research. As part of their research activities, all Institutes include biomedical research, clinical research, and research on health systems, health services, the health of populations, societal and cultural dimensions of health and environmental influences on health.

To further support leading-edge health research of this kind and its translation into economic benefits for Canadians through a commercialization strategy developed by the CIHR, this budget provides a $75-million increase to the annual budget of the CIHR. This investment brings the CIHR's annual budget to over $560 million, more than double the federal funding provided four years ago.

Genome Science Research

Genomic science – the study of the genetic code in people, plants and all other living things – is key to the advancement of biotechnology, a driving force in the new economy. Research in this field is leading to major breakthroughs in our understanding of living organisms and, in the area of human health, will revolutionize the identification and treatment of diseases.

Budget 2000 invested $160 million in Genome Canada, a not-for-profit corporation that supports genome science activities throughout Canada. An additional investment of $140 million was made in Genome Canada at the end of 2000-01. The Government has also increased funding for its regulatory activities concerning genomics to ensure that the new technologies respect and preserve the environment and Canadian ethics and values.

This budget announces a contribution of $10 million to the BC Cancer Foundation in recognition of the seminal work of the late Dr. Michael Smith. Dr. Smith was the founding director of the Genome Sequence Centre (GSC) at the BC Cancer Research Centre and won the Nobel Prize for his work on DNA sequencing. The Government's contribution will support ongoing research at the GSC.

Recent Federal Initiatives in Support of Health

- The Government has also increased significantly its targeted funding to support the purchase of up-to-date medical equipment, improve health information systems and accelerate changes in the way primary health care is provided to Canadians.
  - The **Medical Equipment Fund** provides provinces and territories funding of $1 billion for the purchase and installation of medical and diagnostic equipment, such as MRI machines, CAT scanners, radiation therapy machines and other diagnostic and treatment equipment.
  - The **Health Transition Fund for Primary Care**, which supports innovation and reforms in primary care for Canadians, received $800 million over four years.
  - To support health information and technologies, the **Canada Health Infoway Corporation** was established with a $500-million investment. Development of electronic patient records is a priority for this new corporation.
- As well, the Government has increased significantly its own programs and services in health and health care, including health protection, disease strategies, and services for First Nations.
- As part of its comprehensive strategy to improve the health of Canadians by reducing tobacco use, the Government:
  - raised taxes on tobacco products in April and November 2001; and
  - increased funding for tobacco control programs.

Investing in Skills, Learning and Research

It is now widely recognized that skills, learning and research are critical to success in the global knowledge-based economy. A more educated and skilled labour force is a key driver of productivity and hence the competitiveness of workers, firms and other organizations. Enhanced approaches to the development of a skilled workforce are needed, approaches rooted in Canada's universities, colleges, trade schools and other educational institutions, and based on a spirit of entrepreneurship and lifelong learning.

Research and development are equally important. Research creates ideas and pushes forward the frontiers of knowledge. Development translates that knowledge into new products, services and technologies that are key to high-value-added jobs and growth in all sectors of the Canadian economy.

The Government has long recognized the value of investing in people – in literacy and in the education system, which provides advanced skills and individual economic security; in on-the-job training, which supports job-specific skills; and in universities and other centres of advanced research, where the ideas and instructors of the future are found. That is why, in Budget 1998, the Government introduced the Canadian Opportunities Strategy, a comprehensive plan that built on previously introduced measures to expand access to the knowledge and skills needed for better job opportunities in the 21st century.

Under the Strategy, the Government introduced Canada Millennium Scholarships, Canada Education Savings Grants and the Canada Research Chairs program. It invested heavily in the Canada Foundation for Innovation to upgrade the country's research infrastructure, and it brought the combined budgets of the three granting councils to their highest level ever, a total of more than $1.1 billion annually. The Government also increased funding for research and development programs of direct relevance to the private sector and provided tax encouragement for entrepreneurship, given that more research and development by individual businesses, both large and small, across Canada are key to Canada's future economic performance. In total, the Government's expenditures on science and technology are estimated at $7.4 billion in 2001-02, an increase of 25 per cent from the previous peak.

Skills and Learning

In this budget the Government is doing more to encourage the acquisition of skills and learning by Canadians.

Sector Councils

Sector councils are industry-wide partnerships that bring together employers, unions, workers and educators to assess future employment patterns, skill requirements and training practices in different sectors of the economy. Based on this analysis, practical measures are developed to help employers and workers meet and adapt to the changing needs of each sector. There are currently 29 sector councils.

This budget provides $24 million over the next two years to increase support for exemplary councils and expand the network of councils to other strategic sectors of the economy. When fully phased in, the Government's support of sector councils will double to $60 million per year.

Canada Study Grants for Persons With Disabilities

This budget will improve support for persons with disabilities who pursue higher education. Because many people with disabilities must incur special costs to pursue higher education, Canada Study Grants of up to $5,000 a year are currently available to help pay the cost of services and equipment such as tutors, interpreters (oral, sign), attendant care for studies, specialized transportation to and from school, learning disability assessments, note takers, readers and braillers. Such assistance currently helps more than 4,500 students with disabilities at an annual cost of about $9 million.

This budget increases the maximum grant to cover exceptional costs associated with disabilities from $5,000 to $8,000. It is anticipated that this will address the problems faced by students with very high-cost disability-related needs.

Apart from these grants to help deal with exceptional costs, some students with disabilities may find that the maximum student loans available are not sufficient to meet assessed needs. In these cases, a supplementary grant of up to $2,000 a year will be provided.

The estimated cost of these two measures is $10 million annually.

Apprentice Training

The skilled trades provide good jobs to thousands of Canadians and are essential to the economy. Over the next few years Canada may be faced with a significant shortage of people with trade skills.

To support individuals while they are learning these trades, the employment insurance (EI) program provides income support to apprentices during periods of classroom training. Like everyone else, apprentices must wait two weeks before receiving EI benefits. Currently they must do so each time they leave the workplace for classroom training. This may be a deterrent to completing training and earning their trade qualification.

An apprenticeship program is a single continuous course of study stretching over a number of years. Therefore, it is proposed that the provisions of the EI program be modified so that apprentices in approved training programs are subject to only one two-week waiting period. The estimated cost of this measure is $15 million a year once fully phased in.

Apprentice Vehicle Mechanics' Tools Deduction

Apprentice vehicle mechanics experience high costs for tools. These costs have been identified as a barrier preventing more young people from taking up the trade. The budget proposes to provide tax assistance to help apprentice vehicle mechanics cope with their extraordinary tool costs. Beginning in 2002 they will be entitled to deduct for income tax purposes the cost of buying new tools, to the extent that those costs incurred in a year exceed the greater of $1,000 and 5 per cent of their apprenticeship income. The deduction will be available to employee apprentices who are registered in a provincial or territorial program leading to certification as a vehicle mechanic, for tool costs certified by the employer as having been incurred as a condition of the apprenticeship. The estimated cost of this measure is $10 million a year.

Adult Basic Education – Tax Deduction for Tuition Assistance

Thousands of adult students receive government assistance to pay their tuition fees for basic education at the primary or secondary school level. Under current tax rules, this tuition assistance is included in income without any offsetting credits. For many, the tax cost of receiving this assistance can present a real burden and can discourage them from advancing their education.

To remove this impediment, the budget proposes to exempt from income tax any tuition assistance for adult basic education provided under certain government programs, including employment insurance. This measure will apply to eligible tuition assistance received after 1996. The estimated cost of this measure is $5 million a year.

Extending the Education Tax Credit

The budget proposes to help more students undertake lifelong learning by extending the education tax credit, beginning in 2002, to people who receive taxable assistance for post-secondary education under certain government programs, including employment insurance. The proposed changes will provide significant tax relief to approximately 65,000 Canadians upgrading their skills, and will give them access to the same tax benefits that are available to other post-secondary students. The estimated cost of this measure is $20 million a year.

The education tax credit helps students offset their education expenses. The amounts on which the education tax credit is calculated were doubled in the October 2000 *Economic Statement and Budget Update* to $400 per month of full-time study and to $120 per month of part-time study, effective 2001.

Official Languages

An additional $5 million per year will be provided to promote linguistic exchanges and activities for young Canadians. The current budget for these activities is $24 million per year.

The University of Moncton is establishing a research institute that will focus on the study of public policies, practices and services supporting French and English linguistic minorities across Canada. To help bring this to fruition, this budget provides a $10-million endowment.

Youth Entrepreneurship

This budget provides $7.5 million in 2001-02 to the Canadian Youth Business Foundation so that it can expand its Youth Business Program, which provides funding as well as mentoring and business support to young Canadian entrepreneurs. An additional $6 million will be provided to Shad International to expand its Shad Valley program, which introduces Canadian high school students to the best in science, technology and entrepreneurship experiences in a university setting.

Community Colleges

In Canada there are a wide variety of community colleges with close ties to the communities where they are located. This enables them to respond quickly to the changing knowledge and skill needs of their communities. The Government has begun an active dialogue with community colleges to explore with them how it might help support the important role they play in equipping Canadians with the skills they need for the future.

Recent Federal Initiatives in Support of Skills and Learning

- **The Canada Education Savings Grant** – a grant of 20 per cent on the first $2,000 of contributions made each year to registered education savings plans – encourages and assists families in saving for their children's higher education.
- **Canada Millennium Scholarships** provide more than 90,000 needy students each year with scholarships averaging $3,000 a year to reduce the debt that they would otherwise have to incur.
- **Canada Study Grants** of up to $3,000 provide assistance each year to approximately 25,000 students, including students with dependants, students with disabilities, and high-need part-time students.
- **Tax measures that support post-secondary education** have been enhanced, including the education tax credit, the tuition credit and the scholarship exemption. These measures make education more affordable.
- **The Canada Student Loans Program** has been enhanced to help graduates manage their student debt by increasing the number of people eligible for interest relief, and providing debt reduction for those in extended financial difficulty. As well, students can now claim a tax credit for interest paid on federal and provincial student loans.
- **Tax-free registered retirement savings plan withdrawals** and an **extension of the education tax credit and child care expense deduction to part-time students** help Canadians upgrade their skills through their working life.

Research

Key investments have been made by the Government in every budget since fiscal balance was restored to increase Canada's research performance. These investments, shown in Table 6.2, have greatly improved Canada's research climate. Moreover, they have built in financial momentum that will see greater support for research over the next several years.

To add further momentum, this budget provides close to $1 billion of targeted investments over three years to promote leading-edge research and to sustain Canada's leadership in innovative uses of the Internet.

Strengthening University Research Capacity

In recent years the Government has made significant investments in research conducted in universities and research hospitals. The benefits of such research include new products, services, therapies and industry practices that contribute to economic growth and a higher quality of life for Canadians.

Universities and research hospitals have been highly supportive of these investments. However, they have expressed concerns about rising indirect costs, that is, expenses associated with administration, maintenance and commercialization activities that are not covered by direct federal funding for research.

In Budget 2000 the Government responded to these concerns by designing the Canada Research Chairs program, in which the total costs of research undertaken by professors assigned to the Chairs are covered. Further, the Government provided $400 million in the 2000 *Economic Statement and Budget Update* to the Canada Foundation for Innovation (CFI) to help defray the operating costs associated with new CFI awards.

In recognition of the priority identified by universities and provincial governments for further funding targeted to the indirect costs of research, Budget 2001 provides a one-time investment of $200 million through the granting councils to Canada's universities to help alleviate financial pressures that are associated with federally supported research activity at universities and research hospitals. This initiative will help support world-class research facilities and respond to the needs of Canada's smaller universities in their efforts to become more research-oriented.

The Government is committed to encouraging and supporting excellence in university-based research across Canada. It is also committed to promoting the commercialization of research through university and private sector partnerships and consortia. Looking ahead, the Government will work with the university community on ways to provide ongoing support for indirect research costs that is predictable, affordable and incremental to existing support.

Natural Sciences and Engineering Research Council (NSERC) and Social Sciences and Humanities Research Council (SSHRC)

The Government's contributions to the granting councils have funded research across Canada and supported talented Canadian students with their graduate and post-graduate studies. Beginning with Budget 1998 the Government has substantially increased total funding for the granting councils.

This budget continues the effort launched in 1998 to increase university research activity across all disciplines. Toward that end, the Government will increase the annual budgets of NSERC and SSHRC by 7 per cent each, resulting in an increase of $36.5 million a year for NSERC and $9.5 million a year for SSHRC. These increases will translate into additional research opportunities across Canada and more fellowships and scholarships for graduate students.

Canadian Institute for Advanced Research (CIAR)

CIAR is a non-profit corporation that supports networks of expert researchers who explore long-term scientific, social and economic issues of importance to Canada. CIAR links researchers in Canada to the best in other countries, and is internationally renowned.

The Government has contributed funding to CIAR since 1984 and is currently providing $3.5 million annually. In this budget the Government is providing $25 million to sustain and enhance the organization's research program for five years.

National Research Council of Canada (NRC)

NRC is a significant funder and performer of research across Canada. With research institutes, centres and programs spanning all regions of the country, and with a budget of over half a billion dollars, NRC is making a significant contribution to the development of clusters of research and commercialization activity and, therefore, to regional economic innovation, jobs and growth.

Following Budget 2000 NRC launched a new effort to build research institutes and innovation centres, beginning with $110 million over five years in Atlantic Canada.

This budget provides an additional $110 million over three years for leading-edge technologies and to expand NRC's regional innovation initiative beyond Atlantic Canada. This funding will support the recently announced National Institute for Nanotechnology in Alberta, the Advanced Aluminium Technology Centre in Quebec, a new research program at the Plant Biotechnology Institute in Saskatoon entitled "Crops for Enhanced Human Health," fuel cell research in British Columbia, and initiatives in Ontario and Manitoba.

Connecting Canadians to Information and Knowledge

Canadians are justifiably proud that their country has become one of the most connected nations in the world. It is an important element in building an innovative and learning economy and society.

Canada was the first country to connect all of its schools and libraries to the Internet. Further, it has 100-per-cent satellite coverage of the country and has built the world's fastest, all-optical Internet backbone to connect its major research universities and colleges.

Funding was provided in Budget 1998 for computers and Internet access in communities, schools and libraries through SchoolNet and the Community Access Program. The Government is committed to building on these strengths and to ensuring that Canadians have access to the Internet.

The 2000 budget provided initial two-year funding for a new Government On-Line strategy. In this budget the Government is providing $600 million over the next four years to implement the Government On-Line strategy by 2005. It is also providing resources to modernize the information management and information technology infrastructure of a number of government departments and agencies.

The Government is also providing $110 million of funding to build CA*net 4, a new generation of Internet broadband network architecture that will link all research-intensive institutions, including many community colleges.

Table 6.2
Increased Funding for Research and Technology in Previous Budgets

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003
			(millions of dollars)		
Canada Foundation for Innovation[1]	30	120	180	300	480
Genome Canada[1]				31	36
Canada Research Chairs			60	120	180
Medical Research Council/Canadian Institutes of Health Research	40	72	145	255	255
Natural Sciences and Engineering Research Council	71	111	118	118	118
Social Sciences and Humanities Research Council	9	26	38	58	58
Networks of Excellence		30	30	30	30
National Research Council of Canada	50	44	90	105	100
Atlantic Innovation Fund				23	68
Canadian Space Agency		41	152	237	250
Biotechnology research and regulation		15	45	50	55
Government On-Line			80	200	
Technology Partnerships Canada	140	190	190	190	190
Connectedness[2]	60	97	117	72	
Total	400	746	1,245	1,789	1,820

[1] Amounts shown represent actual or anticipated spending by not-for-profit entities in which the Government has invested in previous budgets.

[2] Includes SchoolNet, the Community Access Program, Smart Communities and Geo Connections.

Looking ahead, as indicated in the Speech from the Throne, the Government will work with Canadian industry, the provinces, communities and the public on private sector solutions to further broadband Internet coverage in Canada, particularly for rural and remote areas. More planning is required to properly achieve the Government's commitment, particularly given rapidly changing technology; as a consequence, the Government will shift its target to the end of 2005. In looking at possible outcomes, it is the Government's expectation that the best approach could very well be to expand the highly successful SchoolNet and Community Access Program to ensure broadband access. Therefore, not only is the Government extending the current SchoolNet and Community Access Program to 2003-04 at an annual cost of $40 million, it is also setting aside $35 million a year for three years thereafter to support such broadband expansion.

Investing in Strategic Infrastructure and the Environment

Infrastructure Investment

The modern economy of the 21st century requires a backbone of sound physical infrastructure to sustain the nation's growth and our quality of life. Whether it be highways, urban transit or fishing harbours, Canada must have the physical infrastructure it needs to succeed. Investments in infrastructure will stimulate job creation and confidence in the short term and make the economy more productive and competitive in the long term.

Previous budgets have allocated funding to improve provincial and municipal infrastructure, including green infrastructure, highways and affordable housing. Budget 2000 introduced both the Infrastructure Canada Program and the Strategic Highway Infrastructure Program.

The Infrastructure Canada Program received $2.05 billion over six years (2000-01 to 2005-06). When combined with the contributions of the other partners, it will generate at least $6 billion in new investment in municipal infrastructure, typically small projects. So far more than 800 projects worth about $1 billion have been approved for funding. The program is expected to provide significant stimulus to the economy in 2002-03. The Strategic Highway Infrastructure Program will provide $600 million for highway infrastructure, providing stimulus to the economy in 2002-03. Budget 2001 builds on these initiatives.

Strategic Infrastructure Foundation

The federal government recognizes the need for additional support for large strategic infrastructure projects. Such projects span a range of areas, including highways, urban transportation, convention centres and sewage treatment. These projects can bring lasting economic and social benefits while providing both stimulus and long-term productivity benefits. In many cases, the private sector is willing to contribute needed capital and bear much of the project risk.

To address these needs, the federal government is announcing the creation of the Strategic Infrastructure Foundation. This budget commits a minimum federal contribution of $2 billion to the Foundation, with an initial allocation from this year's surplus funds at year-end. Working with provincial and municipal governments, the Foundation will provide cost-shared assistance to large infrastructure projects and will give special consideration to public-private partnerships.

The Foundation will be at arm's length from the federal government. Its board of directors will be responsible for assessing projects and making spending decisions.

Affordable Housing

There are shortages of affordable rental housing in many of Canada's urban regions. Construction of rental housing has not been a priority for builders. This, combined with growing urban populations, has pushed vacancy rates down to very low levels and has driven costs beyond the reach of many Canadians. There are also particular problems with housing in remote areas.

To help address these problems, this budget confirms a contribution of $680 million over five years to a capital grants program. Funding will be available to provinces and territories that are prepared to match federal contributions. The Minister responsible for the Canada Mortgage and Housing Corporation has concluded a framework agreement with provincial and territorial ministers responsible for housing, with a view to concluding bilateral cost-sharing agreements as soon as possible.

Critical Government Capital

In the 2000 budget $200 million per year over five years was earmarked to address safety and health concerns within the federal government's own infrastructure. During the course of 2001 additional funding requirements were identified to address health and safety in the maintenance of veterans hospitals, government laboratories and small craft harbours. An additional $236 million has been allocated to address these concerns, including $20 million a year for infrastructure repairs to active fishing harbours.

Border Infrastructure

Budget 2001 provides $600 million over the next five years towards a new border infrastructure program. Under this program, the Government will seek to partner with the provinces, municipalities and private sector, and will help finance improvements to infrastructure at or near the border. The federal government also intends to work with the United States to ensure a co-ordinated approach towards border infrastructure. Projects supported by this program could include new or improved highway access for border crossings; processing centres for commercial vehicles to speed up clearance times; and "soft infrastructure" such as intelligent transportation systems.

Federal Government Support for Physical Infrastructure

- Funded in Budget 2000, the $2.05-billion Infrastructure Canada Program finances typically smaller-scale municipal infrastructure projects over the next five years.
- A further $600-million Strategic Highway Infrastructure Program was funded in Budget 2000 to improve highway infrastructure.
- The Green Municipal Enabling Fund and the Green Municipal Investment Fund were created in 2000 to support energy and water efficiency projects. They were provided with initial endowments of $25 million and $100 million respectively. Amounts under these funds managed by the Federation of Canadian Municipalities are being doubled in this budget.
- This budget provides $600 million to fund a new border infrastructure program. The program will help ensure that sufficient infrastructure capacity is in place to assist trade at our major border crossings.
- The Strategic Infrastructure Foundation is being created in this budget. With a minimum federal contribution of $2 billion, the Foundation will assist large infrastructure projects and encourage public-private partnerships.

Improving Our Environment

The quality of life of all Canadians is closely tied to preserving and improving our natural environment. The Government is committed to continuous environmental improvement. Budget 2001 includes new spending and tax measures intended to ensure continued progress toward a cleaner and healthier environment.

Helping Communities Improve the Environment

This budget further bolsters support for communities – both urban and rural – that actively contribute toward a healthier environment. Launched last year and administered by the Federation of Canadian Municipalities, the Green Municipal Enabling Fund and the Green Municipal Investment Fund have been effective in stimulating community-based feasibility work and investments in more than 100 projects that improve the environment.

Projects involving a wide range of partners are underway across the country in areas such as energy and water savings, community energy systems, urban transit, waste diversion and renewable energy. This budget doubles the Green Municipal Enabling Fund and the Green Municipal Investment Fund, at a cost of $25 million and $100 million respectively in the current fiscal year.

New Production Incentive for Renewable Energy

As part of the Government's commitment to encourage renewable energy production in Canada, this budget proposes a new production incentive for electricity produced from qualifying wind energy projects. An initial incentive payment of 1.2 cents per kilowatt-hour of production, gradually declining to 0.8 cents per kilowatt-hour of production, will be introduced for eligible projects commissioned after March 31, 2002, and before April 1, 2007.

The incentive will be available for the first 10 years of production and will help to provide a long-term stable revenue source. This will result in more investment in wind energy projects in all regions of Canada, which will help address climate change and improve air quality. Provincial and territorial governments are encouraged to provide additional support for these wind energy investments.

The cost of this 15-year program is up to $260 million. Preliminary details will be announced shortly by the Minister of Natural Resources and, following consultations, final program details including eligibility criteria will be announced before April 1, 2002.

Improving Tax Incentives for Renewable Energy and Energy Efficiency

The budget also proposes to broaden eligibility for the income tax incentives that apply to renewable energy and certain energy efficiency projects. Currently eligible projects qualify for accelerated capital cost allowance (CCA) treatment in Class 43.1. The definition of a small hydroelectric project in Class 43.1 will be expanded from projects with an annual average generating capacity of up to 15 megawatts (MW) to projects with a maximum annual rated capacity of up to 50MW. In addition, the class will be broadened to include equipment used to generate electricity from "blast furnace gas." Finally, because of rapid changes in technology in this area, the Government intends to consult with industry to determine whether additional improvements are required for this CCA class. The estimated cost of this measure is $5 million a year.

Promoting Sustainable Woodlot Management

Currently commercial woodlot owners are subject to income tax when they transfer their woodlots to their children. As a result, woodlots may have to be harvested prematurely to generate the revenues required to pay the tax on the transfer. This can be detrimental to the sound management of this resource. The budget proposes to ensure that the existing intergenerational tax-deferred rollover for farm property is available for transfers of commercial woodlots after December 10, 2001, where they are operated in accordance with a prescribed forest management plan. The estimated cost of this measure is $10 million a year.

Recent Federal Initiatives in Support of the Environment

- An initial $100 million for the **Sustainable Development Technology Fund** to stimulate the development and demonstration of promising new environmental technologies.
- A contribution of $60 million to the **Canadian Foundation for Climate and Atmospheric Sciences** to support academic research on climate change and air pollution.
- $150 million to renew the **Climate Change Action Fund** and $60 million for energy efficiency and renewable energy programs to lay the foundation for future greenhouse gas emission reductions by facilitating the development of technologies and supporting energy efficiency and renewable energy projects.
- $90 million allocated for the **National Strategy on Species at Risk** to support habitat stewardship programs and other species protection activities.
- Other federal initiatives already in place include **special tax provisions for renewable energy projects** and the federal government's **green power procurement commitment**, which currently provides a premium payment for renewable energy purchased to meet federal government requirements.

