

By virtually any means of comparison, the Canadian fiscal position is among the weakest of all industrialized countries. Within the G-7, only Italy and the U.K. have higher deficits as a share of GDP, and only Italy has a higher gross public debt as a share of GDP.⁷ Summing corporate and government debt, Canada has the highest level of net foreign indebtedness relative to GDP (at about 40%) of all the G-7 countries.⁸ As a reflection of the tendency to rely on foreign savings, the Canadian current account deficit relative to GDP is also the highest of the G-7 (see Annex).⁹

What Does Deficit Reduction Mean for Trade?

Given the magnitudes of the Canadian debt and deficit, particularly in a relative international context, it is reasonable to assume that they must have significant negative effects on the domestic economy, including the trade sector. Indeed, both the Canadian public and international financial markets have reached that conclusion, and there is now some urgency attached to the need for government to address its fiscal position. The 1995-96 Budget is evidence of the federal government's commitment to carrying out the necessary measures to improve its fiscal record and enhance the macroeconomic environment simultaneously. The specific impact on the trade sector will be largely indirect, but positive nonetheless.

Reduction in Imports

There are two ways to improve the trade balance -- reduce imports and increase exports. Deficit (and government debt) reduction can do both. By stimulating aggregate demand through an increase in public-sector consumption, a deficit can increase imports and cause a deterioration in the trade balance.¹⁰ Due to the openness of the Canadian economy, and the fact that present Canadian deficits are

Ottawa, Winter 1994-95, pp. 45-7.

⁷ See OECD, *op. cit.*, pp. A32, A36. Some fiscal comparisons among G-7 countries are available in this Commentary's Annex.

⁸ No other G-7 country's net international indebtedness is even half as large as a share of GDP. See Annex.

⁹ See Department of Finance, *Canada's Economic Challenges*, Ottawa, January 1994, pp. 43-4.

¹⁰ See N. Bruce and D. Purvis, "Consequences of Government Budget Deficits", in *Fiscal and Monetary Policy*, Royal Commission on the Economic Union and Development Prospects for Canada, University of Toronto Press, Toronto Ontario, 1986, p. 59.