Program Review:

The Government of Canada's Experience Eliminating the Deficit, 1994-1999

A Canadian Case Study

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Addressing International Governance Challenges

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Summary

Many governments relying on increased spending financed by large deficits to pull their countries out of recession will eventually face the challenge of restoring fiscal stability. Based exclusively on publicly available information, this report looks at the path the Government of Canada followed to improve the health of its public finances in the mid-1990s. Over a three-year period (1994-1997), Canada eliminated a sizable budgetary deficit. By 1998-99, all Program Review decisions were implemented. Canada ran consecutive surpluses until 2007-08. The report reviews historical financial data and examines the Program Review exercise of the mid-1990s, describing its development, process, methodology and machinery. It provides an overview of the main results and identifies lessons learned that may be of durable value in Canada and of interest to other countries as they work to restore fiscal stability in the future.

Introduction

Governments around the world have made many attempts to eliminate their deficits and reduce their debt. The results have varied widely, with some more successful than others. As the world economy experiences another recession, governments are again relying on increased spending financed by large deficits and debt. In this environment, it is appropriate and timely to examine previous efforts, assess their results and draw lessons for those who may face similar challenges and have to restore fiscal stability in the future.

Fiscal sovereignty allows a country to set an ambitious course for itself with the confidence that it can align the necessary financial and human resources in support of its plan without transferring the costs of today's choices to future generations. This report explores the experience of the Government of Canada (GoC) in eliminating its deficit and improving the overall health of its public finances between 1994 and 1999. Over a three-year period, Canada eliminated a budgetary deficit of 5.3 percent of GDP. All Program Review decisions were implemented by 1998-99. Canada ran surplus budgets until 2007-08. As a result of this effort, by 2007-08, Canada's debt-to-GDP ratio was below 30 percent, compared to almost 70 percent in 1995-96 — the best performance among the G7 countries. The report identifies some of the lessons learned in the Canadian context that may still be relevant to government leaders.

Public policy decisions matter. They affect the overall performance of countries and the well-being of citizens. Over time they can change the course of events, contribute to building a better future or accompany the decline of nations. These public policy decisions are characterized by long timelines. Years may pass before the impact of these decisions is fully understood and their unintended consequences revealed. As each government lays the foundation on which future governments govern, every decision forms the basis from which new decisions will be made.

To draw lessons from the Canadian experience of the mid-1990s, it is necessary to understand how the country's fiscal problems arose and how some of the conditions of its success in the mid-1990s had their origin in earlier events and decisions.

This report briefly refers to 1975-1984. After two decades of growth and prosperity during which the GoC played an active role in the country's economic and social development, Canada entered a period of economic slowdown accompanied by a rapidly deteriorating fiscal situation. During most of the slowdown, the GoC combined economic stimulation and anti-inflation measures. This strategy enjoyed the strong support of most Canadian opinion leaders of the time, whether in business, academia or politics.

The report makes some general observations about the period 1984-1993, a time of growing public awareness about the impact of large and growing public deficits and debt on Canada's economic performance and the well-being of Canadians. During this period, the GoC introduced ambitious structural reforms and made numerous efforts to reduce spending. The lessons learned were put to good use in later years, as these measures provided an improved context for future fiscal reforms.

The Program Review exercise was initiated in May 1994 and implemented over the following five years. Ten years later, it is time to take stock. On the basis of publicly available documents, this report describes how the exercise came about in terms of the process, the methodology and the machinery. It provides an overview of the main results and identifies lessons learned that may be of durable value in Canada and of interest to some other countries as they work to restore fiscal stability in the future.

Growth, Prosperity, Deficits and Debts: 1975-1984

Canada emerged from World War II with a heavy debt burden. "By the end of the war, the debt-to-GNP ratio was over 100 percent, a figure not approached before or since" (Lewis, 2003: 29). Following the War, Canada enjoyed 25 years of growth and prosperity, leading to a significant increase in the standard of living. By 1970, economic growth allowed the GoC to pay off most of its wartime debt.

About the Author

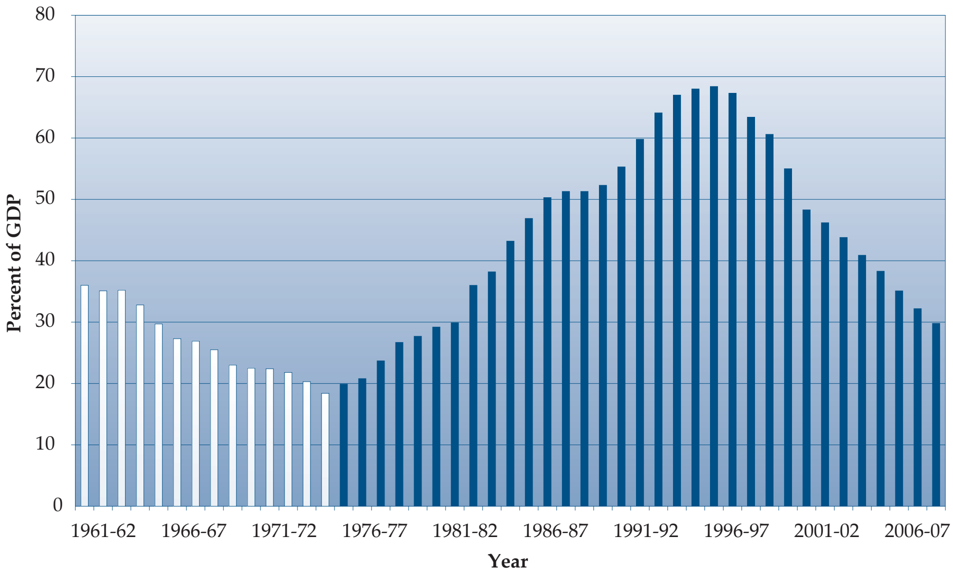
The Honourable Jocelyne Bourgon is a distinguished fellow at CIGI and a visiting professor of Public Administration at the University of Waterloo as well as president emeritus of the Canada School of Public Service. She was appointed to the rank of deputy minister in 1989 and served in various departments: Transport, the Canadian International Development Agency (CIDA) Consumer and Corporate Affairs, and the Canadian Centre for Management Development.

In 1994, she was appointed clerk of the Privy Council and secretary to the Cabinet. She became the seventeenth clerk and the first woman to hold this position. From 1994 to 1999, she led the Public Service of Canada through some of its most important reforms since the 1940s. In December 1998, she was summoned to the Queen's Privy Council for Canada in recognition of her contribution to her country. From 2003-2007, she served as ambassador to the Organisation for Economic Co-operation and Development (OECD).

During the years of growth and expansion, the GoC played an active role in the economic and social development of the country. It invested heavily in the nation's infrastructure, including roads, airports and ports. It assumed increasing social responsibilities by introducing or expanding a variety of programs, including old age security (1952), unemployment insurance benefits (1956, 1971), the family allowance program (1964, 1973), hospital insurance (1956) Medicare (1966), the Canada Assistance Plan (1966) and the Canada Pension Plan (1966).

Through the early 1970s, total public sector debt (federal and provincial) was small and, by all accounts, manageable. With a growing economy, rising revenues largely offset government expenditures. Budgets were more or less in balance. In 1974-75, the GoC had an operating budget surplus of 0.7 percent of GDP (its eighth operating surplus in 14 years). Prudent fiscal management was a matter of offsetting small operating deficits with small surpluses from year to year. For two decades, the debt to GDP ratio had slowly declined, reaching a post-war low of 18.4 percent in 1974-75 (see Figure 1).[1]

Figure 1: Federal Net Debt: 1961-62 to 1974-75



Source: Federal Government Public Accounts, 2008.

With a strong economy supporting an expansive fiscal policy, the country was doing well – strong growth, low levels of unemployment, positive balance-of-trade and rising corporate profits. There was reason to believe that the economy would continue to grow well into the future and that the GoC could rely on this growth to support an active role in the economic and social development of the country.

Stagflation

The picture started to change in the mid-1970s as Western economies, including Canada's, were confronted with stagflation – a combination of low rates of economic growth and high rates of price inflation.

Between 1974 and 1978, the average rate of price inflation was double what it was in the previous six years (up from 4.5 percent to 9.2 percent) while the average rate of GNP growth was cut in half (from 5.7 percent to 3.3 percent).[2]

Fiscal year 1974-75 would bring the last operating surplus the GoC would see for another 12 years.

By 1975, real GNP growth in Canada had been in decline for two consecutive years and inflation was on the rise (price inflation was above 10 percent and new collective wage agreements were in the 20 percent range). Unemployment had risen to seven percent. Pressed to respond to these new economic circumstances, the GoC launched an anti-inflation program (AIP) in October 1975 – a three-year plan to control prices and wages.

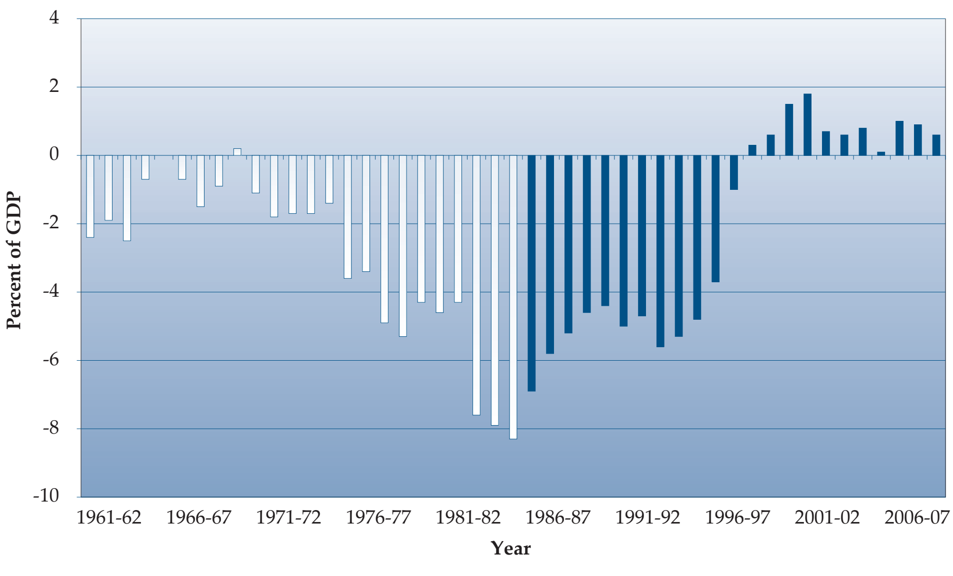
This attack on inflation followed the lead of other countries, including the United States' experimentation with price and wage freezes in the early 1970s, and the United Kingdom's "Statutory Incomes Policy" of 1972-1974. The GoC agreed with other countries that the priority was to slow the rate of inflation without impeding economic recovery.

