

JOINT STATEMENT ON THE NATIONAL ECONOMY

OCTOBER 11, 1990

In making this joint economic statement today, we wish to underline the growing concern within the Canadian business community that domestic macro-economic mismanagement, persistent fiscal laxity, and a failure to come to grips with the magnitude of the competitiveness challenge confronting Canadian industry are steadily undermining Canada's economic prospects.

At present, most of Canada's manufacturing and resource industries are in recession, and many service industries face increasingly unfavourable business conditions. Bankruptcies among small and mid-sized companies are soaring, and business confidence has dropped to levels not seen since the 1981-82 recession. In short, there is mounting evidence that Canada may be on the crest of a full-scale economic recession. Because inflationary pressures remain strong in some parts of our economy, even though growth has come to a halt, the risk is growing that Canada may experience a period of "stagflation."

In a recent statement about the federal government's fiscal position, the Honourable Michael Wilson stated that "changes to government programs are neither necessary nor appropriate to deal with the current situation." We do not agree with this assessment, and it is against this backdrop that this joint economic statement is being issued today by three of Canada's major business organizations.

Canada's weakening economy calls out for some easing of interest rates - indeed, rates have finally started to fall. But the scope for interest rate relief undoubtedly would be significantly greater if Canada's governments collectively had done a better job managing their fiscal and spending policies over the past several years. Unfortunately, the record in these areas is far from impressive.

All levels of government have contributed to Canada's increasingly worrisome fiscal state. Although the federal government has limited the average annual increase in its program spending to under 4% since 1984, it has failed to arrest the dangerous rise in the net federal debt-to-GDP ratio, which escalated sharply in the 1980s and has now reached almost 56%. Canada stands out among industrial countries as one with a particularly strong addiction to government debt. The net public debt has been growing faster in Canada than in most other industrial countries. Successive

federal deficits in the range of \$30 billion each year, and the disastrous increase in debt to which they have given rise, have contributed greatly to the crushingly high real interest rates which Canadian businesses and workers are now facing. High deficits and high interest rates are the inevitable results of a combination of lax fiscal and tight monetary policy; these have proven a deadly combination for the Canadian economy.

In assessing the damage caused by Canada's dismal fiscal policy record, three points deserve emphasis. First, several years of huge deficits have intensified underlying inflationary pressures by injecting unnecessary spending into a fast-growing economy that, until 1990, was operating at or near capacity. Second, large deficits and escalating debt interest payments have cramped the federal government's ability to finance important programs and initiatives in areas such as social policy and the environment. Finally, to meet its enormous debt-financing burden, the federal government has resorted to borrowing a large portion of Canadians' savings over the past few years. The appropriation of the bulk of net domestic savings by government has pushed up interest rates, crowded private borrowers out of the domestic capital market, and resulted in a sharp increase in Canada's foreign indebtedness (which now stands at \$230 billion).

While the fiscal policy record of the federal government has been unimpressive over the past several years, the spending and tax policies of the provinces also have been important factors behind the growing problems of government debt and declining competitiveness. The provinces have added to both inflationary pressures and Canada's fiscal problems through rapid growth of their own program expenditures, which rose on average by 6.4% per year over the 1984/85 - 1989/90 period -- more than 2% higher than the average annual rate of inflation. Ontario has exhibited the least discipline in this regard. Its spending jumped by an astonishing 9-10% annually between 1986 and 1990 -- at a time when the province's overheating economy already was growing briskly.

High interest rates, caused in large part by excessive spending and tax increases at both the federal and provincial levels and by the ballooning federal debt, are seriously undermining Canada's competitive position in the global marketplace. If allowed to continue, high interest rates and the undisciplined spending and tax policies favoured by our governments will erode the future standard of living of all Canadians.

