

CHAPTER 2

Spending Reductions and Reform: Bases for the Success of the 1995 Budget

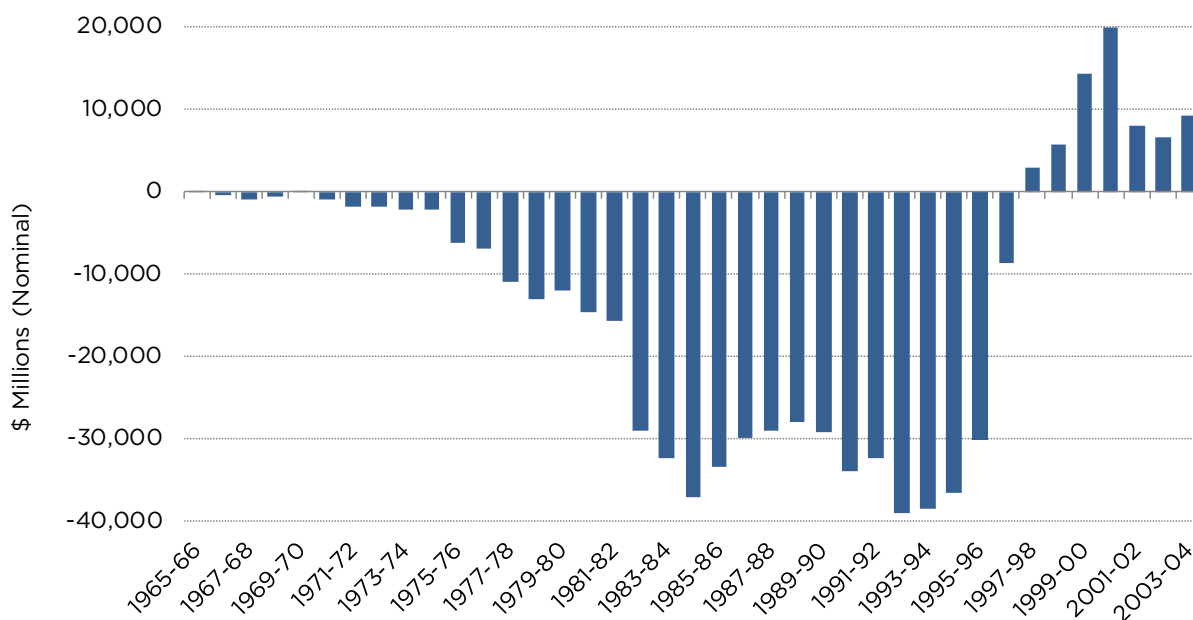
*By Lydia Miljan, Tegan Hill, and Niels Veldhuis**

Introduction

As the introduction to this volume and several of the other essays point out, the 1995 federal budget was an historic achievement. It reversed more than three decades of growth in federal spending, mainly based on ever-larger deficits, which by the early 1990s had left federal finances in a near crisis. Thirty-plus budgets leading up to 1995 had all, to varying extents, paid lip service to the need to control spending and balance the budget. But the 1995 budget was the first to take concrete, purposeful, determined action to do so. More specifically, it reduced and reformed nominal spending over a short period to achieve a balanced budget. As Finance Minister Paul Martin stated in his *Budget 1995 Speech*: “We are acting on a new vision of the role of government in the economy. In many cases that means smaller government. In all cases it means smarter government” (Canada, 1995a: 6).

This essay touches on the historical significance of that approach, the success of focusing on spending reductions and reform, and the process by which the government achieved such large-scale changes in such a short time.

* References and the authors' biographies can be found at the end of this document.