In 1976, the GoC introduced tax cuts to stimulate the economy that were followed by more cuts in 1977 and 1978. As stagflation continued to affect an increasing number of people, government spending also increased, in part due to the rising cost of social programs. The GoC attempted to restrict the "growth" of spending; these early efforts focusing largely on reductions in "planned" spending as well as freezing salary and operating budgets.

With reduced income from taxes, program spending quickly outgrew budgetary revenue. The GoC began to run increasingly large operating deficits. The budgetary deficit reached 5.3 percent of GDP in 1978-79 (see Figure 2); the debt to GDP ratio grew to 26.7 percent of GDP. The GoC was borrowing against the future. Slower but still-growing federal spending was being financed by increasing deficits and growing debt.

Yet, it is important to note that, through most of this period, opinion leaders from government, business and academia strongly agreed with economic stimulation policies. No strong voice emerged to challenge conventional wisdom or this consensus.

Figure 2: Federal Budgetary Surplus or Deficit, 1961-62 to 1984-85



Source: Federal Government Public Accounts, 2008.

After 1978, deficits became chronic. Public debt charges were an increasingly important factor in the growth of the deficit. As the federal deficit became entrenched, it became apparent that the GoC had little experience with managing major fiscal challenges.

Prime Minister Trudeau made one attempt worth noting to limit government spending in 1978. Returning from a Western economic summit in Bonn with a better appreciation of the measures other countries had taken to reduce their deficits, he announced a $2 billion cut from current and planned spending to fund new initiatives. (It was widely reported that most of Trudeau's Cabinet, including the minister of Finance, found out about the planned cuts through the media.)[3]

The Treasury Board Secretariat identified the proposed cuts without involving individual ministers or their deputies. The measures included reducing "planned spending" (such as defence), freezing spending at existing levels (for example, the Canadian International Development Agency (CIDA) and the Canadian Broadcasting Corporation (CBC)); cuts to non-budgetary items (such as Crown corporations, including Atomic Energy of Canada Limited (AECL) and the Canada Mortgage and Housing Corporation (CMHC)) and "across the board" cuts to departmental operating costs. Many departments, which had to accept the proposed cuts or identify alternatives of an equal value, criticized their lack of involvement in the process.

In May 1979, the government of Prime Minister Trudeau was defeated. The Conservative Party formed a minority government and proposed several tax increases to reduce the growth of the deficit. The Conservative government was later defeated over these proposed tax increases, in particular a tax increase on gasoline. In this election, Canadians had signalled they wanted change; however, they were not convinced that increased taxes were the best way forward.

During its short nine-month tenure, the government of Prime Minister Clark introduced a new expenditure management system that was developed by officials following the 1978 cuts exercise. For the first time, policy and expenditure priorities would be decided at the same time by cabinet committees. This innovation would stand when the government of Prime Minister Pierre Trudeau returned to office in

February 1980. The idea of linking policy and spending decisions was viewed as an important instrument for bringing government expenditure under control.

Canada Pursues a Divergent Course

In 1980, early signs of concern about the growing federal government deficit and debt began to emerge. Although it continued to promote large fiscal deficits as an effective tool to stimulate the economy, in its annual report in 1980, the Bank of Canada warned the GoC that a large fiscal deficit would discourage business investment and hold back productivity gains if the economy did not have the "capacity to increase output." A 1980 IMF survey pointed out that Canada's deficit as a percent of GDP was disastrously high in comparison to other industrialized countries, except for Italy.[4]

This did not convince the GoC of the need to change course. If the deficit were to be addressed, it would be through tax increases rather than spending cuts, an approach that led to the demise of the Clark government a few months earlier. The GoC began to publicly discuss the possibility of tax increases.

The deputy minister of Finance stated explicitly before the Senate Committee on National Finances that reducing the deficit "… is going to have to be resolved by general tax increases across the board … I do not believe it would be fair to suggest the deficit problem is going to be resolved by major reductions in federal expenditures" (Canada, 1980b: 26). The prime minister reiterated this position in the House of Commons a week later: "We cannot cut expenses to the tune of some $14 billion. Therefore, if we want to reduce the deficit, at some point there will have to be an increase in taxes" (Canada, 1980a: 1682).

In October 1980, the GoC introduced the National Energy Policy. It would increase its share of revenue from oil and gas production. This and other revenue-generating measures would temporarily reduce the budgetary deficit to 4.3 percent of GDP by 1981-82.

By 1981, many Organisation for Economic Co-operation and Development (OECD) countries had taken action to aggressively reduce their deficits. In its December 1981 Economic Outlook, the OECD reported that the combined deficit of all OECD countries had been reduced from US$73 billion in 1980 to US$35 billion in 1981: a remarkable turn-around. Japan experienced a current account surplus of US$5.5 billion in 1981 after a deficit of US$10.7 billion in 1980, while West Germany reduced its deficit from US$16.4 billion in 1980 to US$8.5 billion in 1981 and expected that trend to continue.

Despite the progress other countries achieved, most experts and opinion leaders in Canada continued to question the wisdom of deficit reduction for fear of exacerbating the recession into which the country was slipping. The Budget of November 1981 ruled out deficit reduction by scaling down government expenditures. New tax measures were introduced. Canada pursued a divergent path from most other industrialized economies and OECD countries.

In 1982, the Canadian economy entered its second recession in three years. Inflation was over 12 percent and unemployment reached a post-war high of 8.6 percent. Growing public debt charges resulting from rising interest rates, more than expenditure increases, were driving up the deficit. Pressure continued to mount for further stimulation and increased spending. In June 1982, the GoC introduced new spending measures for infrastructure and industrial innovation.[5] It imposed controls on the salaries of public servants that had a predictably demoralizing impact on the Public Service of Canada. In October of that year, the GoC eliminated most of the tax increases introduced in the Budget of 1981 and committed to further infrastructure spending to encourage job creation.[6]

In its annual review of the economy in 1982, the Economic Council of Canada urged the GoC to introduce a moderate dose of stimulus in its upcoming budget, postulating that efforts to reduce the deficit could wait until an economic upswing. In December, the governor of the Bank of Canada stated that high government deficits were not hurting the economy and would only drive up inflation if governments competed with the private sector on borrowing markets during an upswing.

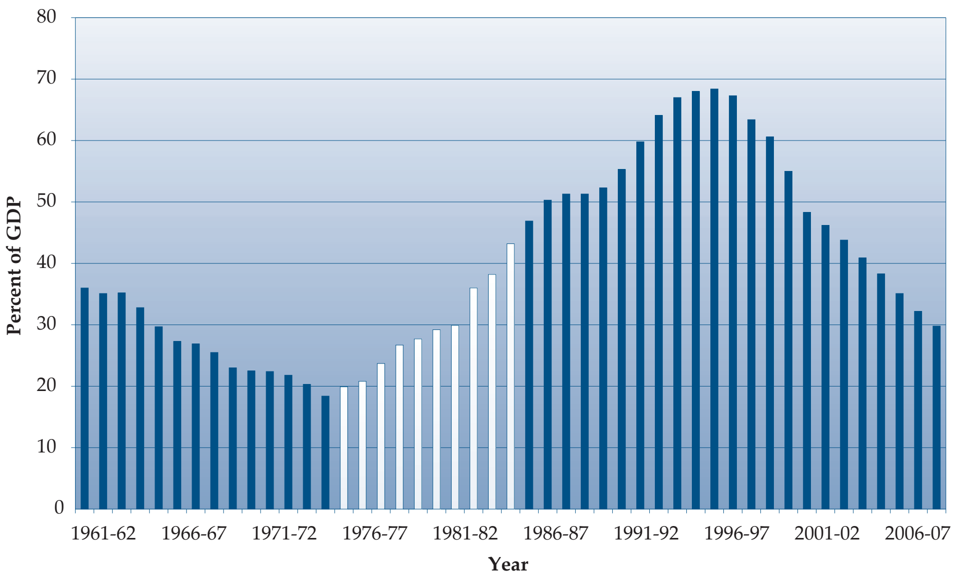
By the end of 1982, most provincial governments were calling on the GoC to inject more money into capital work projects to stimulate the economy, and they continued to call for greater fiscal stimulus and infrastructure development through 1983.[7]

Business groups called for tax cuts to stimulate the economy, even if it raised the federal deficit. The Canadian Chamber of Commerce proposed a tax cut estimated at $2-3 billion. A powerful committee of business leaders headed by Canadian Pacific Chairman Ian Sinclair called for public works spending, even if it caused a larger deficit. Many economists agreed that a $30 billion deficit in 1983-84 could be handled with ease.

Gradually, the view emerged that the GoC could manage a $30 billion deficit with no detrimental effect on the economy and that such a deficit would provide necessary support to those the recession had most affected. With a strong and broad consensus among opinion leaders, the GoC brought down a *Special Recovery Budget* in April 1983 that included further tax breaks and special recovery measures in the form of job creation and infrastructure development.

The budget measures of 1982 and 1983, combined with still growing public debt charges, added substantially to the deficit and debt. The budgetary deficit doubled to $32.4 billion and rose dramatically to 7.9 percent of GDP (see Figure 2). The debt burden grew to 38.2 percent of GDP (see Figure 3).

Figure 3: Federal Net Debt, 1975-76 to 1984-85



Source: Federal Government Public Accounts, 2008.

According to a 1983 IMF report on the G7 countries, only the governments of Canada and the United States were following expansionary policies and had diverged from Japan and industrial European nations even though this meant record budget deficits. However, Canada is very different from the United States; a similar policy course led to very different results.

In the context of this study, no evidence was found that the GoC assessed the merit and relevance of other countries' actions to Canada. As well, no indication was found that the GoC critically re-examined the policy direction it had pursued over so many years.

This period was characterized by the strong consensus among Canadian opinion leaders in favour of a stimulus policy direction in spite of the mounting evidence indicating the adverse consequences of this course of action.

Unlike the United States and some European countries, Canada was not endowed with the broad diversity of views generated by think-tanks, academia or the media. Furthermore, Canadian society does not have a strong tradition of public debate about public policy options (with some notable exceptions such as national unity or Canadian identity).With little public debate and no strong dissenting voices, Canadian public opinion research confirmed a lack of concern among Canadians about the deficit problem. In 1984, according to a Decima Research poll, less than two percent of respondents considered the federal deficit and national debt to be the most important economic problem. A separate poll by Thompson Lightstone obtained similar results.

