HOPE FOR THE BEST, PLAN FOR THE WORST:

SUSTAINING CANADA'S GROWTH THROUGH GOOD TIMES AND BAD

SUBMISSION BY THE
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2004 PRE-BUDGET SUBMISSION TO THE
STANDING COMMITTEE ON FINANCE, HOUSE OF COMMONS
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Thank you for the opportunity once again to appear before this Committee and to offer the views of the *Canadian Council of Chief Executives* (CCCE) with respect to the fiscal priorities of the federal government.

Over the past year, the global economy has continued to enjoy a period of robust growth. Canada has been enjoying its full share of this expansion. Strong demand from our largest market, the United States, has kept overall exports impressively high if unevenly spread between industry sectors and regions of Canada. Outstanding growth in Asia, especially in China, has boosted both exports of raw materials from Canada and the global price of such commodities.

This global performance has extended Canada's heady run of superb economic news. Between 1997 and 2003, Canada recorded the strongest growth in the G-7 in both jobs and standard of living, and we are maintaining large trade and current account surpluses with the rest of the world.

Excellent economic performance in turn continues to have a direct impact on the fiscal health of Canadian governments. The federal government has now reported its seventh consecutive surplus for 2003/04, once again much higher than projected at $9.1 billion. Canada's net foreign debt as a share of the economy is now below that of the United States for the first time ever. Federal debt is now down to 39 percent of GDP, and by the end of this year, Canada is projected to have the lowest total government debt burden in the G-7.

The vast inflow of new revenues to the federal government in recent years has enabled it to address a wide range of important social issues. In recent weeks, substantial new money has been committed to health care and to equalization. Further large sums have been promised for other issues including child care and urban infrastructure and quality of life.

In addressing these issues, however, it is vital to remember two facts. First, social issues cannot be addressed effectively through additional spending in a single year; such efforts must be sustained over time. Second, the economic cycle is not dead. Canada has recent experience with unexpected shocks ranging from SARS and BSE to forest fires and hurricanes, and now there are clear signals that global economic growth is leveling off. Canada has enjoyed an extraordinarily lengthy run of good news, but tougher times inevitably will return at some point.

This period of healthy economic growth and government revenue therefore represents an important window of opportunity. While continuing to hope for the best, the government also must take active measures to plan for the worst, to ensure that its commitments to improving the quality of life of Canadians can be sustained through good times and bad.

RISKS TO THE ECONOMIC OUTLOOK

In the early 1990s, a strong consensus emerged in Canada that we should make the difficult choices needed to vanquish inflation and deficits and adjust to the forces of freer trade within North America and globally. As individuals and as a country, we made those decisions at least in part because we had few options left. Canada was in deep trouble, and Canadians reacted with resilience, ingenuity and determination.

Our country's enviable economic performance in recent years is a tribute to the choices Canadians made more than a decade ago. The extent of Canada's success makes it tempting to relax and reap the fruits of past labours. But the economic exuberance that seems to prevail across much of the industrialized and developing worlds may have reached its apex and certainly is threatened by a wide range of powerful forces. This time, Canadians should not wait for the hammer to fall before responding. As a country, we should be taking advantage of today's good fortune to prepare our economy to weather the worst of the turbulence that may lie ahead.

The global economy faces five major risks, all of which could have a major impact on Canadians: high oil and energy prices; the future of China; the United States trade and current account deficits; that country's huge federal budget deficit; and the continuing threat of global terrorism.

- **Oil prices.** The rising price of oil already has begun to take its toll on the brisk pace of expansion recorded earlier in 2004. The possibility of further shocks to the delicate balance between supply and demand through the winter season is the major short-term risk to the outlook in North America and globally. As a major exporter of energy, Canada is a net beneficiary of high oil prices, but a slowdown in the United States would mean less demand for Canada's goods and services from our largest customer.