Figure 1: Federal Fiscal Balance, 1965-66 to 2003-04¹

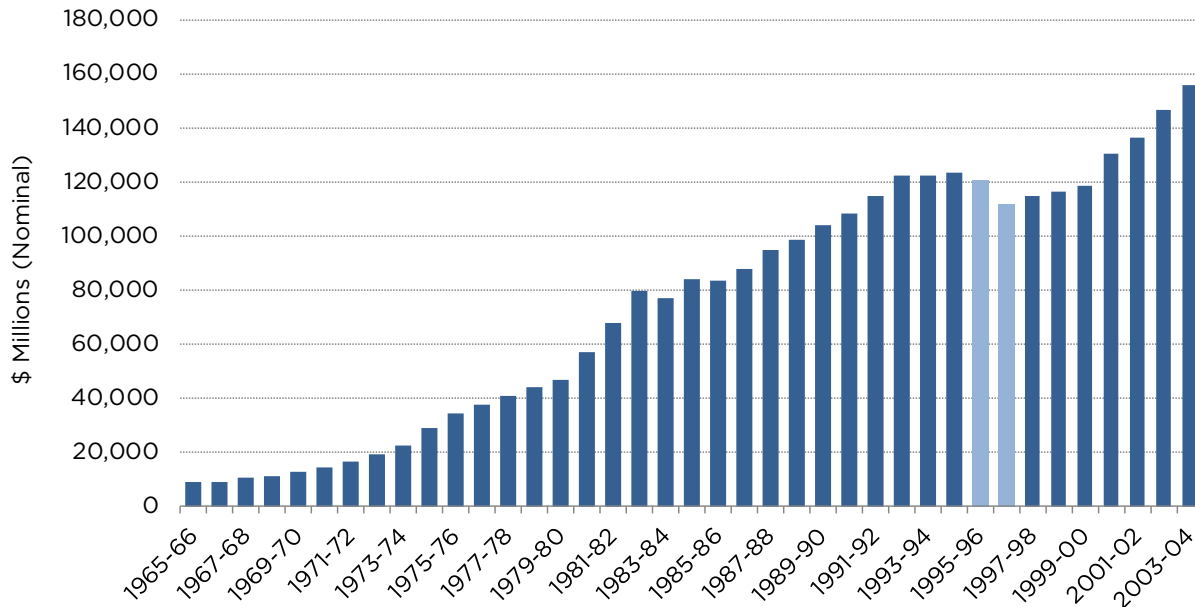
Source: Canada, Department of Finance, 2010, 2019.

A history of deficits

The 1995 budget came at a time when federal finances were facing considerable challenges. Between 1965 and 1995 Ottawa had incurred deficits in all but two years: 1965-66 and 1969-70. Nominal program spending had increased almost without exception during those three decades and public debt charges consumed an ever-growing share of government resources, squeezing out both spending on other programs and tax relief. By the early 1990s, the country was close to a debt and currency crisis.

Figure 1 shows the fiscal balance, i.e., the federal government surplus or deficit, over this period. Figure 2 shows the nominal value of federal program spending. As the figures demonstrate, nominal program spending increased throughout the three decades and was financed largely with deficits (i.e., borrowing). To be absolutely clear, successive governments chose to borrow in order to finance their increased spending.

Some governments—Liberal and Conservative, majority and minority—did recognize the problems caused by the persistent growth in spending. No fewer than 24 budget speeches in the three decades preceding 1995 explicitly declared a policy of expenditure restraint (Hill et al., 2019). Restraint was operationalized as a reduction in the growth of spending,

Figure 2: Program Spending, 1965-66 to 2003/04¹

Source: Canada, Department of Finance, 2010, 2019.

however, rather than in the actual amount of spending. Although the federal government claimed to recognize the problems posed by accumulating deficits and mounting debt it took few concrete actions to stem either.

The 1995 budget

In 1994, the newly elected Liberal government of Jean Chrétien took the first steps toward restoring stability to federal finances with the introduction of *Program Review*. Unlike previous initiatives, *Program Review* was a concerted, government-wide effort to review and assess federal spending with the twin objectives of eliminating the deficit and assessing government policies on the basis of “value for money.” Six specific questions guided the assessment of current spending:

- Does the program serve the public interest?
- Is it affordable?
- Is government intervention necessary?
- What is the appropriateness of the federal government’s involvement?
- Is there potential for private/public sector cooperation?
- Is it efficient?

Program Review was thus intended not only to reduce spending but also, and even more importantly, to determine the appropriate role of the federal government in delivering programs and services to Canadians. Its comprehensive review required ministers to evaluate all programs and services offered by their departments and to determine which could be reduced or eliminated based on the six questions. A critical feature of *Program Review* was that no department, agency, organization, or Crown corporation escaped review (Bourgon, 2009).

Budget 1995 was the first to be derived from *Program Review*. The government identified and introduced spending reductions across almost all federal departments and programs. Table 1 summarizes the planned reductions across departments between 1994-95 and 1997-98. Transport spending saw the deepest cut: 50.8 percent. Natural Resources was next, at 49.4 percent, while industrial and regional support programs were to be reduced by 46.0 percent. The smallest cuts, though still significant, were in heritage and cultural programs, social programs, foreign affairs and international assistance, and defence. All departments, excluding only social programs and justice, incurred reductions in spending in excess of 10 percent. Indian Affairs and Northern Development was one of the very few areas to experience an increase in spending.