Ronald Anderson, a business writer for *The Globe and Mail* stated with some foresight in an article that,

> "If ever the federal Government makes the hard decision to get its finances under control, Canadians may be shocked and angered by the measures that will need to be taken; taxes almost certainly would be raised, some popular spending programs will be slashed, and some programs may need to be abandoned." (Anderson, 1984)

Learning from the Past: 1975 - 1984

Important lessons may be drawn from this period:

1. No public policy agenda is valid for all time. The stimulus policies that served Canada well in the 1950s and 1960s eroded Canada's fiscal health in late 1970s and early 1980s. The challenge for governments is to anticipate emerging trends and adjust public policies to respond to changing circumstances, address emerging needs and seize opportunities. Those governments best able to adjust and adapt stand a better chance of providing their countries with comparative advantages that translate into higher standards of living and a higher quality of life. Governing is a never-ending process of transformation.

2. Public policy choices matter. In ten years (1975-1984), Canada would go from having "one of the best" to "one of the worst" fiscal performances among G7 countries. Actions taken today are already part of framing future decisions.

3. Public policy debate matters. The Canadian experience is a reminder that a strong consensus among opinion leaders does not guarantee the best policy decisions and the best policy outcomes. In fact, the stronger the consensus, the more reason to challenge the status quo and examine different policy choices. Debate elevates public understanding of policy options and improves the likelihood of sound public policy decisions.

4. Public policy preferences must be tempered by evidence. This study found no indication that the Government of Canada took account of the actions of other countries. As a result, Canada did not change its policy course for ten years. It draws attention to the importance of sound policy research and evidence-based policy advice.

By the end of this period, Canadians were ready for a change of government but they were not yet aware of what it would take to eliminate a deficit of 8.3 percent of GDP.

Changing Course: 1984 -1993

When the Progressive Conservative Party won the 1984 federal election, Canada faced the second most serious debt and deficit situation among G7 countries, Italy facing the worst. The GoC's budgetary deficit reached 8.3 percent of GDP. With program spending expanding rapidly and public debt charges consuming an increasing portion of revenue, the GoC's public debt was growing by an average of 25 percent per year and reached 43.2 percent of GDP.[8]

Most provinces were taking action to cut their deficits. In March 1984, the provincial governments of Newfoundland[9] and Nova Scotia[10] tabled budgets to cut their provincial deficits. New Brunswick followed suit in April with a budget that would cut its deficit by almost 50 percent. According to Statistics Canada, the provinces and territories were expected to show a combined deficit of $4.0 billion in fiscal 1985, compared with a deficit of $6.7 billion in fiscal 1984.[11]

The agenda of Prime Minister Brian Mulroney's government was ambitious. It included important structural reforms such as liberalizing trade and reforming the tax system. The Speech from the Throne in November 1984 committed the GoC to restoring fiscal responsibility, reducing the deficit in an orderly manner and controlling the growing debt.

> "That we must deal urgently with the deficit is beyond dispute. If allowed to continue to grow out of control, it will consume our available financial resources, undermine our capacity to respond to new opportunities, put increased pressure on interest rates, and inhibit investment and growth in our economy."(Journal of the Senate of Canada, 1984)

The same month, the government tabled its "Agenda for Economic Renewal." It posited that Canada could not spend its way out of its problems; instead it would have to grow its way to prosperity. This marked a significant departure from the GoC's previous position and the beginning of efforts to build public awareness of the impact of growing deficits and debt for future generations of Canadians.

At a First Ministers' Conference in February 1985, the GoC attempted to collaborate with the provinces to address Canada's economic and fiscal challenges. While the first ministers agreed on the problem, they did not agree on the solutions. They did, however, agree to hold annual first ministers' conferences on the economy for the next five years. On the fiscal side, the focus was on "doing more with less," eliminating waste and reducing overlap and duplication.

The GoC hosted a National Economic Conference in March 1985 bringing together leaders from all walks of society including business, aboriginal communities, women's groups, labour and other governments. Although the Conference began with much enthusiasm, once again participants could not reach consensus on the measures to be taken. The main results were a heightened recognition of the seriousness of the situation and a growing awareness of the importance of the issue.

In May 1985, the GoC started to introduce measures to implement its Agenda for Economic Renewal. "Across the board cuts" were introduced to reduce the size of the Public Service and restrain operating and capital budgets. The GoC announced the privatization of some Crown corporations and the reduction of some industrial subsidy programs. It also signalled its intention to adjust future transfer payments to the provinces. At the same time, it introduced capital gains tax exemptions and other tax measures to promote economic growth.[12]

The decision to reduce taxes on the one hand and to possibly reduce transfer payments on the other hand was controversial and criticized as an attempt to shift the deficit burden to the provinces. The minister of Finance deployed considerable efforts on behalf of the GoC to build public awareness of the impact of sustained large deficits. He argued that the problem was structural, not cyclical, and that, if unchecked, it could deny Canada the investment needed to grow and to create jobs, and ultimately reduce the living standards of Canadians.

The GoC announced more expenditure reductions and more "across the board cuts" affecting all government programs in February 1986. It included salary reductions and/or freezes for politicians and senior public servants. It also introduced further restrictions in the growth of departmental operating costs, the further privatization of Crown corporations and reduced spending on foreign aid and defence.[13]

The GoC projected fiscal stability by the end of the decade. The 1986 budget was the last "fiscal budget" of the government of Prime Minister Brian Mulroney. Further budgets, while announcing additional cuts and freezes, would increasingly focus on structural reform, with Canada-US free trade and tax reform leading the way.

An Early Attempt

Early in the government's mandate, Prime Minister Mulroney announced the creation of a task force to review all departmental programs to be led by Deputy Prime Minister Erik Nielsen (the Nielsen Task Force). The review was modelled on reviews undertaken in the United States (Grace) and the United Kingdom (Rayner). The Nielsen Task Force involved a partnership between the private sector and government — over 100 private sector participants and nearly as many public servants reviewed some 1,000 government programs.

After 18 months of work, the task force recommended substantial subsidy reductions, spending cuts, machinery changes and privatizations amounting to $7 to $8 billion. However, many, in particular the most ambitious recommendations, would never be implemented. One Treasury Board estimate indicated that savings of $500 million in ongoing expenditures reductions could be attributed to the Neilsen exercise. These recommendations were included in the 1985 and 1986 Budgets.

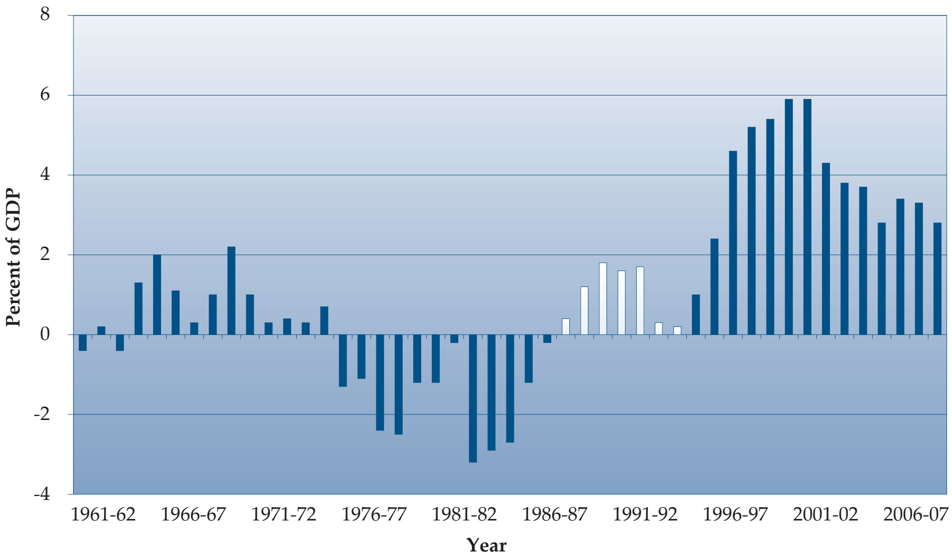
While the work of the task force led to limited expenditure reductions, its most important contribution was the lessons learned, which have been documented by various authors. Ambitious reforms require political commitment and political will at the most senior levels, tapping the best available knowledge in the public sector, building consensus and the support needed to ensure successful implementation. Implementation is the true measure of a policy decision. These lessons would be put to good use in later years.

Making Progress – Not Enough and Not Fast Enough

In the fall of 1986, unforeseen circumstances (lower than expected world oil and grain prices) led the GoC to adjust its deficit target upward, thus accepting a slower fiscal track. Management initiatives and tax measures were introduced in February 1987 to achieve the new target.[14] To maintain the new fiscal track, the GoC once more announced "across the board" cuts to the departmental budgets in 1988.

By 1987-88, the GoC achieved a small operating budget surplus; for the first time in twelve years, it did not borrow to cover its operating costs (see Figure 4). The budgetary deficit had been reduced from 8.3 percent of GDP in 1984-85 to 5.2 percent, a major achievement.

Figure 4: Federal Operating Surplus or Deficit, 1987-88 to 1993-94



Source: Federal Government Public Accounts, 2008

Until 1988-89, the GoC was progressing relatively well in its effort to reduce the deficit. In that year, the budgetary deficit reached a seven-year low of $27.9 billion and, by 1989-90, an eight year low of 4.4 percent of GDP (see Figure 5).

However, total federal and provincial government deficits remained high by historical standards. With interest rates on the rise, the GoC faced growing concern that it would fall farther off its fiscal track. Calls for the GoC to further cut its deficit came not only from international organizations such as the IMF and the OECD but also from the Economic Council of Canada and the Canadian Chamber of Commerce. Finally, the deficit was becoming the top concern of the business community.

By early 1990, taking action on the deficit was also the number one issue for Canadians. One poll by Insight Canada Research showed that Canadians supported spending cuts (foreign aid, defence). Another, conducted by *The Globe and Mail* and CBC News, revealed a willingness to accept the goods and services tax (GST) if it were tied to deficit reduction. A Gallup poll revealed that 80 percent of Canadians were either "very" or "somewhat" concerned about the federal deficit. This consensus emerged as the window of opportunity for further fiscal reforms was closing and the country was facing the early signs of a recession.

From 1989 to 1993, the GoC resorted to increasingly stringent measures in an attempt to control spending and maintain a small operating surplus. However, as the recession took hold in 1991-92, the government would consistently underestimate interest charges on the public debt. High interest rates would thwart the government's efforts to address the deficit issue.