- **China's future.** China's astounding pace of economic growth has been the major driver of higher commodity prices globally. Its emergence as the world's manufacturing powerhouse helps to push down prices of many goods for consumers, but also creates major competitive challenges for Canadian manufacturers. The United States government has predicted that China will overtake Canada as its number one source of imports within five years. This has the potential to lead both to a protectionist backlash in the United States that could affect Canadian exporters and to continuing pressure on Canadian companies to adapt either by raising productivity through investment at home or by moving production abroad in search of lower costs.

A second risk related to China is whether it can sustain orderly growth in the face of growing inflationary pressures. If the Chinese government is unsuccessful in its efforts to steer its economy gently onto a path of sustainable growth, an abrupt drop in Chinese demand would have repercussions both on the prices Canada receives for its commodities and on broader trade flows and growth across Asia and around the world.

- **United States current account deficit.** Year after year, the United States has been fuelling the global economy by buying more goods and services than it sells and by borrowing the money to do so from the rest of the world. Its current account deficit has reached 5.7 percent of GDP and risks widening even further. This is a level that many economists consider unsustainable, and it certainly represents a threat to the stability of the American dollar on international currency markets.

  Most experts agree that the American currency will have to depreciate further to narrow the gap between savings and spending in the United States. This means a still greater challenge for Canadian exporters, one that could be made worse if an abrupt fall in the American dollar triggers much higher interest rates in our largest export market and thereby reduces business and consumer demand as well.

- **United States fiscal deficit.** Canadians know from bitter experience that large and repeated government deficits lead inevitably to economic trouble. The United States government has plunged from surplus back into federal deficits that have reached 3.5 percent of GDP. Given the continuing costs of war in Iraq and heightened homeland security combined with low personal savings rates, an aging population and an underfunded social security system, these deficits seem unlikely to be eliminated any time soon. As Canadians know, one consequence is likely to be higher American interest rates, which again would lead to lower demand in our biggest export market.

- **Global terrorism.** The risk of renewed large-scale terrorist attacks poses a continuing risk to economic growth in North America and globally. Canada's National Security Advisor, Robert Wright, has reminded us that our country has been named as a target by al-Qaeda, and Canadians therefore face a direct threat to our security and prosperity. But whether another major terrorist attack in Canada or elsewhere results just in restrictions on movement of people and goods into the United States or more broadly constrains the openness of trade and travel globally, there will be a negative impact on Canada's economy.

IMPACT OF THE RISING CANADIAN DOLLAR

Factors such as high commodity prices and the fiscal and current account deficits in the United States already have had a huge impact on the exchange rate between the Canadian and American dollars. To some extent, Canada's currency has come into favour internationally because of our country's economic and fiscal strength and strong presence as a commodity producer. However, it is important to recognize that the major cause of the changing exchange rate has been the decline of the United States dollar against all major currencies.

From Canada's point of view, the impact of exchange rate volatility is largely confined to its trade within North America. On the other hand, the United States buys the vast majority of Canada's total exports, and the rise of the Canadian dollar against its American counterpart has been rapid and relentless. From a low of less than 62 cents (U.S.) in January 2002, the Canadian dollar went over 82 cents (U.S.) last week. That is a rise of about 33 percent in 34 months, roughly one percent every month for almost three years, a trend that has put many Canadian companies under severe pressure.

It is important to note that the damage suffered by these companies flows less from the actual exchange rate than from the speed at which the rate has changed. Companies can adapt to any given level of the dollar, and a strong dollar offers important advantages that can include lower interest rates and a higher standard of living for Canadians. However, the process of adapting to a large and very rapid change involves extensive investments and major shifts in corporate strategy that cannot be executed overnight.

Discussions with many of the member chief executives of the CCCE in recent weeks suggest that this impact is not being felt evenly across the economy. For resource producers whose costs are mostly in Canadian dollars but whose products are priced globally in American dollars, the rise in the dollar leads to a sharp drop in profit. The British Columbia forest industry, for example, has estimated that each one-cent rise in the Canadian dollar reduces sales by $150 million annually. On the other hand, the global plunge in the American currency means that the price of many commodities in United States dollars has risen sharply, in many cases more than offsetting exchange rate losses.

