Budget 1995

February 1995

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Department of Finance Canada | Ministère des Finances Canada

Canada

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1995 Budget: Key Actions and Impacts

- Key interim deficit target met: 3 per cent of GDP by 1996-97 – $24.3 billion
- Debt-to-GDP ratio – size of debt relative to the economy – begins to decline in 1996-97
- Three-year savings of $29 billion; $25.3 billion from expenditure cuts
- Almost $7 in expenditure reductions for every $1 in new tax revenues
- No increases in personal income tax rates
- Dramatic cuts in departmental budgets – some halved in three years
- Smaller public service – 45,000 fewer positions
- Major reform of programs: agriculture, transport
- Business subsidies cut 60 per cent
- Programs merged, consolidated, commercialized
- Increased cost recovery, including $975 immigration fee per adult immigrant
- New Canada Social Transfer to provinces in 1996-97
- Unemployment insurance reform intended to be in place July 1, 1996
- Course charted for public pension system reform
- Tax fairness improved: tighter rules for tax deferrals, foreign and family trusts, R&D incentives
- New measures to ensure collection of taxes owed
- RRSP contribution limits reduced; retiring allowance rollovers phased out; overcontribution allowance cut
- Higher taxes for corporations, large banks
- Federal excise tax on gasoline increased by 1.5 cents per litre to help reduce the deficit

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Overview of the 1995 Budget

The Plan for Fiscal Action

The 1995 budget introduces far-reaching action to restore the fiscal health that is essential for a strong and growing economy. The budget will fundamentally reform what the government does and how it does it. It will bring a permanent change in the way government operates.

The objective is to *get government right* so that it can fulfill its social and economic mandates more effectively and sustainably. This will include deep cuts in the *level* of federal program spending – not simply lower spending *growth*, but a substantial reduction in actual dollars spent.

Deficit Targets Will Be Met

The budget actions deliver on the government's commitment to meet its interim deficit targets. The ultimate goal is a balanced budget.

- The interim deficit targets set out in the 1994 budget – $32.7 billion in 1995-96 and 3 per cent of GDP in 1996-97 – will be achieved using prudent economic assumptions and incorporating credible fiscal action. The deficit could be well below targets if economic performance is in line with the average of private-sector forecasts.
- The significant reforms will ensure that spending will be restrained beyond 1996-97. The deficit will continue to fall.

Major Elements of Expenditure Reform

The budget is the second in a two-stage process that began with the February 1994 budget. It takes fundamental action in the following areas:

- It implements the results of Program Review – a comprehensive examination of federal department spending. As a result of the review, government will focus on what is essential and will do it better.
- It acts on a new vision of the federal government's role in the economy, one that includes substantial reductions in business subsidies.

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- It introduces major changes in transfers to the provinces that will renew and modernize the federal-provincial fiscal regime, making it more effective, flexible and affordable.
- It sets the fiscal parameters within which labour market programs will be redesigned to foster increased employability.

Major Fiscal Actions

Fiscal actions total $29 billion over the next three years – by far the biggest set of actions in any Canadian budget since postwar demobilization.

- There will be about seven dollars in spending reductions for every dollar of revenue increases.
- Three years from now, federal spending on programs will be $10.4 billion (8.8 per cent) lower than it is today. The cumulative expenditure savings in that period will exceed $25 billion.

A Fairer Tax System: Sharing the Burden of Deficit Reduction

The budget reflects the government's awareness of the heavy tax burden borne by Canadians and the cost this imposes on the economy. There are no increases in personal income tax rates.

Tax measures are largely directed at removing preferences and increasing fairness. To help meet the deficit targets, the budget announces increases in taxes on business and in the excise tax on gasoline.

Total direct impact of budget measures

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

[1] Three-year cumulative impact of deficit reductions shows the direct reduction in net debt, by the end of the 1997-98 fiscal year, arising from fiscal actions. Restructuring charges of $2.6 billion in 1994-95 are not included. These costs will be offset over the three-year period by lower interest costs associated with actions announced in this budget. Numbers may not add due to rounding.

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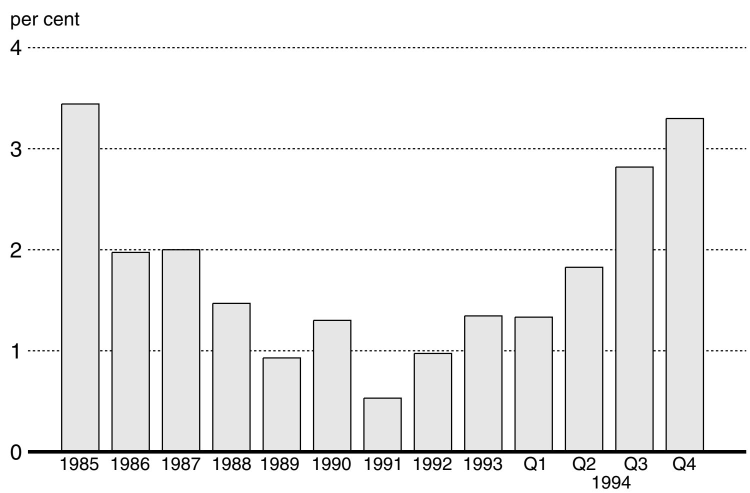
The Economic and Fiscal Situation

Economic Growth is Strong

The Canadian economy is stronger than it has been for years.