In total, *Program Review* was expected to reduce federal spending by \$16.9 billion over three years. The federal government projected that when *Program Review* was combined with other cost-reducing measures spending would fall by \$25.3 billion from 1995-6 to 1997-8. In addition, the share of the economy consumed by government spending would decline markedly, from a peak of 17.1 percent in 1992-3, just before the Chrétien Liberals were elected, to a low of 11.8 percent in 1999-2000 and 2000-01 (Canada, DoF, 2019: table 2).

A significant reason for the government's success in balancing the budget in relatively short order was its overwhelming reliance on spending reductions rather than tax increases. A significant body of research supports a policy of spending cuts over tax increases (see Alesina, 2017). One reason is simply that reducing and reforming spending is entirely within the control of the government. By contrast, relying on tax increases has proved less successful over time. Budgeted revenues often do not materialize, usually because taxpayers' predictable behavioural responses to higher rates mean anticipated revenue increases simply do not occur (see Ferede, 2019 and Laurin, 2018). As it was, tax measures played only a supplementary role in the Chrétien government's budget plan, accounting for just \$3.7 billion of the total of \$29 billion in direct savings. The most notable were a new tax on the investment income of private corporations, elimination

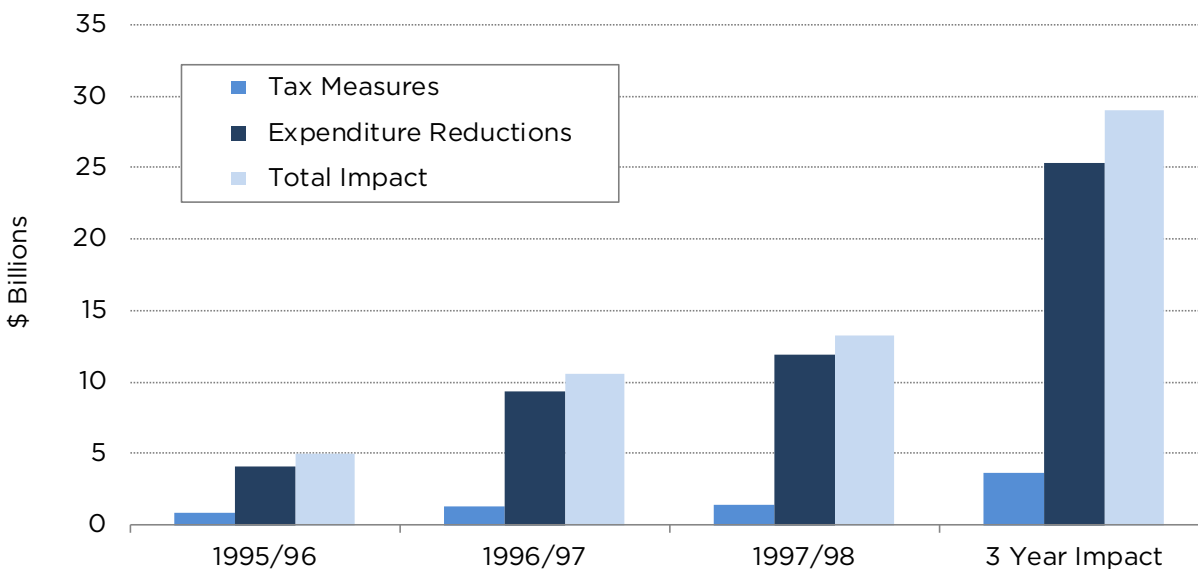
Table 1: Reductions in Program Spending After Program Review