Aboriginal Children

The early years in children's lives are critical to their growth and well-being and lay the foundation for their future participation in learning, work and other endeavours.

Looking ahead, as the Speech from the Throne sets out, it is the well-being of Aboriginal children today that will make possible stronger First Nations communities in the future. This is why, in doing things differently, the Government undertook to improve and expand programs that support early childhood development, to reduce the number of newborns affected by fetal alcohol syndrome, and to do more to meet the special needs some Aboriginal children have in school.

Early Childhood Development

Last year the federal government and the provincial and territorial governments reached a landmark agreement to foster and report on early childhood development across Canada. In support of this undertaking, the federal government agreed to transfer $2.2 billion over five years to provincial and territorial governments to help them in augmenting their support for young children and their families.

Most provinces and territories have announced how they will use the new federal funding. Through various initiatives, all will reach out to families with young children who have special needs, including Aboriginal families.

To complement this initiative with the provinces and territories, this budget builds on federal programs that support early childhood development, with a particular focus on First Nations children on reserves. Over the next two years an additional $100 million will be provided to enhance programs such as child care and head start.

To ensure that these investments are making a difference in the lives of children, new measures will be developed to assess the effectiveness of programs.

Fetal Alcohol Syndrome

As part of last year's agreement to foster early childhood development, provinces – those in western Canada in particular – will include measures to reduce the incidence of fetal alcohol syndrome. This budget provides additional funding to intensify efforts on reserves to reduce this syndrome and its effects. Funding will be increased tenfold, by $25 million over the next two years.

Special Education

Some children face special learning challenges in school because of physical, emotional or developmental barriers to learning. This can include the ongoing impacts of fetal alcohol syndrome and fetal alcohol effects. To support children living on reserve who have special needs at school, funding will be increased by $60 million over the next two years.

Furthering International Assistance

Canadians have not lost sight of their obligation to help the less fortunate peoples of the world. As indicated in the Speech from the Throne, the long-term well-being of Canada and Canadians depends on success in improving global human security, prosperity and development.

Africa Fund

At the G-8 Summit in Genoa, African leaders presented their proposal for a New Partnership for Africa's Development, and G-8 leaders pledged to support this initiative. The Prime Minister has since restated his commitment that development in Africa will be one of the principal themes of the G-8 Summit that Canada will host in Kananaskis in June 2002.

In recognition of this commitment, Canada will establish a trust fund to enable it to work in partnership with African countries, as well as with other donor countries and the international development institutions, to promote sustainable development in Africa. The Government is committing $500 million to this trust fund, with an initial allocation from this year's surplus funds at year-end.

Humanitarian and Reconstruction Assistance in Afghanistan

To assist with the humanitarian emergency in Afghanistan and in surrounding countries, where there are significant numbers of Afghan refugees, Canada will increase the International Assistance Envelope in the current fiscal year by $100 million.

Other International Assistance

In addition, Canada will prepay its obligations to United Nations aid agencies and to the Poverty Reduction and Growth Facility at the International Monetary Fund. In fiscal year 2002-03 this measure will free up $115 million from the International Assistance Envelope that can be used to promote development in impoverished countries.

In addition, the Government will increase the International Assistance Envelope by $285 million in fiscal year 2003-04.

Taken together, these measures provide $1 billion for international assistance over three years.

Recent Federal International Development Assistance Initiatives

Increases in the International Assistance Envelope

- In the 1998 and 1999 budgets Canada provided one-time increases in the International Assistance Envelope of $90 million and $237 million respectively.
- In the February 1999 budget, as part of the Government's strategy to address global environmental problems, funds were provided to cover Canada's contribution to the Prototype Carbon Fund administered by the World Bank. As well, direct assistance to developing countries and economies in transition was increased to help build capacity to reduce and eliminate their releases of persistent organic pollutants.
- In the February 2000 budget the Government increased the International Assistance Envelope by $435 million over the 2000-01 to 2002-03 period. A further $100 million was provided in the February 2000 budget to assist developing countries with climate change initiatives over the same period.
- Subsequently, late in 2000-01 a further $148 million was provided to prepay Canadian obligations to international development agencies and to help Caribbean countries upgrade their systems of financial regulation and supervision.

Support for Debt Reduction

- In the 2000 budget the Government contributed $175 million to the multilateral trust funds of the World Bank and International Monetary Fund that provide debt relief to the world's poorest and most heavily indebted countries. In 2000-01 Canada provided a further $15 million to support the write-down of debts owed by these countries to the Central American Bank of Economic Integration.
- In January 2001 Canada instituted a moratorium on debt service payments from reforming heavily indebted poor countries that are able to use debt relief savings productively.
- Canada has forgiven $1.3 billion of Official Development Assistance (ODA) debt and since 1986 has been providing assistance to developing countries solely in the form of grants. In October 2001 Canada announced that it would convert $447 million of outstanding ODA debt owed by Pakistan to funds to be used for health and education in that country.

Looking Ahead

The strategic investments in this budget form part of the Government's long-term plan, as set out in the Speech from the Throne, to build a strong economy and secure society and improve the quality of life for Canadians. Over the course of its mandate the Government will continue to invest in this plan.

Ingenuity and innovation will be key to building a world-leading economy in the 21st century. This in turn will require the top talent, the best minds, a culture of innovation and entrepreneurship, and a new generation of leaders with a global perspective. Looking ahead, Canada will do more to attract and nurture its share of tomorrow's leaders.

In this context, the Government will continue to consult with Canadians on innovation and skills and learning in the pursuit of its plan.

In the Speech from the Throne, the Government committed to the reforms needed to modernize the Public Service of Canada. Looking forward, the Government will implement its human resource modernization strategy to help ensure an innovative and dynamic public service.

A prosperous and growing agriculture and agri-food sector is vital to Canada's economic health. Agriculture and agri-food is a $130-billion industry, a major source of jobs for Canadians, and a major contributor to the nation's trade surplus. That is why the Government of Canada is working with all provinces and territories, the sector, and Canadian consumers to develop and implement a new, integrated and financially sustainable architecture for agricultural policy for the 21st century. The Government of Canada is committed to providing its share of the predictable and long-term funding needed to support this approach. This new architecture will brand Canada as a world leader in food safety, innovation and environmentally responsible agricultural production. Governments, industry and consumers working together will shift the agriculture sector fundamentally towards prudent investment, greater self-sufficiency and global leadership.

The effective transformation of agriculture – moving beyond year-to-year crisis management – and the renewal of Canada's rural economy will require, among other things, the best possible utilization of our fundamental soil and water resources. For both economic and environmental reasons, the Minister of Agriculture and Agri-Food and the Minister of Natural Resources will examine affordable ways to encourage more of Canada's land base to be dedicated to permanent and/or conservation cover crops, agro-forestry and tree plantations.

The Government is committed to working with Canadians for the long-term prosperity of all regions of the country. In this regard, it looks forward to receiving the follow-up to *Catching Tomorrow's Wave* which had a positive influence on government regional development strategy as it applies to Atlantic Canada. Canada's rural communities, along with their urban counterparts, contribute significantly to the wealth and prosperity of our nation. But they also face unique challenges: geography, distance from markets, a small population base and reliance on primary sector industries vulnerable to sharp cyclical downturns. The Government intends to work with rural communities, their citizens, and stakeholders to develop local solutions to these challenges.

Finally, as noted above, a key element of the Government's long-term plan to encourage economic growth and job creation throughout Canada is its tax reduction plan. As part of that plan, the general corporate income tax rate is being reduced. In this regard, the Government has engaged in extensive consultations on means to extend the lower corporate tax rate to resource income while at the same time improving the tax structure for this important sector. These consultations are continuing.

Table 6.3
Strategic Investments: Bridging to the Future

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Investing in health			
Canadian Institute for Health Information	95		
Health data for First Nations		2.5	2.5
Canadian Institutes of Health Research		75	75
Genome science research	10		
Total	105	77.5	77.5
Investing in skills, learning and research			
Skills and learning			
Sector councils		12	12
Canada Study Grants for persons with disabilities		10	10
Apprentice training		15	15
Apprentice vehicle mechanics' tools deduction		5	10
Adult basic education – tax deduction for tuition assistance	10	5	5
Extending the education tax credit		10	20
Official languages	10	5	5
Youth entrepreneurship	14		
Research			
Indirect research costs	200		
Natural Sciences and Engineering Research Council/ Social Sciences and Humanities Research Council		46	46
Canadian Institute for Advanced Research	25		
National Research Council of Canada	30	40	40
Connecting Canadians to information and knowledge			
CA*net 4	110		
SchoolNet	10	10	10
Community Access Program	30	30	30
Government On-Line		150	150
Total	439	338	353

Table 6.3
Strategic Investments: Bridging to the Future (cont'd)

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Investing in strategic infrastructure and the environment			
Affordable housing		85	170
Strategic Infrastructure Foundation	Commitment of at least $2 billion		
Critical government capital	82	95	59
Green Municipal Investment Fund	100		
Green Municipal Enabling Fund	25		
Production incentive for renewable energy		1	5
Improving tax incentives for renewable energy and energy efficiency		5	5
Promoting sustainable woodlot management		5	10
Total	207	191	249
Aboriginal children			
Special education		30	30
Early childhood development		50	50
Fetal alcohol syndrome/effects		10	15
Total		90	95
International Assistance			
Africa Fund	Commitment of $500 million		
Afghanistan assistance	100		
Other international assistance	115		285
Total	215		285
Total	966	697	1,060

7

Fiscal Management in Uncertain Times

"Managing an economy through tough times means striking the right balance. This budget does that.... It builds on the strong fundamentals Canadians have worked so hard to achieve."

Finance Minister Paul Martin
2001 budget speech

Highlights

- This budget projects balanced budgets or better for 2001-02 and for each of the next two fiscal years.
- The global economic outlook remains uncertain. However, even using the average of the four most pessimistic private sector forecasts, balanced budgets are still projected for each year of the budget plan.
- Program spending is projected to increase by 9.4 per cent in 2001-02. Over three-quarters of this increase is due to higher cash transfers to the provinces and territories for health care, funding to enhance security, and higher employment insurance (EI) and elderly benefits.
- Budgetary revenues are projected to decline in 2001-02, reflecting the impact of the second year of the Government's tax reduction plan, the six-month deferral of monthly corporate tax instalment payments for small businesses, and the weakness in the economy.
- The debt-to-GDP (gross domestic product) ratio is expected to fall to under 50 per cent in 2002-03, its lowest level in 17 years.

- The unforeseen circumstances of both the global economic slowdown and the terrorist attacks of September 11th have created exceptional fiscal pressures. As a result, the Government will use the economic prudence and part of the Contingency Reserve for each year of the budget plan. The Contingency Reserve is set at $1.5 billion for 2001-02, rising to $2.0 billion in 2002-03 and $2.5 billion in 2003-04. It is the Government's intention to rebuild the normal Contingency Reserve and economic prudence as soon as possible.
- In good economic times the Government paid down a substantial amount of debt – $35.8 billion in the last four years. Given the current economic weakness, it has decided not to pay down any debt this year. Any surplus at the end of fiscal year 2001-02 will be dedicated to the Strategic Infrastructure Foundation and the Africa Fund.

Introduction

■ This chapter provides a full and detailed accounting of the federal government's finances by incorporating into the private sector fiscal projections:

– the impact of the changes in the economic outlook since the October 2001 survey of private sector forecasts; and

– the impact of the spending and revenue measures proposed in this budget.

■ Although private sector economists believe five-year fiscal projections are important for planning purposes and public discussion, they are of the view that budget decisions should be made within a rolling two-year horizon. This is because of the uncertainty inherent in long-term economic and fiscal projections. The Government agrees with this approach.

■ This rolling two-year approach to budgeting, first introduced in the 1994 budget, has served Canadians well. The federal deficit, which stood at $42 billion in 1993-94, was eliminated in just 4 years, putting an end to more than 25 years of uninterrupted deficits. Surpluses have been recorded in each of the last 4 years, resulting in a paydown of net public debt of almost $36 billion.

Revised Economic Outlook

The five-year fiscal projections described in Chapter 4 are based on the October 2001 Department of Finance survey of private sector economic forecasts. Since that survey there have been a number of economic developments in both Canada and the U.S. The Department of Finance consulted the private sector economists again in early December to obtain their views on the adjustments required as a result of these developments. The revised economic assumptions in the table below reflect these consultations.

Table 7.1
Budget 2001 Economic Assumptions

	2001	2002	2003
		(per cent)	
Real GDP growth			
October 2001 private sector survey	1.5	1.5	3.9
Budget 2001	1.3	1.1	3.9
GDP inflation			
October 2001 private sector survey	2.6	1.6	1.9
Budget 2001	1.3	0.2	1.9
Nominal GDP growth			
October 2001 private sector survey	4.1	3.1	5.9
Budget 2001	2.6	1.3	5.9
3-month Treasury bill rate			
October 2001 private sector survey	4.0	3.2	4.7
Budget 2001	3.8	2.4	4.0
10-year government bond rate			
October 2001 private sector survey	5.5	5.5	5.9
Budget 2001	5.5	5.5	5.9

- Private sector real GDP growth forecasts for Canada have been revised to an average of 1.3 per cent in 2001 and 1.1 per cent in 2002, down from 1.5 per cent in both years in the October survey. However, the economists still expect growth to pick up by mid-2002, leaving real GDP growth unchanged at 3.9 per cent in 2003.

- GDP inflation has also been revised downwards, with the result that nominal income, the applicable tax base for federal government revenues, is now expected to increase by 2.6 per cent in 2001 and 1.3 per cent in 2002, substantially less than in the October 2001 survey.

- Accompanying this weaker nominal GDP growth are substantially lower short-term interest rates. Private sector forecasters now expect short-term interest rates to average 2.4 per cent in 2002 and 4.0 per cent in 2003. Expectations for 10-year government bonds remain unchanged relative to the October survey.

Implications of the Revised Economic Outlook for the 2001 Budget Fiscal Projections

The lower outlook for both nominal GDP growth and short-term interest rates has differing impacts on the private sector projections of the fiscal surplus.

Table 7.2
Budget 2001: Fiscal Outlook Before Measures Proposed in 2001 Budget

	2001-2002	2002-2003	2003-2004
	(billions of dollars)		
October 2001 private sector survey			
Budgetary surplus: private sector average	7.3	3.8	5.7
Impact of recent economic developments[1]			
Budgetary revenues			
Personal income tax revenues	-0.5	-0.4	-0.3
Corporate income tax revenues	-1.0	-2.5	-1.6
Other revenues	-0.1	-0.3	-0.3
Program spending	0.2	0.1	0.1
Public debt charges	0.3	1.4	1.1
Net impact	-1.1	-1.7	-1.0
Budgetary surplus before 2001 budget measures	6.2	2.1	4.8

Note: Numbers may not add due to rounding.

[1] A negative number implies a deterioration in the fiscal balance while a positive number implies an improvement.

- Financial results for the first six months of 2001-02 were used in deriving the October private sector fiscal projections. The monthly results already reflected much of the economic weakness confirmed by the release of the third-quarter National Accounts results, especially the impact of lower corporate profits on corporate income tax revenues. As a result, some of the deterioration in the fiscal outlook was already reflected in the October private sector fiscal projections.

- The revisions to the economic outlook are estimated to reduce the projected budgetary surplus by $1.1 billion in 2001-02, $1.7 billion in 2002-03 and $1.0 billion in 2003-04. Most of this deterioration results from lower corporate income tax revenues. Personal income tax revenues and other revenues, primarily excise taxes and duties, are also expected to be somewhat lower. In contrast, the outlook for lower short-term interest rates results in significantly lower public debt charges, especially in 2002-03 and 2003-04. In addition, program spending is slightly lower, reflecting the fact that fiscal transfers are assumed to grow in line with the growth in nominal GDP.
- As a result, the adjusted projections of the budgetary surplus, before taking into account the fiscal impact of the measures proposed in the 2001 budget, are $6.2 billion for 2001-02, $2.1 billion for 2002-03 and $4.8 billion for 2003-04.

Spending and Revenue Initiatives Proposed in the 2001 Budget

Table 7.3 presents the fiscal impact of the spending and revenue initiatives proposed in the 2001 budget. The net cost of the proposed actions is $4.7 billion in 2001-02, $111 million in 2002-03 and $2.3 billion in 2003-04.

Table 7.3
Spending and Revenue Initiatives Proposed in the 2001 Budget

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Spending initiatives proposed in this budget			
Enhancing security for Canadians			
Security	1,067	1,217	1,236
Secure, open and more efficient Canada-U.S. border	72	306	260
Total	1,139	1,523	1,496
Bridging to the future			
Investing in health	105	78	78
Investing in skills, learning and research	429	318	318
Strategic infrastucture and the environment	207	181	234
Strategic Infrastructure Foundation: minimum commitment of $2 billion			
Aboriginal children		90	95
International assistance	215		285
Africa Fund: commitment of $500 million			
Total	956	667	1,010
Departmental operations	569	361	198
Total spending initiatives	2,664	2,551	2,703
Revenue and cost recovery initiatives proposed in this budget			
Deferral of corporate income tax instalments for small businesses	-2,000	2,000	
Tax expenditures:			
Investing in skills, learning and research	-10	-20	-35
Investing in strategic infrastructure and the environment		-10	-15
Construction work camps		-10	-10
Air Travellers Security Charge		430	445
Cost recovery		50	50
Total	-2,010	2,440	435
Total spending, revenue and cost recovery initiatives	4,674	111	2,268

Spending and Revenue Initiatives Proposed in the 2001 Budget *(cont'd)*

Spending Initiatives

Enhancing Security for Canadians

■ A number of initiatives have been taken in the aftermath of the September 11th terrorist attacks to enhance security for Canadians and make the Canada-U.S. border more open and efficient. These amount to $1.1 billion in 2001-02 and $1.5 billion in each of the next two fiscal years.

Bridging to the Future

■ Funding has been provided for strategic investments in the areas of health; skills, learning and research; strategic infrastructure and the environment; Aboriginal children; and international assistance. These amount to $1.0 billion in 2001-02, $0.7 billion in 2002-03 and $1.0 billion in 2003-04.

Funding Commitments to the Strategic Infrastructure Foundation and Africa Fund

■ The Government proposes to establish the Strategic Infrastructure Foundation, with a minimum funding commitment of $2 billion, and the Africa Fund, with a commitment of $500 million.

- The amounts to be transferred in 2001-02 will depend on the final outcome of the budgetary surplus for this year.
- Any surplus in 2001-02 will be transferred to honour the Government's commitments. This will be done through legislation and charged to the current fiscal year.
- Should the available surplus at year-end not be sufficient to fully finance these commitments in 2001-02, funding will be made available in future years, depending on the fiscal flexibility at that time.

Government Operations

■ In the February 2000 budget some federal departments and agencies received incremental funding in areas that were regarded as essential to the health and safety of Canadians or critical to the sustainability of high-quality public services. This was based on a major review by the Treasury Board Secretariat of the Government's capacity to deliver existing programs. In this budget some additional funding has been provided including funding associated with the hosting of major international summits in 2001 and 2002 such as the G-8 Summit and, this year, funding to support the Vancouver-Whistler 2010 Olympic bid.

Spending and Revenue Initiatives Proposed in the 2001 Budget *(cont'd)*

Revenue and Cost Recovery Initiatives

Measures to Assist Small Businesses

■ The budget proposes that small businesses be able to defer for six months payments of their corporate income tax instalments for the months of January, February and March 2002, without payment of interest or the assessment of penalties. This deferral will provide an interest-free cash flow benefit to small companies for a six-month period. All corporations with taxable capital that does not exceed $15 million will qualify for this deferral.

■ This deferral reduces federal corporate income tax revenues by $2 billion in 2001-02 and increases them by a similar amount in 2002-03.

Tax Expenditures

■ This budget proposes a number of tax expenditures. These include an apprentice vehicle mechanics' tools tax deduction; a tax deduction for tuition assistance for adult basic education; the extension of the education tax credit; improved tax incentives for renewable energy and energy efficiency; promotion of sustainable woodlot management; and changes to the deductibility of meal costs at construction work camps.

Air Travellers Security Charge

■ To fund the new air security expenditures, the Government proposes to introduce an Air Travellers Security Charge, effective April 1, 2002. This charge will be paid by air travellers – the primary users of the enhanced security measures.

■ This charge is estimated to result in revenues of $430 million in 2002-03 and $445 million in 2003-04. Over the next five years the charge is expected to generate revenue that will be roughly equivalent to the new air security expenditures. The rate of the charge will be reviewed over time to maintain revenues in line with these expenditures.

Cost Recovery Measures

■ Cost recovery measures directly related to enhancing security are also being proposed in this budget. These fees offset the costs of the new fraud-resistant Permanent Resident Card and the expedited pre-approved traveller pass programs at land border crossings and airports. This is expected to generate $50 million in additional revenues in both 2002-03 and 2003-04.

Fiscal Outlook: Summary

Table 7.4 summarizes the impact of the measures proposed in the 2001 budget on the adjusted fiscal projections.

Table 7.4
Budget 2001: Fiscal Outlook

	2001-2002	2002-2003	2003-2004
		(billions of dollars)	
Budgetary surplus pre-2001 budget measures	6.2	2.1	4.8
Budget 2001 measures			
Spending initiatives	-2.7	-2.6	-2.7
Revenue measures	-2.0	2.4	0.4
Net impact	-4.7	-0.1	-2.3
Less: Contingency Reserve	1.5	2.0	2.5
Budgetary balance	0.0	0.0	0.0

Note: Numbers may not add due to rounding.

- The net impact of the measures proposed in the 2001 budget reduces the adjusted budgetary surplus by $4.7 billion in 2001-02, $0.1 billion in 2002-03 and $2.3 billion in 2003-04.
- A Contingency Reserve of $1.5 billion in 2001-02, rising to $2.0 billion in 2002-03 and $2.5 billion in 2003-04, has been set aside, with the result that balanced budgets or better are projected for each year.
- However, any surplus at the end of fiscal year 2001-02 will be dedicated to the proposed $2-billion Strategic Infrastructure Foundation and the proposed $500-million Africa Fund. The actual allocation will be made when the final results for 2001-02 become available in the fall of 2002.

Budget Planning in the Current Environment

■ The size of the Contingency Reserve and economic prudence included in this budget is smaller than in previous budgets. Previously the Contingency Reserve was set at $3 billion per year, with an additional amount for economic prudence.

■ These amounts were included to cover risks arising from unforeseen circumstances, like those being experienced now.

■ During 2001 the unforeseen circumstances of both the slowdown in the global economy and the September 11th terrorist attacks created a high degree of uncertainty and exceptional fiscal pressures.

■ In these circumstances, this budget funds the substantial measures to enhance security for Canadians. As well, the Government is making strategic investments to support Canadians and the Canadian economy through the current period of weakness and uncertainty. These investments are based on two criteria:

- they must be consistent with advancing the Government’s long-term plan to build a strong economy and secure society and to improve the quality of life for Canadians; and
- they must fit within the prudent fiscal framework and, where possible, provide stimulus during the period of economic weakness and position Canada to take advantage of the economic recovery.

■ Most economists would argue that, given the progress made in restoring fiscal health, the Government should not attempt to offset the impact of the weakness in the economy on its revenues and spending in the current circumstances. Rather, it should allow the “automatic stabilizers” to work.

■ Therefore, for 2001-02 and for the next two fiscal years, the Government will not set aside any economic prudence and will use a portion of the Contingency Reserve.

- For 2001-02 the Contingency Reserve is set at $1.5 billion. It increases in each of the next two years – rising to $2.0 billion in 2002-03 and $2.5 billion in 2003-04.
- It is the Government’s intention to rebuild the normal Contingency Reserve and economic prudence as soon as possible.