In early 1989, the GoC announced more spending cuts and tax increases. This included "deferring planned spending" (defence, child care), "restraining spending growth" (official development assistance, transfers to the provinces, regional development funding), reducing subsidies (passenger rail, business subsidies) and further cuts affecting government operations. This was followed in December 1989 with an announcement by the president of the Treasury Board of additional measures designed to save a further $1.4 billion over three years. [15]

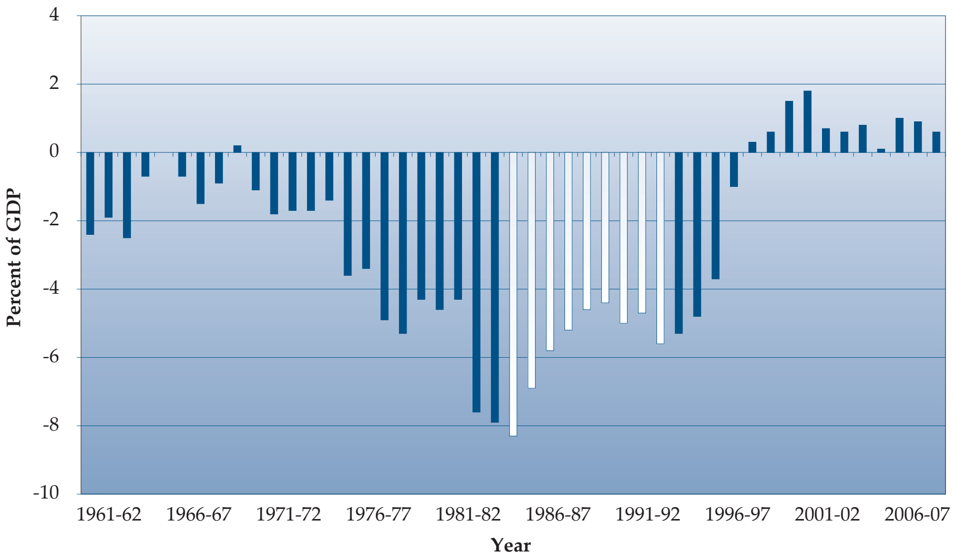
In 1990, the GoC announced expenditure controls affecting a broad range of government operations[16] and the minister of Finance announced that the GST would contribute to deficit reduction. In 1991, the GoC extended the expenditure control measures announced in 1990 and imposed further restraints on government spending.[17]

Within the Public Service, tensions were rising as departments struggled to maintain services with ever-declining resources. In March 1999, the president of the Treasury Board froze public service salaries. This precipitated the largest federal public service strike in Canadian history in September 1991.

To cope with the economic downturn, the GoC introduced tax reductions and new spending on infrastructure and training in February 1992, and further spending cuts including cuts to a wide range of programs and an "across the board" three percent cut to departmental operating budgets, to pay for these measures.[18]

The GoC announced more "across the board" cuts[19] in 1992, cutting departmental operating budgets by another three percent and freezing public service salaries for an additional two years. Later that year, the GoC announced plans to reform the unemployment insurance regime, changes that would help achieve fiscal savings down the road. It introduced still further cuts to departmental operating budgets in April 1993.[20] Between 1984 and 1993, the GoC made a total of 22 budget cuts, each more difficult than the previous and each more demoralizing for the Public Service.[21] But despite these efforts, the budgetary deficit was once again on the rise, reaching 5.6 percent of GDP in 1992-93 (see Figure 5). The federal debt reached 64 percent of GDP.

Figure 5: Federal Budgetary Surplus or Deficit, 1984-85 to 1992-93



Source: Federal Government Public Accounts, 2008

Structural Reform and Agenda Overload

To make matters more challenging, the growing deficit and debt were not the only issues on the GoC's agenda. From 1984 to the election of 1988, the government pursued an economic agenda that extended well beyond restoring the health of public finances, launching a number of major structural reforms, many of which would mature or enter a critical phase simultaneously. While they created more favourable conditions for Canada's economic performance and for future public sector reforms, they also caused serious agenda overload for the government during the last few years of its mandate. The following is a reminder of the critical phases of some of the most important reforms during this period.

Free Trade Agreement

At their conference on the economy in February 1985, first ministers endorsed the "cautious" exploration of a free trade agreement with the United States. The United States Congress approved fast-track legislation giving negotiators until October 1987 to reach an agreement. Thus began an intense period of work involving all provincial governments and federal departments. The Canada-United States Free Trade Agreement dominated the 1988 election campaign, just as the early signs of recession began to emerge. Following the election, the government of Prime Minister Brian Mulroney quickly passed legislation and the agreement came into effect on January 1, 1989.

In 1990, the Government of Mexico formally asked the United States to open talks on a free trade agreement between the two countries. The GoC decided to pursue negotiations of what would become the North American Free Trade Agreement (NAFTA) and negotiations began in June 1991.

Tax Reform

In the Speech from the Throne of 1986, the GoC committed to pursue comprehensive tax reform. A White Paper on Tax Reform was released in June 1987. Proposed reforms were to be implemented in two stages. The first phase, in 1988, before an election, would lower personal income tax rates. The second phase, after the election, would reform the federal sales tax system. This two-phased approach was criticized as politically motivated. Tax reform became a contentious issue as the government entered its second mandate.

In September 1990, with Liberal senators threatening to defeat the tax reforms (GST), the prime minister added eight senators to the upper chamber to tip the scales in the government's favour. A seven percent GST came into effect on January 1, 1991.

Constitutional Reform

Late in its first mandate, the GoC decided to open another front. Several First Ministers' Conferences on constitutional issues led to the signature of the Meech Lake Accord in June 1987. This emotionally charged issue mobilized the attention of cabinet ministers and the prime minister for the better part of 1987. The accord collapsed when it did not receive ratification in all provincial legislatures. The consequences for national unity were devastating. A new mega-round of constitutional negotiations followed in an attempt to mitigate these consequences and to find a modern constitutional compact.

Much of 1992 was consumed by constitutional negotiations. In June, the GoC, all provinces, territorial governments and four aboriginal associations reached unanimous agreement on a vast and complex set of constitutional amendments known as the Charlottetown Accord, which was defeated in a national referendum in October 1992. This agenda absorbed a substantial amount of the time of ministers and the Public Service. When met with a global recession, an overloaded agenda would spell trouble for the government.

By 1993, Decima Polls showed Canadians' concern for the deficit at an all-time high and out-ranking job creation. An April 1993 Gallup poll reported that 70 percent of Canadians would cut spending to reduce the deficit, rather than increase spending to stimulate the economy. A broad-based societal consensus for action had emerged.

Even though the budgetary deficit (at 5.3 percent of GDP) was some three percentage points lower than when the government of Prime Minister Mulroney took office in 1984, the government was blamed for the lack of progress on addressing the deficit and debt issue. The progress achieved over the first six years of its mandate was long-since forgotten.

The main contribution to restoring the fiscal health of public finances were the structural reforms that provided more favourable conditions for the Canadian economy and lay the basis for future fiscal reforms. The extent of the benefits to the Canadian economy of the GST and the Canada-United States Free Trade Agreement would only become evident years later. In November 1993, the government was defeated.

Learning from the Past: 1984 - 1993

Important lessons were learned during this period. The Public Service gained experience about fiscal management, including the merit of various approaches, the conditions of success, and the risks to be avoided. Lessons included:

1. Agenda overload increases the risk of failure. Eliminating a sizable deficit is a major undertaking. Fiscal reform of the scale discussed in this article affects all government departments and agencies, leaving little room for other ambitious reforms.

2. Public awareness is necessary for citizens to accept the sacrifice demanded of them. The lower the public awareness of the problem, the harder it is to reduce government spending and the longer it takes to implement fiscal reform.

3. "Across the board" cuts and freezes that affect program and services in an undifferentiated way have significant perverse effects. Such cuts erode the quality of public services, reduce the quantity of available services for the same level of taxpayer contribution and affect morale in the Public Service. Over time, they erode citizens' confidence in government, in the public sector and in public organizations.

4. Efficiency measures or "doing more with less" are not viable solutions to eliminate a sizable deficit. They may help with internal reallocations from lower to higher priorities, but there is no substitute

to making choices about the relative importance of government programs to eliminate a large deficit. It comes down to repositioning the role of the government within the collective means of citizens.

5. Acting quickly can help avoid unforeseen circumstances. External factors beyond the control of government can steer it off course. Each failed attempt makes the next one increasingly difficult. Once the process has begun, it is preferable to aim for a balanced budget.

This experience would be put to good use in the future when circumstances would once again make an attempt at fiscal sovereignty possible.

Regaining Canada's Fiscal Sovereignty: 1993 - 1999

During the election campaign of 1993, all political parties emphasized economic growth and job creation as priorities, with comparable reference to deficit reduction.

The Liberal Party promised to reduce the deficit to three percent of GDP by the end of its third year in office. This commitment was consistent with the approach of other countries and similar to that which was subscribed to by the European Community. This commitment would be achieved through economic growth and some spending cuts such as in defence, consulting services and grants to businesses.

The Progressive Conservative Party promised to eliminate the deficit within five years, by eliminating waste and inefficiency, cutting government operating costs, business subsidies, and reducing international assistance and defence spending. It also promised not to shift the deficit burden to the provinces.

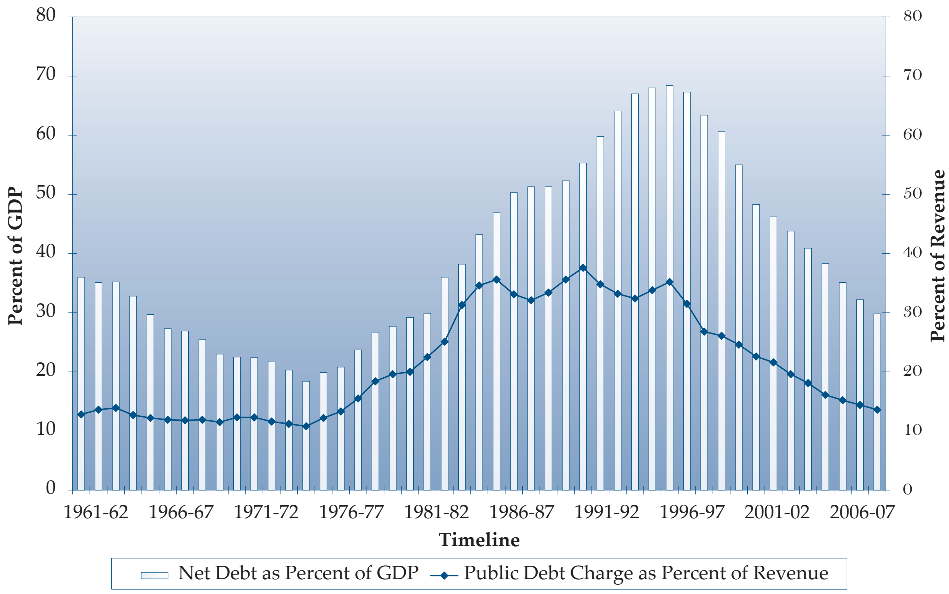
The Reform Party had the most ambitious proposal. It proposed to eliminate the deficit in three years by cutting government operations and programs. Transfers to the provinces, business, special interest groups and individuals would be reduced.

The Bloc Québécois promised, if it held the balance of power in a minority government, to force the GoC to cut spending by $10 billion in the first year by eliminating waste, cutting military spending, eliminating duplication of programs provided by the provinces and ending tax shelters.