Our three organizations are convinced that a determined national effort is urgently needed to address Canada's looming fiscal crisis. Action on the deficit/debt front is essential to pave the way to lower interest rates, lower inflation, and improved competitiveness. While some of us would like to see even stronger action, we all agree that at the very least the following elements

of our proposed action plan should be carried out. These elements are as follows:

- A two-year freeze on federal program spending. This is an essential first step to halt, and then reverse, the rise in the debt-to-GDP ratio. In our view, the current deficit reduction strategy outlined in the February 1990 federal budget, viewed in the light of current economic circumstances, will fail to generate confidence -- either within Canada or abroad -- that decisive progress is being made in righting Canada's dangerously unbalanced fiscal position. A reduction in the debt-to-GDP ratio should be achieved through limits on federal program spending. At the end of the two-year period, the federal government would need to re-examine its fiscal position to determine the extent of further expenditure restraint needed to bring the deficit and debt under firm control.

- Immediate action by the provincial governments to reduce the excessive growth in their program spending, which in recent years has been rising at well above the rate of inflation.

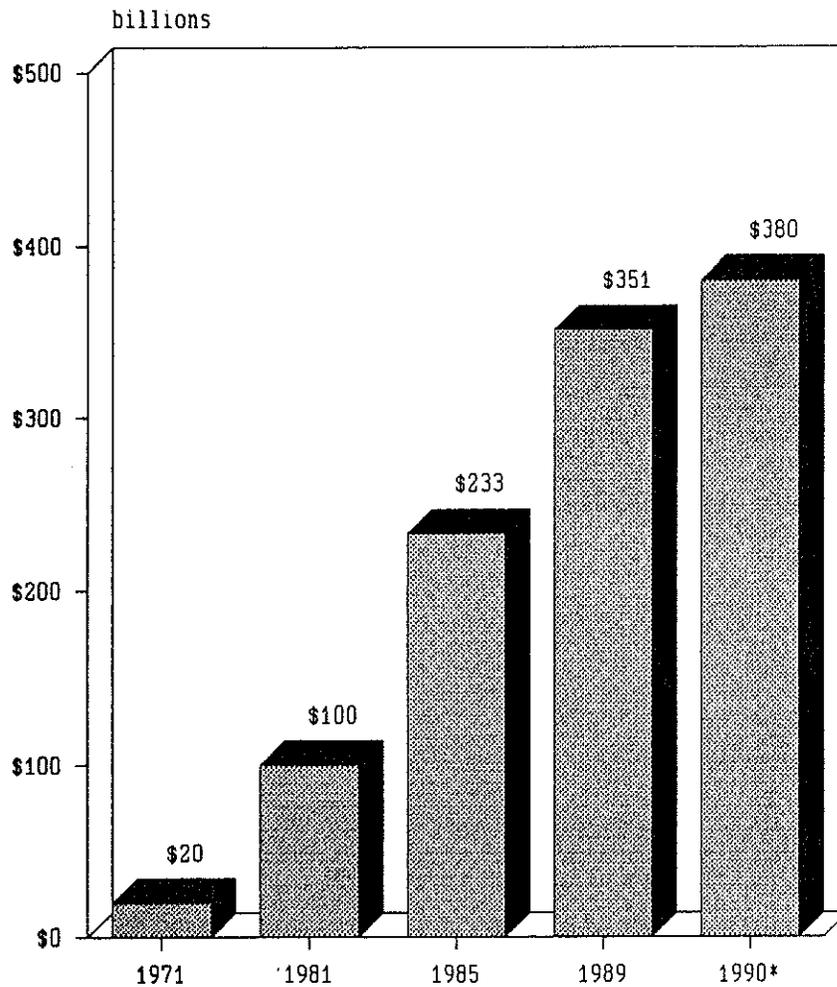
It is critical that Canadians recognize the seriousness of the fiscal challenge now facing our country. All of us, including business, must be prepared to reduce our demands on government. We believe that the steps identified above, if acted upon by both levels of government, will help to build a strong foundation for achieving economic objectives shared by all Canadians -- lower interest rates, more jobs, a better inflation performance, improved international competitiveness, and the restoration of confidence in Canada's economic prospects in the decade ahead. These initiatives on their own will not ensure economic success in the future. A broadly-based and sustained effort at strengthening and renewing our economic foundations will be necessary. Our three organizations pledge to work with all interested Canadians in securing this objective.