■ In good economic times the Government has paid down significant amounts of debt – $35.8 billion in just four years. Given the current economic weakness, debt paydown at this time is not appropriate. Therefore, any surplus at the end of fiscal year 2001-02 will be dedicated to honouring the Government’s funding commitment to the Strategic Infrastructure Foundation and the Africa Fund.

Summary Statement of Transactions: The Two-Year Planning Horizon

Balanced budgets or better are projected for 2001-02 and each of the next two fiscal years.

Table 7.5
Summary Statement of Transactions: Budget 2001

	2000-2001	2001-2002	2002-2003	2003-2004
	(billions of dollars)			
Budgetary transactions				
Budgetary revenues	178.6	171.3	174.7	180.7
Program spending	119.3	130.5	136.6	140.2
Operating balance	59.2	40.7	38.2	40.4
Public debt charges	42.1	39.2	36.3	38.1
Less: Contingency Reserve		1.5	2.0	2.5
Budgetary balance	17.1	0.0	0.0	0.0
Net public debt[1]	547.4	547.4	547.4	547.4
Non-budgetary transactions				
Loans, investments and advances	-1.7	-1.9	-1.9	-2.2
Pensions and other accounts	1.3	-1.7	0.0	2.6
Other	2.2	1.7	0.9	0.8
Total	1.8	-1.9	-1.0	1.2
Financial requirements/source	19.0	-1.9	-1.0	1.2
Per cent of GDP				
Budgetary revenues	16.9	15.8	15.9	15.5
Program spending	11.3	12.0	12.4	12.1
Public debt charges	4.0	3.6	3.3	3.3
Net public debt[1]	51.8	50.5	49.9	47.1

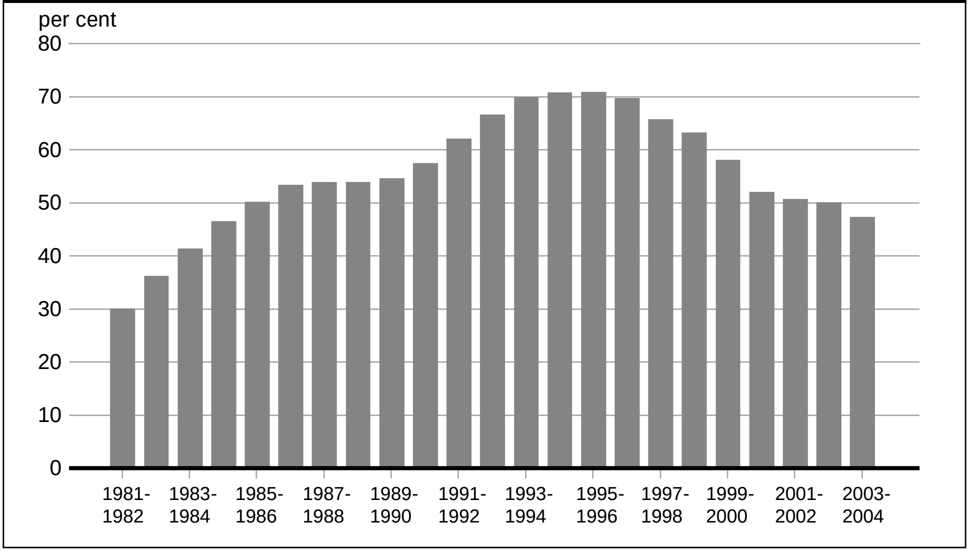
Note: Numbers may not add due to rounding.
[1] Assumes no incremental debt paydown.

■ Net financial requirements of $1.9 billion and $1.0 billion are estimated for 2001-02 and 2002-03 respectively due to the net requirement of funds for non-budgetary transactions. This reflects the one-time transfers of applicable pension assets to those Crown corporations setting up their own pension plans and borrowings associated with the Government assuming the administration of the Canada Student Loans program. The net financial requirements in these years can be sourced through the management of the Government's cash balances. A net financial source is again expected in 2003-04.

Debt Burden Lowest in 17 years

Based on the adjusted economic forecasts, the debt burden – net public debt as a per cent of GDP – is projected to fall from 51.8 per cent in 2000-01 to under 50 per cent in 2002-03. This would be the lowest ratio in 17 years.

Federal Debt-to-GDP Ratio



Budgetary revenues decline in 2001-02

Budgetary revenues are projected to decline by $7.3 billion in 2001-02, reflecting the impact of the second year of the tax reduction plan, the 2001 budget proposal to defer monthly income tax instalment payments for small businesses, and the weakness in nominal income growth. Most of the rebound in 2002-03 is attributable to the deferral of these payments. In 2003-04 budgetary revenues are expected to rebound somewhat.

Table 7.6
Budgetary Revenues

	2000-2001	2001-2002	2002-2003	2003-2004
	(billions of dollars)			
Income tax				
Personal income tax	82.3	80.3	80.0	84.3
Corporate income tax	28.2	23.6	25.4	24.6
Other income tax	4.3	4.0	4.1	4.2
Total income tax	114.8	107.9	109.5	113.1
Employment insurance revenues	18.7	17.8	17.6	17.5
Excise taxes/duties				
Goods and services tax	25.0	25.7	26.9	28.8
Customs import duties	2.8	2.9	2.9	3.1
Other excise taxes and duties	8.3	8.6	8.9	9.2
Total	36.1	37.2	38.8	41.1
Total tax revenues	169.7	162.9	165.9	171.7
Non-tax revenues	8.9	8.4	8.8	9.0
Total budgetary revenues	178.6	171.3	174.7	180.7
Per cent of GDP				
Personal income tax	7.8	7.4	7.3	7.3
Corporate income tax	2.7	2.2	2.3	2.1
Employment insurance revenues	1.8	1.6	1.6	1.5
Goods and services tax	2.4	2.4	2.5	2.5
Other excise	1.1	1.1	1.1	1.1
Tax revenues	16.1	15.0	15.1	14.8
Non-tax revenues	0.8	0.8	0.8	0.8
Total	16.9	15.8	15.9	15.5

Increase in program spending in 2001-02

■ Program spending is expected to increase by $11.2 billion, or 9.4 per cent, in 2001-02. Of this increase, over three-quarters, or $8.7 billion, is due to the following:

- $3.8 billion in higher cash transfers under the Canada Health and Social Transfer (CHST);
- $2.7 billion in higher EI benefits, attributable both to the program enhancements announced in previous budgets as well as an increase in the number of beneficiaries;
- $1.2 billion in new measures to enhance security for Canadians and to ensure a secure, open and efficient border; and
- $1 billion in higher elderly benefits, reflecting a growing number of individuals eligible for benefits and higher average benefits, which are indexed to inflation.

■ Program spending is projected to increase by 4.7 per cent in 2002-03, primarily reflecting ongoing increases in major transfers to persons (both elderly and EI benefits) and in major transfers to other levels of government, primarily CHST cash transfers related to the September 2000 agreements on health renewal and early childhood development. In contrast, direct program spending is estimated to advance by only 2.6 per cent, in line with the projected increase in inflation and the population.

■ An increase in program spending of only 2.6 per cent is projected for 2003-04, as an improving labour market due to the expected rebound in economic growth results in lower EI benefits, while the growth in direct program spending is projected to remain restrained.

Table 7.7
Program Spending

	2000-2001	2001-2002	2002-2003	2003-2004
	(billions of dollars)			
Major transfers to persons				
Elderly benefits	24.3	25.3	26.4	27.4
Employment insurance benefits	11.4	14.1	15.9	15.5
Relief for Heating Expenses	1.5			
Total	37.2	39.3	42.3	42.9
Major transfers to other levels of government				
Canada Health and Social Transfer	13.5	17.3	18.6	19.3
Medical Equipment Fund	1.0			
Fiscal arrangements	12.7	12.2	12.4	13.1
Alternative Payments for Standing Programs	-2.5	-2.4	-2.5	-2.6
Total	24.7	27.1	28.5	29.8
Direct program spending	57.5	64.1	65.8	67.5
Total program spending	119.3	130.5	136.6	140.2
Per cent of GDP				
Major transfers to persons				
Elderly benefits	2.3	2.3	2.4	2.4
Employment insurance benefits	1.1	1.3	1.5	1.3
Total[1]	3.5	3.6	3.9	3.7
Major transfers to other levels of government				
Canada Health and Social Transfer	1.4	1.6	1.7	1.7
Fiscal arrangements	1.2	1.1	1.1	1.1
Alternative Payments for Standing Programs	-0.2	-0.2	-0.2	-0.2
Total	2.3	2.5	2.6	2.6
Direct program spending	5.4	5.9	6.0	5.8
Total program spending	11.3	12.0	12.4	12.1

[1] Includes Relief for Heating Expenses.

Sensitivity of the Fiscal Outlook to Economic Shocks

The fiscal projections are extremely sensitive to changes in economic assumptions – particularly to changes in real GDP growth, inflation and interest rates.

Table 7.8
Sensitivity of Fiscal Outlook to Economic Shocks

	Year 1	Year 2
	(billions of dollars)	
Estimated change in fiscal position from:		
1-per-cent decrease in real GDP growth		
Revenue impact	-1.8	-1.9
Expenditure impact	0.5	0.7
Deterioration in budgetary balance	-2.4	-2.6
1-per-cent decline in GDP inflation		
Revenue impact	-1.9	-1.8
Expenditure impact	-0.5	-0.5
Deterioration in budgetary balance	-1.4	-1.3
100-basis-point decrease in interest rates		
Revenue impact	-0.4	-0.5
Expenditure impact	-1.1	-1.9
Improvement in budgetary balance	0.8	1.4

Note: Numbers may not add due to rounding.

■ A decrease in the growth of real GDP (through equal reductions in employment and productivity) would lead to lower federal government revenues through a contraction in various tax bases and an increase in spending, primarily due to higher EI benefits. Using the standard sensitivity analysis, a 1-per-cent decrease in real GDP for one year would lower the budgetary balance by $2.4 billion in the first year and by $2.6 billion in the second year.

- A 1-per-cent reduction in the growth in nominal GDP resulting solely from a one-year decline in the rate of GDP inflation would lower the budgetary balance by $1.4 billion in the first year and $1.3 billion in year two. Most of the impact would be on budgetary revenues, as wages and profits would be lower, as well as the price of goods and services subject to sales and excise taxes. The impact on expenditures would be largely reflected in those programs that are indexed to inflation, such as elderly benefit payments.
- A sustained 100-basis-point decline in all interest rates would improve the budgetary balance by $0.8 billion in the first year, rising to $1.4 billion in year two. This improvement comes solely from the reduction in public debt charges, which reduces overall budgetary expenditures. Expenditures would fall $1.1 billion in the first year and $1.9 billion in year two, as longer-term debt matures and is refinanced at the lower rates. Moderating this impact are somewhat lower interest earnings on the Government's interest-bearing assets, which are recorded as part of non-tax revenues.

Balanced Budgets Even Under Lower Growth Scenarios

To assess the fiscal impact of differing views on Canada's economic prospects, two alternative scenarios are presented for illustrative purposes: the recent International Monetary Fund (IMF) forecast and the average of the four most pessimistic economic forecasts in the December survey.

Table 7.9
Alternative Economic Assumptions: Lower Growth Scenarios

	2002	2003
	(per cent)	
Real GDP growth		
December 2001 private sector average	1.1	3.9
International Monetary Fund	0.8	3.6
Average of four most pessimistic private sector forecasts	0.6	3.9
	2002-2003	2003-2004
	(billions of dollars)	
Fiscal impact		
Budget 2001 budgetary surplus (Contingency Reserve)	2.0	2.5
Estimated change in fiscal position:		
International Monetary Fund	-0.7	-1.5
Four most pessimistic	-1.4	-1.6
Adjusted budgetary balance		
International Monetary Fund	1.3	1.0
Four most pessimistic	0.6	0.9

- The IMF forecasts real GDP growth of 0.8 per cent for 2002 and 3.6 per cent for 2003, while the average of the four most pessimistic forecasts results in real GDP growth of only 0.6 per cent in 2002, with a rebound to 3.9 per cent in 2003. These forecasts compare to the average of private sector forecasts of 1.1 per cent and 3.9 per cent, respectively.
- Using sensitivity analysis, the IMF economic outlook reduces the budgetary surplus to $1.3 billion in 2002-03 and $1.0 billion in 2003-04. Using the four most pessimistic growth forecasts, the budgetary surplus is reduced to $0.6 billion in 2002-03 and $0.9 billion in 2003-04
- Under either of these lower-growth scenarios, there are still balanced budgets or better in both years.

Annex 1

Spending and Tax Relief Since the 1997 Budget

Spending and Tax Relief Since the 1997 Budget

The following tables present the fiscal impact of spending and tax relief initiatives since 1997-98 – the first year a budgetary surplus was recorded. They show the various initiatives undertaken in the 1998, 1999 and 2000 budgets, the 2000 *Economic Statement and Budget Update*, and the 2001 budget, as well as cumulative totals.

Table A1.1
Spending and Revenue Initiatives: 2001 Budget

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Spending initiatives			
Improving the quality of life for Canadians and their children			
Health initiatives	182	181	173
Employment insurance benefits	35	89	89
New partnerships with Aboriginal peoples	19	123	125
Crime prevention	53	62	75
Cultural initiatives	305	395	196
International assistance	240	37	311
Total	834	887	969
Making Canada's economy more competitive			
Investing in skills, learning and research	549	318	318
Strategic infrastructure and the environment	284	225	278
Total	833	543	596
Providing essential public services			
Security	1,067	1,217	1,236
Maintaining a secure, open and efficient border	72	307	260
Departmental operations	752	464	318
Total	1,891	1,997	1,814
Total spending initiatives	3,558	3,427	3,377
Tax expenditures and general tax/revenue actions			
Improving the quality of life for Canadians and their children			
Donations of certain publicly traded securities to charities		70	70
Tobacco tax increases	-275	-440	-440
Total	-275	-370	-370
Making Canada's economy more innovative	10	40	60
Revenue and cost recovery measures			
Deferral of corporate income tax instalments for small businesses	2,000	-2,000	
Air Travellers Security Charge		-430	-445
Other cost recovery		-50	-50
Total	2,000	-2,480	-495
Tax expenditures and general tax/revenue actions	1,735	-2,820	-805
Total spending and tax/revenue initiatives	5,297	607	2,572

Table A1.2
Spending and Tax Initiatives: 2000 Economic Statement

	2000-2001	2001-2002	2002-2003	2003-2004
	(millions of dollars)			
Spending initiatives				
Improving the quality of life for Canadians and their children				
Canada Health and Social Transfer		2,800	3,600	4,300
Other health initiatives	1,500	200	200	200
Employment insurance (EI) benefits	200	450	500	500
Relief for Heating Expenses	1,345			
Total	3,045	3,450	4,300	5,000
Making Canada's economy more competitive				
Canada Foundation for Innovation	500			
Social Sciences and Humanities Research Council		20	20	20
Clean environment		100	100	100
Total	500	120	120	120
Total spending initiatives	3,545	3,570	4,420	5,120
Tax expenditures and general tax actions				
Improving the quality of life for Canadians and their children				
Canada Child Tax Benefit		260	355	355
Caregiver credit/disabilities	25	100	110	110
Total	25	360	465	465
Making Canada's economy more competitive				
Education tax credit	10	225	230	240
Capital gains inclusion rate	20	175	485	715
Flow-through shares	5	35	40	50
Total	35	435	755	1,005
General tax relief and fairness measures				
Personal income tax relief	1,395	5,745	6,380	6,185
Corporate income tax reductions		160	1,140	1,790
Reduction in EI premium rates[1]	100	300		
Total	1,495	6,205	7,520	7,975
Tax relief	1,555	7,000	8,740	9,445
Total	5,100	10,570	13,160	14,565

[1] Assumes employee premium rate of $2.25 for 2001, $2.20 for 2002 and $2.10 for 2003.

Table A1.3
Spending and Tax Initiatives: February 2000 Budget

	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
			(millions of dollars)		
Spending initiatives					
Improving the quality of life for Canadians and their children					
Canada Health and Social Transfer[1]	2,500				
Support for families with children			607	965	950
Opportunities for Canadians with disabilities		33	37	32	30
Assisting the homeless	63	235	220	220	16
Total	2,563	268	863	1,217	996
Making the economy more competitive					
Investing in research and innovation					
Canada Foundation for Innovation	900				
Genome Canada	160				
Other	35	208	278	268	328
Total	1,095	208	278	268	328
Promoting environmental technologies and practices	235	148	143	159	170
Strengthening federal, provincial and municipal infrastructure		300	550	750	750
Total	1,330	656	971	1,177	1,248
Providing essential public services					
Defence	634	546	550	600	650
Economic adjustment	661	511	500		
Furthering international co-operation	175	110	155	200	155
Operating and capital	505	1000	834	760	752
Total	1,974	2,167	2,039	1,560	1,557
Total spending initiatives	5,867	3,091	3,873	3,953	3,801
Tax expenditures and general tax actions					
Improving the quality of life for Canadians and their children					
Canada Child Tax Benefit		475	1,020	1,350	1,665
Making the economy more competitive					
Capital gains inclusion rate		15	135	230	230
Rollover of capital gains		20	75	75	75
Taxation of gains on qualifying stock options		10	75	75	75
Total		45	285	380	380
General tax relief and fairness measures					
Personal income tax relief		2,790	4,385	5,615	6,790
Corporate income tax reductions		-65	250	310	325
Fairness measures	-25	-55	-30	-25	-25
Reduction in EI premium rates[2]	345	1,392	2,174	2,980	3,780
Total	320	4,062	6,779	8,880	10,870
Total tax initiatives	320	4,582	8,084	10,610	12,915
Total spending and tax initiatives	6,186	7,672	11,957	14,563	16,715

[1] The 1999-2000 CHST cash supplement was paid into a third-party trust in 2000-01, on passage of authorizing legislation.
[2] Assumes a 10-cent-per-year reduction in employee premium rates for 2001, 2002 and 2003.

Table A1.4
Spending and Tax Initiatives: February 1999 Budget

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
	(millions of dollars)					
Building a secure society						
Strengthening health care for Canadians						
Canada Health and Social Transfer[1]	3,500		1,000	2,000	2,500	2,500
Other health care initiatives						
Improving health information systems	95	28	85	120	120	120
Promoting health-related research and innovation[2]	160	50	115	225	225	225
First Nations health services		20	60	110	110	110
Preventive and other health initiatives		49	104	134	134	134
Total	255	147	364	589	589	589
New partnerships with Aboriginal peoples		49	144	159	159	159
Crime prevention	13	95	128	159	159	159
Furthering international co-operation	187	55	80	80	80	80
Addressing environmental challenges	12	18	17	17	17	17
Other						
Equalization – technical improvements		48	97	145	194	225
Official languages in education		70	70	70	70	70
Parks Canada	35					
Compensation and benefit issues in the military		175	175	175	175	175
Total	4,002	657	2,075	3,394	3,943	3,974
Building a strong economy						
Building on the Canadian Opportunities Strategy						
Creating knowledge						
Canada Foundation for Innovation[2]	100					
Support for advanced research	16	50	55	55	55	55
Disseminating knowledge		27	42	27	27	27
Commercializing knowledge		121	232	317	317	317
Supporting employment		265	265	265	265	265
Total	116	463	594	664	664	664

Table A1.4
Spending and Tax Initiatives: February 1999 Budget (cont'd)

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
	(millions of dollars)					
Economic adjustment						
Canadian Fisheries Adjustment and Restructuring Program	600	355	116	48		
Agriculture Income Disaster Assistance Program	600	285	15			
DEVCO	41	5	21	21	21	
Total	1,241	645	152	69	21	
Total: building a strong economy	1,357	1,108	746	733	685	664
Total spending initiatives	5,359	1,765	2,821	4,127	4,628	4,638
Tax expenditures and general tax actions						
Building a secure society						
Increase in Canada Child Tax Benefit			225	300	300	300
General tax relief and fairness measures						
Extension of $500 supplement to all taxpayers		665	1,110	1,290	1,499	1,742
Increase in tax-free income by $175		270	450	525	613	715
Elimination of 3% surtax		595	995	1,150	1,329	1,536
Tax fairness measures		15	25	100	100	100
Reduction in 1999 EI premiums	300	1,250	1,250	1,250	1,250	1,250
Total	300	2,795	3,830	4,315	4,791	5,343
Total	300	2,795	4,055	4,615	5,091	5,643
Total spending and tax initiatives	5,659	4,560	6,876	8,742	9,718	10,281

1 CHST supplement in 1998-99 was paid to a third-party trust in 1999-2000

2 An additional $200 million is being allocated to the Canada Foundation for Innovation. It is expected that about half will be used to improve infrastructure for health research.

Table A1.5
Spending and Tax Initiatives: February 1998 Budget

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
	(millions of dollars)						
Canadian Opportunities Strategy							
Canada Millennium Scholarship Foundation	2,500						
Canada Study Grants		100	103	57	120	120	120
Increased funding for granting councils		120	135	150	150	150	150
Canada Student Loans Program		50	145	150	158	158	158
Canada Education Savings Grant		267	334	434	499	500	500
Connecting Canadians to information and skills	55	60	70	75	75	75	75
Supporting youth employment		50	75	100	100	100	100
Total	2,555	647	862	965	1,102	1,103	1,103
Building a secure society							
Increase in CHST cash floor	200	900	1,500	1,500	1,400	1,200	1,000
Other health initiatives							
National AIDS Strategy		41	41	41	41	41	41
Canadian Breast Cancer Initiative		7	7	7	7	7	7
Sustaining Canada's blood system		55	55	25	25	25	25
Hepatitis C	800						
Tobacco Demand Reduction Strategy		10	10	10	10	10	10
Total	800	113	113	83	83	83	83
Total	1,000	1,013	1,613	1,583	1,483	1,283	1,083
Support for families							
Increased funding for employability							
Assistance for persons with disabilities		15	20	20	20	20	20
New partnership with Aboriginal people	350	126	126	126	126	126	126
Promoting Canadian culture and sports	43	103	153	153	153	153	153
Strengthening communities		42	67	67	67	67	67
Environmental efficiency and innovation		94	94	94	94	94	94
Furthering international co-operation	90	70	20	20	20	20	20
Total	483	435	460	460	460	460	460
Total spending initiatives	4,038	2,110	2,955	3,028	3,065	2,866	2,666
Tax expenditures and general tax actions							
Canadian Opportunities Strategy							
Credit for interest on student loans		80	130	145	155	165	165
Lifelong learning (RRSPs)		15	40	45	50	55	55
Part-time education tax credit (includes part-time CCED)		25	90	90	90	90	90
EI premium holiday for youth			100	100			
Total		120	360	380	295	310	310

Table A1.5
Spending and Tax Initiatives: February 1998 Budget (cont'd)

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
	(millions of dollars)						
Building a secure society							
Deductibility of health/dental insurance premiums			90	110	125	125	125
Caregiver credit		30	120	125	130	130	130
Canada Child Tax Benefit			320	750	850	850	850
Child care expense deduction		20	45	45	45	45	45
Disability measures		5	5	5	5	5	5
Alternative minimum tax and RRSPs		70	20	20	20	20	20
Emergency services		5	10	10	10	10	10
Total		130	610	1,065	1,185	1,185	1,185
General tax relief and fairness measures							
Eliminate surtax for taxpayers up to $50,000		710	1,175	1,365	1,430	1,498	1,498
Tax relief for low-income taxpayers		170	270	315	330	346	346
Reduction in EI premiums	235	725	725	725	725	725	725
Tax fairness measures		-5	-25	30	35	41	41
Total	235	1,600	2,145	2,435	2,520	2,610	2,610
Total targeted and general tax actions	235	1,850	3,115	3,880	4,000	4,105	4,105
Total spending and tax actions	4,273	3,960	6,070	6,908	7,065	6,971	6,771

Table A1.6
Summary of Spending and Tax Actions Since 1997 Budget

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	Cumulative total
				(millions of dollars)				
Spending initiatives								
Building a secure society								
Strengthening health care for Canadians								
Canada Health and Social Transfer	200	4,400	4,000	2,500	6,200	7,300	8,000	32,600
Other health initiatives	800	368	260	1,947	872	872	872	5,989
Other	483	697	1,054	3,003	3,431	3,484	3,566	15,718
Total	1,483	5,465	5,313	7,450	10,503	11,656	12,438	54,307
Building a strong economy								
Canadian Opportunities Strategy	2,555	763	2,829	3,069	4,150	3,860	3,913	21,139
Economic adjustment		1,241	645	152	69	21	21	2,149
Total	2,555	2,004	3,474	3,221	4,219	3,881	3,934	23,288
Providing essential public services			1,974	2,167	3,930	4,027	3,853	15,950
Total spending initiatives	4,038	7,469	10,761	12,837	18,651	19,563	20,224	93,545
Tax expenditures and general tax relief								
Canadian Opportunities Strategy		120	360	460	1,025	1,055	1,075	4,095
Building a secure society								
Canada Child Tax Benefit			320	1,450	2,430	2,855	2,855	9,910
Other		130	290	340	160	65	65	1,050
General tax relief		880	2,975	8,355	17,265	16,730	20,927	67,132
Tax fairness measures		-5	-35	0	105	-362	-380	-678
EI premium reductions	235	1,025	2,320	3,467	4,449	4,955	4,955	21,405
Total	235	2,150	6,230	14,072	25,434	25,295	29,497	102,913
Total spending and tax initiatives	4,273	9,619	16,991	26,909	44,086	44,858	49,722	196,458

Annex 2

Update on Income Tax Relief for Canadians

Overview

In the October 2000 *Economic Statement and Budget Update*, the federal government announced the largest tax cut in Canadian history.