The New Democratic Party had the least ambitious plan. Nevertheless, it recognized the need to contain the deficit and, if elected, stated that it would not increase the deficit during its term in office.

A Liberal government, led by Prime Minister Jean Chrétien, was elected to office in November 1993. By this time, the GoC's debt had reached 67 percent of GDP. Servicing that debt consumed roughly 35 percent of government revenues, up from 11 percent in 1974-75 (see Figure 6).

Figure 6: Federal Net Debt/Public Debt Charges



Source: Federal Government Public Accounts, 2008

The Speech from the Throne of January 1994 made little reference to the growing deficit and debt burden. The Budget of February 1994 reaffirmed the electoral commitment of reducing the deficit to three percent of GDP over three years. It said little about how this would be accomplished other than the minister responsible for Public Service Renewal would lead a review of

> "… all aspects of departmental spending to ensure that lower priority programs are reduced or eliminated and that the government's diminished resources are directed to the highest priority requirements…."(Martin, 1994a)

The budget was not well received in financial circles. This, and several weeks of negative media coverage, would convince the government that it had to take the fiscal situation seriously.

The government of Prime Minister Jean Chrétien used Program Review as its primary vehicle to eliminate the deficit during its first term in office. The Privy Council Office developed the concept, modelling it on the approach initiated by the Department of Transport in 1992-93. Program Review drew on the lessons learned from previous attempts to reduce the deficit.

The model took shape through various discussions between the prime minister, the minister responsible for Public Service Renewal, the minister of Finance and the secretary to the Cabinet. The Cabinet Office, the Department of Finance and the Treasury Board Secretariat also played an active role. It was introduced in Cabinet by the prime minister — a clear signal of its importance. Program Review was different from every prior exercise in its approach, the scope of the effort, the process and the guiding principles.

The Approach

Program Review rejected the concept of "across the board" cuts and the view that a sizable deficit could be eliminated through increased productivity. Instead, it posited that no alternative existed other than to evaluate the relative importance of government programs and services within the overall fiscal framework. Once these choices were made, the GoC could consider the relative efficiency of various policy options. As it was role focused, it was not based on performance indicators or performance results, which is best suited to reallocations and not to reducing a sizable deficit.

Seen in this light, the exercise was less about "what to cut" and more about "what to preserve" to give Canada the comparative advantages needed to prosper in the future — less of a fiscal exercise and more of "un projet de société" undertaken under severe fiscal constraints. Program Review offered each department an opportunity to "redesign itself to fulfil its roles and responsibilities within a federal government better adapted to the needs and requirements of the future and within its constrained budget"(Massé, 1994).

The Scope

Program Review was a broad-based exercise involving all departments and organizations reporting to a minister and through a minister to Parliament, including agencies, Crown corporations or quasi-judicial bodies. It took a portfolio-based approach and nothing was off the table.

Soon after the election, the GoC launched a number of policy reviews ranging from defence to foreign policy, science and technology, small business and the efficiency of the federation to a review of all federal agencies. These reviews were progressively rolled into Program Review. The last to be integrated was social security, covering a complex range of social programs and transfers to individuals.

The Process

One of the most important characteristics of the Program Review process was the reliance on ministers and deputy ministers as the architects of departmental reforms.

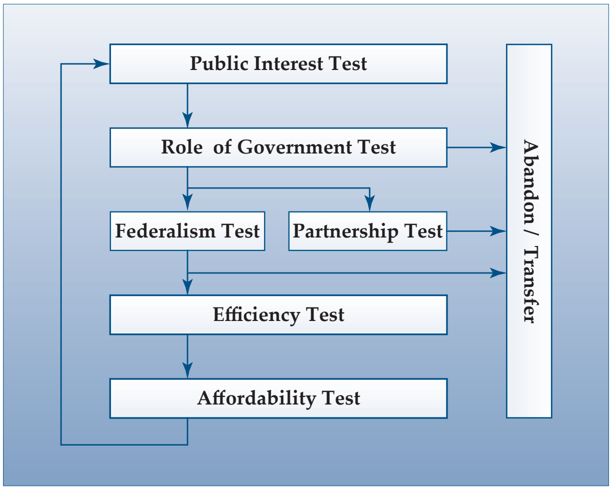
Minister and deputy ministers "as a team" were given the responsibility of coming forward with a common proposal for the future role of the department in serving Canadians, taking into account the GoC's three-year fiscal plan. This approach ensured a strong link between policy choice and policy implementation, and reduced the risk of tactical behaviour (ministers arguing that they could do more if it was not for the resistance of the Public Service, and public servants arguing that they could do more if there was political will to take action).

Recognizing the diversity of circumstances, missions and mandates, the GoC gave ministers and deputies a free hand on how to prepare their proposals, who to involve and how broadly to consult. In some departments, the process was more open and widely shared with employees than in others. Some had significant stakeholder involvement, while others conducted their reviews internally. Some could rely on strong internal policy research and years of consultation with key stakeholders, while this was severely lacking in others.

Departments were not given individual fiscal targets until later in the exercise. This was important for several reasons. First, central agencies did not have sufficient knowledge to set reasonable fiscal targets for individual departments. Second, centrally imposed targets would have made it impossible for departments to put forward proposals that exceeded the target. Third, targeted cuts would deliver cuts, not role realignment.

However, ministers and deputy ministers were given a "common set of principles," framed as six interconnected tests (see Figure 7), with which to carry out their review. The tests were an interactive sequence of questioning going from the role to the effectiveness and finally to the affordability of the overall proposal.

Figure 7: Program Review Test - Decision Tree



These tests served as the conceptual framework for the exercise. They were framed as six questions:

1. Does the program or activity continue to serve a public interest?
2. Is there a legitimate and necessary role for government in this program area or activity?
3. Is the current role of the federal government appropriate or is the program a candidate for realignment with the provinces?
4. What activities or programs should or could be transferred in whole or in part to the private or voluntary sector?
5. If the program or activity continues, how could its efficiency be improved?
6. Is the resultant package of programs and activities affordable within the fiscal restraint? If not, what programs or activities should be abandoned?

As a result, Program Review was an ongoing process that looped back on itself if the overall proposal did not generate significant savings.

The tests were used for many years after the Program Review decisions had been implemented to assess departmental proposals for reallocation or for funding new initiatives.

Another important characteristic of Program Review was the opening up of the federal budget process. Although details of the budget were kept confidential, the minister of Finance opened a broad dialogue with private sector experts, Parliament and Canadians about planning assumptions and potential fiscal measures. This contributed to building public understanding and support for an ambitious reform program. The minister also opened the process to ministers, using a cabinet committee to recommend budget options. This approach would be continued for future federal budget initiatives. Within the Public Service, the deputy minister of Finance was the architect of the most open approach to budget planning that the Department of Finance had ever undertaken, working closely with the Privy Council Office and the Treasury Board Secretariat to review assumptions, options and proposals, thus ensuring a seamless approach.

Important innovations would help ensure success. Planning assumptions for growth and interest rates were more cautious than the private sector average. All policy reserves were eliminated. A "contingency reserve" was created to deal with unforeseen circumstances in the economy that, if not required to hit the spending targets, would contribute to lower the deficit. The Treasury Board Secretariat reduced restraints on departments, making it easier to reallocate funds and implement decisions.

The Machinery – Three Tables and a Small Secretariat

The decision-making process was crucial in Program Review's success. Each department was required to submit a Strategic Action Plan containing their minister's and deputy minister's proposals for reform.

Three committees reviewed the departmental proposals:

- A steering committee of deputy ministers, operating as a peer review committee;
- A special cabinet committee of ministers to vet the proposals and build political consensus; and
- Full cabinet to arbitrate major issues and ensure overall balance and cabinet solidarity. The prime minister ensured discipline and the political support of ministers, caucus and the governing party.

The Deputy Ministers' Committee

The clerk of the Privy Council and secretary to the Cabinet chaired the steering committee of deputy ministers. In Canada, the secretary to the Cabinet plays a key role in managing the community of deputy ministers in support of government-wide priorities. With direct access to the prime minister, the clerk's commitment to chair the steering committee sent a strong signal of the importance of the exercise. This committee served as a peer review panel, a clearing house for all departmental proposals and the primary source of advice to departments and to the special cabinet committee on the plans of departments.

The committee of deputy ministers included experienced deputy ministers representing the Privy Council Office, the Department of Finance and the Treasury Board Secretariat, as well as large and small departments. The members were:

- Jocelyne Bourgon, clerk of the Privy Council and secretary to the Cabinet (Chair);
- David Dodge, deputy minister of Finance;
- Robert Giroux, followed by V. Peter Harder, secretary of the Treasury Board;
- Mel Cappe, deputy minister of the Environment;
- Suzanne Hurtubise, deputy secretary, Plans and Priorities, Privy Council Office;
- Ranald Quail, deputy minister of Public Works and Government Services Canada;
- Janet Smith, deputy minister of Western Economic Diversification; and
- Wayne Wouters, executive director, Program Review Secretariat, Privy Council Office.

The committee operated in an open and transparent manner. All assessments prepared were shared with the minister, the deputy minister and members of the cabinet committee. The committee's findings were presented to the cabinet committee by the deputy secretary to the Cabinet, Plans and Priorities. This gave sponsoring ministers a full voice in the discussion, freeing them from defending or opposing the proposals. It allowed them and their colleagues on the cabinet committee to focus on forging a political consensus.

The Cabinet Committee

The special cabinet committee provided the political oversight to the exercise. Its membership was carefully selected by the prime minister. From an institutional perspective, besides the chair, it included the minister of Finance, the president of the Treasury Board, the chairs of the Economic and Social Cabinet committees and the leader of the government in the House of Commons. It also included ministers who provided strong, balanced regional representation and a diversity of political perspectives. The members were:

- The Honourable Marcel Massé, president of the Privy Council, minister of Intergovernmental Affairs and minister responsible for Public Service Renewal (Chair);
- The Honourable Paul Martin, minister of Finance;
- The Honourable Art Eggleton, president of the Treasury Board;
- The Honourable Sheila Copps, deputy prime minister, minister of the Environment and chair of the Cabinet Committee on Social Development Policy;
- The Honourable Herb Gray, leader of the Government in the House of Commons and solicitor general of Canada;
- The Honourable André Ouellet, secretary of state for External Affairs and chair of the Cabinet Committee on Economic Development Policy;
- The Honourable Anne McLellan, minister of Energy, Mines and Resources;
- The Honourable Sergio Marchi, minister of Citizenship and Immigration; and
- The Honourable Brian Tobin, minister of Fisheries and Oceans.

The choice of chair was an important decision. With no department of his own, but access to the prime minister, the chair's primary responsibility was to build a strong political consensus on behalf of the government.