- Real output grew about 4¼ per cent in 1994, the fastest in the G-7.
- 433,000 jobs have been created in the past year – all of them full-time. The unemployment rate has fallen 1.7 percentage points to 9.7 per cent.
- Manufacturing output is up over 9 per cent in the past year.
- At 1.5 per cent, excluding the effects of last year's tobacco tax reduction, inflation equals its lowest rate in three decades.
- Unit labour costs in Canada have fallen 1.3 per cent since mid-1993.
- Improved cost performance has led to record-breaking exports, a growing trade surplus, and a dramatic improvement in the current account.
- Highest business confidence since 1979 underpins solid investment growth.

Canada's trade position: Merchandise trade surplus



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The International Environment

- **Major overseas economies:** Increased growth is expected in 1995 and 1996, particularly in Germany and the U.K. The Japanese recovery has been hesitant, but is expected to gain momentum. Slight inflation and short-term interest rate increases are expected.
- **United States:** Vigorous 1994 growth pushed unemployment down and inflation up. The Federal Reserve Board raised its benchmark interest rate from 3 to 6 per cent. Recent U.S. economic performance – inflation pressures build and monetary conditions tighten until the economy experiences a sharp slowdown – could be repeated. It is assumed that U.S. short-term interest rates will increase throughout 1995, peaking at 4 per cent in 1996. This should cause U.S. growth to slow substantially in 1996 and cool U.S. inflation and interest rate pressures.

Fiscal Impact: 1994-95

Based on expectations of improved economic growth, a moderate rise in interest rates, and the impact of the 1994 budget's restraint measures, the 1994 budget forecast that the deficit would decline to $39.7 billion in 1994-95 (including a contingency reserve of $2.4 billion).

However, 1994 short-term interest rates rose 1 percentage point more than forecast and long-term rates were 2 percentage points higher. As a result:

- Debt charges in 1994-95 will be $1 billion higher than forecast.
- But the impact of higher interest rates has been more than offset by lower program spending ($1.9 billion below the 1994 budget forecast) and higher budgetary revenues ($1.2 billion above the forecast).
- The underlying deficit for 1994-95 is expected to be $35.3 billion – $4.4 billion lower than the target of $39.7 billion set in the 1994 budget.

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Prudent Economic Assumptions

Economic assumptions drive fiscal forecasts and determine the budget action needed to achieve deficit targets. Overly optimistic assumptions lead to missed fiscal targets and damaged credibility. Using prudent economic assumptions and taking sufficient fiscal action will ensure that deficit targets are met.

Key Variables

Real growth, inflation and interest rates significantly affect the fiscal forecast. Prudent projections have been developed for each. While individually they could turn out differently, together they reduce the likelihood of missed targets.

Economic Assumptions for Canada

These assumptions are deliberately biased toward prudence – there is a better than even chance that the actual outcome, overall, will be more favourable.

- **Interest Rates:** Mid-February short-term rates of about 8 per cent were more than 400 basis points higher than 20-year lows in January 1994. This reflects rising U.S. rates and financial markets' concern regarding Canada's financial situation. Short-term interest rates are assumed to average 8.5 per cent and long-term rates 9.7 per cent this year. In 1996, short-term interest rates are assumed to fall 100 basis points.
- **Output and Inflation:** Strong employment growth and good trade performance points to continued robust growth in the first half of 1995, despite relatively high interest rates. Real growth of about 3¾ per cent in 1995 is likely, possibly slipping to 2.5 per cent in 1996 as higher interest rates weaken household spending and slower U.S. growth hinders export expansion.

The good economic performance in 1994 and 1995 will substantially reduce, but not eliminate, the amount of spare capacity in the economy. Underlying inflation will be in the 1½ to 2 per cent range for both 1995 and 1996.

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Comparison with Private Sector Projections

A February survey shows that the government's economic assumptions are more cautious than the average private sector projection.

- Views on real growth and inflation are similar for 1995. The government's assumptions are below the private sector average for 1996.
- Short- and long-term interest rate assumptions are higher than the private sector outlook – by 70 basis points in 1995 and 60 basis points in 1996.

Comparison with Previous Economic Assumptions

The major change to the economic assumptions over the past year relates to interest rates, which have been revised upwards significantly for both 1995 and 1996. Partly as a result, the real GDP growth assumption for 1996 has been lowered.

Economic assumptions

	Actual 1993	Actual[1] 1994	Assumption 1995	1996
Real GDP growth (%)	2.2	4.3	3.8	2.5
GDP deflator increase (%)	1.1	0.6	1.6	1.8
Nominal GDP				
$ billion	712	746	787	821
Growth (% change)	3.4	4.9	5.5	4.3
CPI inflation rate (%)	1.8	0.2	1.8	1.8
Employment growth (%)	1.3	2.1	3.0	2.0
Unemployment rate (%)	11.2	10.4	9.5	9.4
91-day Treasury bill[2] (%)	4.8	5.5	8.5	7.5
10-year benchmark government bond rate (%)	7.2	8.4	9.7	9.0

[1] The GDP figures are estimates.

[2] The rate on 90-day commercial paper, which is approximately 20 basis points higher than the 91-day Treasury bill rate, was used in the February 1994 budget and the October Update. The change was made since the Treasury bill rate is more relevant for debt-servicing costs.

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The Fiscal Outlook

Fiscal Year 1994-95

- The expected underlying deficit for 1994-95 of $35.3 billion will be raised to $37.9 billion by one-time restructuring charges totalling $2.6 billion related to the elimination of certain transportation subsidies and public service reductions in the 1995 budget.

