Takin' Care of Business:
The Impact of Deficit Reduction on the Trade Sector

On 27 February 1995, the federal government released its budget for the fiscal year 1995-96 with a projected deficit of $32.7 billion. In 1994-95, the deficit was $37.9 billion. The goal of the government is to reduce its shortfall to 3% of GDP (about $24.3 billion) by 1996-97. While there has been much public discussion regarding the merits of deficit reduction in Canada, and financial markets have periodically drawn international attention to the issue, comparatively little attention has been paid to the effects of deficit reduction on the trade sector. This Commentary will focus on the (mostly indirect) effects of deficit reduction -- and government debt reduction -- on the trade sector.

The Deficit and Debt in Perspective

In Canada, total government expenditures have exceeded total government revenues since 1975. Over the last 20 years, federal government spending has consistently exceeded federal government revenues, and, taken together, the provinces have spent more than they have collected in all but two years (1978 and 1988). At the federal level, the deficit reached $32.7 billion in 1993.[1] The total provincial deficit has grown markedly in recent years, from $4.5 billion in 1990 to $17.2 billion in 1993. The total government deficit (including federal, provincial and municipal levels) was close to 7% of Gross Domestic Product in 1993.

The OECD estimates that, in 1993, the structural, or non-cyclical, component of Canada's total government deficit was 4.5% of potential GDP.[2] The structural component of a deficit is that portion that is not associated with a temporary cyclical downturn in economic activity, when government expenditures typically increase and government revenues typically decline. This structural component is considered a

---

[1] This is on a national accounts basis. See Statistics Canada, *Canadian Economic Observer*, Statistics Canada, December 1994, table 3. Data released in budget documents are on a public accounts basis. National accounts are reported for calendar years, while public accounts are reported for fiscal years. In addition, national accounts data are meant to capture all government transactions, including those outside the budget such as Canada and Quebec pension plans.

[2] Potential GDP is the level of production sustainable at normal rates of capacity utilization and employment of labour. When actual output is below potential output, as is the case during a cyclical downturn, an output gap is said to exist. The OECD estimates that, in 1993, Canada's output gap was 4.4% of potential output. See OECD, *Economic Outlook*, No. 56, OECD, Paris, December 1994, pp. 34, A33.