Even in the manufacturing and service sectors, not all Canadian companies have been affected equally. The net impact tends to reflect the extent to which their costs are in Canadian dollars and their revenues in United States dollars. The high degree of integration in the North American economy means that goods manufactured in Canada often contain a high proportion of parts imported from the United States, which mitigates the impact of the rising Canadian dollar. And in both the manufacturing and service sectors, Canadian enterprises that report their results in United States dollars, either publicly or within multinational corporations, are able to show improved results in that currency even if their Canadian-dollar revenues are flat.

That said, it is important to recognize that a significant portion of the Canadian economy is facing an extraordinary challenge as a result of the unusually rapid rise in the Canadian dollar since the beginning of 2003. These companies need to decide how best to respond, whether to accelerate their investments in new equipment and technology in order to maintain the competitiveness of their Canadian operations, or whether to look at alternate strategies involving shifts in operations to the United States or to other jurisdictions.

THE NEED FOR A BALANCED APPROACH

Given the serious risks facing the global economy and the extent to which large segments of the Canadian economy already are feeling the pinch from slowing demand in the United States and the meteoric rise in the Canadian dollar, it is clear that the next federal budget must adopt a carefully balanced approach to fiscal priorities.

While the government continues to allocate resources to the priorities that it identified during the recent election campaign, these efforts to improve the quality of life of Canadians today must be matched by reinvestment in growth for tomorrow.

In the early years of surplus budgets, the government took important measures to foster continued economic growth by reducing taxes and paying off debt as well as by expanding research and addressing social needs through new spending. More recently, however, the government's emphasis has shifted to spending. Both transfers to the provinces and direct program spending have been rising at a pace that simply cannot be sustained unless further measures are taken to strengthen the country's future economic growth.

When the CCCE appeared before this Committee last year, we spoke of three priorities: fiscal prudence, spending review and tax policy. All three of these areas have a continuing role in ensuring sustained growth in jobs and incomes for Canadians. To this list, we would now add a fourth pillar, one identified recently in the excellent final report of the External Advisory Committee on Smart Regulation, that of regulatory reform.

CHANGING THE CULTURE OF SPENDING

When the CCCE spoke to this Committee in 2003, our central recommendation was to develop a rigourous and ongoing process for the review and reallocation of federal spending. We put forward what we called the "5 percent solution", an approach that would require each minister and deputy minister to identify each year the least effective five percent of spending under their direction.

Even if limited to direct program spending, exempting debt service, transfers to provinces, Employment Insurance and old age pensions, we suggested that such an exercise would generate more than $3 billion each year that could be shifted to new or growing priorities. Every family reviews its needs and wants on a regular basis, and shifts its spending accordingly. Canadians have a right to expect no less from their governments.

We note that the government has adopted a short-term target of identifying $12 billion in potential savings over a five-year period. To this end, it has in fact asked each department to identify the least effective five percent of its spending. Recommendations put forward by deputy ministers are now being considered by the Expenditure Review Committee of Cabinet with a view to meeting the $12-billion target in the next budget so that the government will be in a position to make firm commitments of these funds to more pressing priorities.

As noted recently by Minister of National Revenue John McCallum, this short-term review is important, but is just the start. Once this target has been met, it is his stated intention to establish a permanent spending review process, one that would become the initial stage in the annual budget cycle. His goal, and one that the CCCE supports strongly, is to change the culture of government, to ensure that every year, every minister and senior official takes a hard look at how they are spending taxpayers' money and how this money might be used more effectively in future.

The fact is that governments, like Canadian families, always will face new priorities and new issues that must be addressed. In recent years, Canada's unusually strong economic growth has enabled the federal government to accelerate program spending at a very high rate. Since 1999/2000 fiscal year, *annual* program spending has jumped by $32 billion dollars. That is an increase of 29 percent in just four years, an average of close to 7 percent per year.