Fiscal Outlook With 1995 Budget Actions

- Without the large fiscal actions in the 1995 budget, increased debt financing costs would drive the 1995-96 deficit $5.0 billion above the $32.7 billion target. In 1996-97, the deficit would decline only to $34.9 billion, $10.6 billion above the level required to meet the government's interim target of 3 per cent of GDP or $24.3 billion.
- Fiscal actions amount to $5.0 billion in 1995-96, $10.6 billion in 1996-97 and $13.3 billion in 1997-98.
- The budget actions ensure that the deficit falls to $32.7 billion in 1995-96 and to 3 per cent of GDP by 1996-97 or $24.3 billion – the interim target. This is the lowest deficit-to-GDP ratio since 1974-75.
- The operating balance – the difference between budgetary revenues and program spending – will swing from a deficit of $4.0 billion in 1993-94 to a surplus of $29.4 billion in 1996-97, the largest such surplus relative to GDP since 1951-52. The dramatic turnaround in the operating balance is due to reductions in program spending.
- The rate of growth in net public debt will slow significantly. By 1996-97, it is reduced below the rate of growth in the economy.
- If economic growth and interest rates in 1995 and 1996 are in line with the average of private sector forecasts and the contingency reserves are not needed, the deficit in 1996-97 would fall to about $19 billion, or 2.3 per cent of GDP. The debt-to-GDP ratio would decline from 73.2 per cent in 1994-95 to 71.8 per cent in 1996-97.
- Even using the prudent economic assumptions, the fiscal outlook would continue to improve in 1997-98.

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The fiscal outlook[1]

	1994-95	1995-96	1996-97
		(billions of dollars)	
February 1994 budget deficit targets	39.7	32.7	–
Impact of economic factors	-4.4	5.0	–
Status quo deficit	35.3	37.7	34.9
Restructuring charge	2.6	–	–
Impact of actions to reduce deficit	–	-5.0	-10.6
February 1995 budget deficit	37.9	32.7	24.3

1 Includes impact of budget measures.

Revenue Outlook

- Tax actions will yield $0.9 billion in 1995-96 and $1.3 billion in 1996-97.
- In 1995-96, budgetary revenues are forecast to increase by 6.5 per cent, with most of the growth associated with the 5.5 per cent increase in nominal GDP. The measures announced in this and last year's budgets to improve tax fairness, tighten tax preferences, increase user charges and adjust certain excise tax rates, also contribute to growth in revenues.
- Revenue growth is expected to slow in 1996-97, advancing by only 3.1 per cent as higher interest rates affect household spending and slower growth in the U.S. restrains exports expansion.

Expenditure Outlook

- Total budgetary expenditures are expected to peak in 1995-96 at $163.5 billion, an increase of $600 million from 1994-95.
- Program spending – all spending except debt charges – falls dramatically from $120 billion in 1993-94 to $114.0 billion in 1995-96 and to $107.9 billion in 1996-97.
- By 1996-97, the ratio of program spending to GDP is expected to fall to 13.1 per cent, the lowest ratio since 1950-51.

Financial Requirements

- The government's financial requirements, a measure of the federal government's borrowing on credit markets, will decline sharply from $26 billion in 1994-95 to $13.7 billion in 1996-97, due to the decline in the deficit over that period.
- 1996-97 financial requirements are 1.7 per cent of GDP, the lowest ratio since 1974-75.

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Getting Government Right

Program Review Overview

The Program Review was announced in the 1994 budget "to ensure that the government's diminished resources are directed to the highest priority requirements and to those areas where the federal government is best placed to deliver services."

Its main objective was to review all federal programs in order to bring about the most effective and cost-efficient way of delivering programs and services that are appropriate to the federal government's role in the Canadian federation.

Ministers were asked to review their own portfolios and provide their view on the federal government's future roles and responsibilities. Government programs and activities were reviewed using six tests: serving the public interest; necessity of government involvement; appropriate federal role; scope for public sector/private sector partnerships; scope for increased efficiency; and affordability.

The Program Review encompassed about $52 billion worth of spending, excluding only major statutory programs.

Structural Change in Government Role

The Program Review will lead to long-lasting structural change in *what* the government does. For example:

- No longer will the federal government own, operate and subsidize large parts of Canada's transportation system. It will focus instead on core policy and regulatory responsibilities and ensure the safety and security of the system.

- The Program Review will help establish an integrated, "whole-farm" approach to the government's farm safety net program which emphasizes income stabilization rather than income support.

- The business community has often stated that it does not need or want the level of assistance it receives from the federal government. In the Program Review, subsidies to business will be reduced by 60 per cent over the next three years. More importantly, the remaining assistance will be largely in the form of loans and other repayable contributions.

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In other areas, there will be fundamental change in *how* the government delivers programs and services. Many departments will alter the way they deliver services to increase efficiency and improve services to Canadians.