Canadians are already benefitting from the tax reduction plan. The tax cuts are providing significant stimulus to the economy today. They also contribute to building a strong economy for the future. The reductions will:

- lower the personal income tax burden by 21 per cent on average and by 27 per cent for families with children, by 2004-05; and
- promote jobs, growth, entrepreneurship and innovation by creating a Canadian advantage in the taxation of businesses and capital gains relative to the U.S.

As Table A2.1 indicates, these tax cuts will provide about $17 billion in tax relief this calendar year and $20 billion in 2002.

Table A2.1
Tax Relief in 2001 and 2002

	2001	2002
	(billions of dollars)	
Total Tax Relief	17.3	19.9
Personal income tax	14.4	15.7
Corporate income tax	0.5	1.4
Employment insurance	2.4	2.8

This annex provides an overview of income tax relief in place for 2001, as well as information about further tax relief for 2002 and beyond.

Tax Relief for 2001

The Government's tax reduction plan includes tax relief for individuals (see Table A2.4) and measures to encourage job creation, growth, entrepreneurship and innovation (see Table A2.5).

Personal Income Tax Relief

- Full indexation of the personal income tax system was restored as of January 1, 2000.
- Personal income tax rates for all taxpayers were lowered and the deficit–reduction surtax was eliminated effective January 1, 2001.
- The Canada Child Tax Benefit (CCTB) was substantially increased to help low- and middle-income families with children.
- Additional tax assistance was provided to those who need it most, including people with disabilities, and caregivers.
- Tax support for students in post-secondary education was substantially increased.

Measures for Jobs, Growth, Entrepreneurship and Innovation

- Corporate income tax rate reductions for the highest-taxed sectors, such as services, have already begun with a 1-percentage-point reduction, bringing the rate for 2001 to 27 per cent. As legislated under the tax reduction plan, this rate will be reduced further to 25 per cent in 2002, 23 per cent in 2003 and 21 per cent in 2004 and subsequent years.
- The corporate tax rate on small business income between $200,000 and $300,000 earned by a Canadian-controlled private corporation from an active business carried on in Canada was reduced from 28 per cent to 21 per cent effective January 1, 2001.
- The capital gains inclusion rate for individuals and corporations was cut to one-half. As a result, capital gains are typically taxed at a lower rate in Canada than in the U.S.
- Employees may now defer the income inclusion from exercising certain employee stock options in publicly listed corporations until the shares are sold.
- Individuals may now defer qualifying capital gains on small business shares to the extent that the proceeds are reinvested in other eligible small business shares.

Tax Relief for 2002 and Beyond

The measures announced in the Government's tax reduction plan have been legislated and will continue to deliver significant tax relief in 2002 and subsequent years.

Personal Income Tax Relief

In 2002 tax filers will continue to benefit from indexation of the tax system (see Tables A2.2, A2.3 and A2.6). The indexation factor for 2002 is 3 per cent. All indexed personal income tax parameters will be adjusted by this factor. This will reduce the tax burden for all taxpayers. It will also increase the value of benefits for low-income families and individuals provided by refundable credits such as the CCTB and the goods and services tax credit (GSTC).

Indexation will raise the income thresholds for all tax brackets in 2002. For example:

- The amount of income that all individuals can earn annually before paying federal income tax will increase by $222 as a result of the basic personal amount increasing from $7,412 in 2001 to $7,634 in 2002.
- For those with taxable income subject to the 22-per-cent rate, the threshold will be raised from $30,754 to $31,677, meaning that $923 more of their income will be taxed at the lower 16-per-cent rate.

Indexation also ensures that the value of tax assistance for seniors, people with disabilities and caregivers will rise in 2002.

Table A2.2 shows income thresholds and selected credit amounts as indexed for 2002.

Table A2.2
Selected Personal Income Tax Parameters

	2001	2002
	(dollars)	
Basic personal amount	7,412	7,634
Spousal/equivalent-to-spouse amount	6,293	6,482
Taxable income at which 22-per-cent bracket begins	30,754	31,677
Taxable income at which 26-per-cent bracket begins	61,509	63,354
Taxable income at which 29-per-cent bracket begins	100,000	103,000
Age amount	3,619	3,728
Disability amount	6,000	6,180
Disability amount supplement for children with severe disabilities	3,500	3,605
Caregiver amount	3,500	3,605
Infirm dependant amount	3,500	3,605

Note: See Table A2.6 for a complete list of indexed parameters.

Indexation not only protects Canadians from automatic tax increases caused by inflation, it also means that the value of benefits for low-income families and individuals, such as the CCTB and the GSTC, will rise in 2002.

Table A2.3 shows benefit amounts and selected thresholds as indexed for 2002.

Table A2.3
Canada Child Tax Benefit and Goods and Services Tax Credit Parameters

	July 2001	July 2002
	(dollars)	
Canada Child Tax Benefit		
Maximum benefit		
First child	2,372	2,444
Second child	2,172	2,238
Third child	2,097	2,160
Additional benefit for third and subsequent child(ren)	78	80
Additional benefit for children under 7 years	221	228
Goods and services tax credit (GSTC)		
Adult maximum	207	213
Child maximum	109	112
Single supplement	109	112
Phase-in threshold for the single supplement	6,710	6,911
Family net income at which GSTC begins to phase out	26,941	27,749

Note: See Table A2.6 for a complete list of indexed parameters.

Canadian taxpayers will benefit considerably in 2002 from the Government's tax reduction plan. For instance, relative to what their income taxes or benefits would have been without the Government's tax reduction plan:

- A typical two-earner family of four with a combined income of $60,000 will pay $1,262 less net federal income tax in 2002 – a savings of about 22 per cent.
- A typical one-earner family of four with $40,000 in income will pay $1,311 less net federal income tax in 2002 – a savings of about 40 per cent.
- A typical single parent with one child and $25,000 in income will receive additional net benefits of $724 in 2002.

Beyond 2002 further measures have been legislated to provide tax relief. By 2004 these measures will:

- ensure that the basic personal amount, the amount an individual can earn tax-free, is at least $8,000;
- ensure that the spousal amount is at least $6,800;
- raise the second bracket threshold to at least $35,000;
- raise the third bracket threshold to at least $70,000;
- raise the fourth bracket threshold to at least $113,804;
- raise the amount of family net income at which the National Child Benefit supplement is fully phased out and the CCTB base benefit phase-out begins to at least $35,000; and
- reduce the phase-out rate of the base benefit of the CCTB from 5 per cent to 4 per cent (from 2.5 per cent to 2 per cent for families with one child).

Table A2.4 provides a summary of tax relief measures for individuals under the Government's tax reduction plan.

Measures for Jobs, Growth, Entrepreneurship and Innovation

Businesses will also see further tax relief in 2002 and subsequent years.

On January 1, 2002, the general corporate income tax rate, which applies to the highest-taxed sectors such as services, will be cut by 2 percentage points to 25 per cent.

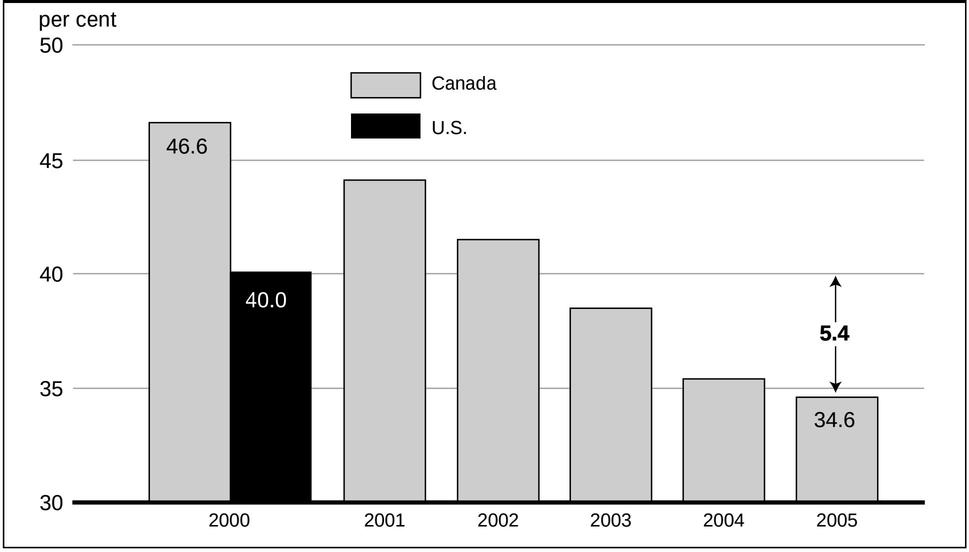
This cut builds on the 1-percentage-point reduction already in place for 2001, and will be followed by additional legislated 2-percentage-point cuts in each of the following two years. By 2004 the general rate will be reduced to 21 per cent. This will encourage job creation and growth, reward entrepreneurship and innovation, and improve the international competitiveness of our business environment.

Small businesses are already benefitting from the full rate reduction to 21 per cent on business income between $200,000 and $300,000.

The reduction in the general corporate tax rate applies to sectors, such as services, that were the highest taxed. Manufacturing and processing (M&P) income was already taxed at a lower rate. For this reason, the corporate tax rate for M&P income was not reduced. Similarly, the corporate tax rate that applies to resource income was not reduced as the resource sector benefits from a number of sector-specific tax measures. The Government has engaged in extensive consultations on means to extend the lower corporate tax rate to resource income while at the same time improving the tax structure. These consultations are continuing.

The combination of federal and provincial actions will result in the average general rate of corporate taxation (taking into account capital taxes) in Canada being about 5 percentage points below the U.S. average rate by 2005 (see chart below).

Corporate Income and Capital Tax Rates in Canada and the U.S.



Note: Rates are based on changes announced to December 2001. Rates include the income tax rate equivalent of capital taxes.

As the summary box below shows, corporate tax rate cuts combined with other measures in the Government's tax reduction plan are creating a business advantage for Canada relative to the U.S.

The Canadian Advantage

Large- and medium-sized businesses

Five-percentage-point lower average corporate tax rate in Canada than in the U.S. by 2005.

Small businesses

Significantly lower corporate rates in Canada on income above $75,000.

Capital gains

Two-percentage-point lower average top capital gains tax rate in Canada than the typical top capital gains tax rate in the U.S.

The $500,000 lifetime capital gains exemption on small business shares has no equivalent in the U.S.

Research and Development

A 20-per-cent research and development (R&D) tax credit in Canada for all R&D expenditures compared to the U.S. 20-per-cent tax credit, which is only for incremental R&D.

A 35-per-cent refundable tax credit available to smaller Canadian-controlled private corporations; no equivalent in the U.S.

Table A2.4
Summary of Tax Relief Measures for Individuals Under the Government's Tax Reduction Plan

- Personal income tax rates for all taxpayers were lowered effective January 2001.
  - The 17-per-cent tax rate was reduced to 16 per cent.
  - The 24-per-cent tax rate – reduced from 26 per cent in the 2000 budget – was reduced further to 22 per cent.
  - The 29-per-cent top tax rate was reduced to 26 per cent on income between about $60,000 and $100,000.
  - The deficit-reduction surtax was eliminated.
- Support for families with children was increased.
  - Effective July 1, 2001, the CCTB was increased, with the maximum benefit for the first child rising to $2,372 in July 2001 and to more than $2,500 by 2004.
  - Effective July 1, 2001, the income threshold at which the National Child Benefit (NCB) supplement is fully phased out, and the CCTB base benefit begins to be phased out, was increased to $32,000.
- Additional assistance was provided to those who need it most.
  - Effective January 2001, the disability amount was raised from $4,293 to $6,000.
  - Effective January 2001, the caregiver amount and infirm dependant amount were raised from $2,386 to $3,500.
  - Effective January 2001, the disability amount supplement for children with severe disabilities was raised from $2,941 to $3,500.
- Tax support for post-secondary education was substantially increased.
  - Effective January 2001, the education amount was doubled from $200 per month to $400 per month for full-time students, and from $60 per month to $120 per month for part-time students.
- Due to concern about the impact of rising energy prices on home-heating costs, in early 2001 the Government provided one-time relief to low- and modest-income Canadians of $125 per individual and $250 per family.
- Full indexation of the tax system, announced in the 2000 budget and effective as of January 1, 2000, protects Canadians from the automatic tax increases that would have resulted from inflation every year if the tax system were not indexed.
- The following measures have been legislated to provide that by 2004:
  - the basic personal amount will be at least $8,000 (up from $7,412 in 2001);
  - the spousal amount will be at least $6,800 (up from $6,293 in 2001);
  - the second bracket threshold will be at least $35,000 (up from $30,754 in 2001);
  - the third bracket threshold will be at least $70,000 (up from $61,509 in 2001);
  - the fourth bracket threshold will be at least $113,804 (up from $100,000 in 2001);
  - the amount of family net income at which the NCB supplement is fully phased out and the CCTB base benefit phase-out begins will be at least $35,000 (up from $32,000 in 2001); and
  - the phase-out rate of the base benefit of the CCTB will be reduced from 5 per cent to 4 per cent (from 2.5 per cent to 2 per cent for families with one child).

Table A2.5
Summary of Measures for Jobs, Growth, Entrepreneurship and Innovation Under the Government's Tax Reduction Plan

- A legislated timetable provides that the general corporate income tax rate will be reduced from 28 per cent to 21 per cent, with a 1-percentage-point reduction in 2001 followed by a 2-percentage-point cut in 2002, and additional 2-percentage-point cuts in each of the following two years.
- Effective January 1, 2001, the corporate income tax rate on small business income between $200,000 and $300,000 earned by a Canadian-controlled private corporation from an active business carried on in Canada was reduced from 28 per cent to 21 per cent.
- Effective October 18, 2000, the capital gains inclusion rate – reduced from three-quarters to two-thirds in the 2000 budget – was cut further from two-thirds to one-half.
- Consistent with the reduction in the capital gains inclusion rate, the employee stock option deduction was increased to one-half.
  - The 2000 budget also allowed employees to defer paying tax on exercising certain qualifying employee stock options in publicly listed shares until the shares are sold.
- The 2000 budget introduced a measure that permits individuals to defer qualifying capital gains on small business shares to the extent that the proceeds are reinvested in other eligible small business shares. The October 2000 *Economic Statement and Budget Update* increased the size of an eligible investment from $500,000 to $2 million and the size of business eligible for the rollover from $10 million to $50 million.
- Effective January 1, 2001, self-employed individuals can deduct in computing income the portion of Canada Pension Plan and Quebec Pension Plan contributions that represents the employer's share.

Table A2.6
Detailed List of Indexed Personal Income Tax Parameters

	Pre-2000 budget	2001	2002
		(dollars)	
Personal amounts and bracket thresholds			
Basic personal amount	7,131	7,412	7,634
Spousal/equivalent-to-spouse amount	6,055	6,293	6,482
Net income threshold	606	630	649
Taxable income at which 22-per-cent bracket begins	29,590	30,754	31,677
Taxable income at which 26-per-cent bracket begins	59,180	61,509	63,354
Taxable income at which 29-per-cent bracket begins	n/a	100,000	103,000
Credit amounts to reflect needs			
Infirm dependant amount	2,353	3,500	3,605
Net income threshold	4,778	4,966	5,115
Caregiver amount	2,353	3,500	3,605
Net income threshold	11,500	11,953	12,312
Disability amount	4,233	6,000	6,180
Disability amount supplement for children with severe disabilities	n/a	3,500	3,605
Allowable child care and attendant care expenses	n/a	2,050	2,112
Medical expense tax credit 3 per cent of net income ceiling	1,614	1,678	1,728
Refundable medical expense tax credit supplement	500	520	535
Minimum earnings threshold	2,500	2,598	2,676
Family net income threshold	17,419	19,705	20,296
Age amount	3,482	3,619	3,728
Net income threshold	25,921	26,941	27,749
Old Age Security repayment threshold	53,215	55,309	56,968
Goods and services tax credit (GSTC)[1]			
Adult maximum	199	207	213
Child maximum	105	109	112
Single supplement	105	109	112
Phase-in threshold for the single supplement	6,456	6,710	6,911
Family net income at which GSTC begins to phase out	25,921	26,941	27,749
Canada Child Tax Benefit (CCTB)[1]			
Base benefit	1,020	1,117	1,151
Additional benefit for third child	75	78	80
Additional benefit for children under 7 years	213	221	228
Family net income at which CCTB base benefit begins to phase out	29,590	32,000	32,960
National Child Benefit (NCB) supplement			
First child	955	1,255	1,293
Second child	755	1,055	1,087
Third child	680	980	1,009
Family net income at which NCB supplement begins to phase out	20,921	21,744	22,397
Family net income at which NCB supplement phase-out ends	29,590	32,000	32,960

[1] GSTC and CCTB benefits are paid on a benefit year cycle beginning in July.

Annex 3

The Budgetary Balance, Financial Requirements/Source, and National Accounts Budget Balance

Alternative Measures of Annual Fiscal Position

There are three basic measures of the federal government's fiscal position – two are based on the Public Accounts (the budgetary balance and financial requirements/source) and one on the System of National Accounts, as prepared by Statistics Canada.

Differences in the measures arise because the accounting frameworks are designed for different purposes.

Public Accounts Budgetary Balance

The fundamental purpose of the Public Accounts is to provide information to Parliament on the Government's financial activities, as required under the Financial Administration Act. The Public Accounts are based on generally accepted accounting principles for the public sector (as recommended by the Canadian Institute of Chartered Accountants' Public Sector Accounting Board) and are audited by the Auditor General of Canada.

Public Accounts Financial Requirements/Source

The financial requirements/source, excluding foreign exchange transactions, measures the difference between cash payments by the Government and cash receipts. It is roughly equivalent to the amount of money that the Government has to borrow in credit markets or the amount of market debt that the Government is repaying. However, in any one year, changes in the Government's cash balance and foreign reserve position can also have an effect on the level of market debt.

In essence, the budgetary balance includes obligations incurred by the federal government during the course of the year, whereas the financial requirements/source only includes the actual cash outlay related to these obligations.

Prior to April 1, 2000, the main difference between the budgetary balance and the financial requirements/source was the treatment of federal government employees' pension accounts. The budgetary balance included the total annual pension-related obligations (the Government's contribution as an employer for current service costs plus interest on its borrowings from the pension accounts), while the financial requirements/source included only the benefits paid out in that year less employee premiums paid.

The recent legislated reform of the federal employee pension plans has significantly narrowed this difference. Effective April 1, 2000, contributions to the plans are invested in the market, thereby reducing the difference between the budgetary balance and financial requirements/source by about $3.5 billion.

Most industrialized countries present their budgets on a basis that is more comparable to the financial requirements/source than to the Public Accounts measure of the budgetary balance. The financial requirements/source corresponds closely to the unified budget balance in the United States.

National Accounts Budget Balance

The primary objective of the National Accounts is to measure current economic production and income. The government sector in the National Accounts is treated on the same basis as other sectors of the economy. As such, only tax revenues collected on income generated in the current year are included as revenues, and only spending which relates to economic activity in the current year is included as expenditures. The current National Accounts treat the transactions of federal government employees' pension accounts as part of the personal sector.

- National Accounts budget balances are used for international fiscal comparisons by the Organisation for Economic Co-operation and Development and the International Monetary Fund.
- The National Accounts also provide a consistent framework for aggregation and comparison of the fiscal positions of the various levels of government in Canada.

Conclusion

The Public Accounts budgetary balance (deficit or surplus) is the most comprehensive of the three measures. It includes all financial transactions between the Government and outside parties. It also includes liabilities incurred during the year for which no cash payment has been made.

Each of the three measures provides important and complementary perspectives on the Government's fiscal position. Although the measures differ in their levels, their trends are broadly similar (see the table and chart on the next page).

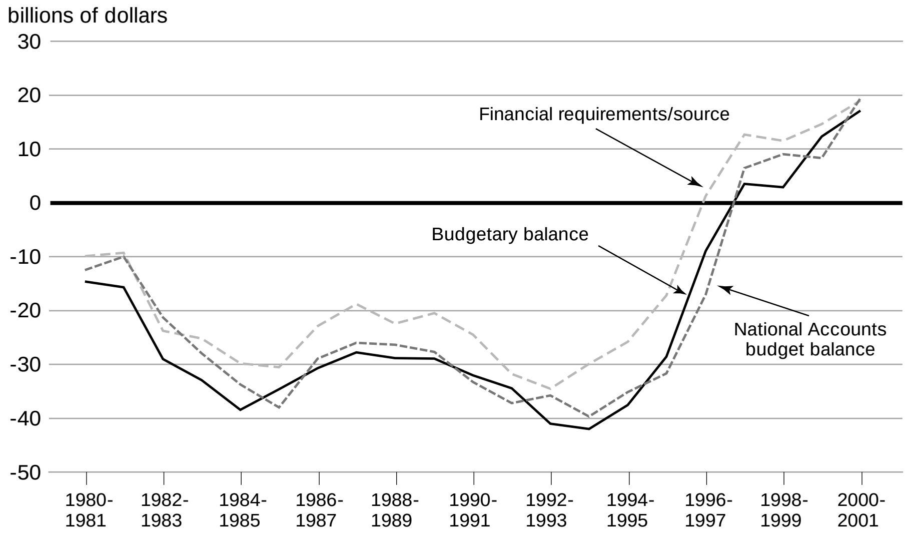
Table A3.1
Alternative Measures of the Federal Fiscal Position
1980-81 to 2000-01

	Budgetary balance		Financial requirements/source (excluding foreign exchange transactions)		National Accounts budget balance[1]	
Fiscal year	(millions of dollars)	(per cent of GDP)	(millions of dollars)	(per cent of GDP)	(millions of dollars)	(per cent of GDP)
1980-81	-14,556	-4.6	-9,917	-3.1	-12,545	-4.0
1981-82	-15,674	-4.3	-9,264	-2.6	-10,001	-2.8
1982-83	-29,049	-7.6	-23,819	-6.3	-21,341	-5.6
1983-84	-32,877	-8.0	-25,219	-6.1	-27,880	-6.8
1984-85	-38,437	-8.5	-29,824	-6.6	-33,677	-7.5
1985-86	-34,595	-7.1	-30,510	-6.3	-37,998	-7.8
1986-87	-30,742	-6.0	-22,918	-4.5	-28,933	-5.6
1987-88	-27,794	-5.0	-18,849	-3.4	-25,990	-4.6
1988-89	-28,773	-4.7	-22,424	-3.6	-26,292	-4.3
1989-90	-28,930	-4.4	-20,530	-3.1	-27,697	-4.2
1990-91	-32,000	-4.7	-24,538	-3.6	-33,309	-4.9
1991-92	-34,357	-5.0	-31,800	-4.6	-37,214	-5.4
1992-93	-41,021	-5.8	-34,497	-4.9	-35,787	-5.1
1993-94	-42,012	-5.8	-29,850	-4.1	-39,696	-5.4
1994-95	-37,462	-4.8	-25,842	-3.3	-35,088	-4.5
1995-96	-28,617	-3.5	-17,183	-2.1	-31,700	-3.9
1996-97	-8,897	-1.1	1,265	0.2	-16,957	-2.0
1997-98	3,478	0.4	12,729	1.4	6,476	0.7
1998-99	2,884	0.3	11,491	1.3	9,026	1.0
1999-00	12,298	1.3	14,566	1.5	8,321	0.9
2000-01	17,148	1.6	18,991	1.8	19,371	1.8

Note: A positive number denotes a surplus, a negative number denotes a deficit.