Total program spending is forecast to rise by another 7.6 percent this year, a jump of almost $11 billion, and the recent health care accord locks in an annual 6 percent escalation over the long term. By 2010, the TD Bank Financial Group projects that program spending will reach $193 billion a year, 76 percent higher than a decade earlier. In other words, federal spending has been growing and is on track to keep growing at a pace much faster than inflation plus population growth, faster than nominal economic growth and well above the CCCE's recommended cap of the rate of GDP growth minus one percent.

Spending on urgent priorities that rises faster than the economy that forms the government's tax base clearly cannot be sustained without either a return to the high-tax and deficit-prone policies that drove the country to the fiscal brink in the early 1990s or a determined and continuing effort to reallocate spending to these more urgent purposes from existing uses. Whether the government chooses priorities moving forward that involve tax reduction or additional spending, the need for review and reallocation of existing spending will remain constant.

REALLOCATION THROUGH DEBT REDUCTION

The CCCE always has argued strongly in favour of a prudent approach to fiscal planning, supporting the use of both substantial contingency reserves and prudent assumptions in forecasting future growth. Given the extensive risks to the global economic outlook and signals of slower growth already being felt within the Canadian economy, such prudence in planning remains essential.

The degree of prudence built into budget forecasts, when combined with the unexpectedly strong economic growth of recent years, has produced some large year-end surpluses. The size of these surpluses has led to accusations both of poor forecasting and of deliberate attempts to reduce public expectations by hiding the amount of money flowing into federal coffers.

Such criticism is misplaced. First, prudent planning means that unexpectedly bad news -- of which Canada will assuredly get its share over time -- will not plunge the government abruptly back into deficit. Second, year-end surpluses that go to paying down debt are not wasted. Far from it: debt reduction is in fact of great value both to those who argue for lower taxes and to those who favour sustaining and expanding program spending.

Surely no form of public spending is less useful than paying interest on debt. Paying down the principal on the federal debt has a double impact: it both cuts the amount on which interest has to be paid in future and reduces the risk premium and interest rate that the government has to pay on what is left. By paying down debt, the government is reallocating spending from debt service to other purposes, all of which are more useful in meeting the current and future needs of Canadians.

Debt repayment is the surest and most effective way for governments to free up resources for new priorities in future. The $61 billion that it has paid down over the past seven years has freed up between $3 billion and $3.5 billion a year from now on, money that now can be used to fund and sustain major new initiatives in other areas.

The debt repayments already made will generate some $15 billion to $17 billion in savings for reallocation over the next five years. This represents a greater impact than the $12 billion to be found through the current spending review, and with far less effort. Continued debt repayment will be critical in enabling the government to meet the evolving needs of Canadians as the population ages and constrains the tax base provided by the incomes of working Canadians.

TAX CUTS AS A TOOL FOR ACCELERATING GROWTH

Debt reduction is a straightforward way to increase the fiscal flexibility and capacity of the government in the years ahead. A more important but more complex means of increasing the future flow of revenue is through smart tax policy.

Tax policy effectively decides the balance between the costs that taxes impose on economic activity to fund current consumption and the room they leave for individuals and companies to invest in growth.

The federal government made a very important decision in 2000 to establish tax reduction as a cornerstone of its economic strategy. The short-term benefits to Canadians were impressive enough. The $100 billion in tax reductions over five years have put more money in the pockets of Canadian families and created stronger incentives for businesses to make the investments that lead to more jobs, higher incomes and better returns to those saving for or living in retirement.

These past tax reductions have had an important impact on the lives of Canadians, but major tax issues remain to be addressed. Three issues in the personal income tax structure that the CCCE has raised in the past are: the need to get more low-income Canadians off the tax rolls altogether; the need to reduce the stiff marginal rates facing modest-income families with children; and the need to flatten the rate curve that pushes highly skilled workers into the top tax bracket far too quickly.

As the fiscal situation allows, the CCCE continues to support measures to address these issues, including increases to the basic personal exemption, reduction of income-tested clawbacks in child benefits, higher contribution limits for registered retirement savings plans and pension plans, creation of an additional tax-prepaid savings plan and an increase in the floor for the top personal income tax bracket to $150,000.