Departmental savings under Program Review[1]

	1995-96	1996-97	1997-98
	(millions of dollars)		
Natural Resource Sector	**328**	**380**	**581**
Agriculture	215	128	272
Fisheries and Oceans	51	80	110
Natural Resources	26	82	68
Environment	35	90	131
Transport	**555**	**953**	**1,111**
Industrial, Regional and Scientific-Technological Support Programs	**508**	**476**	**581**
Industry (and specified agencies)	93	148	212
Science and Technology Agencies[2]	71	108	142
Regional Agencies	144	220	227
Infrastructure	200		
Justice and Legal Programs	**32**	**59**	**75**
Justice	6	12	17
Solicitor General	25	47	58
Heritage and Cultural Programs	**142**	**274**	**387**
Foreign Affairs and International Assistance	**490**	**515**	**711**
Foreign Affairs/International Trade	109	134	171
International Assistance Envelope	381	381	540
Social Programs	**877**	**1,580**	**1,771**
Citizenship and Immigration	100	69	103
Health	49	138	201
Human Resources Development	600	1,100	1,100
Indian Affairs and Northern Development	5	97	177
Canada Mortgage and Housing	64	115	128
Veterans Affairs	59	61	62
Defence/Emergency Preparedness	**350**	**557**	**1,033**
PUITTA[3]	**200**	**276**	**280**
General Government Services[4]	**232**	**391**	**523**
Parliament/Governor General	**3**	**8**	**15**
Expenditure Management System	**150**	**150**	**150**
Other Program Review (unallocated)		**250**	
Total	3,867	5,869	7,217

[1] Savings include additional cost-recovery revenues that appear in non-tax revenues.

[2] Includes granting councils, the Canadian Space Agency and the National Research Council.

[3] *Public Utilities Income Tax Transfer Act.*

[4] Includes Central Agencies, Public Service Commission, Statistics Canada, National Revenue, Parliament, and Public Works and Government Services.

Numbers may not add due to rounding.

Departmental Spending Reductions

Departmental spending will be cut by $3.9 billion in 1995-96, $5.9 billion in 1996-97 and $7.2 billion in 1997-98 relative to what would have been the case without Program Review. The expenditure reductions reflect government priorities as well as the scope for program rationalization and efficiency improvements.

- The largest percentage declines in spending will take place in Transport, Industrial, and Regional support programs, where spending will fall by about half between 1994-95 and 1997-98. This principally reflects sharp reductions in business subsidies. Spending on science and technology by the science agencies of Industry Canada's portfolio will be reduced by proportionally less than the average decline in the department's Industrial, Regional and Scientific-Technological programs, reflecting the importance of government support for R&D.

- Defence spending will also fall sharply, declining by $1.6 billion between 1994-95 and 1997-98. The cuts in defence spending resulting from this budget reflect the *1994 Defence White Paper* and are in addition to large reductions announced in last year's budget.

- Spending levels will be halved in some departments. The smallest percentage reductions will occur in departments dedicated to social programs, justice and corrections.

- In almost all cases the cuts will be on top of planned spending levels that were *already* declining as a result of decisions in the February 1994 budget. Hence by 1997-98, spending subject to the Program Review will have declined 18.9 per cent relative to 1994-95.

Federal departmental spending after Program Review[1]

	Spending levels		Change	
	1994-95	1997-98	$ millions	per cent
	(millions of dollars)			
Natural Resource Sector	**4,847**	**3,333**	**-1,514**	**-31.2**
Agriculture	2,073	1,628	-445	-21.5
Fisheries and Oceans	775	565	-211	-27.2
Natural Resources	1,262	638	-624	-49.4
Environment	737	503	-234	-31.8
Transport	**2,851**	**1,404**	**-1,447**	**-50.8**
Industrial, Regional and Scientific-Technological Support Programs	**3,798**	**2,355**	**-1,443**	**-38.0**
Industry (and specified agencies)	1,301	742	-560	-43.0
Science and Technology Agencies[2]	1,359	1,038	-321	-23.6
Regional Agencies	1,138	576	-562	-49.4
Justice and Legal Programs	**3,298**	**3,132**	**-166**	**-5.0**
Justice	757	693	-64	-8.4
Solicitor General	2,541	2,439	-102	-4.0
Heritage and Cultural Programs	**2,897**	**2,221**	**-676**	**-23.3**
Foreign Affairs and International Assistance	**4,082**	**3,292**	**-789**	**-19.3**
Foreign Affairs/International Trade	1,488	1,231	-257	-17.3
International Assistance Envelope	2,594	2,061	-532	-20.5
Social Programs	**13,003**	**12,013**	**-990**	**-7.6**
Citizenship and Immigration	663	601	-62	-9.4
Health	1,815	1,746	-70	-3.8
Human Resources Development	2,544	1,660	-885	-34.8
Indian Affairs and Northern Development	3,761	4,208	447	11.9
Canada Mortgage and Housing	2,131	1,942	-189	-8.9
Veterans Affairs	2,088	1,857	-232	-11.1
Defence/Emergency Preparedness	**11,574**	**9,925**	**-1,648**	**-14.2**
PUITTA	**250**	**0**	**-250**	**-100.0**
General Government Services	**4,967**	**4,137**	**-831**	**-16.7**
Parliament/Governor General	**309**	**277**	**-32**	**-10.2**
Total	51,875	42,089	-9,785	-18.9
Per cent of GDP	7	5		

[1] As noted in Table 4.1, Program Review resulted in additional deficit reduction through increases in cost recovery and revenue generation. These savings are not reflected in this Table.

[2] Includes granting councils, the Canadian Space Agency and the National Research Council.

Numbers may not add due to rounding.

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Smaller Public Service

A more focused, effective and frugal government will require fewer employees to deliver government programs. Accordingly, by the time that 1995 budget actions are fully implemented, federal employment is expected to decline by about 45,000 or 14 per cent. Some of the jobs lost in government will be transferred to the private sector, including 6,000 positions in Transport Canada.

