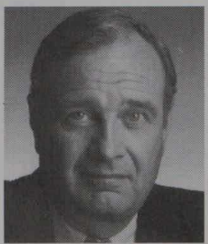
THE CANADIAN EXPERIENCE IN REDUCING BUDGET DEFICITS AND DEBT



Excerpts from a speech by Paul Martin, Canada's Minister of Finance, to the Federal Reserve Bank of Kansas City Symposium on "Budget Deficits and Debt: Issues and Options," in Jackson Hole, Wyoming, September 1, 1995

The growth of debt since the mid-70s has coincided not only with the maturation of the modern welfare state but also with the great productivity slowdown in all of the advanced economies. In this regard, Canada's situation has much in common with most G-7 countries.

....as we headed into the 1981-82 recession, (federal government) debt was a manageable 30 per cent of GDP. Five years later, the ratio had climbed over 50 per cent and warning lights had begun to flash. With the last recession, it jumped again, from about 55 per cent of GDP in 1989-90 to approximately 73 per cent today....

We entered the 1993 election campaign with a commitment to ultimately balance the budget and a very specific interim target to reduce the deficit to 3 per cent of GDP by 1996-97. While some have considered this to be an insufficiently ambitious target, the reality is that Canada's federal deficit has exceeded $4^1/_2$ per cent of GDP virtually every year since 1976 and the resulting accumulation of debt made hitting the 3 per cent target in 1996-97—down from about 6 per cent in 1993-94—a really significant challenge....

I would emphasize that 3 per cent is an interim target on the way to a balanced budget....it can be argued that an even more fundamental objective in strictly economic terms is to put the debt-to-GDP ratio on a steady downtrend....

We have already made a great deal of fiscal progress.

■ ...spending cuts and some very limited revenue measures will total C$29 billion over the three years through fiscal 1997-98. To put that figure in a U.S. context, it would be equivalent to roughly US$210 billion of action over the same period.

■ The fiscal savings will come overwhelmingly from spending cuts—they will outweigh tax increases by a ratio of 7 to 1....

■ Program spending by 1996-97 will be 10 per cent lower than in 1993-94. In fact, Canada is the only member of the G-7 to budget an absolute decline in program spending.

■ By 1996-97, the 3 per cent deficit target will be met and our market borrowing requirement...will be down to 1.7 per cent of GDP, projected to be the lowest among central governments of G-7 countries.

■ The operating surplus is forecast to be 3.6 per cent of GDP (C$30 billion) by 1996-97. Most significantly, this will be sufficient to finally begin cutting the debt ratio....

The foundations for fiscal recovery are already solidly in place.

These facts and figures tell only part of the story....More fundamentally, we have sought to change permanently the structure of federal government spending. Since our fiscal problem is structural, our remedies must be structural as well....

We have developed a comprehensive game plan to address the underlying issues, focusing primarily on promoting productivity growth while working to correct aspects of the labour market that have caused Canada's core unemployment rate to roughly double over the past 20 years....

For example, it was clear to us that many long-standing business subsidies were in fact hurting our productivity and competitiveness. So in last February's budget we cut total subsidies to business by 60 per cent over the next three years...

We realized that many features of Canada's unemployment insurance system were impeding rather than promoting the efficient function of our labour market. So we are taking significant steps to transform unemployment insurance—with emphasis on getting the incentives right and on active measures to help the long-term jobless.

We also took a hard look at federal transfer payments to the provinces, which this year will account for almost 23 per cent of program spending.

...to give the provinces greater flexibility we will convert the present cost sharing of social assistance payments into part of a larger block grant....the new block-funded transfer will still require provinces to respect certain nation-wide principles, particularly in respect of health care delivery but also in the social assistance domain....

The 1995 budget also announced significant reductions in spending by federal departments and agencies. As a result, departmental outlays by 1997-98 will be close to 20 per cent lower (in absolute dollar terms) than last fiscal year; the public service will be reduced by about 15 per cent or roughly 45,000 positions; and several activities, notably in the transport sector, will be privatized or commercialized.

...the principal elements of our budget strategy were:

■ First, to set two-year rolling deficit targets backed-up by an ironclad political

Unless otherwise noted, all figures are in Canadian dollars. The official noon exchange rate on October 4 was US$1= C$1.3308.

October Referendum on Quebec Sovereignty

On September 7, the Parti Québécois government of Quebec introduced sovereignty legislation in the National Assembly and released the question for a referendum to be held on October 30:

Do you agree that Quebec should become sovereign after having made a formal offer to Canada for a new economic and political partnership, within the scope of the bill respecting the future of Quebec and of the agreement signed on June 12, 1995?

The question refers to an agreement between the leaders of the Parti Québécois, the Bloc Québécois (the official Opposition in the Canadian Parliament) and a new provincial party, Action Démocratique, which calls for sovereignty coupled with an offer from Quebec to Canada to negotiate an economic and political association.