More generally, tax policy provides a highly efficient means of meeting social as well as economic goals, as through the Canada Child Benefit. As with spending programs, tax provisions also need to be reviewed and reformed on a continuing basis in order to respond to the evolving needs of Canadians within an ever-changing global economy.

In the short term, the most urgent tax policy issues are in the corporate sector. As noted earlier, the extremely sharp rise in the Canadian dollar is putting immense pressure on exporters, especially in the manufacturing sector. Over time, companies can and will find ways to adapt to such pressure, but the speed of the rise is squeezing profits just as it adds to the urgency of investing in new machinery and equipment to boost productivity and competitiveness.

The choices that Canada makes on corporate tax policy will have a huge impact on how quickly Canadian enterprises adapt to a higher dollar and a more competitive global environment, and on the extent to which their responses maintain and add to employment in Canadian communities.

The economic evidence on this issue is clear. Corporate tax policy is the key to sustaining and improving the quality of life of Canadians and to enabling more people to get jobs, families to raise their incomes, businesses to invest and grow and governments to increase their future tax base. No form of taxation does more damage to future growth than corporate taxation, and dollar for dollar, no form of tax reduction is more effective in speeding up economic growth.

The corporate income tax cuts announced in 2000 have helped to generate the economic growth and the resulting budgetary surpluses that the government continues to enjoy. Further reduction in corporate tax rates is the most effective way for Canada to carve out a meaningful competitive advantage in the global struggle to attract business investment and jobs.

Critical in this regard is Canada's competitive position relative to the United States. Canada's overall tax burden remains far higher than that of our major trading partner and competitor for investment, and that overall balance cannot be shifted significantly in the short term. As the CCCE has recommended to this Committee in the past, however, it is eminently feasible to aim for a 10 percentage point advantage on corporate tax rates.

The Department of Finance estimates that Canada already enjoys a modest advantage of 2.3 percentage points over the United States, as measured by the average combined federal/provincial and federal/state statutory rates. The government's remaining tax reduction commitments would bring Canada's advantage to 3.4 percentage points by 2008, a third of the way to the CCCE's recommended target.

The idea of further corporate tax cuts will strike some people as unnecessary or even undesirable. The CCCE would offer three reasons to be more ambitious:

- First, while Canada's statutory corporate income tax rate is now marginally lower than that of the United States, the effective tax rate faced by companies is actually higher. As Jack Mintz of the C.D. Howe Institute has pointed out, provincial capital taxes, sales taxes on components of capital investments and less favourable write-offs for depreciation and inventory more than offset Canada's lower statutory rate. Canada remains at a net disadvantage.

- Second, even Canada's slight edge on the statutory rate may soon be eroded. Re-elected United States President George W. Bush has made it clear that further major tax cuts are a core part of the agenda for his second term. American corporate tax rates have been remarkably stable in past years, but this situation seems likely to change.

- Third, in competing for investment with the United States, it is not enough for Canadian communities to be able to offer tax rates that are simply in the same ballpark. As the largest portion of the North American market, the United States has a natural advantage as a location for new plants and operations serving the continent as a whole. To make Canada the preferred base for serving North America, it is essential to offer some compelling arguments that speak directly to the bottom line.

There are several ways to achieve the kind of significant corporate tax advantage recommended by the CCCE. Most obviously, as the government conducts both its short-term and continuing reviews of federal spending, it should look in particular at whether some of the money now devoted to business subsidies could contribute more effectively to economic development through equivalent cuts in corporate taxation. The CCCE believes that lower corporate tax rates can be justified as smart economic policy in their own right, but is suggesting that further corporate tax cuts could be of net benefit to the economy even if delivered on a fiscally neutral basis.

This kind of trade-off has been widely discussed. The Conservative Party of Canada made this approach part of its platform in the recent election campaign. And in his days as a member of this Committee, the current Minister of Public Works brought forward the idea of abolishing the Atlantic Canada Opportunities Agency in return for elimination of corporate income tax in the Atlantic region -- suggesting that the substitution of business subsidies for corporate tax cuts is a concept that can cross party lines.