Fair, Well-Managed and Orderly Reductions

The government understands the value of employment security to its employees and the quality of the services they deliver to Canadians. In the face of such extraordinary pressure to downsize, the government is obliged to consider extraordinary measures. The President of the Treasury Board has announced the specific measures the government is prepared to take. These measures will allow departments to manage their reductions effectively while treating fairly employees who must go and those who will stay. These measures include:

- **Early Retirement Incentive**: Surplus employees aged 50 or over with 10 or more years of employment will be able to retire with an immediate pension based on years of service with no penalty for early retirement. The 15-week separation benefit available under the Work Force Adjustment Directive (WFAD) to surplus employees eligible for a continuing pension benefit will be eliminated for the duration of the early retirement incentive.
- **Cash-Based Early Departure Incentive**: Comparable to private-sector practice, a cash-based early departure incentive program will be made available for three years to surplus employees in departments designated by Treasury Board as “most affected” because they are unable to meet their reductions through existing or workforce adjustment mechanisms. The National Defence Civilian Reduction Program will be folded into this regime and its benefit structure will be brought in line on March 31, 1996.
- **Assistance to Employees**: Employee transition services will be augmented. This includes career counselling and job-search assistance. Management-labour committees will be established in all regions to identify employment opportunities inside and outside the Public Service.

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- **Pre-retirement Transition Leave**: Amendments to the *Public Sector Compensation Act (PSCA)* will allow the introduction of voluntary measures such as pre-retirement transition leave without pay, and permit employees to take off blocks of time and average their incomes over the year.
- **Non-Salary Terms and Conditions of Employment**: Amendments to the PSCA will permit sensible, neutral-cost changes to non-salary terms and conditions of employment.

Work Force Adjustment Directive

The WFAD will be changed to facilitate the orderly, cost-effective management of organizational and structural change. For example, legislation will modify restrictions on contracting out and the definition of mobility. As well, certain provisions of the WFAD will be suspended for three years so that surplus employees in "most affected" departments who decline the departure incentive will cease to be paid after six months and will be laid off one year after that, unless alternative employment is found.

Incentive Costs

Costs associated with the early departure incentives are estimated at this time to be about $1 billion. Consistent with private-sector accounting conventions, these costs will be included in the 1994-95 fiscal year as a one-time restructuring charge.

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Reducing Business Subsidies

Business subsidies frequently fail to achieve their desired purpose. As the OECD Jobs Study expressed it: "They tend to slow rather than stimulate adjustment; they discourage rather than encourage innovation, and they tend to become permanent."

As a key element of creating a new role for the federal government in the economy, the actions in the budget will eliminate or substantially reduce departments' business subsidies. Total business subsidies will decline from $3.8 billion in 1994-95 to $1.5 billion by 1997-98. By 1997-98, business subsidies will be 60 per cent lower than 1994-95 levels.

The Western Grain Transportation Act (WGTA): To improve grain transportation and more effectively meet our international trade obligations, the annual $560 million subsidy to the railways will be eliminated as of August 1, 1995. There will be a transition to market-determined freight rates. Measures will be introduced to facilitate removal of uneconomic branch lines and to change pooling points for Canadian Wheat Board export shipments.

A package of transition measures will be provided, including a payment of $1.6 billion to owners of Prairie farm land. A multi-year adjustment package of $300 million will facilitate transition to a more efficient transportation system. Credit guarantees on up to $1 billion of sales will be provided to non-sovereign buyers of Canadian Wheat Board agri-food products.

Atlantic Region Freight Assistance Act (ARFAA) and the Maritime Freight Rates Act (MFRA): These inefficient subsidies cost $99 million per year and will be eliminated July 1, 1995. A $326 million transportation adjustment program will be paid over five years for regions currently receiving ARFAA/MFRA subsidies. Transition programs will let provinces target assistance to meet local shippers' adjustment needs and to provide for improved infrastructure.

Dairy Subsidy: The dairy producer subsidy will be reduced by 30 per cent over the next two years. The program's future will be reviewed in consultation with the industry and the provinces.

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Agricultural Safety Net: Overall funding for safety net programs, including the Net Income Stabilization Account, Crop Insurance and the Gross Revenue Insurance Program, will be reduced by 30 per cent over the next three years. The remaining funding will pay for a core national whole-farm stabilization program, crop insurance, and province-specific companion programs.

Feed Freight Assistance: This transportation subsidy will be terminated. Transitional funding will be provided over the next ten years. Consultations on how the transitional funds can best enhance the competitiveness of affected regions will be undertaken with the provinces and affected industries.

Industry Canada: Industry Canada will further reduce remaining business subsidies. Remaining spending will focus on joint private/public-sector initiatives in high-growth sectors.

Cultural Industries: Subsidies provided to cultural industries under the Department of Canadian Heritage will be reduced, including an 8 per cent reduction over three years in the postal subsidy (which subsidizes the mailing rates of certain Canadian books and magazines). Reductions will also result from a restructured book publishing program.

Regional Agencies: The agencies will focus on small- and medium-size enterprises, but will provide loans and repayable contributions rather than direct subsidies. The agencies' field offices, and those of Industry Canada in Ontario, will provide a single point of contact to federal government programming for the small business sector. As well, in an effort to facilitate access to capital for small- and medium-size enterprises in their region:

- **The Federal Office of Regional Development – Quebec** will investigate the potential of forging new alliances with the Federal Business Development Bank and other financial institutions to deliver business assistance more effectively and on more commercial terms.
- **The Department of Western Economic Diversification** will move to eliminate direct financing assistance provided to individual businesses on a non-commercial basis. Specialized investment funds will be established, in co-operation with private/public financial institutions, to improve small business' access to capital. These strategic alliances will pay particular attention to the issue of access to capital for small firms engaged in the 'new economy'. They will explore new lines of business not currently served by commercial institutions, and attempt to increase the supply of 'patient' capital for these firms.
- **The Atlantic Canada Opportunities Agency** will continue to work with the provinces and the private sector to increase access to investment capital through support for the establishment of a new, private-sector-operated Atlantic venture capital fund.