SOME FACTS ABOUT GOVERNMENT DEFICITS AND DEBT

- The combined federal/provincial government debt now stands at a staggering \$450 billion. That is more than \$17,000 for every Canadian.
- Among the seven leading industrial countries, Canada has the second largest government debt burden, equivalent to more than 70% of our gross domestic product. Only in Italy is the burden of government debt higher.
- In spite of seven consecutive years of positive economic growth, Ottawa's budget deficit was still close to \$30 billion in the 1989-90 fiscal year. This is equivalent to 4.7% of gross domestic product, which is far too high given the current stage of the business cycle.
- The federal government pays \$95 million every day in interest costs. That's almost \$4 million per hour, or \$65,000 per minute. Every dollar spent on interest payments is one less dollar available for basic government programs and services.
- The average family of four now pays out \$125 a week to cover the interest charged on the federal debt.
- Increasing taxes is not a realistic solution to the deficit/debt problem. The average Canadian family already spends about 50 cents of every dollar of cash income on various kinds of taxes -- income taxes, sales and excise taxes, property taxes, etc.
- Canada is borrowing more and more from foreigners, in large part because of our governments' insatiable appetite for debt. Net foreign indebtedness jumped from \$137 billion in 1983 to \$230 billion last year. Canada and the United States are now the world's two biggest debtor nations.

Chart 1

The Rising Federal Debt



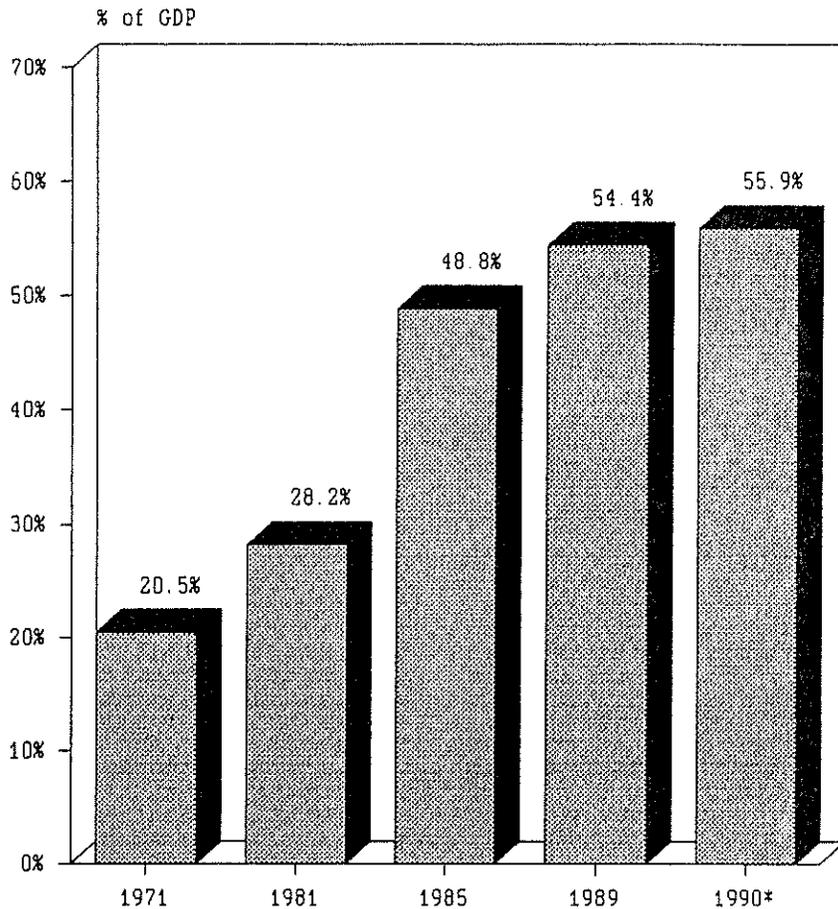
* forecast

Source: The Budget (February 20, 1990)

- The federal debt jumped dramatically through the 1980s. It is expected to reach \$380 billion by the end of the 1990-91 fiscal year (March 31, 1991). This is almost four times higher than the \$100 billion in federal debt accumulated in all the years prior to 1981.