	Spending (billions)		Reductions	
	1994-95	1997-98	\$ millions	percent
Natural Resource Sector	4.8	3.3	-1.5	-31.2
Agriculture	2.1	1.6	-0.4	-21.5
Fisheries and Oceans	0.8	0.6	-0.2	-27.2
Natural Resources	1.3	0.6	-0.6	-49.4
Environment	0.7	0.5	-0.2	-31.8
Transport	2.9	1.4	-1.4	-50.8
Industrial, Regional and Scientific Programs	3.8	2.4	-1.4	-38.0
Industry (and specified agencies)	1.3	0.7	-0.6	-43.0
Science and Technology Agencies	1.4	1.0	-0.3	-23.6
Regional Agencies	1.1	0.6	-0.6	-49.4
Justice and Legal Programs	3.3	3.1	-0.2	-5.0
Justice	0.8	0.7	-0.1	-8.4
Solicitor General	2.5	2.4	-0.1	-4.0
Heritage and Cultural Programs	2.9	2.2	-0.7	-23.3
Foreign Affairs and International Assistance	4.1	3.3	-0.8	-19.3
Foreign Affairs/International Trade	1.5	1.2	-0.3	-17.3
International Assistance Envelope	2.6	2.1	-0.5	-20.5
Social Programs	13.0	12.0	-1.0	-7.6
Citizenship and Immigration	0.7	0.6	-0.1	-9.4
Health	1.8	1.7	-0.1	-3.8
Human Resources Development	2.5	1.7	-0.9	-34.8
Indian Affairs and Northern Development	3.8	4.2	0.4	11.9
Canada Mortgage and Housing	2.1	1.9	-0.2	-8.9
Veterans Affairs	2.1	1.9	-0.2	-11.1
Defence/Emergency Preparedness	11.6	9.9	-1.6	-14.2
General Government Services	5.0	4.1	-0.8	-16.7
Parliament/Governor General	0.3	0.3	0.0	-10.2
Total	51.9	42.1	-9.8	-18.9
Percent of GDP	7	5		

Notes: Numbers may not add due to rounding or the exclusion of other relatively minor line items

Source: Canada, Department of Finance, 1995b.

Figure 3: Direct Impact of Budget Measures



Source: Canada, Department of Finance, 1995b.

of the deferral of tax on business income, reduced contribution limits for RRSPs and money purchase plans, and rate increases for the large corporations' tax, the corporate surtax, and gasoline and tobacco taxes.

Figure 3 shows the breakdown of spending cuts versus tax hikes in *Budget 1995*. According to the government, there would be only one dollar of revenue increase for every seven dollars (roughly) of spending reduction (Canada 1995b: 9). Specifically, in 1995-6, spending reductions would account for \$4.1 billion in savings and tax measures only \$0.9 billion. The equivalent numbers over the next two fiscal years were to be \$9.3 billion vs. just \$1.3 billion and \$11.9 billion vs. just \$1.4 billion. Over the entire three years the ratio of spending cuts to tax increases was to rise from 4.6 to 7.2 to 8.5. All this reflected the federal government's conscious decision to focus on spending cuts rather than tax increases.

The results

As a result of *Budget 1995* and the reforms it introduced, the federal government exceeded its deficit reduction targets. By 1997-98, only two years after the *Budget 1995* spending cuts, the budget was in surplus for the first

time in a quarter century (at \$3.0 billion). It would remain in surplus for the next decade (see figure 1).

It should be stressed just how unusual an event the reduction in nominal program spending introduced in the 1995-6 budget was. As figure 2 shows, nominal program spending declined from \$123.2 billion in 1994-95 to \$111.3 billion in 1996-97—nearly \$12 billion—a 9.7 percent reduction in spending over two years. This reduction in nominal-dollar spending occurred at a time when both population and the price level were rising. It therefore represented a real cut in per capita federal spending, a rare occurrence in Canadian fiscal history.

In 1996-97, public debt charges also began to fall in nominal terms and by 1997-98 so, too, did the federal debt (Canada, 2019). Both these trends continued until the 2008-9 recession. As a result, by 2008-09, public debt charges only consumed 11.9 cents for each dollar in tax revenue, compared to 38.0 cents in 1990-91, while the federal debt was down to \$468 billion, a reduction of \$95 billion from its peak of \$563 billion 1996-97.

Conclusion

From 1965 to the early 1990s the nominal program spending of Canada's federal government grew routinely, year after year, and efforts to curtail it were, with few exceptions, insufficient, impermanent, or poorly implemented. The government's habit of financing its spending by borrowing culminated in a near-crisis in 1995. The reforms implemented in *Budget 1995* quickly restored fiscal balance and sustainability to federal finances. A critical component of these reforms was *Program Review*, which led to reduced and reformed government spending. No departments, organizations, or agencies were excluded from review and the cuts it led to constituted, for the most part, actual reductions in nominal spending, not simply reductions in the growth rate of spending. The expenditure reductions brought about by *Program Review* led to nearly a decade of budgetary surpluses, substantially reduced the federal debt, and vastly improved the state of federal finances.