Cutting the statutory corporate income tax rate is the simplest but not the only way to reduce the burden on investment and jobs. What matters most in the end is not the headline rate but the effective tax rate that corporations actually pay. Changes within the existing tax framework such as improvements in capital cost allowance rates can have just as much impact as cutting the statutory rate.

In the context of the rapid rise in the Canadian dollar and the resulting urgent need to expand investment in productivity-enhancing technology, the Committee should consider in particular whether it makes sense to have an effective tax rate on investment in machinery and equipment that is more than 10 percentage points higher than the effective rate on investment in structures and 15 percentage points higher than on investment in land.

The CCCE would note that corporate investment decisions respond not to a single rate, but to the combined impact of federal, provincial and municipal levies. The federal government has shown important leadership in the corporate tax reductions that have been made to date. Some but not all provinces have moved in the same direction. Provinces that want to attract more investment and foster more jobs will have to do their share in reducing the corporate tax burden. However, only the federal government can adopt tax measures that will help communities from coast to coast.

Lower corporate tax rates do more than stimulate the investment that leads to more jobs and higher incomes. International and Canadian experience also illustrates the extent to which lower corporate tax rates can actually lead to higher rather than lower revenues for governments.

Within Canada, the corporate income tax rate dropped by two percentage points on January 1, 2003, yet in fiscal 2003/04, federal revenue from corporate income tax rose by more than $5 billion or 23 percent. On January 1, 2004, the corporate tax rate dropped another two percentage points, yet in the first five months of this fiscal year, corporate income tax revenues already are up by a further eight percent.

Corporate financial health goes hand in hand with job growth. Since the beginning of 2003, Canada's economy has generated an additional 427,000 jobs. Job growth in turn leads to higher tax revenue on personal incomes and consumption.

The cuts in corporate income tax cannot take full credit for this robust economic and job growth. Canada's economy is benefiting from a range of factors beyond our control, notably strong demand in our largest market, the United States, and from the rise in global commodity prices flowing from China's extraordinary growth. However, tax policy is a lever that Canada does control and smart tax policy could help to keep our economy rolling even when the global economy turns down.

Even if one considers only the impact on corporate income tax revenue, international experience suggests that lower corporate tax rates could leave Canadian governments better off. For instance, if Canada were to drop its combined federal/provincial corporate tax rate to 10 percentage points below the 40 percent average charged in the United States, it would put our country on par with the 30 percent rate charged in Australia.

Yet according to the IMD World Competitiveness Yearbook 2004, Australia collects corporate income tax revenue equal to 4.32 percent of its GDP, compared with collections of just 2.98 percent of GDP for

Canada. Australian governments, despite a significantly lower tax rate, collect corporate tax revenue that is 45 percent higher than Canadian governments as a share of the economy.

Overall, Canada's corporate income tax rate is the fourth highest out of the 60 countries measured by IMD, yet it ranks only 33rd in terms of corporate income tax revenue. At the other end of the scale, Ireland charges the lowest corporate income tax rate, at just 12.5 percent, yet collects revenue equal to 3.71 percent of GDP, almost 25 percent more than Canada. Singapore, with the second-lowest tax rate at 20 percent, also collects a bigger share of its economic pie in corporate income tax revenue than does Canada.

In addition to accelerating growth by encouraging business investment, lower corporate tax rates can help an economy to attract more companies that make more money and at the end of the day generate greater revenue for governments as well as more jobs and higher incomes for individuals and their families.

In summary, Canada needs to make sure that its tax policies are effective in making this country a place in which hard-working people can build better lives and want to invest for the future, and that offers compelling reasons for businesses from around the world to choose Canadian communities as their preferred base for serving customers across North America and globally.

The single most effective way to achieve this objective is to continue building on the framework of corporate tax reduction launched in 2000, with a focus in the short term on changes in corporate tax policy that will help Canadian exporters to adapt quickly to the rise of the

Canadian dollar through expanded investments in productivity-enhancing machinery and equipment.