[1] National Accounts budget balance figures are on a calendar-year basis.

Alternative Measures of the Federal Fiscal Position



Alternative Measures of Federal Debt

As the deficits or surpluses derived from these three measures are different, so are the measures of debt (Table A3.2).

- The accumulation of annual budgetary deficits and surpluses since Confederation is the net public debt.
- For financial requirements/sources, the relevant measure is the stock of market debt that the Government has outstanding.
- Another important debt measure in the Public Accounts is interest-bearing debt. This measure includes all interest-bearing liabilities of the Government of Canada and is the most appropriate measure for calculating the average effective interest rate. Interest-bearing debt is larger than market debt because it includes liabilities that have not been issued on markets – notably the Government's liabilities to its employees' pension accounts. Interest-bearing debt is also larger than the net debt because it includes the Government's liabilities only, while the net debt includes financial assets.
- The National Accounts debt represents the Government's total liabilities minus its financial assets. It is broadly comparable to net debt on a Public Accounts basis.

Table A3.2
Alternative Measures of the Federal Debt
1980-81 to 2000-01

	Net debt		Interest-bearing debt		Market debt		National Accounts debt[1]	
Fiscal year	(millions of dollars)	(per cent of GDP)	(millions of dollars)	(per cent of GDP)	(millions of dollars)	(per cent of GDP)	(millions of dollars)	(per cent of GDP)
1980-81	91,948	29.2	112,418	35.7	83,138	26.4	75,366	23.9
1981-82	107,622	29.8	126,684	35.1	93,167	25.8	88,788	24.6
1982-83	136,672	35.9	154,221	40.5	116,562	30.6	113,148	29.7
1983-84	169,549	41.1	184,849	44.8	142,901	34.7	147,051	35.7
1984-85	207,986	46.1	219,458	48.7	172,719	38.3	184,108	40.8
1985-86	242,581	49.8	253,381	52.0	201,229	41.3	220,027	45.2
1986-87	273,323	53.2	286,034	55.7	228,611	44.5	251,950	49.0
1987-88	301,117	53.7	313,948	56.0	250,809	44.8	275,588	49.2
1988-89	329,890	53.7	345,057	56.1	276,301	45.0	301,693	49.1
1989-90	358,820	54.4	370,104	56.1	294,562	44.7	335,512	50.9
1990-91	390,820	57.3	406,475	59.6	323,903	47.5	367,757	54.0
1991-92	425,177	61.9	440,181	64.1	351,885	51.2	404,805	58.9
1992-93	466,198	66.4	477,034	67.9	382,741	54.5	446,205	63.5
1993-94	508,210	69.7	514,510	70.5	413,975	56.7	489,881	67.1
1994-95	545,672	70.6	550,192	71.2	440,998	57.1	525,779	68.0
1995-96	574,289	70.7	586,387	72.2	469,547	57.8	563,174	69.3
1996-97	583,186	69.5	600,557	71.6	476,852	56.8	573,680	68.4
1997-98	579,708	65.5	594,825	67.2	467,291	52.8	569,955	64.4
1998-99	576,824	63.0	594,985	65.0	460,427	50.3	561,743	61.3
1999-00	564,526	57.9	597,932	61.3	456,406	46.8	557,860	57.2
2000-01	547,378	51.8	589,232	55.8	446,403	42.3	537,498	50.9

[1] National Accounts debt figures represent net financial assets on a calendar-year basis.

Annex 4

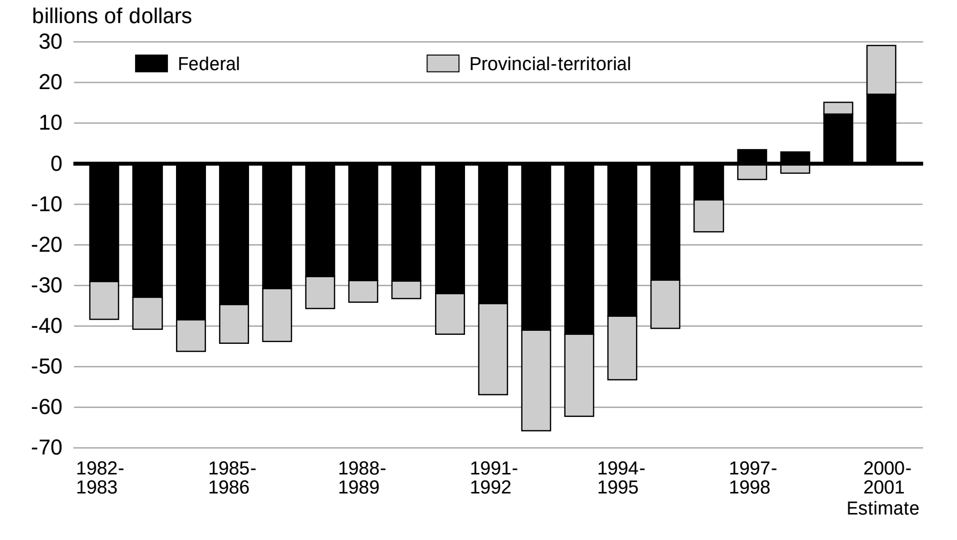
Fiscal Performance of Canada's Federal-Provincial-Territorial Government Sector

Highlights

- The aggregate federal-provincial-territorial government sector recorded an estimated surplus of $29.2 billion in 2000-01, the third consecutive annual surplus.
- In addition to the federal government, eight provinces and two territories are estimated to have recorded surpluses in 2000-01.
- The net public debt-to-GDP (gross domestic product) ratio has fallen at both levels of government. The federal ratio has declined by nearly 19 percentage points from its peak of 70.7 per cent in 1995-96. The aggregate provincial-territorial ratio has declined by 5.5 percentage points from its peak of 28.0 per cent in 1997-98.
- Although declining, debt charges as a per cent of total revenues are still significantly higher at the federal level than at the provincial-territorial level.
- Since 1992-93 program spending as a share of GDP has declined significantly at both levels of government.
- Provincial-territorial revenues are higher than those collected by the federal government. Although revenues as a percentage of GDP are expected to decline at both levels of government, the decline at the federal level should be more pronounced, given the federal government's $100-billion Five-Year Tax Reduction Plan and strong growth in federal transfers to provinces and territories under existing legislation.

Federal-provincial-territorial governments recorded an aggregate surplus in 2000-01 for the third consecutive year

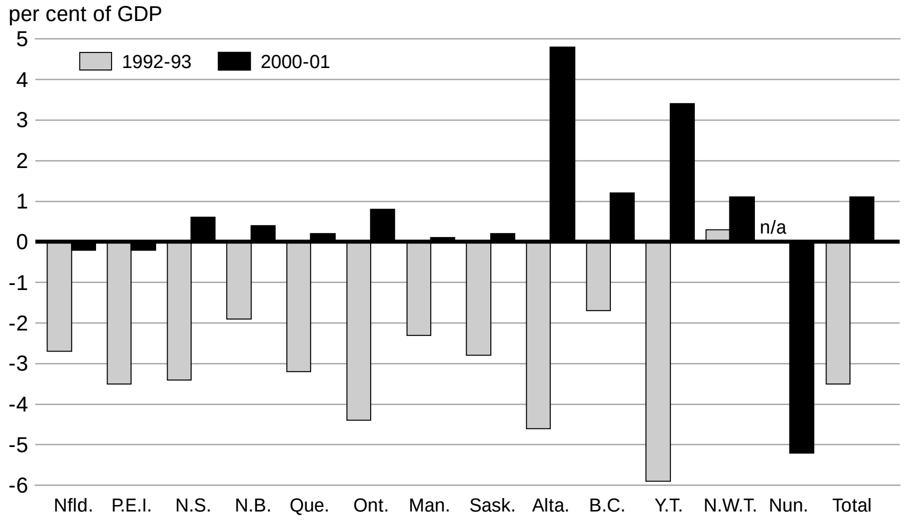
Federal and Provincial-Territorial Budgetary Balances
(Public Accounts Basis)



- In 2000-01 federal-provincial-territorial governments are estimated to have recorded an aggregate surplus of $29.2 billion, the third consecutive surplus.
- This represents a remarkable improvement from 1992-93, when the federal-provincial-territorial government sector posted a $65.8-billion deficit.
- From 1993-94 to 2000-01 the federal budgetary balance moved from a deficit of $42 billion to a surplus of $17.1 billion.
- The provincial-territorial government sector is estimated to have recorded a surplus of $12.0 billion in 2000-01, the second consecutive surplus after more than 30 years of uninterrupted deficits.

Most provinces and territories are expected to record budgetary surpluses in 2000-01

Provincial-Territorial Budgetary Balances
(Public Accounts Basis)

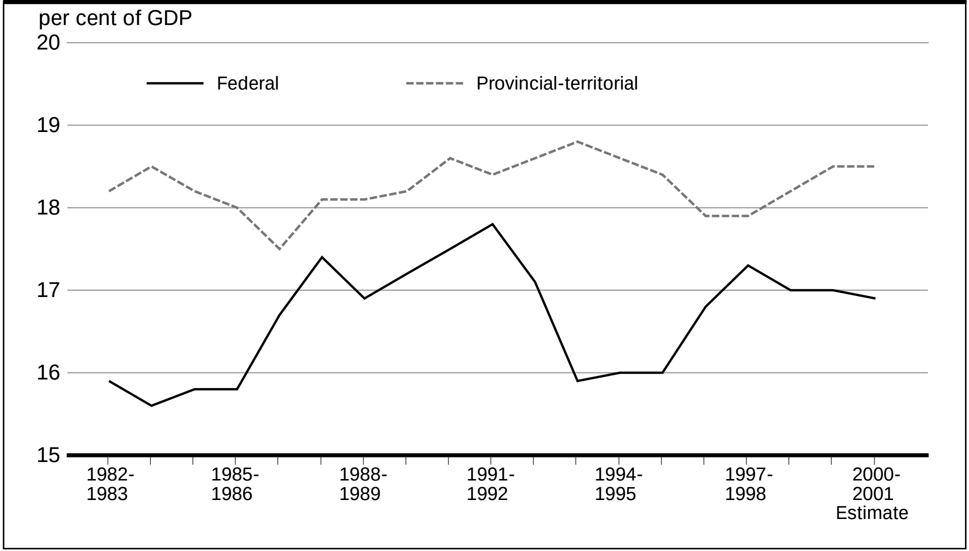


Source: Provincial Public Accounts, with the exception of P.E.I., Quebec, Yukon, Northwest Territories and Nunavut, which are based on the latest available data.

- Eight provinces and two territories are estimated to have recorded a budgetary surplus in 2000-01.
- In contrast, in 1992-93 all but one of the 12 provincial-territorial budgets (Northwest Territories) were in deficit.

Total provincial-territorial revenues consistently higher than federal revenues

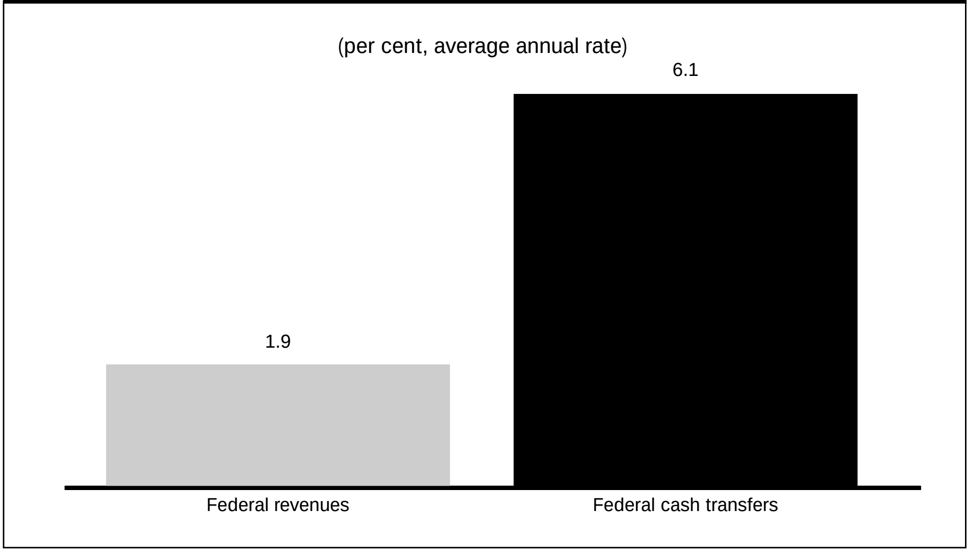
Federal and Provincial-Territorial Revenues
(Public Accounts Basis)



- For the last 20 years provincial-territorial revenues have consistently exceeded federal revenues.
- The provincial-territorial revenue-to-GDP ratio is also more stable than the federal ratio as the federal government's revenues are more sensitive to cyclical variations, given its larger share of personal income tax revenues.
- The federal ratio has declined steadily since 1997-98, reflecting the impact of recent tax measures. It is expected to decline further over the medium term, reflecting the impact of the $100-billion Five-Year Tax Reduction Plan, which will be fully in place by 2004-05.
- In contrast, the provincial-territorial revenue-to-GDP ratio has increased in recent years despite tax cuts, primarily reflecting strong growth in revenue sources unique to the provinces, such as resource royalties and gaming profits.

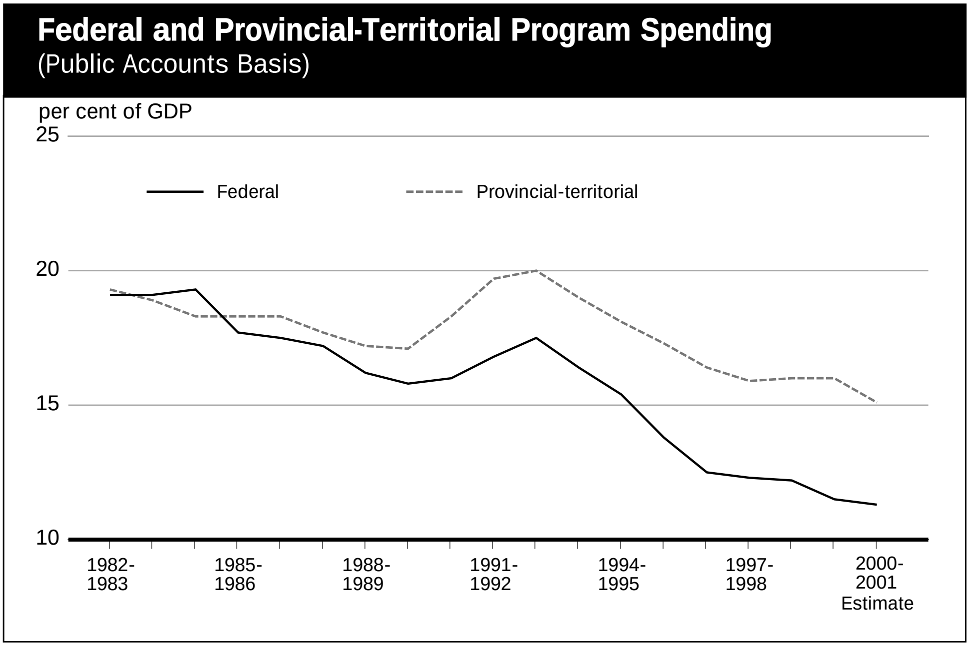
The provinces will benefit from strong growth in federal cash transfers

Growth in Federal Revenues and Cash Transfers to Provinces
(2000-01 to 2005-06)



- Total provincial government revenues include both own-source revenues and cash transfers from the federal government for such programs as the Canada Health and Social Transfer (CHST) and equalization. These transfers make up from 7 per cent to 44 per cent of individual provinces' total revenues.
- With the recent $21.1-billion increase in the CHST over five years and increasing equalization payments, federal cash transfers to the provinces are projected to grow rapidly in the coming years.
- Depending on the growth of provincial fiscal capacities, which have an impact on equalization payments, federal cash transfers could grow by up to 6.1 per cent annually over the next five years. These funds will help the provinces finance key social programs such as health care and education.
- In contrast, federal revenues are forecast to grow at an average annual rate of just 1.9 per cent from 2000-01 to 2005-06.

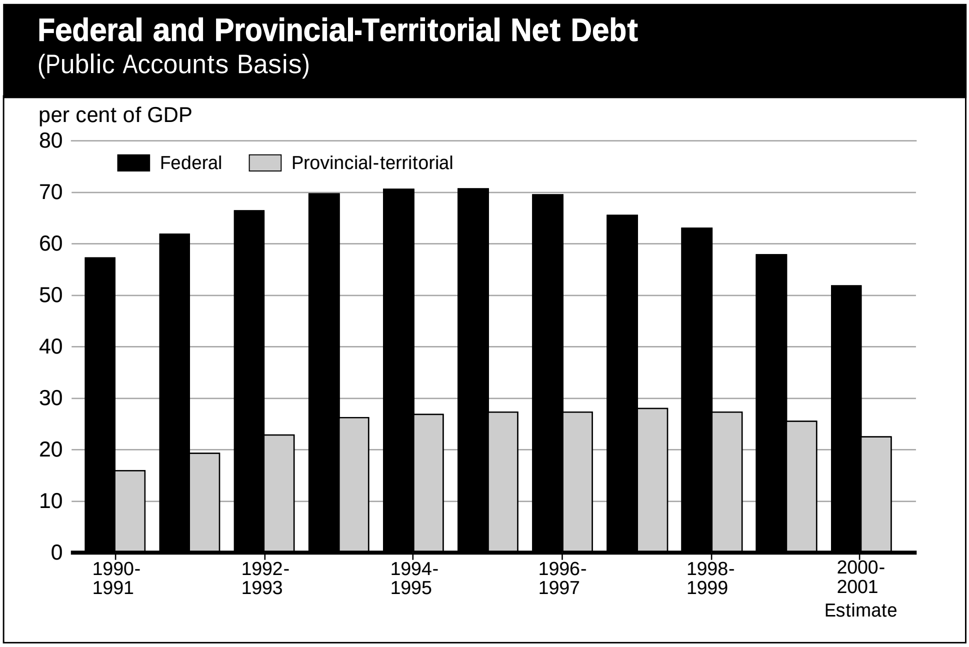
Program spending has declined significantly as a share of GDP



■ At both levels of government, deficit elimination has primarily been achieved through program-spending reductions.

■ From 1992-93 to 2000-01 federal program spending as a share of GDP fell by 6.2 percentage points – from 17.5 per cent to 11.3 per cent. Over the same period provincial-territorial program spending fell by 4.9 percentage points – from 20.0 per cent to 15.1 per cent.

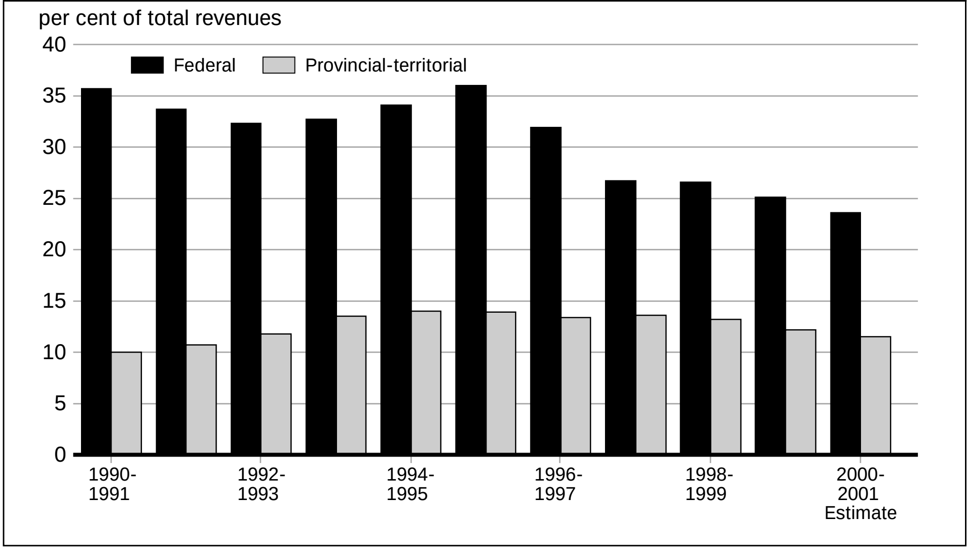
The debt burden is much larger at the federal level



- Throughout the past decade the federal debt burden, as measured by the ratio of net public debt to GDP, has been more than twice as high as the provincial-territorial debt burden.
- In 2000-01 the federal debt-to-GDP ratio was estimated at 51.8 per cent, a drop of 18.9 percentage points from its peak of 70.7 per cent reached in 1995-96.
- The provincial-territorial ratio was estimated at 22.5 per cent in 2000-01, a decline of 5.5 percentage points from its peak of 28.0 per cent in 1997-98.

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)



- As a result of its larger debt burden, the federal government faces much higher debt charges than the provincial-territorial government sector.
- The federal government must therefore spend a larger proportion of its revenues on debt charges.
- In 1995-96 the federal government spent 36.0 cents of every dollar of revenue on debt charges. Although significant progress has been made in reducing this burden, federal debt charges still consume 23.6 cents of every dollar of revenue, compared to 11.5 cents for the provincial-territorial government sector.

Annex 5

Canada's Financial Performance in an International Context

Introduction and Overview

■ This annex compares Canada's financial position with that of the other Group of Seven (G-7) countries (United States, United Kingdom, France, Germany, Japan and Italy).

■ Two factors tend to complicate international comparisons: differences in accounting methods among countries, which affect the comparability of data, and differences in financial responsibilities among levels of government within countries. For this reason, the standardized System of National Accounts definitions and data, which are fairly uniform among countries, are used for international comparisons. The Organisation for Economic Co-operation and Development (OECD) produces a complete series of estimates based on this system. The data presented in this annex are based on the OECD's June and November 2001 *Economic Outlook* publications and, as such, do not include any data revisions since then.

■ Between 1992 and 2000 Canada made the most dramatic improvement in its financial situation among the G-7 countries. Over this period Canada recorded a turnaround of more than 12 percentage points in its financial balance as a share of gross domestic product (GDP), compared to 4.5 percentage points for the G-7 countries as a whole.