Assigning this role to the minister responsible for Public Service Renewal gave more freedom to the minister of Finance to argue for greater fiscal discipline and encourage an aggressive approach to deficit reduction. It also gave the minister of Finance more time for broad public consultations, such as with the finance and business communities, interest groups, citizens and parliamentarians.

The cabinet committee relied heavily on the important principle that "nothing is agreed until everything is agreed," which deflected tactical behaviour by those who hoped they could be exempted and, at the same time, protected those who came forward early with ambitious proposals.

The Prime Minister and Cabinet

The third level of oversight was full cabinet, the most important decision-making forum of the GoC. Cabinet is comprised of all ministers and is chaired by the prime minister. It provided the political leadership to the review, ensured ministerial solidarity and assessed the overall balance and impact of the proposals. The role of Cabinet and the leadership of the prime minister were critically important to the success of Program Review.

The prime minister played a key role in ensuring the discipline of the governing party and the participation of all. No department was exempt, no minister was allowed to step aside leaving the burden to others, no exceptions or "special cases" were allowed until after the following election.

This undertaking would not have been possible without the resolve of Prime Minister Chrétien and his strong collaboration with the minister of Finance. Whatever differences they might have had, on this matter they were determined to stay the course. This was an essential condition for success.

The collective and inclusive nature of this process, the transparency of the exercise and the discipline provided by the prime minister built confidence and trust and encouraged ministers to bring forward increasingly ambitious proposals. It was a defining characteristic of Program Review and one of the most impressive and modern Canadian examples of cabinet government.

The Program Review Secretariat

A small secretariat consisting of an executive director, five officers and two support staff was created in the Privy Council Office. Available to facilitate liaison among departments and central agencies and responsible for ensuring a coordinated presentation to the deputy minister and minister committees, it reported to the deputy secretary to Cabinet, the second most senior deputy in the Canadian public service. Since it was not a permanent institution, staff was seconded for the period of the review.

The Review Chronology – Step by Step

Program Review was formally launched on May 18, 1994. That day, the president of the Privy Council and minister responsible for Public Service Renewal wrote to his cabinet colleagues to outline the general approach and the guiding principles for the exercise. The letter informed ministers that they and their departments were responsible for reviewing and assessing their own programs and activities against a common set of guidelines. At the same time, the secretary to the Cabinet briefed all deputy ministers on what was expected of them over the coming months. Departments were given three months to develop their plans.

In June 1994, the Program Review Secretariat issued a short presentation on organizing for Program Review. It insisted on the need to modernize the work of the GoC, noting that "across the board" cuts were not a desirable way to manage fiscal restraint. It drew lessons from the Neilsen Task Force exercise of 1984 and lessons from other countries, and reminded departments that meeting the overall fiscal target would require "real" cuts, not just reductions in planned spending increases.

Departments were advised to designate a "program review coordinator," to help manage departmental coordination and ensure timely liaison with the Program Review Secretariat. As it was anticipated that a number of "horizontal reviews" would be required in the fall to address cross-cutting issues common to several departments and agencies, program review coordinators would also contribute to government-wide coordination.

In early July, the secretariat issued more detailed guidelines for the development of "Strategic Action Plans" dealing mainly with issues of common format and data. It reiterated that the central objective was to identify core federal roles and responsibilities and provide modern, affordable government. Program Review had to proceed expeditiously under a tight timeline as the work had to be completed in time for the Budget of February 1995. Strategic Action Plans were to be submitted to the Program Review Secretariat by August 31.

In September 1994, at a Speech to the Canadian Chamber of Commerce, Prime Minister Chrétien reiterated the importance and objectives of Program Review. He said that his government did not believe in cutting and slashing simply for the sake of cutting and slashing, and continued, "We believe that government can and must be a force for good in society. Therefore we must get our priorities right"(Chrétien, 1994).

The committee of deputy ministers started to review departmental proposals in mid-September, meeting every two weeks for a full day. To facilitate the review, the committee agreed that departments and agencies with similar roles and responsibilities would be reviewed as a cluster during the same session. For instance, the Cabinet Office, the Department of Finance, the Treasury Board Secretariat and the Public Service Commission were reviewed together. In this particular case, the committee decided to review them first to reinforce the message that no organization would be exempted, not even those reporting to the prime minister and the minister of Finance.

The chairs of the cabinet committee and the deputy minister committee agreed that the committee of deputy ministers would perform a challenge function. It would share its assessment notes and recommendations with all members of the cabinet committee and with the sponsoring minister and deputy minister. As noted above, the deputy secretary to Cabinet would present the assessment notes at the cabinet committee.

The cabinet committee held its first organizing meeting on August 30, 1994. It started its substantive work in late September and met weekly through November. In early December, it met twice weekly to address cross-cutting issues in order to identify additional savings.

The prime minister was briefed regularly and full cabinet received regular updates. During Program Review, Prime Minister Chrétien expanded the practice of ministers' retreats (all-day events that allow ministers to look ahead and to focus on government-wide priorities) that existed under previous governments to integrate the government's budget planning cycle. During Program Review, the prime minister used ministers' retreats to build and consolidate political support for proposals.

The first retreat took place in late October 1994, following which departments were given targets with which to finalize their action plans. The targets had the benefit of the minister and deputy minister's own thinking about possibilities, taking into account the results of the deputy minister peer review and cabinet committee discussions. Even then, the notional targets were designed to be challenging.

Through the fall, ministers developed an ambitious package of reforms sufficient to eliminate the deficit over three years and, therefore, exceeding by far the overall target initially set in Budget 1994.

In the late fall, the Mexican peso crisis clearly demonstrated the vulnerability of nations to international financial markets and underlined the loss of control that a government can experience from carrying too much debt. Canada's fiscal problems concerned international investors, resulting in significant pressure on the Canadian dollar and upward pressure on interest rates. This led Moodys to issue a pre-budget credit warning. In January 1995, "Bankrupt Canada?" a *Wall Street Journal* editorial, stated that if Canada did not take dramatic action to address its debt problem, it could "hit the debt wall." The seriousness of the situation "shook Ottawa and Canada's financial community to the core" (Chrétien, 2007: 65).

The Program Review recommendations were tabled at a cabinet retreat on January 17, 1995, as part of cabinet's consideration of Budget 1995. Canada's deteriorating economic situation and vulnerability to international financial markets increased the determination of ministers to resolve Canada's fiscal situation and consolidated the consensus to move ahead with an ambitious plan.

Program Review decisions were announced in Budget 1995 and confirmed in the budget legislation, affording them legal protection. Protecting those decisions meant that it would be difficult to undo any single decision, thus preventing erosion. The decision to incorporate Program Review decisions in the budget legislation required a detailed discussion among departments and central agencies to confirm what had been agreed upon. A team consisting of the Program Review Secretariat and departmental program review coordinators was established to oversee implementation.

A second round of Program Review took place in 1995, focusing largely on horizontal issues that cut across departments. This would yield some additional measures that were announced in Budget 1996.

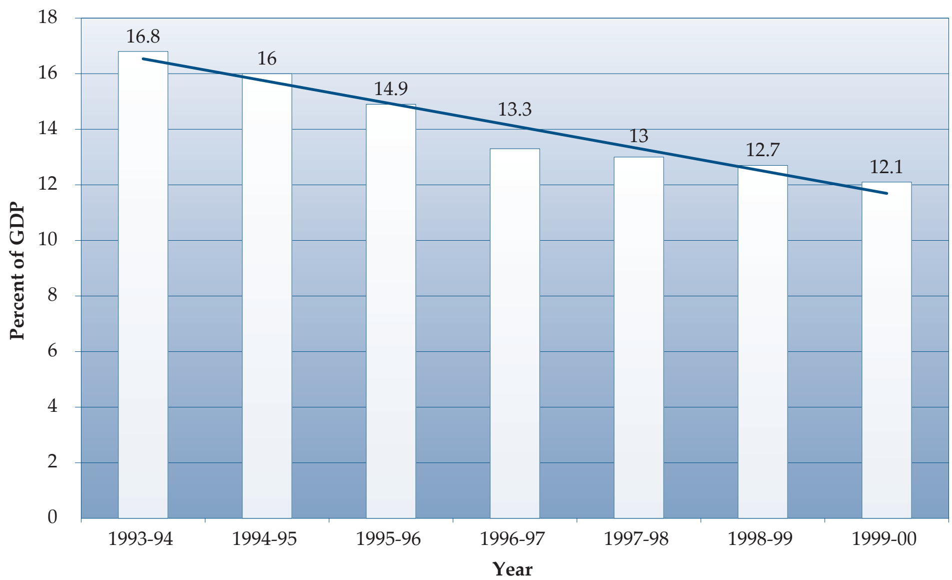
Program Review would result in the most important realignment of the GoC's role since World War II — and it was achieved peacefully, without the social unrest that some other countries experienced.

Program Review: The Outcomes

An Unprecedented Reduction in Program Spending

As a result of Program Review, program spending (which includes all spending except interest payments on the public debt) declined in absolute terms by over 10 percent between 1994-95 and 1996-97. Half of these reductions were the result of changes to statutory programs, including employment insurance benefit payments to individuals and fiscal transfers to the provinces. Relative to the size of the economy, the decline was even more dramatic. Program spending fell from 16.8 percent of GDP in 1993-94 to 12.1 percent in 1999-2000, its lowest level since 1949-50 (see Figure 8). These reductions resulted in significant progress in addressing structural spending problems.

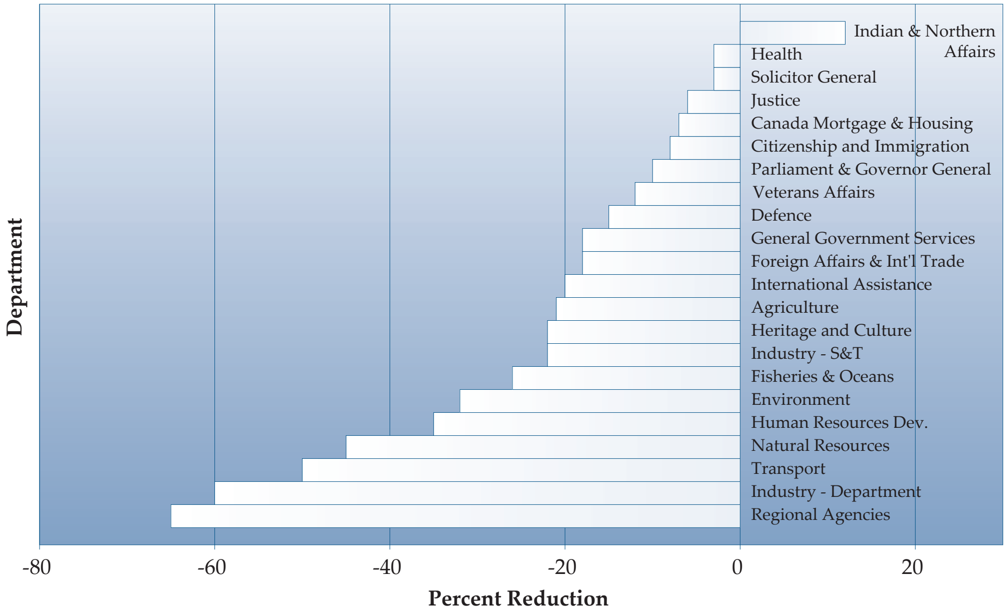
Figure 8: Program Spending



Source: Federal Government Public Accounts, 2008

Since the exercise focused on the GoC's role, different departments were called upon to make very different contributions (see Figure 9).