REGULATORY REFORM: LOW COST AND HIGH IMPACT

While regulatory reform is not technically a fiscal issue, the CCCE would argue that this policy area offers a low-cost opportunity to make a huge impact in enhancing the business environment, attracting investment, raising productivity and increasing Canadian competitiveness.

To compete and win internationally, Canada needs a regulatory structure that is simpler, faster, more transparent and more predictable. The final report of the External Advisory Committee on Smart Regulation in September 2004 has provided a superb blueprint for action by the federal government and laid out a series of clear and sensible recommendations that deserve prompt action.

As the CCCE noted at the time, smart regulation improves the protection of people and the environment while enabling companies to move faster in making investments and creating jobs. It is good for the economy and good for communities. Perhaps most important at a time of rising demand for public services such as health care, smarter regulation would make a real difference in spurring innovation and improving Canada's competitiveness without adding to the burden on taxpayers.

The CCCE supports in particular the smart regulation committee's call for development of a new federal regulatory policy by September 2005 and creation of multi-stakeholder "swat teams" by December 2004 to identify regulatory issues that can be addressed immediately in priority sectors of the economy.

Three of the report's recommendations are especially deserving of early action:

- *improving international cooperation* by treating regulatory policy as a fundamental element of Canada's foreign policy and working toward single review and approval within North America;
- *eliminating small but costly regulatory differences* between Canada and the United States; and
- working with provincial governments to create a national approach and possibly a *single agency for environmental assessments*.

The task now is to turn this valuable report into a series of concrete actions that increase the effectiveness of current regulations while ensuring a government-wide commitment to ongoing regulatory reform. The desire to foster better regulation and improved results for Canadians should be an objective that cuts across party lines. Implementing these sound recommendations should be a priority during the current session of Parliament.

Smart regulation and smart fiscal policy go hand in hand. Prompt action in improving the regulatory environment within Canada would compound the benefits of sound fiscal and tax policy and speed up the impact of measures such as corporate tax cuts in enabling companies to make new investments and create jobs.

THE TIME TO ACT IS NOW

After the years of harsh fiscal discipline and business restructuring of the 1990s, Canadians have become used to good economic news. The choices we made then have paid off with strong job growth and record tax revenues for governments. The federal government in particular has the capacity to make a range of policy choices that it could only dream about ten years ago.

There is no shortage of issues vying for political attention. Canadians want better health care, better schools, better child care and communities that are better places to live and work. But they also are trusting governments to use their tax money wisely.

Perhaps most important of all, Canadians want the security of knowing that whatever policy choices are made today can be sustained over time. While public opinion currently supports an activist agenda, this support is based on a fundamental assumption that the economy will remain strong.

No government can simply assume that the economy will remain strong. A strong economy flows from sound fiscal and monetary policy, from choices that make Canada a better place for people to live and to work and for enterprises to invest and to grow.

A smart federal strategy for the economy as described here must have four elements:

- First, the government must maintain prudence in fiscal planning, to ensure that the budget balance does not return to deficit and that continued debt reduction keeps freeing up more of the money now spent on interest payments.

- Second, the government must make rigorous spending review an essential part of every year's budget cycle, so that it can continuously shift money from less effective uses and lower priorities toward newer and more urgent purposes.
- Third, the time has come for a second major round of tax reduction, this one with an initial focus on corporate taxation, to give Canada a meaningful competitive advantage within North America in attracting investment and creating jobs.
- Fourth, the government must act quickly and decisively on the recommendations of the External Advisory Committee on Smart Regulation, to take advantage of the many ways it has identified to improve the business environment without adding to the burden on taxpayers.

A decade ago, Canada waited for a crisis to forge a new consensus, one that required painful choices and years of effort to produce the healthy economy that we enjoy today. This time, Canadians should opt for a better approach. Instead of waiting for the next crisis and then finding ways to cope, we should take advantage of today's fiscal flexibility. We should act now to ensure that Canada's economy keeps growing and can sustain a high quality of life through both the relentless competitive pressures and the inevitable ups and downs that we will assuredly face in the world of tomorrow.