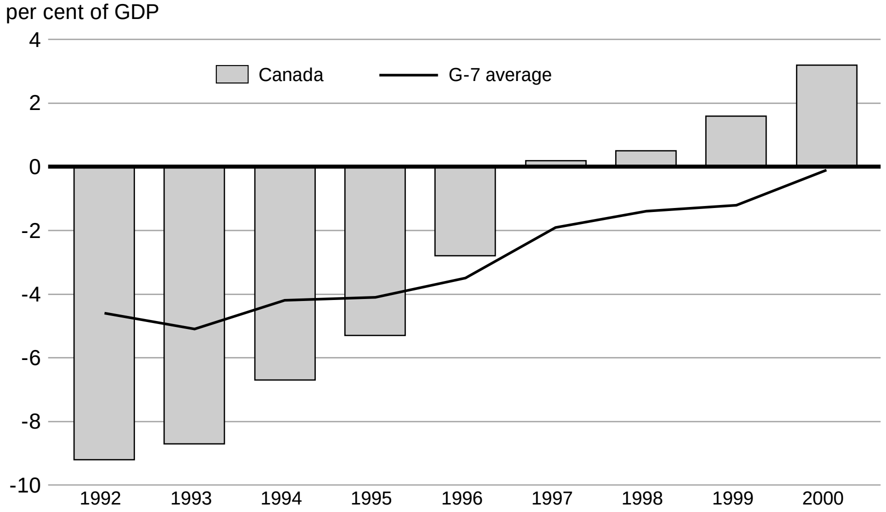
■ In 2000 Canada's surplus was estimated at 3.2 per cent of GDP, compared to an average deficit of 0.1 per cent for the G-7 countries.

■ As a result, Canada achieved the sharpest decline in the net debt-to-GDP ratio among the G-7 countries over the past five years.

■ On the basis of comparable budget-based data, the Canadian federal government achieved a surplus in 1996-97, one year earlier than the U.S. federal government. In 2000-01 the Canadian federal financial surplus stood at 1.8 per cent of GDP, compared to a surplus of 1.3 per cent in the U.S.

Canada’s financial balance has improved significantly compared to the G-7 average

Total Government Financial Balances
(National Accounts Basis)



Source: *OECD Economic Outlook No. 70, Preliminary Edition* (November 2001), *OECD Economic Outlook No. 69* (June 2001).

■ Canada’s total government[1] financial balance has improved substantially since the early 1990s.

■ The total government deficit peaked at 9.2 per cent of GDP in 1992, compared to the G-7 average deficit-to-GDP ratio of 4.6 per cent that same year.

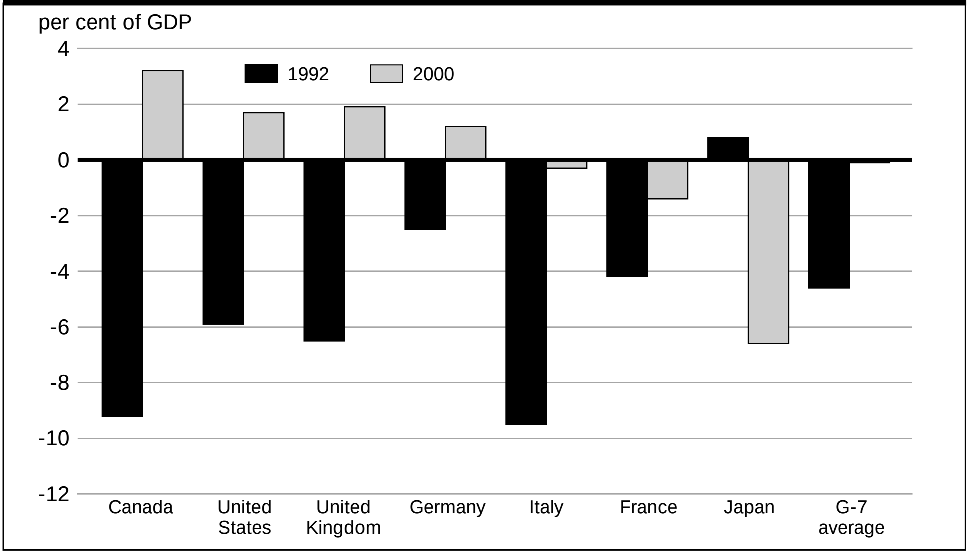
■ By 1997, however, financial improvements at all levels of government enabled Canada’s total government sector to post a surplus.

■ In 2000 Canada’s surplus reached 3.2 per cent of GDP, compared to an average deficit of 0.1 per cent in the G-7 countries.

[1] Includes federal, provincial-territorial and local governments as well as the Canada Pension Plan and Quebec Pension Plan.

Canada has achieved the most dramatic reversal in the financial balance of any G-7 country

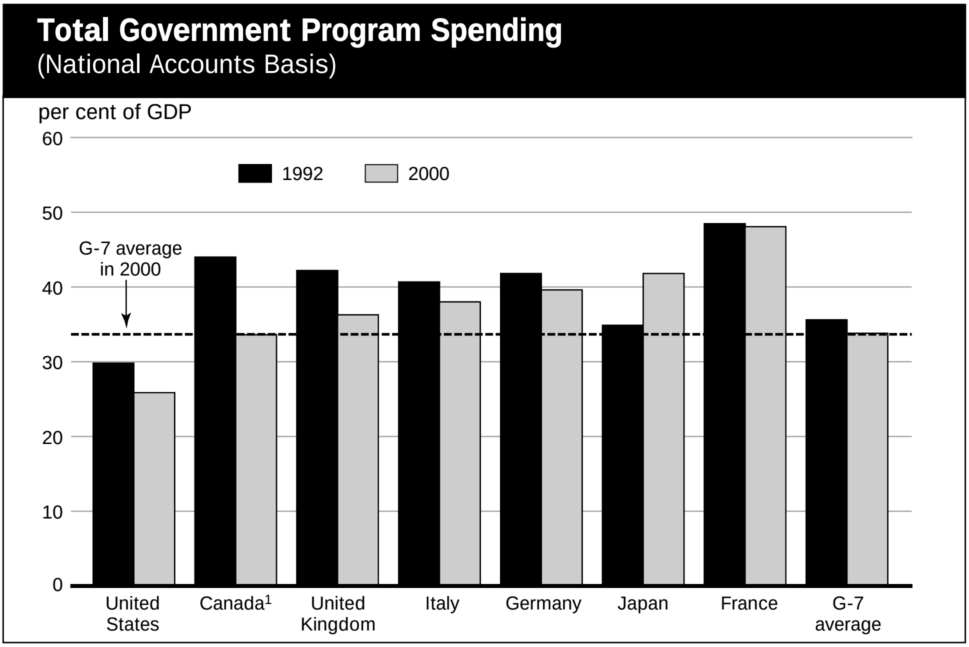
Total Government Financial Balances in the G-7
(National Accounts Basis)



Source: *OECD Economic Outlook No. 70, Preliminary Edition* (November 2001), *OECD Economic Outlook No. 69* (June 2001).

- Canada made the largest financial improvement of the G-7 countries from 1992 to 2000. In 1992 Canada had the second highest deficit in the G-7 in relation to GDP, whereas it posted the highest financial surplus relative to GDP in 2000.
- Over this period Canada's financial balance registered a turnaround of more than 12 percentage points.

Canada's program spending as a share of GDP has been brought in line with the G-7 average



[1] The OECD data overstate Canadian government outlays relative to those of other countries because Canadian government revenues from the sale of goods and services are classified as receipts, whereas such revenues are netted off of outlays in the data for other countries. On a comparable basis, Canada's program spending relative to GDP would be about 3 percentage points lower than shown in the chart.

Source: *OECD Economic Outlook No. 69* (June 2001).

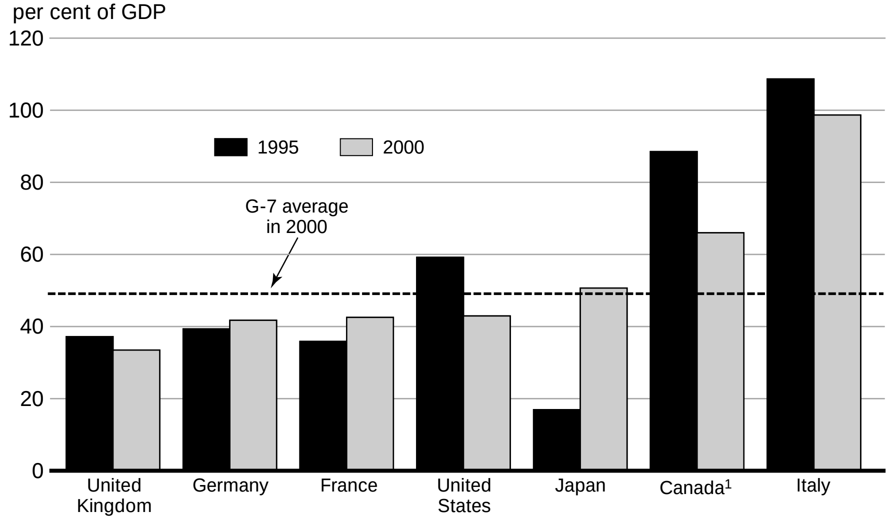
■ The rapid turnaround in Canada's financial position, as a percentage of GDP, is attributable in large part to a sharp reduction in program spending.

■ Between 1992 and 2000 Canada's total government program spending as a share of GDP was reduced by 10.4 percentage points, more than in any other G-7 country.

■ In relation to the size of the economy, Canada's program spending is now slightly below the G-7 average, while in 1992 it was well above the G-7 average.

Canada has recorded the sharpest decline in the net debt-to-GDP ratio among the G-7 countries

Total Government Net Debt
(National Accounts Basis)



[1] Includes non-autonomous government employee pension plan liabilities, which amounted to about 19 per cent of GDP in 1999.

Source: *OECD Economic Outlook No. 69* (June 2001).

■ When comparing Canada's net debt-to-GDP ratio with those of other countries, it is important to note that the Canadian data include government employee pension liabilities. This overstates Canada's debt position relative to countries that have large unfunded liabilities for such pensions, which are not included in the National Accounts measure of government debt. Among the G-7 countries, only U.S. debt data are strictly comparable with those of Canada.

■ Canada has achieved the sharpest decline in the net debt-to-GDP ratio over the last five years. Between 1995 and 2000 the ratio fell 22.5 percentage points. However, Canada's debt burden remains above the G-7 average.

Canada-United States Federal Comparison

■ This section compares the financial situation of the Canadian federal government with that of the U.S. federal government using budget-based data.

■ In making such comparisons, it is important to note that there are fundamental differences in the accounting practices and responsibilities of the Canadian and U.S. federal governments. For example, the public pension plan is considered part of the federal sector in the U.S., whereas the Canada Pension Plan is not part of the Canadian federal sector.

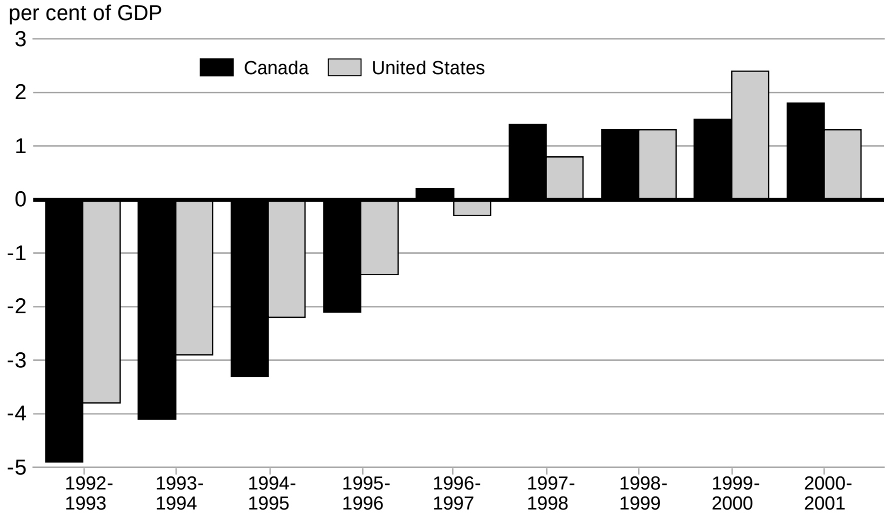
■ That being said, a reasonable comparison of the two countries' financial situations may be made using the financial requirements/source of the Canadian federal government (rather than the budgetary balance) and the U.S. federal unified budget balance. This primarily compares the financial situation in both countries on a cash basis of accounting.

■ On this basis, both countries have achieved significant improvements since the early 1990s, moving from a deficit to a surplus position. The Canadian federal government achieved a surplus in 1996-97, one year earlier than the U.S. federal government.

■ Similarly, Canadian federal market debt (rather than net public debt) is the most appropriate measure of debt to be compared with U.S. federal debt held by the public. Both countries have registered a significant decline in the market debt-to-GDP ratio since the mid-1990s.

Canada recorded a financial surplus one year earlier than the U.S.

Federal Government Financial Balances
(Public Accounts Basis)

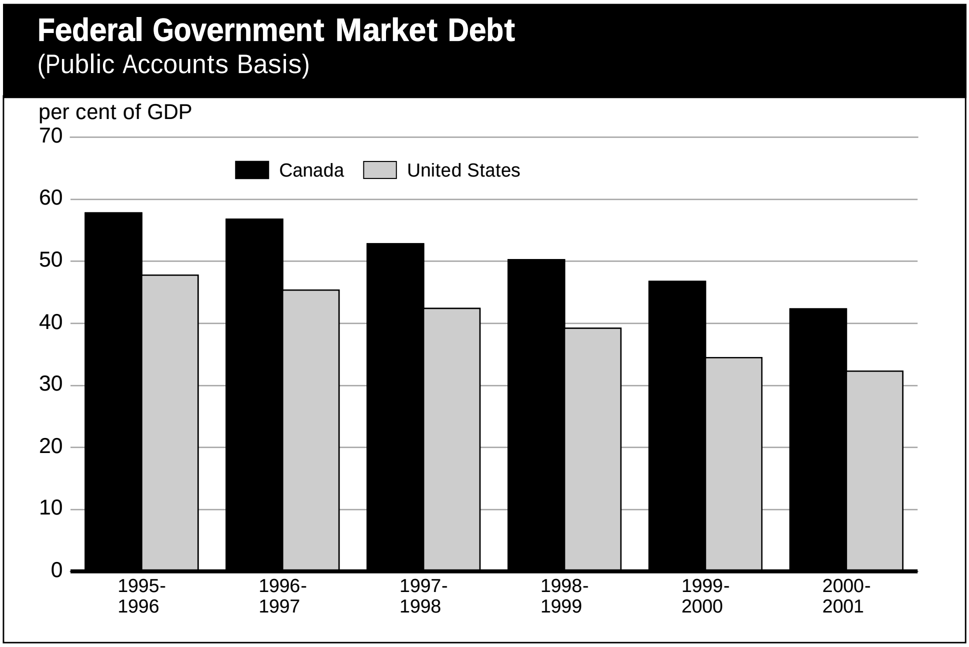


Note: This chart shows financial requirements/sources for Canada and the unified budget balance for the U.S., for fiscal years ending March 31 and September 30 of the same year for Canada and the U.S. respectively.

Sources: Canada - Department of Finance Canada. U.S. - Department of the Treasury and Budget of the United States Government, Fiscal Year 2002.

- In the early 1990s both Canada and the U.S. had significant deficits at the federal level. The Canadian federal deficit peaked at 4.9 per cent of GDP in 1992-93, compared to a deficit of 3.8 per cent in the U.S.
- However, both countries achieved a significant turnaround over the past decade, with the Canadian federal government recording a financial surplus in 1996-97, one year earlier than the U.S.
- In 2000-01 the Canadian federal financial surplus reached 1.8 per cent of GDP, slightly higher than the U.S. surplus of 1.3 per cent of GDP.

The market debt-to-GDP ratio has been significantly reduced in both countries



Note: This chart shows market debt for Canada and debt held by the public for the U.S., for fiscal years ending March 31 and September 30 of the same year for Canada and the U.S. respectively.

Sources: Canada - Department of Finance Canada. U.S. - Department of the Treasury and Budget of the United States Government, Fiscal Year 2002.

- For debt comparisons, the comparable measures are market debt for Canada and publicly held debt for the U.S.
- While the Canadian federal market debt-to-GDP ratio remains above that of the U.S., both countries have achieved a marked decline in the debt ratio since the mid-1990s. In fact, the ratio has been reduced by 15.5 percentage points in both countries since 1995-96.

Annex 6

The Government's Response to the Auditor General's Observations on the 2001 Financial Statements

In the 2001 *Public Accounts of Canada*, the Auditor General expressed a clean opinion on the Government's financial statements for 2000-01.

The Auditor General raised a number of matters for Parliament's attention. These are:

- compliance with the Employment Insurance Act;
- transfers to foundations;
- the Canada Foundation for Sustainable Development Technology;
- the Financial Information Strategy – the move to full accrual accounting;
- departmental financial statements;
- offsetting Canada Child Tax Benefit disbursements against revenues ("netting");
- the Debt Servicing and Reduction Account;
- simplified and useful financial statements – the *Annual Financial Report of the Government of Canada*; and
- dictating accounting treatment in legislation.

The Government's responses to the Auditor General's observations on the 2001 financial statements are discussed in detail in this annex.

Compliance With the Employment Insurance Act

According to the Auditor General, the Canada Employment Insurance Commission (the Commission), which is responsible for setting employment insurance premium rates, did not provide an adequate justification for the size and rate of growth of the balance in the Employment Insurance Account in setting premium rates for 2001.

The Employment Insurance Act requires that the Commission set premium rates at levels that will cover program costs while keeping rates relatively stable over the business cycle – at the cyclical break-even rate. However, the stability requirement is inconsistent with a growing cumulative balance in the Account. Furthermore, as the Chief Actuary of Human Resources Development Canada notes, given the difficulties of making accurate forecasts at any time, as a practical matter, adjustments to the premium rates may be needed.

The December 1999 Report of the Standing Committee on Finance noted that the current rate-setting process "involves not only a 'look forward' process in assessing the level of revenues sufficient to cover program costs over a business cycle, but also a 'look back' process by taking into consideration the level of any past excesses or shortfalls of revenues relative to program costs." As employment insurance premium revenues and program costs are consolidated in the Government's budgetary balance, the "look back" provision, the Report concluded, will cause serious disruptions to the overall management of the federal government's budget. The Report recommended, therefore, that employment insurance rates be set on the basis of levels of revenues needed to cover program costs over the business cycle looking forward, and not take into account the level of the cumulative surplus or deficit.

Recognizing these difficulties, the Government announced that it would undertake a review of the premium rate setting process. In the interim Bill C-2 gave power to the Governor in Council to set the rates for 2002 and 2003.

Transfers to Foundations

The Auditor General is concerned with the way the Government accounts for transfers to foundations because most of the funding provided has yet to be spent on the ultimate purposes intended. She urges the Government to change its accounting, recognizing expenditures only when the foundation transfers the funds to the ultimate recipient. In addition, she is critical of the overall accountability and governance arrangements of foundations.

The Government recognizes that the booking of liabilities to these foundations is an area where existing accounting standards do not offer explicit guidance, and that professional judgment must be brought to bear. Recognizing this, the Government consulted two major accounting firms, both of which endorsed the Government's approach. Furthermore, the previous Auditor General reported that he undertook research on the accounting treatment of such "special purpose entities" to determine if they should be consolidated in the Government's financial statements as part of the Government's overall reporting entity. From his research, he concludes that the application of current PSAB (Canadian Institute of Chartered Accountants' Public Sector Accounting Board) accounting recommendations requires considerable judgment to determine the appropriate accounting treatment. A PSAB task force is currently reviewing this issue to determine if additional guidance is required.

The Government has consistently argued that its decisions to provide funding to arm's-length organizations, such as the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation, established liabilities that should be recorded in the year that the decisions to provide funding were made. Decisions on the projects selected are made by the directors of the foundations under broad agreements signed with the Government. The Government continues to believe that, in applying PSAB recommendations, these entities should not be considered part of government and, therefore, not consolidated within its financial statements.

This current accounting treatment enhances transparency and accountability to Parliament and Canadians. As such, in accordance with its stated accounting policy, non-recurring liabilities will be recognized in the year the decision to incur them is made, provided the enabling legislation or authorization for payment receives parliamentary approval before the financial statements for that year are finalized.

The Canada Foundation for Sustainable Development Technology

The Auditor General expressed concerns over the process that the Government used to create and fund the Canada Foundation for Sustainable Development Technology as well as the use of the Government's contingencies vote to provide temporary funding to the foundation.

The sustainable technology initiative was first announced in the February 2000 budget. To this end the Government, upon the approval of the Treasury Board, entered into a funding agreement with a not-for-profit private sector corporation. While this agreement was signed before the passage of Bill C-4, which enabled Parliament to directly determine the mandate, governance and accountability arrangements, the legislated authority to enter into this agreement already existed under the Energy Efficiency Act and the Department of the Environment Act.

As there were no alternative funding authorities immediately available, access to Treasury Board vote 5 enabled the Government to honour its liability to the corporation. The use of this vote for new grants and increases to existing grants has been an accepted practice for decades and is fully reported to Parliament in the Supplementary Estimates.

As a result, the Government believes that the creation and funding of this foundation respected all parliamentary authorities and practices.

The Financial Information Strategy – The Move to Full Accrual Accounting

Currently the Government records most of its expenditures and non-tax revenues on an accrual basis of accounting. In contrast, tax revenues and capital assets are recorded on a cash basis of accounting. In previous budgets the Government has indicated its intention to move to full accrual accounting, and the Auditor General has supported this move.

The Auditor General notes that while the Government has made progress toward its objective, all departments and agencies have a lot of work to do to implement full accrual accounting.

The specific areas where the Auditor General comments on the progress being made include tangible capital assets, environmental liabilities, accrual of tax revenues, and Aboriginal claims.

The Government recognizes the implementation of the Financial Information Strategy (FIS) and full accrual accounting as a priority and recently provided additional support to departments in this area. It will continue to work closely with the Office of the Auditor General to ensure the successful implementation of FIS and full accrual accounting.

However, it is government convention that the audited financial statements report on the same basis of accounting as that used in the budget. Given the timing of the 2001 budget and the fact that important components of the information required to implement full accrual accounting have not yet been verified and audited, it is not possible to move to a full accrual basis of accounting at this time. Therefore, the Government has decided to delay the implementation of full accrual accounting for at least one year.

Departmental Financial Statements

As part of FIS, departments will be required to produce annual financial statements. The Auditor General notes that there are several issues that still need to be resolved before departments will be fully in a position to produce appropriate detailed financial statements.

The Treasury Board Secretariat will continue to work closely with the Office of the Auditor General and departments to ensure that meaningful departmental financial statements are produced.

Offsetting Canada Child Tax Benefit Disbursements Against Revenues ("Netting")

The Auditor General points out that the Government currently reports revenues and expenditures on a net basis. For budgetary purposes, there are a number of tax expenditures that are netted against revenues and a number of revenue items that are netted against spending. Netted against revenues are the Canada Child Tax Benefit (CCTB), the quarterly goods and services tax credit (GSTC) and repayments of Old Age Security benefits. Netted against spending are revenues of consolidated Crown corporations and revenues from levies charged by departments for specific services, such as the costs of policing services in provinces. This netting has no impact on the overall budgetary balance.

The Auditor General has recommended that the financial statements and the budget be prepared only on a gross basis. Of particular concern to the Auditor General is the CCTB, which is currently netted against personal income tax revenues. The Auditor General argues that this represents incomplete financial disclosure.

However, it is important to note that the Government already publishes this information in both the *Annual Financial Report of the Government of Canada* and the Public Accounts.

The "net" presentation is the appropriate approach for the budget because it is consistent with the way Parliament appropriates funds. Furthermore, programs like the CCTB and the quarterly GSTC are integral parts of the tax system – these programs are administered through the tax system. They are thus netted from tax revenues for budgetary purposes.

The Debt Servicing and Reduction Account

The Debt Servicing and Reduction Account (DSRA) was established by statute in June 1992. Under that legislation all GST revenues, net of applicable input tax credits, rebates and the low-income credit, along with the net proceeds from the sale of Crown corporations and gifts to the Crown explicitly identified for debt reduction, must be deposited into this Account. The funds in this Account are earmarked to pay interest on the public debt and, ultimately, to reduce the debt.

The Auditor General questions the need for this Account, given the fundamental concept of the Consolidated Revenue Fund (CRF). All revenues received by the Government must be deposited in the CRF and any disbursements from it must be authorized by Parliament.