Chart 2

Federal Debt as % of GDP



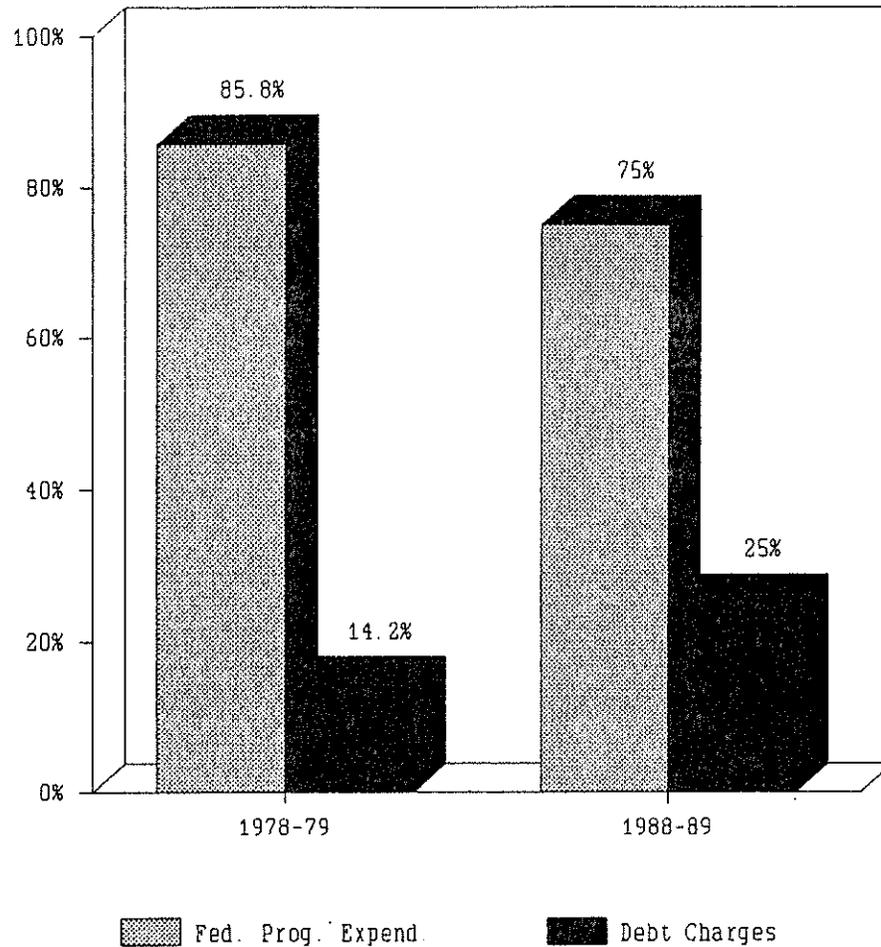
* forecast

Source: The Budget (February 20, 1990)

- The federal debt has also been growing rapidly, measured as a proportion of total economic activity (gross domestic product). The debt/GDP ratio is the best overall indicator of the economic burden of Ottawa's addiction to deficit finance. Since 1981, the federal debt/GDP ratio has almost doubled. This worrisome trend is even more alarming in light of the fact that Canada's economy experienced seven consecutive years of positive real economic growth over the period 1983-89.