Notes to the Chapters

Introduction: The 1995 Budget, 25 Years On **by William Watson**

1. Though the IMF had intervened in 1962 after a run on the Canadian dollar during the Diefenbaker years.
2. All budget numbers are from Canada (2019).

CHAPTER 1: The Path to Fiscal Crisis: Canada's Federal Government, 1970 to 1995 **by Livio Di Matteo**

1. In addition to depleting them of revenues, these tax expenditures also greatly complicated the personal and corporate income tax systems (see Vaillancourt, Lammam, Ren and Roy, 2016).
2. *Program Review* (1994) required departments to evaluate their programs and led to significant structural change in some federal government programs (see Veldhuis, Clemens, and Palacios, 2011: 25).
3. In particular, Canada's fiscal situation was highlighted in a January 12th editorial in the *Wall Street Journal* that argued that Canada had reached a "debt wall" and might need assistance from the International Monetary Fund (Veldhuis, Clemens, and Palacios, 2011: 19).

CHAPTER 2: Spending Reductions and Reform: Bases for the Success of the 1995 Budget **by Lydia Miljan, Tegan Hill, and Niels Veldhuis**

1. Due to a break in the series following the introduction of full accrual accounting, data from 1983-84 onward are not directly comparable with earlier years.

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CHAPTER 3: How the Chrétien-Martin Budgets Cut Corporate Welfare in the Mid-1990s

by Mark Milke

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Born and raised in Canada, Professor Henderson earned a BSc degree in mathematics from the University of Winnipeg before heading south to complete his PhD in economics at the University of California, Los Angeles.

He is a frequent contributor to *The Wall Street Journal* and was previously a frequent contributor to *Fortune*. He has also written scholarly articles for the *Journal of Policy Analysis and Management*, *Journal of Monetary Economics*, *Cato Journal*, *Regulation*, *Contemporary Policy Issues*, and *Energy Journal*.

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Ron Kneebone is Scientific Director of the Social Policy & Health research division in the School of Public Policy at the University of Calgary. His published research has dealt with issues of government financing, deficits and debt reduction but he has more recently focused on issues of social assistance, poverty reduction, income inequality, and the economics of homelessness.



Lydia Miljan is an Associate Professor of Political Science at the University of Windsor and a Fraser Institute Senior Fellow. She was Director of the Fraser Institute's Alberta Policy Research Centre and from 1988 to 2001 was the Chair of the National Media Archive. She holds a PhD in Political Science from the University of Calgary specializing in political communication. Prof. Miljan teaches in the areas of Canadian public policy, research methodology, and politics and the media. Her main research interests include how journalist's personal views are reflected in news content and public opinion formation. In addition to peer-reviewed papers, she is the author of three books: *Public Policy in Canada*, *Hidden Agendas: How Journalists Influence the News*, and *Cross-Media Ownership and Democratic Practice in*



Trevor Tombe is an Associate Professor of Economics at the University of Calgary and a Research Fellow at The School of Public Policy, University of Calgary. He has an MA and a PhD in Economics from the University of Toronto. Much of his research focuses on trade, public finance, productivity, and Canadian economic and fiscal policy. He has published in top economics journals, including the *American Economic Review*, *Journal of Monetary Economics*, *Review of Economic Dynamics*, and *Canadian Journal of Economics*, among many others. He is an active contributor to Canadian policy debates, with publications through the University of Calgary's School of Public Policy and in the general media. He has also served on various expert panels, including the Yukon Financial Advisory Panel and the Alberta Market Access Task Force.



Niels Veldhuis is President of the Fraser Institute. He has written six books and more than 50 peer-reviewed studies on a wide range of economic topics. He has written more than 200 articles and commentaries that have appeared in over 50 newspapers including the *Globe and Mail*, *Wall Street Journal*, *National Post*, and the *Economist*. He holds a Bachelor's Degree in Business Administration, with joint majors in business and economics, and a Master's Degree in Economics from Simon Fraser University.



William Watson was born and raised in Montreal and educated at McGill and Yale. He taught economics at McGill from 1977 to 2017. He is best known for his regular columns in the *National Post* and for his appearances on Canadian radio and television. He is a senior fellow at the Fraser Institute, where he blogs weekly. His book, *Globalization and the Meaning of Canadian Life*, published by the University of Toronto Press, was runner-up for the Donner Prize for best book on Canadian public policy of 1998. His latest book is *The Inequality Trap: Fighting Capitalism instead of Poverty*.