Figure 9: Changes in Federal Department Spending 1997-98 Relative to 1994-95



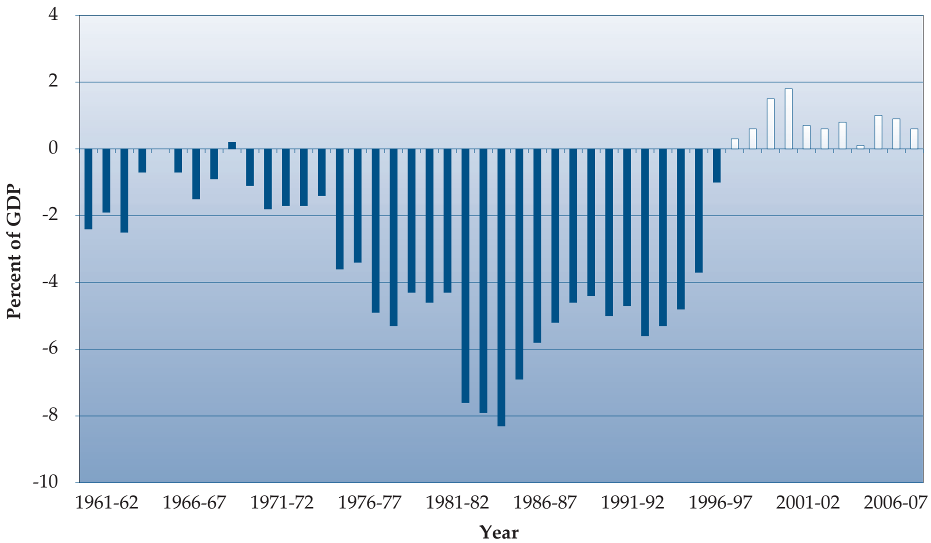
Source: Martin, 1995

Some program spending, such as for aboriginal peoples and children, was increased. Some departments made modest reductions in light of their importance to the well-being of Canadians, e.g., those in the health and justice sectors. Some used the opportunity to fundamentally redefine their mission to better respond to the changing needs of Canadians in the twenty-first century. This was the case for Transport, Industry, Fisheries and Oceans and, to a lesser extent, Agriculture. In retrospect, some departments cut too deeply and reinvestments and course corrections became necessary in subsequent years. It rapidly became clear in the Department of National Defence, for instance, that the rent expected as a result of the end of the Cold War would not materialize. Missions were becoming more numerous, more complex and more costly.

Elimination of the Deficit

As a result of favourable circumstances (no recession), the benefits of previous structural reforms (economic growth precipitated by free trade agreements and a growing revenue base resulting from tax reform), as well as sustainable expenditure reductions resulting from Program Review, the GoC eliminated its deficit in three years, leading to its first surplus budget in 28 years in 1997-98 and to 11 consecutive years of surpluses. The surplus would reach 1.8 percent of GDP in 2000-2001, despite a world-wide economic downturn (see Figure 10).

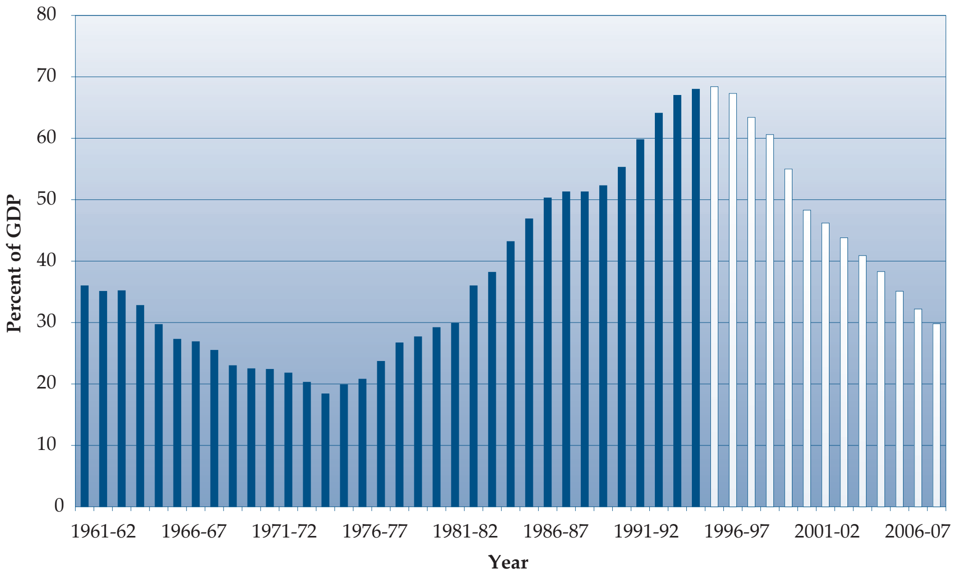
Figure 10: Federal Budgetary Surplus or Deficit, 1997-98 to 2007-08



Source: Federal Government Public Accounts, 2008

By 2007-08, the federal debt-to-GDP ratio was down to 29.8 percent from a high of almost 70 percent in 1995-96 (see Figure 11).

Figure 11: Federal Net Debt, 1995-96 to 2007-08

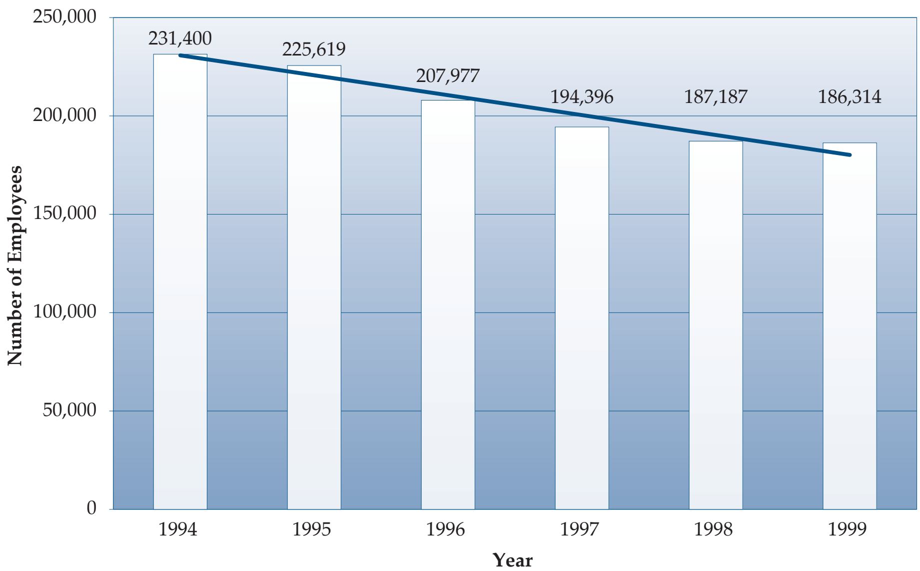


Source: Federal Government Public Accounts, 2008

A Smaller Public Service

Program Review had a significant impact on the size of the Public Service. Over five years, Public Service employment declined by 45,000 employees — a reduction of 19 percent (see Figure 12). This included 8,000 employees whose positions were transferred to the private sector, the not-for–profit sector or to other levels of government. It does not include employment reductions in the Royal Canadian Mounted Police (RCMP), Canadian Forces military personnel or in separate employers, such as Crown corporations. Total federal public sector employment declined by about 55,000 when these reductions were taken into account.

Figure 12: Public Service Employment



Source: Treasury Board of Canada, 1999

When it embarked on Program Review, the GoC realized that many employees would be affected so it introduced, for a limited time, clear and consistent downsizing assistance packages that ensured fair treatment for those affected. A combination of special programs and flexible administration (allowing affected employees who wished to remain in the Public Service to easily fill vacant positions) allowed for a smooth transition under difficult circumstances.

Early Retirement Incentive (ERI) was a three-year program for permanent employees who were declared surplus from any department or organization for whom the Treasury Board was the employer. Under ERI, employees who took early retirement within 60 days of being declared surplus would not have their pension reduced as a result of retiring early.

Early Departure Incentive (EDI) was a three-year program for permanent employees who were declared surplus from "most affected" departments (where the employment impact of Program Review decisions was beyond what could be managed through existing management methods). Affected employees received a cash payment if they resigned from the Public Service. The amount of the payment varied based on salary, age, years of service and pension eligibility.

As a result of these measures, large personnel reductions were accomplished with few involuntary departures from the Public Service and without the labour unrest or service interruptions characteristic of other countries' efforts to reduce the size of their public services.

Repositioning the GoC's Role

The overall outcome of Program Review was captured in *Getting Government Right, A Progress Report*, prepared by the Privy Council Office and tabled in the House of Commons by the President of the Treasury Board on March 7, 1996. This report led to the annual publication of *Results for Canadians, A Management Framework for the Government of Canada*, by the Treasury Board Secretariat, beginning in 2000.

Program Review decisions amounted to a profound realignment of the GoC's role, its activities now concentrated around five core roles:

- To strengthen the economy and the economic union to ensure a prosperous country for Canadians.
- To enhance social solidarity by preserving and modernizing the social union so that the caring and sharing society is truly Canada-wide in scope.
- To pool national resources to achieve common goals efficiently and effectively.
- To protect and promote Canadian values and identity while celebrating Canada's diversity.
- To defend Canada's sovereignty and speak for Canadians collectively on the world stage.

In many cases, particularly in the economic sector, the GoC shifted its role from ownership and operations to core policy development and regulatory responsibilities that would stimulate economic growth and job creation. Many subsidy programs – in the business, transportation, agriculture and energy sectors – were reduced or eliminated.

In the social sector, roles were realigned among levels of government to reduce overlap and duplication and provide integrated services to citizens. For example, the federal government ceased to provide direct support for job training, and the provinces were offered the opportunity to take over the management of social housing.

Partnerships were built with the provinces, local communities, the private sector and the not-for-profit sector to better deliver programs and services to citizens in areas such as youth job creation, tourism, fresh water fisheries management, environmental management, food safety, refugee settlement and crime prevention.