Chart 3

**Federal Program Expenditures
versus Debt Charges
(% of total spending)**

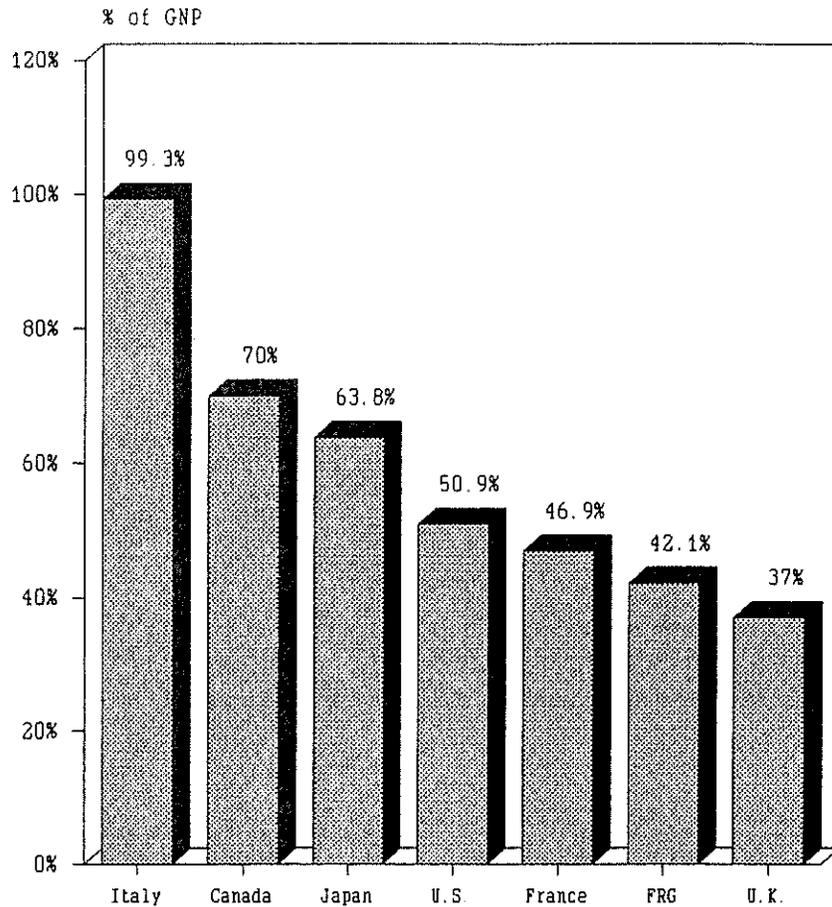


Source: The Budget (February 20, 1990)

- Federal government debt has grown so large that interest payments on that debt now constitute the largest single federal expenditure item. In fiscal year 1989-90, interest payments on the debt were approximately \$40 billion. Debt servicing charges now amount to almost 80% of all federal personal income tax revenues, and account for one quarter of total federal spending. Unless sustained progress in reducing the deficit is made, debt-servicing payments will continue to represent an ever-rising share of federal spending.