Therefore, the specific revenues of the DSRA must be deposited in the CRF, and the public debt expenditures chargeable to the Account must be appropriated from it by Parliament. Since all of the information relating to the DSRA is already reported in other parts of the Government's financial statements, there appears to be limited usefulness in having a separate financial statement.

The House of Commons Standing Committee on Finance's recommendations for the 2000 budget included elimination of the DSRA.

Although all of the information relating to the DSRA is already reported in other parts of the Government's financial statements, as noted by the Auditor General, the Government believes that, at this time, the DSRA provides useful information to Canadians on the flow of GST revenues, gifts to the Crown and the net gains associated with the disposals of investments in Crown corporations. This information is enhanced through the presentation of a separate audited statement. As a result, the Government does not propose that any changes be made at this time.

Simplified and Useful Financial Statements – the *Annual Financial Report of the Government of Canada*

The Auditor General notes that the *Annual Financial Report of the Government of Canada* (AFR) should be revised so that it is more useful and understandable to a wider variety of users.

Upon the recommendations of the previous Auditor General and working closely with the Auditor General's staff, substantial improvements have been made to the AFR. In addition, a user survey was conducted following the release of the 1998-99 AFR.

Results of that survey, which were published in the 2000 budget, were generally very positive. The majority of respondents were "very satisfied" or "somewhat satisfied" with organization and content and felt that the AFR contained a sufficient amount of information.

As with all of its other publications, the Government will continue to ensure that the AFR is useful and understandable to a broad range of users.

Dictating Accounting Treatment in Legislation

The Auditor General has expressed concern that the legislative wording for the Canada Health and Social Transfer supplements appeared to be dictating the accounting treatment to be followed in the financial statements. As such, the Auditor General recommends that the applicable legislation should not stipulate the fiscal year to which such one-time payments apply.

The Government follows accounting policies based upon generally accepted accounting principles in the preparation of its financial statements. It therefore recognizes liabilities when they are incurred. Legislation does not dictate accounting treatment in the Government's financial statements.

Annex 7

Tax Measures: Supplementary Information and Notice of Ways and Means Motion

Table of Contents

Tax Measures: Supplementary Information

Overview

This annex provides detailed information on each of the tax measures proposed in this budget.

Table A7.1 lists those measures that are proposed to be legislated pursuant to the 2001 budget and provides estimates of their budgetary impact.

This annex also provides a detailed listing of measures that have been introduced since 1994 that enhance tax fairness and achieve economic and social objectives.

Finally, this annex provides a Notice of Ways and Means Motion to amend the Income Tax Act.

Table A7.1
Federal Revenue Impact of Proposed Measures

	2001-2002	2002-2003	2003-2004
	(millions of dollars)		
Personal Income Tax Measures			
Apprentice Vehicle Mechanics' Tools Deduction	–	-5	-10
Adult Basic Education – Tax Deduction for Tuition Assistance	-10	-5	-5
Extending the Education Tax Credit	–	-10	-20
Promoting Sustainable Woodlot Management	–	-5	-10
Donations of Certain Publicly Traded Securities to Charities[1]	–	-70	-70
Business Income Tax Measures			
Improvements to the Tax Incentives for Renewable Energy and Energy Efficiency	–	-5	-5
Deferral of Corporate Tax Instalments for Small Businesses	-2,000	2,000	–
Venture Capital – Partnerships	–	–	–
Construction Work Camps	–	-10	-10
Total	-2,010	1,890	-130

– Small, non-existent or prevents revenue loss.

[1] Measure announced prior to the budget.

Personal Income Tax Measures

Apprentice Vehicle Mechanics' Tools Deduction

Individuals employed as apprentice vehicle mechanics must typically provide their own tools for the on-the-job component of their apprenticeship. The cost of these tools is high in relation to their apprenticeship income and, consequently, can constitute a barrier to entering the trade.

The budget proposes to provide an income tax deduction for the extraordinary portion of the cost of new tools acquired by apprentice vehicle mechanics after 2001. To be eligible for this employee expense deduction, the tools must be acquired while the apprentice is registered with a provincial or territorial body in a program leading to designation as a mechanic licensed to repair automobiles, aircraft, or any other self-propelled motorized vehicles. Also, the apprentice's employer must certify that the tools are required as a condition of, and for use in, the apprenticeship.

The amount of the deduction will be the total cost of new tools acquired in a taxation year, less the greater of $1,000 and 5 per cent of the individual's apprenticeship income for the year. Any part of the eligible deduction that is not taken in the year in which the tools are acquired can be carried forward and deducted in subsequent taxation years.

The cost of the individual's tools for other income tax purposes will be the acquisition cost less the deductible portion of that cost. If an individual (or a non-arm's-length person) disposes of the tools for proceeds in excess of this reduced cost, the excess amount will be included in income in the year of disposition. However, tools will be eligible for the existing rollovers that apply to transfers of property to a corporation or a partnership.

Example

Alexandra, an apprentice vehicle mechanic, earns $25,000 as an apprentice in a year and spends $5,000 on new tools in the year. Alexandra's deduction is $3,750 ($5,000 – $1,250 [the greater of $1,000 and 5 per cent of $25,000]), representing a federal income tax savings of $600.

The individual will also be eligible for a rebate of the goods and services tax/harmonized sales tax paid on the portion of the purchase price of the new tools that is deducted in computing employment income.

These measures will apply to the 2002 and subsequent taxation years.

Adult Basic Education – Tax Deduction for Tuition Assistance

Basic education is primary or secondary level education or other forms of training that do not currently qualify for the tuition tax credit. Some adult students who take basic education to upgrade their skills receive direct financial assistance from governments to pay their tuition fees. This tuition assistance must be included in income, and the tuition fees do not qualify for any tax relief.

The budget proposes that individuals may deduct, in computing their taxable income, the amount of tuition assistance received for adult basic education that has been included in their income. In order to be eligible, the tuition assistance must be provided under:

- Part II of the Employment Insurance Act (or a similar program provided by a province or territory under a Labour Market Development Agreement); or
- another training program established under the authority of the Minister of Human Resources Development, such as the Employability Assistance for People with Disabilities initiative or the Opportunities Fund for Persons with Disabilities.

This measure will apply to eligible tuition assistance received after 1996. Administrative procedures will be established over the coming months to enable individuals who received eligible tuition assistance before 2001 to recover the income taxes paid, or to eliminate the income taxes owing, on these amounts.

Extending the Education Tax Credit

The education tax credit helps students defray non-tuition costs of post-secondary education and training, such as textbooks. The education amounts – the amounts used to calculate the education tax credit – were doubled in the October 2000 *Economic Statement and Budget Update* to $400 per month of full-time study and $120 per month of part-time study.

The education tax credit cannot currently be claimed by students who receive financial assistance for post-secondary education under government training programs. The budget proposes to extend access to the education tax credit to students who receive taxable assistance for post-secondary education under:

- Part II of the Employment Insurance Act (or a similar program provided by a province or territory under a Labour Market Development Agreement); or

- another training program established under the authority of the Minister of Human Resources Development, such as the Employability Assistance for People with Disabilities initiative or the Opportunities Fund for Persons with Disabilities.

This measure will apply to the 2002 and subsequent taxation years.

Promoting Sustainable Woodlot Management

Currently a taxpayer may make an intergenerational transfer of farm property in Canada on an income tax-deferred rollover basis, if the property was principally used in a farming business in which the taxpayer or a family member was actively engaged on a regular and continuous basis. Similar rules apply to intergenerational transfers of shares of family farm corporations and interests in family farm partnerships.

The operation of a commercial woodlot may, in certain circumstances, constitute a farming business. However, the intergenerational rollovers are generally not available for commercial woodlots because, aside from monitoring, the management of a woodlot may not demand regular and continuous activity. As a result, many commercial woodlot owners are currently subject to income tax on intergenerational transfers of their woodlots. This can be detrimental to the sound management of the resource if woodlots are harvested prematurely to pay the tax.

The budget proposes to facilitate intergenerational rollovers of commercial woodlot operations that are farming businesses. Where the regular and continuous activity test set out in the existing rollover rules cannot be met, a new test will be implemented strictly for the purpose of applying those rules to commercial woodlot operations. The new test will allow an intergenerational rollover where the conditions of the existing rollover rules are otherwise met and the transferor or a family member is actively involved in the management of the woodlot to the extent required by a prescribed forest management plan.

Specific criteria for prescribed forest management plans will be developed in consultation with interested parties. For transfers that occur before these criteria are developed and prescribed, it will be required that a plan exist providing for the necessary attention to a woodlot's growth, health, quality and composition.

This measure will apply to transfers that occur after December 10, 2001.

Donations of Certain Publicly Traded Securities to Charities

On October 12, 2001, the Government announced its intention to make permanent the 1997 budget measure that provides special tax assistance for donations of certain securities to public charities. This measure was originally scheduled to expire on December 31, 2001.

Under the measure, the amount included in the income of a donor for capital gains tax purposes arising from donations of eligible securities to public charities is one-half the amount included for other capital gains. Eligible securities are shares, debt obligations and rights listed on a prescribed stock exchange, shares of the capital stock of mutual fund corporations, units of mutual fund trusts, interests in certain segregated fund trusts, and prescribed debt of, or guaranteed by, Canada or a province. This measure has helped to significantly increase donations of securities over the past five years. Making it permanent will support the important work of charities in meeting the needs of Canadians.

The Government also proposes to make permanent the 2000 budget measure that reduces the tax on employment benefits in respect of donations of eligible securities acquired through stock option plans, to parallel the treatment for donations of eligible securities.

As previously announced, the Government intends to continue to work with the charitable sector to determine whether there is an appropriate and cost-effective basis for broadening this measure beyond its current application.

Goods and Services Tax Credit Responsiveness

The goods and services tax credit (GSTC) helps to offset the impact of the GST on low- and modest-income Canadians. The GSTC is paid quarterly over the 12-month period (the benefit year) beginning each July. Currently the GSTC is calculated on the basis of income and family information provided as of the end of the previous calendar year, six months before the beginning of the benefit year. As a result, the GSTC for a particular benefit year does not respond to changes in family circumstances that occur after the end of the previous calendar year. For GSTC purposes, changes in family circumstances include events such as births, deaths, marriages, reaching the age of 19 years, and becoming or ceasing to be resident in Canada.

The Government announced in the 1999 budget that the Department of Finance and the Canada Customs and Revenue Agency would work together to improve the responsiveness of the GSTC and streamline its administration. This budget confirms that, beginning with benefits payable for July 2002, an individual’s GSTC entitlement for a quarter will be based on the individual’s family circumstances at the end of the preceding quarter.

Business Income Tax Measures

Improvements to the Tax Incentives for Renewable Energy and Energy Efficiency

Under the capital cost allowance (CCA) regime, Class 43.1 describes certain renewable energy and energy efficiency equipment that qualifies for an accelerated CCA rate of 30 per cent. This class provides an incentive for new investments that will help Canada meet its environmental objectives.

Since Class 43.1 was introduced in the 1994 budget, the Government has expanded eligibility for this class on several occasions to further encourage investments in renewable energy and energy conservation projects.

The budget proposes to increase the upper limit on the size of small hydro-electric projects that qualify for Class 43.1 to a maximum annual rated capacity of 50 megawatts (MW), from the current limit of an annual average generating capacity of 15MW. This change will encourage investment in small hydro-electric projects, including new run-of-the-river projects, and complement provincial initiatives that have provided further opportunities for power producers to invest in small hydro-electric projects. The change will apply to property acquired after December 10, 2001.

Class 43.1 also includes property that is part of a system that generates electrical energy and that has a heat rate attributable to fossil fuel of less than 6000 BTU per kilowatt-hour of electrical energy generated by the system. It is proposed that “blast furnace gas”, which is a by-product of the steel manufacturing process, be included in the definition of fossil fuel. This change will encourage an energy efficient use of blast furnace gas by steel mills, and will be effective for property acquired after 2000.

Finally, because of rapid changes in technology in this area, the Government intends to consult with industry to determine whether additional improvements are required for this CCA class. In this context, the Government will also explore whether a more streamlined process could be implemented to determine new types of projects that would be eligible for Class 43.1.

Deferral of Corporate Tax Instalments for Small Businesses

Many small businesses are facing additional challenges as the economy has slowed. In order to provide a cash flow benefit to small corporations, the budget proposes to defer payment of their federal corporate tax instalments for the months of January, February and March 2002 for a period of at least six months, without payment of interest or the assessment of penalties.

Corporations will qualify for this instalment deferral if they are resident in Canada and did not have more than $15 million of taxable capital employed in Canada in the previous taxation year. A corporation that is considered for income tax purposes to be associated with other corporations will be eligible only if the taxable capital employed in Canada of all of the associated corporations did not exceed $15 million in the previous year. Both federal income and capital tax instalments will be deferred.

In respect of provinces that have a corporate tax collection agreement with the federal government, eligible corporations will also be able to defer their provincial income tax instalments for the same period. Provincial tax revenues will not be affected as the federal government pays provinces that have entered into tax collection agreements on an assessment basis, rather than on a collections basis.

Corporations must make their final payment of taxes owing for a taxation year two or three months after the end of that year (the balance-due day). To ensure that all small corporations effectively benefit from at least a six-month deferral of their January, February and March 2002 instalments, the balance-due day will be extended in circumstances where it would have otherwise occurred before a deferred instalment payment.

Also, to reduce administrative and compliance complexity, any deferred instalment payment that would otherwise be payable after year-end, but before the balance-due day for the year, will be due only on the balance-due day.

The following table sets out the schedule for the deferral of instalments and the deadline for making balance-due day payments.

Schedule for Deferred Tax Instalments and Balance-Due Day

Taxation Year-End	Instalments Deferred			Balance-Due Day (BDD)
	January 2002	February 2002	March 2002	
January 2002	Deferred to BDD	See January 2003 taxation year-end	See January 2003 taxation year-end	Extended to July 2002
February 2002	Deferred to BDD	Deferred to BDD	See February 2003 taxation year-end	Extended to August 2002
March 2002	Deferred to BDD	Deferred to BDD	Deferred to BDD	Extended to September 2002
April 2002	Deferred to BDD	Deferred to BDD	Deferred to BDD	Extended to September 2002
May 2002	Deferred to BDD	Deferred to BDD	Deferred to BDD	Extended to September 2002
June 2002	Deferred to BDD	Deferred to BDD	Deferred to BDD	Remains or extended to September 2002
July 2002	July 2002	Deferred to BDD	Deferred to BDD	Remains September or October 2002
August 2002	July 2002	August 2002	Deferred to BDD	Remains October or November 2002
September 2002	July 2002	August 2002	September 2002	Remains November or December 2002
October 2002	July 2002	August 2002	September 2002	Remains December 2002 or January 2003
November 2002	July 2002	August 2002	September 2002	Remains January or February 2003
December 2002	July 2002	August 2002	September 2002	Remains February or March 2003
January 2003	See January 2002 taxation year-end	August 2002	September 2002	Remains March or April 2003
February 2003	See February 2002 taxation year-end	See February 2002 taxation year-end	September 2002	Remains April or May 2003

Farm Credit Canada

Farm Credit Canada (FCC) is a federal Crown corporation that provides specialized financial services to farming operations. It is Canada's largest term lender to primary producers and small- to medium-sized agribusiness. Currently FCC is prescribed as one of the federal Crown corporations that is subject to federal income tax.

The budget proposes that, for taxation years that begin after December 10, 2001, FCC not be subject to federal income and capital taxes. This change will provide the same tax treatment for FCC as is provided for Export Development Corporation and the Business Development Bank of Canada, two other federal Crown corporations that provide specialized financial services.

Venture Capital – Partnerships

The budget proposes two measures to facilitate the use of limited partnerships by tax-exempt and foreign investors in structuring their venture capital investments.

Qualified Limited Partnerships

Currently a limited partnership structure may be unattractive to pension funds and other tax-exempt investors because interests in limited partnerships are generally treated as foreign property for the purposes of the income tax rules that limit the amount of foreign property that a deferred income plan can hold.

The Income Tax Regulations provide several exceptions to the characterization of limited partnership investments as foreign property, including an exception for qualified limited partnerships (QLPs). One of the conditions for eligibility as a QLP is that no limited partner, or non-arm's-length group of limited partners, may hold more than a 30-per-cent interest in the partnership. This ownership limitation has been identified as a potential impediment to venture capital investment by tax-exempt entities in Canada.

To remove this potential impediment, the budget proposes to eliminate the 30-per-cent ownership limitation for QLPs. Accordingly, a limited partnership may be a QLP even though a limited partner, either alone or as part of a non-arm's-length group, has more than a 30-per-cent ownership interest in the partnership. However, for the purpose of the foreign property rules, any limited partner or group that holds more than a 30-per-cent interest in a QLP will be treated as owning a proportionate interest of each property owned by the QLP, including any foreign property. An ownership interest of 30 per cent or less in a QLP will remain exempt from treatment as foreign property.

This measure will apply after 2001.

Use of Canadian Investment Managers

The budget also proposes to make it easier for non-residents who invest through partnerships to retain Canadian investment managers and advisors.

In general, Canada taxes non-residents on their income from sources in Canada, including income from carrying on a business in Canada. Section 115.2 of the Income Tax Act is an interpretive rule which ensures that, provided certain conditions are met, a "qualified non-resident" is not considered to be carrying on business in Canada solely because it engages a Canadian firm to provide certain investment management and administration services.

Currently a partnership is a "qualified non-resident" only if none of its members is resident in Canada. Thus a partnership that has some non-resident members cannot rely upon the assurance that section 115.2 provides. This lack of certainty has been identified as a potential impediment to venture capital investment in Canada.

The budget proposes to clarify how section 115.2 applies to partnerships and their members, and to enable the non-resident members of a partnership to avail themselves of the assurance provided by the section. First, the definition "qualified non-resident" will be changed so that it will no longer include a partnership, but will instead apply separately to each partner. Second, the rule will be changed to provide that a "qualified non-resident" is not considered to carry on business in Canada solely because a Canadian resident provides investment management and administration services to the non-resident or to a partnership of which the non-resident is a member. It should be noted that this assurance extends only to the non-resident partners: a partner who is resident in Canada is not a "qualified non-resident" and cannot benefit from section 115.2.

These changes to section 115.2 will apply to the 2002 and subsequent taxation years.

Construction Work Camps

Generally, only 50 per cent of otherwise deductible business expenses for meals or entertainment are deductible for income tax purposes. This limitation reflects the personal consumption element of these expenses. However, the 1998 budget introduced an exception to this rule to allow full deductibility for the reasonable cost of meals incurred by employers in respect of employees working at certain "semi-remote" work sites. In order to qualify under this exception, a work site must be at least 30 kilometres from the nearest urban area of at least 40,000 people, and the employee cannot be expected to return home daily.

This exception may not address situations where, given the large size and short duration of a construction project, the local infrastructure of an urban area having a population of more than 40,000 is insufficient to support a large temporary workforce. In such a case, employers may establish a temporary work camp to provide meals and accommodation at or near the construction site. The budget proposes to allow full deductibility for the cost of meals provided to an employee housed at a temporary work camp constructed or installed specifically for the purpose of providing meals and accommodation to employees working at a construction site. It will also be required that the employee cannot be expected to return home daily.

The goods and services tax/harmonized sales tax (GST/HST) follows the income tax rules in its treatment of meal expenses. Accordingly, 100 per cent of the GST/HST paid or payable by an employer on the cost of fully deductible meals provided at a qualifying construction work camp will be recoverable by the employer as input tax credits.

This measure will apply to expenses incurred after 2001.

Other Measures

First Nations Taxation

In each budget since 1997, the Government expressed its willingness to put into effect taxation arrangements with interested First Nations. To date, the Government has entered into taxation arrangements allowing seven First Nations to levy a tax on sales on their reserves of fuel, tobacco products and alcoholic beverages. In addition, personal income tax collection and sharing agreements have been entered into with the seven self-governing Yukon First Nations. The Government is once again expressing its willingness to discuss and to put into effect arrangements in respect of direct taxation with interested First Nations.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994 – 2001)

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

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.

2000 Budget

- Restored full indexation of the tax system.
- Reduced the middle tax rate from 26 per cent to 24 per cent.
- Eliminated the 5-per-cent deficit-reduction surtax for income up to about $85,000 and announced that the rate would be reduced to 4 per cent.
- Reduced the capital gains inclusion rate from three-quarters to two-thirds.
- Permitted a rollover of capital gains on the disposition of qualified small business investments.
- Allowed deferral of the income inclusion from exercising qualifying stock options until disposition.
- Reduced the general corporate income tax rate from 28 per cent to 27 per cent.
- Reduced the corporate tax rate on income between $200,000 and $300,000 earned by a Canadian-controlled private corporation from an active business carried on in Canada from 28 per cent to 21 per cent.

2000 Statement

- Reduced personal income tax rates:
  - lowered the 17-per-cent rate to 16 per cent;
  - lowered the 24-per-cent rate to 22 per cent;
  - lowered the 29-per-cent rate to 26 per cent on income between $61,509 and $100,000; and
  - eliminated the deficit-reduction surtax.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

General Tax Relief *(cont'd)*

- Reduced the capital gains inclusion rate from two-thirds to one-half.
- Expanded the rollover of capital gains on the disposition of qualified small business investments, with the amount of the rollover raised from $500,000 to $2 million and the size of business eligible for the rollover raised from $10 million to $50 million.
- Implemented the schedule for reducing the general corporate income tax rate to 21 per cent by 2004.
- Legislated to provide that by 2004:
  - the basic personal amount, the amount an individual can earn tax-free, will be at least $8,000;
  - the spousal amount will be at least $6,800;
  - the second bracket threshold will be at least $35,000;
  - the third bracket threshold will be at least $70,000; and
  - the fourth bracket threshold will be at least $113,804.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

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 a two-step $250-million enrichment of the Working Income Supplement (WIS) of the Child Tax Benefit (CTB).
- Replaced the seven-year limit by an unlimited carry-forward of unused registered retirement savings plan (RRSP) room.

1997

- Announced a new 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 from the $125 million announced in the 1996 budget to $195 million and restructured it 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.
- Enriched the CCTB by $300 million in July 2000 to enhance benefits for modest-and middle-income families.
- Ensured that the maximum goods and services tax credit (GSTC) supplement is provided to low-income single-parent families.
- Allowed greater flexibility to transfer RRSP and registered retirement income fund (RRIF) proceeds to financially dependent children upon the death of the RRSP/RRIF owner.

2000 Budget

- Introduced changes to the CCTB:
  - increased the CCTB base benefit by $70 per child in July 2000; and
  - increased the National Child Benefit (NCB) supplement by $200 per child in July 2001.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Families and Seniors *(cont'd)*

2000 Statement

- Introduced changes to the CCTB:
  - increased the NCB supplement by an additional $100 per child in July 2001; and
  - increased the income threshold at which the NCB supplement is fully phased out and the base benefit begins to be phased out to $32,000 in 2001.
- Legislated that by 2004:
  - the amount of family net income at which the CCTB phase-out begins will be at least $35,000; and
  - the phase-out rate of the base benefit of the CCTB will be reduced from 5 per cent to 4 per cent (from 2.5 per cent to 2 per cent for families with one child).

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Education and Skills

1996

- Increased the amount used to establish the education credit from $80 per month to $100 per month.
- Raised the annual limit on the transfer of the tuition 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 to an RESP, 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.

2000 Budget

- Increased the partial annual exemption from $500 to $3,000 for scholarship, fellowship or bursary income.

2000 Statement

- Doubled the amount used to establish the education credit from $200 per month to $400 per month for full-time students and from $60 per month to $120 per month for part-time students.

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

Education and Skills *(cont'd)*

Other 2000 Announcements

- Removed certain undue restrictions on the goods and services tax/harmonized sales tax (GST/HST) exemption for vocational training and extended the exemption to situations where the training is provided by a government department or agency.