Barriers were eliminated among organizations in the federal government and the delivery structure was changed. The Canada website was created to provide one-stop access to government services on the internet. New information technologies were harnessed to improve immigration and citizenship services, business services and employment services.

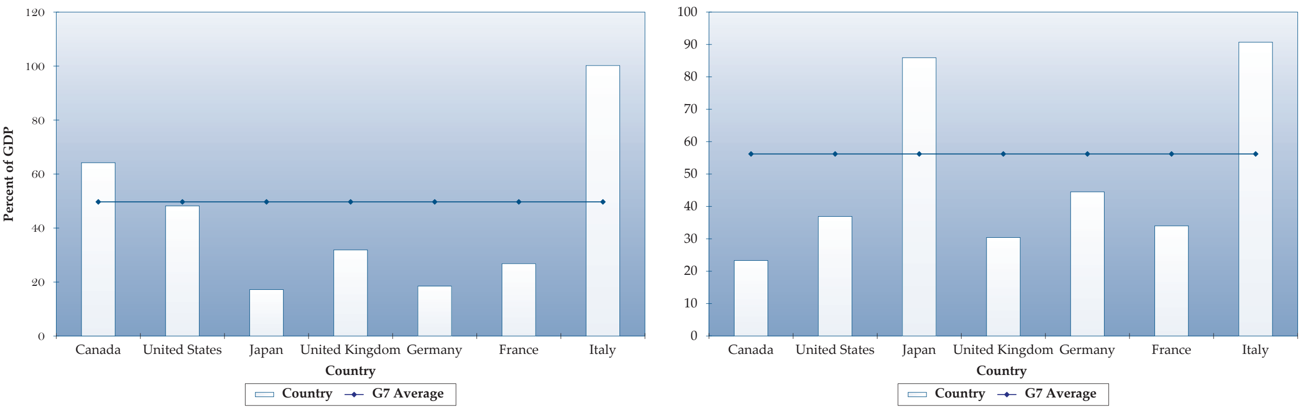
Alternative delivery models were developed for national parks, food inspection and revenue collection. Cost recovery and user fees were introduced or increased for some services that are provided to a defined set of clients or citizens. It also led to the re-engineering of government services and the modernization of some service delivery functions. A dedicated effort was undertaken to give greater flexibility to departments.

Regaining the Capacity to Invest in the Future

By 1997, as the government of Prime Minister Chrétien entered its second mandate, the country had made much progress. Economic growth was strong, inflation was low, job creation was improving and exports were at record levels.

From 1997 to 2003, Canada had an average annual average growth in employment of 2.3 percent and an average annual rate of growth in its standard of living of 2.8 percent. This was the strongest growth rate among G7 countries. The real income of Canadians increased by 20 percent in that period as measured by GDP per capita. From having the second highest net financial liabilities in the G7 in 1993, by 2007 Canada's net financial liabilities were the lowest in the G7 (see Figure 13).[22]

Figure 13: Government Net Financial Liabilities - 1998 & 2007



Source: Federal Government Public Accounts, 2008

Looking Back – Looking Forward

This was not the first time a country has had to eliminate a sizable deficit, nor will it be the last. While the reasons for a deficit and the circumstances faced by various countries may vary, a wealth of experience is available on how deficit reduction can be successfully achieved. While tailored approaches will be required, it is possible to learn from the past and from others.

From the Canadian experience with Program Review, the following lessons can be drawn:

1. Eliminating a sizable deficit is a "societal project" not a normal budget exercise. A budget exercise often involves a small number of people working in relative secrecy. The purpose of the exercise is to reconcile fiscal capacity with demands for funding, including funding for new government priorities. Eliminating a sizable deficit involves a realignment of the role of government in society. As such, it requires a more open and inclusive approach, one that engages the "whole of government."

2. Scale is important. Scale makes possible reforms that alone would not be politically feasible. All programs have beneficiaries. Cuts that affect individual programs unleash a strong reaction on the part of those beneficiaries. The scale of Program Review helped to balance single interests with the collective interest. The public judgment about the merit of the approach hinged on the relative fairness of the proposals among regions, groups, income levels, and so forth.

3. Speed is important. Successful public sector reforms are incrementally implemented over time. However, where a high level of societal consensus has been achieved, it is preferable to move expeditiously. It creates hope at the end of the tunnel.

4. Prudence is important. Prudence is about protecting the collective journey while avoiding slippage due to unforeseen circumstances. A high degree of prudence was built around Program Review. It was achieved through lower-than-average fiscal hypotheses, the creation of a contingency reserve and the elimination of policy reserves for funding new initiatives.

5. Luck plays a role, but it does not last forever. During the period of Program Review, there were no major external shocks to throw the exercise off course. Furthermore, the North American Free Trade Agreement created strong external demand for Canadian exports. This, combined with a weak dollar, replaced domestic demand and facilitated adjustment. But, chance does not last forever. The next economic downturn will come and will reveal if the measures taken were sustainable. Canada did well during the following economic downturn (2001) and 11 surplus budgets demonstrate that the reforms were sustainable.

6. It can be done. The test of a successful reform is whether the desired outcome is accomplished at the lowest possible costs to society while minimizing the unintended consequences. In that perspective, easy cuts and easy targets may be the worst approach since they might not be sustainable; could erode some of the levers needed to meet priority societal needs in the future and cause damage to the public sector institutional capacity to serve. It is possible to lead ambitious reforms and to make choices in a principled and defensible way for citizens and public servants.

Conclusion

This Canadian case study is an example of cabinet government at its finest. It is an impressive example of partnership between elected officials and public servants. It is written in praise of Canadians who were willing to accept the actions that needed to be taken. Citizens are always the real heroes of public sector reform, because it is they who must accept the sacrifice and it is they who pay the price of failure. Over time, future generations of public officials, both elected and non-elected, owe it to those who made the sacrifice to protect the outcomes that were achieved for future generations of Canadians.

Acknowledgements

The author would like to thank Brian Johnson for his contribution to the preparation of this report, as well as Kathryn Rose and Jordan Baker for their research assistance. She would like to acknowledge the contribution of The Honourable Marcel Massé in presenting the Canadian case study in various countries, David Dodge for his review and comments and Dr. Ken Coates for his support and historical perspective. The author takes full responsibility for the content of this report.

Endnotes

1 Unless otherwise noted, financial data used in this report is from the *Federal Government Public Accounts, Fiscal Reference Tables*, (Ottawa: Department of Finance, September, 2008). There are two methods of presenting government financial data: public accounts (used for the presentation of financial data to Parliament) and national accounts (used to measure the impact of government activity on the economy). While they provide somewhat different measures, the pattern is about the same over time. Except where making international comparisons, public accounts data is used for purposes of this report. National accounts data is used for international comparisons.

2 These calculations were made from Bank of Canada Review, (May, 1979) Table 1. The idea and basic structure for these calculations came from Wayne Simpson (1980). *"Wage Structure and Stagflation in the 1970s."* Economic Council of Canada, Discussion Paper No. 161: 2.

3 For example, see Chrétien's view of the event in Chrétien, Jean (1985). *Straight from the Heart*. Toronto: Key Porter. Pp 117.

4 Canada's deficit as a percentage of expenditures was 22.3 percent for the year 1978, compared to Italy's 32.4 percent of expenditures (on a national accounts basis).

5 This was comprised of $200 million to the Canada Community Development Program and $300 million over a two-year period to promote industrial innovation within the Enterprise Development Program, Defense Industry Productivity Program and the Labour Adjustment Program.

6 Some measures included another $500 million in job creation programs, along with $200 million for the housing industry and $400 million for the modernization of the railways in Western Canada.

7 For example, an open letter from The Honourable Vic Schroeder, the finance minister from the Government of Manitoba, to Marc Lalonde, the federal minister of Finance, detailed how capital spending would speed up recovery, which was followed by a series of proposals for infrastructure development in Manitoba.

8 Due to a break in the series following the introduction of full accrual accounting, data from 1883-84 onward are not directly comparable with earlier years.

9 Newfoundland's deficit was cut by more than 50 percent.

10 The estimated deficit for 1984-85 was 21.8 percent lower than the previous year's forecast.

11 This data is on a national accounts basis.

12 Privatization included the Northern Transportation Company Limited, Teleglobe Canada, Canadian Arsenals Limited and the Government's interest in the Canada Development Corporation. Subsidy reductions included transportation subsidies, including VIA Rail as well as certain industrial and agricultural subsidies.

13 Salaries would be cut for members of the House of Commons and Senate and for the Prime Minister and Cabinet and frozen for deputy ministers, assistant deputy ministers and equivalent exempt staff. There would also be a two percent reduction in all non-statutory government programs and Canadair and Eldorado Nuclear would be privatized.

14 Management measures included accelerating the remittance of source deductions, deferring defence spending, limiting official development assistance spending and increasing the air transportation tax. Tax measures included increasing and extending federal sales and excise taxes.

15 Measures included freezes on public service construction in Ottawa, travel restrictions on MPs and public servants, the closure of some Parliamentary restaurants, the sale of government jets and the closure or amalgamation of several government agencies.

16 Expenditure controls would affect a wide range of government programs with the exception of major income support programs and most transfers to lower-income provinces. Measures included capping Canada Assistance Plan payments for some provinces and funding for other programs at five percent, holding EPF financing constant. Spending on programs not subject to the expenditure control plan would be reduced by $800 million. Funding was cancelled for OSLO oil sands project and polar icebreaker and Petro-Canada and Telesat Canada would be privatized.

17 The expenditure control measures announced in the 1990 Budget were extended. Additional spending controls were imposed on programs not subject to the expenditure control plan.

18 Other measures included reductions in ministerial salaries, tighter travel guidelines, cuts to departmental communications budgets, cuts in defence spending, restraining the growth of spending on social housing, streamlining or winding up several boards and commissions.

19 Other measures included freezing funding for Research Councils for two years and reducing federal grants and contributions by 10 percent.

20 Federal program spending would be held to zero real growth; defence spending was frozen; growth in Research Council funding and international assistance was limited; grants and contributions were further reduced, as was regional development funding subsidies were reduced to CBC and VIA Rail; and social housing payments were capped.

21 In addition to the 12 budget measures mentioned above, there were other internal measures, such as freezing departmental year end operating budgets or not allowing the normal carry forward of lapsing funds.

22 The source for this comparison is taken from *Federal Government Public Accounts, Fiscal Reference Tables*, (Ottawa: Department of Finance, September, 2008). The original source is stated to be *OECD Economic Outlook*, No. 83 (June 2008) and Federal Reserve, *Flow of Funds Accounts of the United States* (June 2008), with US data adjusted to exclude certain government employee pension liabilities to improve comparability with other countries' debt measures.

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