Privatizing/Commercializing Government Operations

The government will privatize and/or commercialize government operations where feasible and appropriate. Non-essential equity holdings, assets and services will be considered for privatization, or placed on a more commercial basis, where it can be shown to improve service and reduce costs while continuing to protect the public interest.

Reasons to Privatize or Commercialize

Privatizing/commercializing operations which government no longer needs to run represents good management and common sense. This approach will help to reduce financing requirements, debt servicing costs and the deficit. It will also contribute to better economic performance through increased efficiency, competition and new private-sector investment.

Candidates

- **Petro-Canada:** The government will dispose of its common shares of Petro-Canada. The timing and proceeds of sale will be subject to market conditions.
- **CN:** The Minister of Transport will take action to sell CN. Doing so will provide the company with the freedom to make strategic operating and investment decisions quickly. It will also enable CN to seek new sources of private-sector capital in order to fund those decisions. The timing and proceeds of sale will be subject to market conditions.
- **Transport Canada's Air Navigation System (ANS):** The government will commercialize ANS, which comprises the air traffic control system, flight information system and electronic navigation aids. Terms and conditions of transfer and operating framework will be finalized in late 1995. Transport Canada will also commercialize other current operations, including airports, which will be transferred to local authorities.
- **Canada Communication Group (CCG):** The Minister of Public Works and Government Services will oversee the full or partial divestiture of CCG. Formerly the Queen's Printer, CCG provides printing, publishing and communications services to federal departments on a fee-for-service basis.

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Other Opportunities

The government will seek and undertake other opportunities for privatization and commercialization. Initiatives which may be pursued include:

- The National Capital Commission will operate on a more commercial basis.
- Natural Resources Canada will reorganize its geomatics activities and move towards Special Operating Agency status.
- Environment Canada will explore alternatives for more efficient delivery of weather services, including commercialization.
- The Department of Agriculture and Agri-Food will share responsibilities and streamline arrangements with industry for inspection and regulation activities.
- The Department of Fisheries and Oceans (DFO) will seek to enter into partnerships with the fishing industry and others in the management of capacity, licensing and compliance. DFO will also divest recreational harbours to municipalities or other interested parties and rationalize commercial fishing harbours.
- The Canadian Space Agency will focus increasingly on private-sector partnerships and joint ventures for earth observation, space science and technology.
- The Department of National Defence will look at enhancing its private-sector partnerships.
- The Departments of Health, Agriculture, Fisheries and Oceans and Industry will co-operate, in consultation with the food industry and the provinces, to improve the effectiveness and cost-efficiency of the federal component of the Canadian food inspection system.

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The Canada Social Transfer

A New Transfer System

Improving the effectiveness of the Canadian federation requires changes to the fiscal relationship between Ottawa and the provinces. The budget announces a significant reform to the system of federal transfers to the provinces and territories — the Canada Social Transfer (CST).

Currently, the federal government transfers funds to the provinces and territories to help them provide social programs to Canadians. Funding for health and post-secondary education is provided under Established Programs Financing (EPF) while funding for social assistance and social services is provided under the Canada Assistance Plan (CAP).

How it Works

Beginning in 1996-97, these transfers will be replaced by a single transfer – CST. Unlike the current system which is based partly on cost-sharing arrangements, CST will be a block fund, like EPF. This means that the amounts transferred will not be determined by provincial spending decisions (as under cost sharing). The new transfer will be provided through cash payments and tax points. The Equalization program, which benefits the lower-income provinces, is untouched and payments will continue to grow, ensuring that all provinces can provide comparable levels of service at comparable rates of taxation. Equalization, together with the CST, will total over $35 billion in 1996-97 (Table 1).

Amount of CST Transfers

The provinces will receive $29.7 billion in transfers under the existing programs for 1995-96, about the same as in 1994-95, to allow for a period of stability before change. Under the CST, funding to provinces will be reduced from what it would otherwise have been in 1996-97 by $2.5 billion to $26.9 billion. It will be further reduced from what it would otherwise have been in 1997-98 by $4.5 billion to $25.1 billion. While these reductions are significant, they are less than cuts to other federal government program spending.

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For the first year, 1996-97, CST will be allocated among provinces in the same proportion as the 1995-96 total of EPF and CAP transfers which are being replaced (Table 2). This gives provinces certainty about their allocation for the year so they can do their fiscal planning.

The Minister of Finance will consult with provinces and territories in developing a permanent method of allocating payments among provinces under CST for 1997-98 onward.

Giving Governments More Flexibility

The new transfer will end the intrusiveness of previous cost-sharing arrangements and will reduce long-time irritants:

- Provinces will no longer be subject to rules stipulating which expenditures are eligible for cost sharing or not.
- Provinces will be free to pursue their own innovative approaches to social security reform.
- The expense of administering cost sharing will be eliminated.
- Federal expenditures will no longer be driven by provincial decisions on how, and to whom, to provide social assistance and social services.