Chart 4

Total Public Debt* International Comparisons, 1990



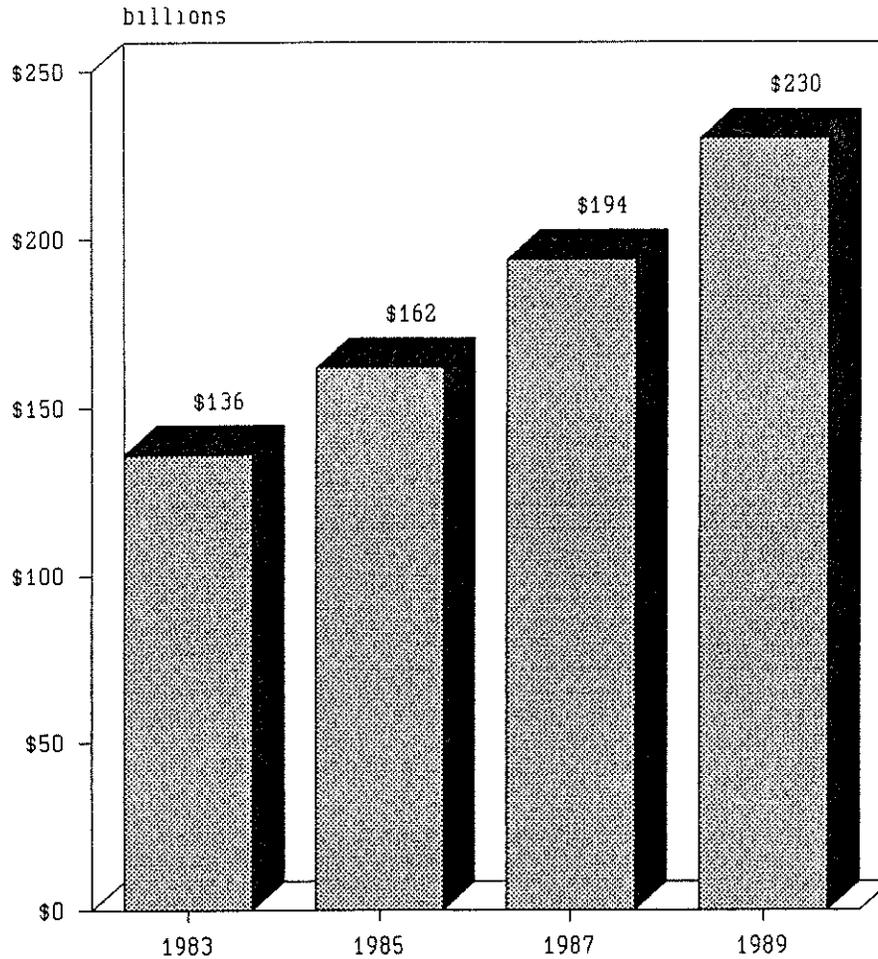
*gross public debt

Source: OECD, Economic Outlook (June 1990)

- By international standards, Canadian governments appear to have developed an almost uncontrollable appetite for debt. According to estimates by the Organization for Economic Co-operation and Development, Canada has the second-highest level of total government indebtedness -- federal and provincial combined -- of all the G7 countries. Only Italy has a worse debt record than Canada.

Chart 5

Canada's Net Foreign Debt

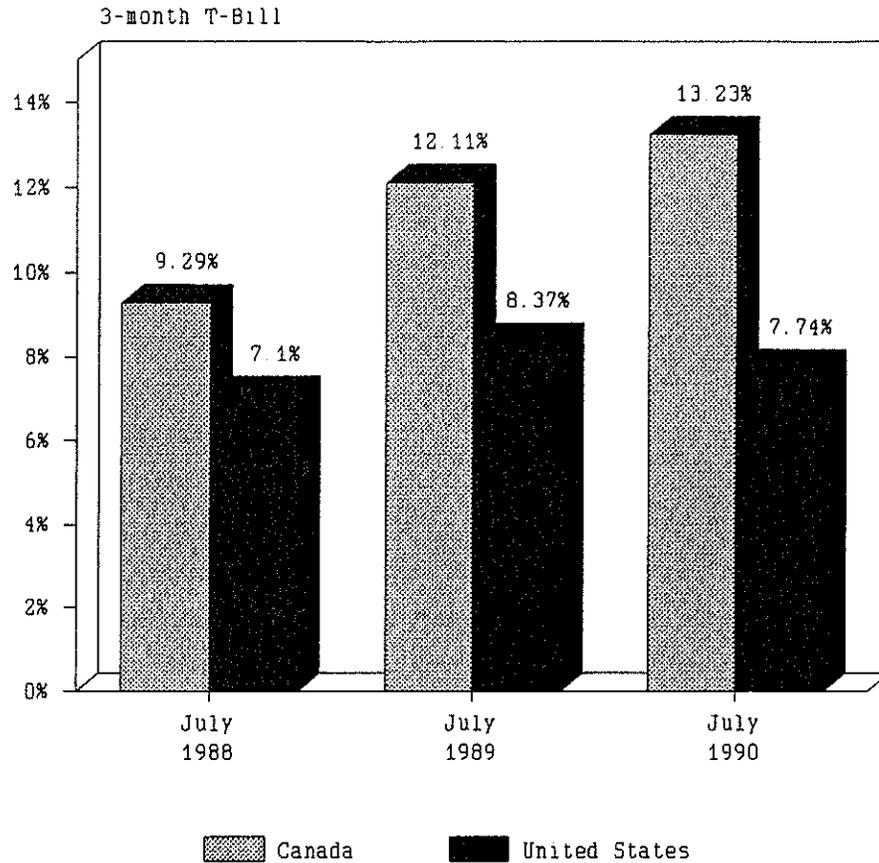


Source: Statistics Canada (catalogue 67-202)

- Canada's governments have sharply increased their foreign borrowing in recent years. In addition, because Ottawa has also been borrowing such a large proportion of Canadians' total savings in order to finance the deficit, the Canadian private sector increasingly has been "crowded out" of domestic capital markets and forced to borrow abroad. The result of these trends has been a dramatic rise in Canada's foreign indebtedness, which now stands at some 35% of gross domestic product.