2001

- Proposing measures to exempt from income tax government tuition assistance for adult basic education.
- Proposing to extend the education tax credit to individuals who receive taxable assistance for post-secondary education under certain government programs, including employment insurance.
- Proposing to allow apprentice vehicle mechanics to deduct a portion of tool expenses incurred as a condition of apprenticeship.

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

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.
- Provided a 100-per-cent GST rebate on books purchased by public libraries, educational institutions and other specified bodies.

1997

- Provided a half-inclusion rate on capital gains arising from donations made before 2002 of certain publicly traded securities.
- Raised the income limit for donations from 50 per cent to 75 per cent.
- Allowed 25 per cent of capital cost allowance (CCA) recapture of donated property to be included 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/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.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Tax Assistance for Charities and Public Institutions *(cont'd)*

2000 Budget

- Reduced tax on employment benefits in respect of donations of shares acquired through stock option plans to parallel treatment for donations of certain publicly traded securities.
- Extended the charitable donations tax credit to donations of RRSP, RRIF and insurance proceeds that are made as a consequence of direct beneficiary designations.
- Reduced capital gains income inclusion by one-half in respect of gifts of ecologically sensitive land and related easements, covenants and servitudes.

2001

- Proposing to make permanent the measure providing a half-inclusion rate on capital gains arising from donations of certain publicly traded securities to public charities.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Persons With Disabilities

1996

- Enriched the tax credit for infirm dependants.
- Expanded zero-rating of orthopaedic and orthotic devices under the GST.
- Extended GST relief on purchases of vehicle modifications necessary for people with disabilities.

1997

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

1998

- Introduced a new tax credit for caregivers for in-home care of related seniors and persons with disabilities.
- Extended the Home Buyers' Plan to persons with disabilities.
- Added training expenses for caregivers to the list of expenses eligible for the medical expense tax credit.
- Allowed certification for the disability tax credit (DTC) by occupational therapists and psychologists.
- Exempted respite care services from the GST/HST.

1999

- Expanded the medical expense tax credit.

2000 Budget

- Extended eligibility for the DTC to individuals requiring extensive therapy.
- Expanded the list of relatives to whom the DTC can be transferred.
- Provided additional tax assistance for families caring for children with severe disabilities by introducing a $2,941 supplement for children eligible for the DTC.
- Increased the maximum child care expense deduction available in respect of persons eligible for the DTC from $7,000 to $10,000.
- Extended income tax assistance for expenses relating to the costs of adapting a new home to the needs of a disabled person.
- Expanded the attendant care deduction to include the cost of an attendant required in order to attend school.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Persons With Disabilities *(cont'd)*

2000 Statement

- Increased the DTC amount from $4,293 to $6,000 effective January 1, 2001.
- Increased the caregiver tax credit amount from $2,386 to $3,500 effective January 1, 2001.
- Increased the infirm dependant tax credit amount from $2,386 to $3,500 effective January 1, 2001.
- Increased the amount for the supplement to the DTC for children with severe disabilities from $2,941 to $3,500 effective January 1, 2001.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

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.

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

Personal Income Tax Measures to Better Target Tax Preferences *(cont'd)*

1999

- Introduced a measure 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.
- Introduced special rules for the treatment of retroactive lump-sum payments.
- Provided more equitable treatment of income earned by communal organizations.

2000 Budget

- Reduced the federal surtax on income not earned in a province from 52 per cent of basic federal tax to 48 per cent.
- Removed the $1,000 deemed adjusted cost base and proceeds of disposition for personal-use property acquired as part of an arrangement in which the property is donated.

2000 Statement

- Provided one-time relief for heating expenses of $125 for individuals and $250 for families eligible for the GST credit for January 2001.
- Introduced a temporary federal investment tax credit at a rate of 15 per cent for mineral exploration expenses incurred in Canada pursuant to a flow-through share agreement.

2001

- Proposing to extend the existing intergenerational income tax-deferred rollover for farm property to commercial woodlots.

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

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 capital tax surcharge on 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.

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

Business Income Tax Measures to Better Target Tax Preferences *(cont'd)*

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.

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 the 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

- Extended the capital tax surcharge on large deposit-taking institutions.
- Ensured that electricity generating activities are taxed equitably.
- Clarified the tax status of non-resident funds that retain Canadian service providers.
- Updated rules governing LSVCCs to ensure consistency with provincial programs and address issues relating to corporate restructuring.
- Improved CCA rules to encourage the productive use of flare gas.

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

Business Income Tax Measures to Better Target Tax Preferences *(cont'd)*

2000 Budget

- Modified the thin capitalization rules to work more effectively.
- Repealed the non-resident-owned investment corporation provisions.
- Modified the treatment of provincial deductions for SR&ED that exceed the actual amount of the expenditure.
- Clarified the treatment of weak currency borrowing as equivalent to a direct borrowing in the currency that is used by the taxpayer to earn income.
- Clarified foreign tax credit rules and rules regarding the deductibility of foreign exploration and development expenses.
- Extended the manufacturing and processing (M&P) tax credit to corporations that produce, for sale, steam for uses other than the generation of electricity.
- Proposed adjustments to improve the CCA system for certain rail assets; M&P equipment; certain electrical generating equipment; and heat/water production and distribution equipment.

2000 Statement

- Allowed self-employed individuals to deduct the portion of Canada Pension Plan and Quebec Pension Plan contributions representing the employer's share, beginning January 2001.

2001

- Proposing to defer the January, February and March 2002 corporate tax instalments for small businesses.
- Proposing to expand the class of renewable energy and energy efficient equipment eligible for accelerated depreciation.
- Proposing to remove tax-related impediments to venture capital investment in Canada through the use of partnerships by Canadian pension plans and by foreign investors.
- Proposing to allow full deductibility of meals provided at temporary construction work camps.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Sales and Excise 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 under the GST/HST for direct sellers.

1999

- Introduced a GST/HST rebate for multi-employer pension plans to provide comparable sales tax treatment relative to single-employer pension plans.

2000 Budget

- Introduced a new export distribution centre program to relieve the GST/HST cash-flow burden.
- Introduced a GST rebate, equal to 2.5 percentage points of tax, for newly constructed, substantially renovated or converted residential rental accommodation not eligible for an existing rebate.
- Reduced the annual exemption from the excise tax on tobacco exports from 2.5 per cent to 1.5 per cent of production.

Other 2000 Announcements

- Expanded the GST/HST new housing rebate to include bed and breakfast establishments.
- Enabled a person to return purchased real property to the vendor within one year of purchase and recover the tax paid under the original contract.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Sales and Excise Tax Measures to Better Target Tax Preferences *(cont'd)*

2001

- Proposed adding industrial hemp seed to the list of tax-free agricultural products under the GST/HST.
- Proposed adding a blood substitute product known as plasma expander to the list of tax-free goods under the GST/HST.
- Proposed the removal of the GST/HST group relief exemption for clearing and settlement services supplied outside a closely related group of corporations in the financial services sector.
- Proposed the removal of ships' stores excise tax relief for certain vessels, and a compensating temporary fuel tax rebate.
- Proposed a new tobacco tax structure, including a two-tiered export tax regime for exported Canadian tobacco products.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2001)

Simplifying and Improving Tax Administration and Enforcement

1994-97

- Strengthened outreach and education programs.
- Enhanced easy-to-understand automatic telephone information systems.
- Met with special tax filer 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.
- Implemented 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.
- Implemented exchange of information provisions to help deal with tax havens.
- Implemented 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

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

Measures to Enhance Tax Fairness and
Achieve Economic and Social Objectives (1994-2001)

Simplifying and Improving Tax Administration and Enforcement *(cont'd)*

2000 Budget

- Authorized the Minister of National Revenue to obtain judicial authorization, in certain circumstances, to take immediate action to protect GST/HST revenues.
- Allowed the Canada Customs and Revenue Agency to provide relevant taxpayer information to the police for investigation purposes.
- Extended tax penalties to persons who interfere with an official performing a collection duty.

Other 2000 Announcements

- Empowered the Minister of National Revenue to waive or cancel interest, or a penalty calculated in the same manner as interest, that is otherwise payable under the non-GST/HST portions of the Excise Tax Act.
- Refined the rules related to the electronic filing of GST/HST returns by removing the requirement to apply to the Minister of National Revenue for approval, provided established criteria are satisfied.

2001

- Proposed to institute a new procedure to revoke or deny registered charitable status for charities that support terrorist activities.
- Proposed to improve the responsiveness of the GST credit effective July 2002.
- Proposed a new legislative and administrative framework for the taxation of spirits, wine and tobacco.

Notice of Ways and Means Motion

Notice of Ways and Means Motion to Amend the Income Tax Act

That it is expedient to amend the *Income Tax Act* to provide among other things:

Apprentice Vehicle Mechanics' Tools

(1) That, for the 2002 and subsequent taxation years,

(a) there may be deducted, in computing the income of an individual from employment in the year as an apprentice mechanic registered in a provincial program leading to designation as a mechanic licensed to repair self-propelled motorized vehicles, an amount not exceeding the lesser of the individual's deductible tool costs for the year and the amount that would otherwise be determined under section 3 of the Act to be the individual's income for the year;

(b) where the individual's deductible tool costs for a taxation year exceed the amount deducted in respect of those costs for the year, the excess be available for deduction in computing the individual's income from employment for subsequent taxation years; and

(c) for the purposes of this paragraph and paragraph (2), the individual's deductible tool costs for a taxation year be the amount, if any, by which

(i) the total cost of new tools and ancillary equipment that are acquired by the individual at a time in the year when the individual is under the apprenticeship, and that are certified by the individual's employer to be required as a condition of, and for use in, the apprenticeship

exceeds

(ii) the greater of $1,000 and five per cent of the individual's income for the year from the apprenticeship.

(2) That, where the cost of a property is included in computing an individual's deductible tool costs for a taxation year,

(*a*) for all other purposes of the Act, the individual's cost of all such property acquired in the year be reduced pro rata by the individual's deductible tool costs for the year; and (*b*) where the property is disposed of by the individual (or by a person with whom the individual does not deal at arm's length or that acquired the property from any such person in a transaction to which subsection 85(1) or 97(2) of the Act applied), the amount by which the proceeds of disposition exceed the cost of the property, as adjusted by subparagraph *(a)*, be included in computing the income for the year of disposition of the individual or of the person, as the case may be.

Adult Basic Education

(3) That, for the 1997 and subsequent taxation years, there be deducted in computing an individual's taxable income for the year an amount that

(a) is received by the individual in the year under a program referred to in subparagraph 56(1)(*r*)(ii) or (iii) of the Act, a program established under the authority of the *Department of Human Resources Development Act* or a prescribed program;

(b) is assistance for the payment of tuition fees of the individual that do not qualify for the tuition fee credit;

(c) is included in computing the individual's income; and

(d) is not otherwise deductible in computing the individual's taxable income.

Education Tax Credit

(4) That, for the 2002 and subsequent taxation years, financial assistance included in computing an individual's income and received under a program referred to in subparagraph 56(1)(*r*)(ii) or (iii) of the Act, a program established under the authority of the *Department of Human Resources Development Act* or a prescribed program not affect the individual's eligibility for the education tax credit.

Promoting Sustainable Woodlot Management

(5) That

(*a*) subsections 70(9) and 73(3) of the Act, which provide rollover treatment for certain inter-generational transfers of farm property, be modified with respect to transfers made after December 10, 2001 of property used principally in a woodlot farming business by requiring, as an alternative to the condition that certain individuals be actively engaged in the business on a regular and continuous basis, that they be engaged in the business to the extent required by a prescribed forest management plan; and

(*b*) amendments be made to the definitions "interest in a family farm partnership" and "share of the capital stock of a family farm corporation" in subsection 70(10) of the Act to provide comparable treatment under subsections 70(9.2) and 73(4) of the Act.

Donations of Publicly Traded Securities

(6) That

(*a*) the reduced capital gains inclusion rate provided under paragraph 38(a.1) of the Act in respect of certain donations apply to such donations made after 2001; and

(*b*) the deduction provided in computing taxable income under paragraph 110(1)(*d*.01) of the Act in respect of certain donations of securities apply to such donations of securities acquired after 2001.

GSTC Responsiveness

(7) That an eligible individual's goods and services tax credit payment for a quarter that begins after June 2002 be calculated taking into account the individual's relevant family circumstances at the end of the preceding quarter.

Deferral of Corporate Tax Instalments for Small Businesses

(8) That the Act be amended to provide

(*a*) that, where a corporation is an eligible corporation (as described in subparagraph (*c*)) for a taxation year and the taxation year includes one or more days in January, February or March, 2002 (in this paragraph referred to as the corporation's "eligible instalment days") on which an instalment on account of the corporation's tax under any of Parts I, I.3, VI and VI.1 of the Act in respect of the taxation year would otherwise become due, the corporation's balance-due day for the taxation year be the later of

(i) the day that would otherwise be the corporation's balance-due day for the taxation year, and

(ii) the day that is six months after the corporation's last eligible instalment day in the taxation year;

(*b*) that if an instalment on account of an eligible corporation's tax under any of Parts I, I.3, VI and VI.1 of the Act, in respect of a particular taxation year of the corporation, would otherwise become due on an eligible instalment day of the corporation, that instalment not become due on that day, but instead become due

(i) if the particular day that is six months after the eligible instalment day is in the particular taxation year, on the particular day, and

(ii) in any other case, on the corporation's balance-due day (determined in accordance with subparagraph (*a*)) for the particular taxation year; and

(*c*) that a corporation be an eligible corporation for a particular taxation year if the corporation is resident in Canada throughout the particular taxation year and the corporation's taxable capital employed in Canada, within the meaning assigned by Part I.3 of the Act, for its preceding taxation year did not exceed

(i) where the corporation is not associated with any other corporation in the particular taxation year, $15 million, and

(ii) where the corporation is associated with one or more other corporations in the particular taxation year, the amount by which $15 million exceeds the total of the taxable capital employed in Canada of all those other corporations for their last taxation years that ended in the last calendar year that ended before the beginning of the particular taxation year.

Qualified Limited Partnerships

(9) That, in applying the provisions of the Act relating to the foreign property limit after 2001, any person that holds, either alone or as part of a group of persons that do not deal with each other at arm's length, more than 30 per cent of the limited partnership units in a qualified limited partnership be deemed to hold, instead of those units, a proportion of each property of the partnership that is equal to the proportion of those limited partnership units actually held by that person.

Use of Canadian Investment Managers

(10) That, for the 2002 and subsequent taxation years, section 115.2 of the Act, which ensures that the provision by a Canadian service provider of designated investment services to a qualified non-resident does not, by itself, cause the non-resident to be considered to be carrying on business in Canada, be amended so that the provision of such services to a partnership does not, by itself, cause a non-resident member of the partnership to be considered to be carrying on business in Canada.

Construction Work Camps

(11) That an exception to section 67.1 of the Act be introduced to allow full deductibility of business expenses incurred after 2001 for meals provided to a taxpayer's employee at a work camp if

(*a*) the duties of the employee are performed at a site in Canada at which the taxpayer carries on construction activities;

(*b*) the site is a special work site, described in subparagraph 6(6)(*a*)(i) of the Act, to the employee;

(*c*) the employee is lodged at the work camp for the purpose of performing duties at the site; and

(*d*) the camp is a temporary facility that is constructed or installed for the purpose of providing meals and lodging to employees performing duties at the site.

Annex 8

Air Travellers Security Charge: Supplementary Information and Notice of Ways and Means Motion

Supplementary Information

Air Travellers Security Charge

The budget proposes to introduce an Air Travellers Security Charge to fund the new air security expenditures. The charge will be paid by air travellers – the primary users of the enhanced air security measures.

The Air Travellers Security Charge will apply in respect of emplanements in Canada, other than emplanements on connecting flights. The application and rate of the charge will depend on where the airline ticket is purchased and the location of the travel – that is, whether it is domestic, transborder or other international travel. For this purpose, "transborder" travel refers to travel between Canada and the continental U.S. (that is, not including Hawaii), or the Islands of St. Pierre and Miquelon, that does not include any other international travel. The rate of the charge for transborder travel takes into account that U.S. taxes also apply.

The total cost of the security charge indicated below represents the combined amount of the security charge and any applicable goods and services tax (GST), or federal portion of the harmonized sales tax (HST). Where the GST/HST applies to air travel, that tax will be calculated on the total cost of the travel, including the Air Travellers Security Charge. The GST/HST applies to passenger air travel that is wholly within Canada and to transborder travel that originates in Canada. The GST/HST does not apply to other international passenger air travel.

Air Travel Purchased in Canada

If the air travel is purchased in Canada, the Air Travellers Security Charge will be payable by the purchaser and collected by the air carrier or its agent at the time of payment for the air travel.

The Air Travellers Security Charge will apply to purchases in Canada that include air travel occurring on or after April 1, 2002 for which payment is made on or after that date. In this case, the total cost of the charge, including the GST (or federal portion of the HST) where applicable, will be as follows:

- For travel wholly within Canada – $12 per emplanement, to a maximum of $24 per ticket (for example, $12 for a one-way trip with no stopovers and $24 for a round trip).
- For transborder travel – $12 per emplanement in Canada, to a maximum of $24 per ticket for two or more emplanements in Canada.
- For travel from Canada to another international destination (including such travel involving connections or stopovers in the U.S.) – $24.

Air Travel Purchased Outside Canada

If the air travel is purchased outside Canada, the Air Travellers Security Charge will be payable by the passenger at the time of emplanement at a Canadian airport on a flight leaving Canada, unless the air carrier or its agent has collected the charge at the time of the ticket purchase and evidence of the payment is submitted by the passenger at the time of emplanement.

The security charge will apply to purchases made outside Canada for which payment is made on or after April 1, 2002 for air travel that includes an emplanement in Canada after May 31, 2002. In this case, the total cost of the charge will be as follows:

- For transborder travel – $12 per emplanement on a flight leaving Canada, to a maximum of $24 per ticket if it includes more than one emplanement on a flight leaving Canada.
- For other international travel, including such travel involving connections or stopovers in the U.S. – $24.

Additional Information

Passenger air transportation services provided on aircraft with a maximum certified take-off weight of not more than 2730 kilograms will be exempt from the Air Travellers Security Charge. Exemptions will also be provided for certain other specialty air services, such as air ambulances.

The Air Travellers Security Charge will be implemented under a new statute. The Minister of National Revenue will be responsible for the administration and enforcement of that Act, which will be carried out by the Canada Customs and Revenue Agency (CCRA).

Air carriers that collect the security charge will be required to be registered for purposes of the new Act, and to account for and remit the charges collected to the CCRA. The Act will provide for all necessary collection, enforcement and appeal mechanisms.

Examples

The table below provides examples of the total cost of the Air Travellers Security Charge for selected domestic, transborder and international travel, including GST (or the federal portion of the HST) where applicable.

Air travel ticket	Total cost of security charge
Edmonton – Winnipeg, one-way	$12
Montreal – Calgary, return	$24
St. John’s – Toronto, one way via connection in Halifax	$12
Ottawa – Washington, return	$12
New York – Toronto, return	$12
Vancouver – Tokyo	$24
Ottawa – New York – Athens	$24

Notice of Ways and Means Motion

Notice of Ways and Means Motion to Introduce an Act to Implement an Air Travellers Security Charge

That it is expedient to introduce an Act to implement an Air Travellers Security Charge and to provide among other things:

(1) That every person who acquires in Canada from an air carrier an air transportation service that includes transportation provided on or after April 1, 2002 and for which consideration is paid or becomes payable on or after that day be required to pay to Her Majesty in right of Canada a charge in respect of the service at the time the consideration is paid or becomes payable, whichever is earlier.

(2) That every person who, on or after June 1, 2002, emplanes in Canada on an aircraft used in the transportation of the person to a destination outside Canada that is part of an air transportation service acquired outside Canada for which consideration is paid or becomes payable on or after April 1, 2002 be required to pay to Her Majesty a charge in respect of the service at the time of the emplanement.

(3) That an air transportation service not be subject to the Air Travellers Security Charge if

(a) all of the transportation included in the service is

(i) provided on aircraft whose maximum certified take-off weight does not exceed 2,730 kg,

(ii) provided on aircraft referred to in subsection 56(1) of the *Canada Transportation Act*, or

(iii) listed in, or prescribed under, subsection 56(2) of the *Canada Transportation Act*; or

(b) the service is a prescribed service.

(4) That an air transportation service be defined as all of the transportation of a person by air for which a single ticket is issued and that includes an emplanement in Canada.

(5) That an emplanement be defined as an embarkation on an aircraft, other than an embarkation

(a) for the purpose of transferring to a connecting flight; or

(b) that results from the provision of emergency or ground services.

(6) That the continental zone be defined as Canada, the United States (except Hawaii) and the Islands of St. Pierre and Miquelon.

(7) That, where an air transportation service is acquired in Canada, the Air Travellers Security Charge in respect of the service be equal to:

(a) $11.22 for each emplanement in Canada included in the service, to a maximum of $22.43, if

(i) the service does not include transportation to a destination outside the continental zone, and

(ii) tax under subsection 165(1) of the *Excise Tax Act* is required to be paid in respect of the service;

(b) $12.00 for each emplanement in Canada included in the service, to a maximum of $24.00, if

(i) the service does not include transportation to a destination outside the continental zone, and

(ii) tax under subsection 165(1) of the *Excise Tax Act* is not required to be paid in respect of the service; or

(c) $24.00, if the service includes transportation to a destination outside the continental zone.

(8) That, where an air transportation service rendered to a person is acquired outside Canada, the Air Travellers Security Charge in respect of the service be equal to:

(a) $11.22 for each emplanement in Canada on an aircraft used to transport the person to a destination outside Canada but within the continental zone, to a maximum of $22.43, if

(i) the service does not include transportation to a destination outside the continental zone, and

(ii) tax under subsection 165(1) of the *Excise Tax Act* is required to be paid in respect of the service;

(b) $12.00 for each emplanement in Canada on an aircraft used to transport the person to a destination outside Canada but within the continental zone, to a maximum of $24.00, if

(i) the service does not include transportation to a destination outside the continental zone, and

(ii) tax under subsection 165(1) of the *Excise Tax Act* is not required to be paid in respect of the service; or

(c) $24.00, if the service includes transportation to a destination outside the continental zone.

(9) That an air carrier from whom an air transportation service is acquired in Canada be required to collect, as agent of Her Majesty, the Air Travellers Security Charge payable in respect of the service.

(10) That an air carrier on whose aircraft a person is transported from Canada to a destination outside Canada as part of an air transportation service acquired outside Canada be required to collect, as agent of Her Majesty, the Air Travellers Security Charge payable in respect of the service.

(11) That any person who collects an amount as or on account of the Air Travellers Security Charge in respect of an air transportation service be required to remit the amount to Her Majesty.

(12) That, if the Air Travellers Security Charge that an air carrier is required to collect at the time of an emplanement has been collected by another air carrier, the other air carrier be required to account for the charge and remit it to Her Majesty.

(13) That any air carrier that is required to collect the Air Travellers Security Charge be required to be registered for the purposes of the Act implementing the charge and to file returns accounting for amounts collected by the carrier as or on account of the charge in the prescribed form and manner and within the time provided to do so.

(14) That every air carrier that is required to collect the Air Travellers Security Charge and that fails to do so be made liable to Her Majesty for the amount of the charge.

(15) That authority be provided to impose interest or penalty in respect of any failure of a person to pay, collect or remit an amount as and when required under the Act implementing the Air Travellers Security Charge.

(16) That authority be provided to impose penalties on any person that fails to comply with any provision of the Act implementing the Air Travellers Security Charge.

(17) That all necessary administrative, assessment, collection, refund, enforcement and appeal provisions be enacted to enable the administration and enforcement of the Act implementing the Air Travellers Security Charge.

(18) That authority be provided for the Governor in Council to make regulations

(a) prescribing anything that, by the Act implementing the Air Travellers Security Charge, is to be prescribed or is to be determined or regulated by regulation; or

(b) generally to carry out the purposes and provisions of that Act.