Safeguarding Standards for Canadians

The transfer of federal funds to the provinces will safeguard standards:

- The federal government will continue to enforce the principles of the *Canada Health Act*.
- Provinces must continue to provide social assistance without minimum residency requirements.

The federal government, under the leadership of the Minister of Human Resources Development, will invite all provincial governments to work together on developing, through mutual consent, a set of shared principles and objectives that could underlie the new transfer. In this way, all governments could reaffirm their commitment to the social well-being of Canadians. The Minister of Health will continue to work with provincial and territorial health ministers to renew Canada's health system.

A New Approach to Federal-Provincial Fiscal Relations

The Canada Social Transfer represents a new approach to federal-provincial fiscal relations marked by greater flexibility and accountability for provincial governments, and more sustainable financing arrangements for the federal government. It continues the evolution towards more mature fiscal relations.

Table 1
Major Transfers to Provinces and Territories
(Estimated entitlements)

	1994-95	1996-97	Change
		(millions of dollars)	
Newfoundland	1,484	1,512	+28
Prince Edward Island	316	323	+7
Nova Scotia	1,932	1,949	+17
New Brunswick	1,610	1,632	+22
Quebec	11,446	11,096	-350
Ontario	10,530	9,653	-877
Manitoba	2,039	2,032	-7
Saskatchewan	1,411	1,450	+39
Alberta	2,525	2,313	-212
British Columbia	3,573	3,291	-282
Northwest Territories	74	68	-6
Yukon	34	32	-2
Total	**36,974 [1]**	**35351 [2]**	**-1,623**

[1] Comprised of Equalization, EPF and CAP.

[2] Canada Social Transfer and Equalization.

Table 2
The Canada Social Transfer: CST
(Estimated Entitlements)

	CAP/EPF		CST
	1994-95	**1995-96**	**1996-97**
	(millions of dollars)		
Newfoundland	608	608	551
Prince Edward Island	137	137	124
Nova Scotia	964	966	875
New Brunswick	763	764	692
Quebec	8,098	8,141	7,376
Ontario	10,530	10,653	9,653
Manitoba	1,141	1,143	1,036
Saskatchewan	982	981	888
Alberta	2,525	2,552	2,313
British Columbia	3,573	3,632	3,291
Northwest Territories	74	75	68
Yukon	34	35	32
Total	**29,429**	**29,686**	**26,900**

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Protecting Elderly Benefits

Canada's retirement income system has three main components:

- employment-related pension income under the Canada and Quebec Pension Plans;
- Old Age Security (OAS) and Guaranteed Income Supplement (GIS); and
- tax assisted retirement savings: Registered Pension Plans and Registered Retirement Savings Plans.

The 1995 budget begins action to put Canada's retirement income system on a fairer and sustainable basis.

Canada Pension Plan (CPP)

CPP pensions are paid entirely by contributions made by employers and employees, and are based on past earnings. This fall, the finance ministers of Canada and the provinces will meet for their regular five-year review of the financing of the CPP as mandated by law. Their review will be based on the actuarial report of the CPP recently tabled in Parliament.

The report concludes that CPP contribution rates will have to rise from 5.4 per cent in 1995 to some 14 per cent in 2030, 1 percentage point higher than previously expected. Costs have risen in the short- and long-term because disability benefits have been higher than anticipated and contributions have been lower as a result of the recent recession.

Old Age Security and Guaranteed Income Supplement

These benefits today cost over $20 billion, a cost that is estimated to grow by 60 per cent over the next 15 years as the population ages. The government will release a paper later this year on the changes required in the public pension system to ensure its affordability. The goal is to bring in legislated changes to take effect in 1997. The basic principles for reforming OAS and GIS shall be:

- undiminished protection for all seniors who are less well off, including those receiving GIS;
- a continuation of full indexation of benefits to protect seniors from inflation;

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- the provision of OAS benefits on the basis of family income, as is currently the case with GIS;
- greater progressivity of benefits by income level; and
- control of program costs.

Consultations with seniors, and Canadians generally, on the precise nature of the needed changes will occur when the paper is released later this year. In the interim, two measures will be implemented effective July 1996:

- OAS payments will be calculated and paid out net of the high-income recovery amounts, based on income reported on the previous year's tax return. This measure will not affect the amount of benefits provided to seniors. The only change is that the OAS benefit will be reduced before it is sent out rather than being taxed back after individuals have received their cheques. The high-income recovery affects only those individuals with incomes above $53,215.
- OAS recipients who are no longer resident in Canada will have to file a statement of their world-wide income in order to continue to receive OAS benefits. Currently, non-residents with incomes above $53,215 escape the high-income recovery. They are treated more favourably than residents of Canada.

Tax-Assisted Retirement Savings

The budget proposes actions on the third part of the retirement income system – tax-assisted retirement savings. Details of these actions can be found in the fact sheet, *Tax-Assisted Retirement Savings*, elsewhere in this booklet.

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Tax Assistance for Retirement Savings

The government provides tax assistance for retirement savings by allowing contributions to pension plans to be deducted from income in computing tax. The return on savings in the plans is not taxed each year. Tax is paid when income is received from the plans.

Registered Pension Plans (**RPPs**) are pension plans for employees sponsored by employers or unions and funded through contributions by employees and employers. Defined-benefit RPPs provide a pension that is generally calculated on the basis of earnings and years of service. Money-purchase plans provide whatever pension income the accumulated contributions and return on investment in the RPP will buy at retirement.