Chart 6

Interest Rates: Canada vs United States

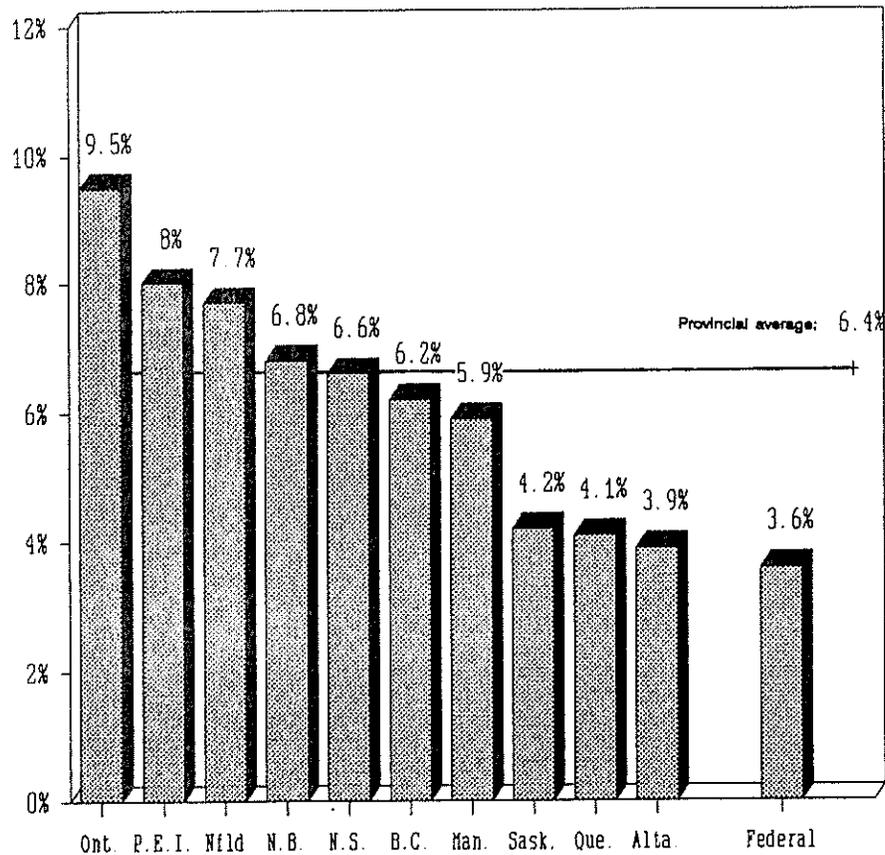


Source: Bank of Canada Monthly Review

- High government deficits and debt are contributing to high interest rates. As a percentage of gross domestic product, the annual federal deficit and accumulated public debt are both higher in Canada than they are in the United States. Coupled with the very tight monetary policy being followed in Canada, this has resulted in a widening short-term interest rate differential between Canada and the United States, even though the rate of inflation in the two countries is quite comparable. The extremely high cost of capital in Canada is having a negative impact on investment, productivity and competitiveness. A credible program to get the deficit and debt under firm control would help to pave the way to lower interest rates and a reduced Canada-United States interest rate spread.

Chart 7

**Average Annual Percentage Increase in
Program Expenditures
1984-85 to 1989-90**



Source: The Budget (February 20, 1990)

- Rapid growth of government spending in the last half of the 1980s has been a key factor behind both rising taxes and inflation. The federal government has done a much better job of controlling its program spending than most of the provinces. Closer co-ordination of federal and provincial government fiscal and economic policies would help to get the interrelated problems of high interest rates, inflation, and government debt under better control.