Registered Retirement Savings Plans (**RRSPs**) are savings plans for individuals and the self-employed that provide retirement income based on what the accumulated contributions and return on investment in the plan will buy at retirement. RRSP contributors may also belong to an RPP.

The 1995 Budget:

- reduces the contribution limits for RRSPs and money-purchase RPPs which will produce fiscal savings while affecting only individuals earning over $75,000;
- lowers the $8,000 allowance for overcontributions to RRSPs which will substantially eliminate an opportunity for unintended tax deferrals; and
- phases out the tax-free rollover of retiring allowances to RRSPs, a measure which is no longer needed under the reformed system of pension and RRSP limits.

Reduction in Pension and RRSP Contribution Limits

The reductions in pension and RRSP limits will not compromise the integrity and effectiveness of the private retirement saving system. The measures will adjust the limits to a level where full tax assistance is provided on earnings up to about 2.5 times the average wage, the target set under pension reform. The specific changes are:

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- The dollar limit on deductible RRSP contributions will be reduced to $13,500 for 1996 and 1997 and then increased by $1,000 a year to reach $15,500 in 1999.
- The dollar limit on contributions to money-purchase pension plans will also be reduced to $13,500 in 1996. It will then be increased by $1,000 a year to $15,500 in 1998.
- The dollar limit on Deferred Profit Sharing Plan (DPSP) contributions will continue to be one-half the limit for RPPs.
- The current maximum pension limit for defined-benefit RPPs will be frozen through 1998. The pension and DPSP limits will be indexed beginning in 1999, and the RRSP limit in 2000.
- The government will consider modifying the RRSP limits, without incurring additional revenue costs, to restore lost RRSP room to employees who leave pension plans before retirement.

RRSP Overcontribution Allowance

- A penalty tax of 1 per cent applies to excess RRSP contributions above a margin of $8,000. Beginning in 1996, this overcontribution allowance will be reduced from $8,000 to $2,000. This will be phased-in to allow existing excess contributions to be retained until they can be deducted against new RRSP room, rather than forcing them to be withdrawn.

Retiring Allowance Rollovers

- The tax provisions that allow individuals to transfer to an RRSP up to $2,000 per year of service out of a retiring allowance will be phased out by reducing the limit to zero for years of service after 1995.
- Individuals may continue to transfer up to $2,000 per year of service before 1996, plus $1,500 for each year before 1989 in which they earned no pension or DPSP benefits.

Pay Out of Locked-In RRSPs

- Holders of RRSPs that are locked in under a provision of the *Pension Benefits Standards Act* will be allowed to purchase Life Income Funds, a more flexible way of managing retirement income funds. They can now only purchase life annuities with these funds.

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Eliminating Deferral of Tax on Business Income

Among a number of measures proposed in the budget to improve the fairness of the tax system is an important change affecting individuals who report business income (including professional income). To eliminate the deferral of taxes, these taxpayers will be required to report their business income on a calendar year basis, effective for taxation years starting after 1994.

The measure affects all sole proprietorships, professional corporations and partnerships (where at least one member of the partnership is an individual, professional corporation, or another affected partnership).

How Taxes Are Currently Deferred

Currently, business income is reported by an individual on the basis of a business' fiscal period. That fiscal period may or may not coincide with the end of the calendar year (December 31), which is the end of the annual reporting period for employment and other types of income.

In calculating income for a calendar year, an individual must include income from any business with a fiscal period ending in that year. Therefore, if the business' fiscal period ends prior to December 31, the reporting of business income earned between the end of that fiscal period and December 31 can be delayed. As a result of the delay in reporting the business income, the payment of taxes on that income can be deferred.

Transitional Relief

Given that most affected taxpayers would otherwise be required to report more than 12 months of business income in their 1995 tax returns, the measure includes provisions to bring the additional amounts into income over a 10-year transitional period, subject to some restrictions. The measure allows for 5 per cent of the additional income to be included in 1995, 10 per cent to be included in each of the subsequent eight years and 15 per cent to be included in the last year.

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Extended Reporting Period

Since some individuals will now have less time to prepare their financial statements and income tax returns, individuals (other than trusts) with business income (other than only from limited partnerships) will be given until June 15 of each year to complete and file their income tax returns. However, any tax owing will continue to be payable on April 30 and interest on unpaid taxes will be charged from that date.

Changed Year-End for GST

Persons required to have a December 31 fiscal year-end and who are GST registrants will have the same year-end for GST purposes. For individuals who file annually for GST purposes, the GST filing period will also be extended to June 15 but, as with income taxes, any GST owing will continue to be due on April 30. Revenue Canada will provide further details regarding changes to reporting periods for GST purposes.

Illustration of Transitional Provision

Consider an individual with the following characteristics:

- the individual's unincorporated business earns $120,000 in each fiscal period; and
- the business has a January 31 year-end (i.e. the reporting of 11 months of income is deferred one year).

Income of $110,000, earned between February 1, 1995 and December 31, 1995 is currently deferred for tax purposes.

Calculation of Business Income for Tax Purposes

	1995	1996
Business income		
– fiscal period ended Jan. 31/95	$120,000	
– fiscal period ended Dec. 31/96		$120,000
Inclusion of income that otherwise would have been deferred for tax purposes:		
– income earned Feb. 1/95 – Dec. 31/95 – $110,000 (A)		
– annual inclusion percentage (B)	5%	10%
– additional income to be taxed (A x B)	$5,500	$11,000
Income from business to be reported	$125,500	$131,000

Further details on this measure can be found in Annex 6 of the Budget Plan.