

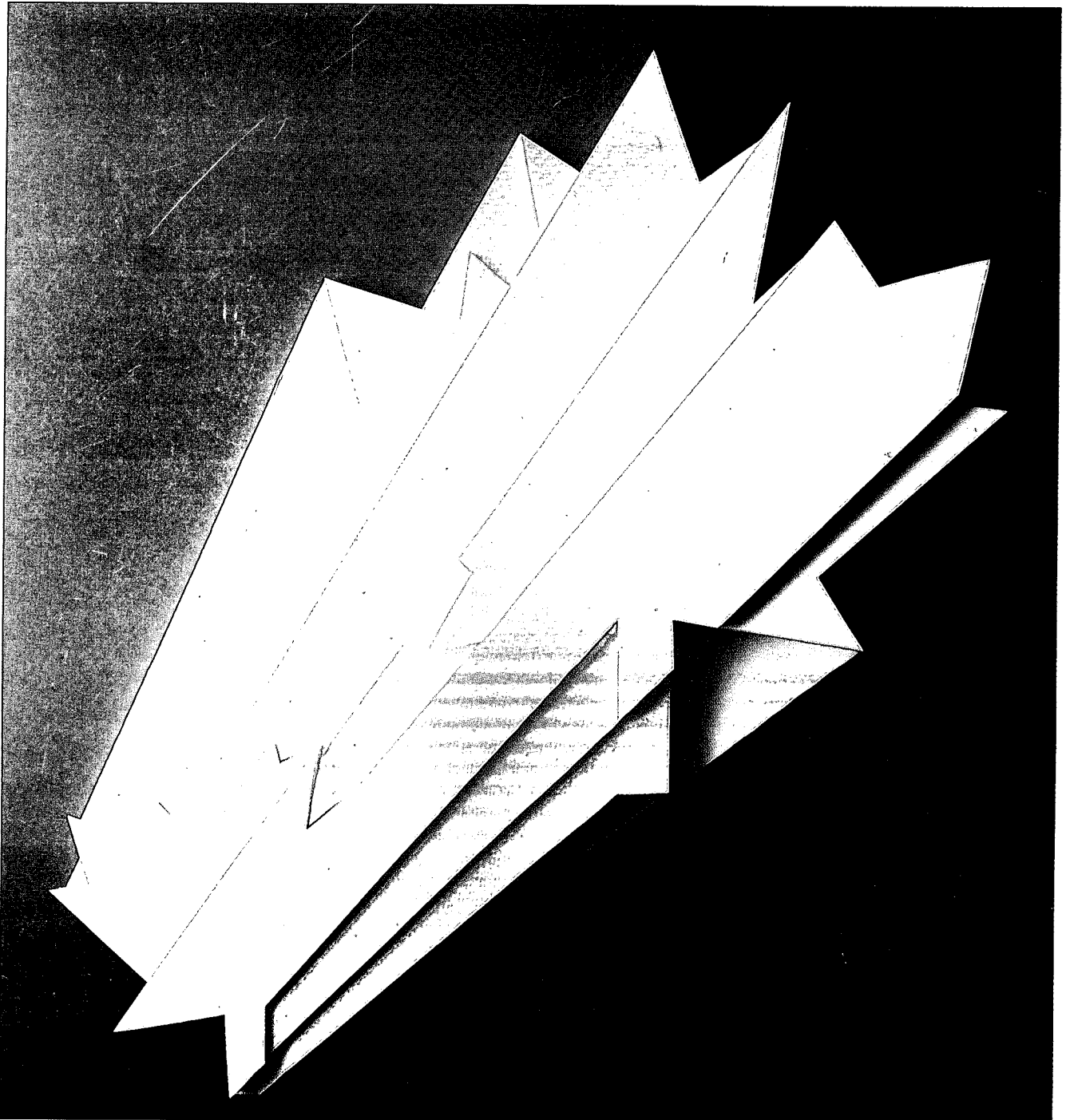
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g Economic Renewal

# The Budget Speech

Delivered in the House of Commons  
by the Honourable Michael H. Wilson

February 26, 1986



Canada

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Securing Economic Renewal

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Delivered in the House of Commons  
by the Honourable Michael H. Wilson  
Minister of Finance  
Member of Parliament for Etobicoke Centre  
February 26, 1986

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This Budget Speech is accompanied by the following documents:

1. The Budget Papers
2. Canada's Economic Prospects, 1986-1991
3. The Fiscal Plan

The **Budget Papers** provide detailed explanation of the measures in this budget and the Notices of Ways and Means Motions.

**Canada's Economic Prospects** sets out the economic outlook to 1991 and provides the economic assumptions on which the fiscal projections are based.

The **Fiscal Plan** describes in detail the government's revenue and expenditure plan to 1990-91 and provides information on financial, accounting and debt operation issues.

The Budget Speech should be read in conjunction with these accompanying documents.

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## **Introduction**

I want to speak frankly to this House, and to the people of Canada.

My message today is a serious one, and in many ways not pleasant. But it must be said. And it must be understood.

We have made tremendous progress together in the past 18 months. Growth has been strong. Jobs are being created in record numbers. The deficit is coming down.

But the mounting burden of public debt continues to threaten our future. It is growing faster than our ability to pay. It must be controlled.

When Canadians elected this government, our mandate was clear. It was to create jobs. But to create those jobs we had to solve the problems left by a decade of financial mismanagement.

In November of 1984, I placed before this House a plan to fulfil this mandate. In the major document entitled "*An Agenda for Economic Renewal*", we set out a comprehensive strategy based on three fundamental principles.

First, the best way to create jobs is through private initiative.

Second, good government does not mean more government, it means more efficient government.

And third, Canada's prosperity depends on restoring the health of the nation's finances.

## **A Record of Action**

We set to work immediately. The actions we have since taken fulfil an essential part of the Agenda that we brought forward 16 months ago.

Through our first eight months in office:

- We worked actively to build a constructive relationship with our provincial colleagues.
- We launched the Canadian Jobs Strategy.
- We reduced expenditures and improved programs.
- We signed the Western and Atlantic Energy Accords.
- We established Investment Canada.
- We initiated regulatory reforms in the areas of transportation, telecommunications, financial institutions and competition policy.
- We restored close and co-operative relations with our allies and trading partners.

In May of last year, we took further action.

- We reduced the operating costs of all government departments.
- We cut industrial grants.
- We closed costly heavy water plants.
- We reduced transportation expenditures.
- We provided major incentives for investment in small business.
- We improved the pension system.
- We introduced a new child benefit system to increase assistance to those most in need while reducing overall costs.
- We established a program to sell surplus assets and privatize Crown corporations.
- We appointed an independent commission to examine the unemployment insurance system.
- And we launched a process to reform the corporate income tax.

Last May I said we would reduce the deficit to \$33.8 billion this year. We will meet that target. I said we would control government spending. I projected expenditures this year at \$105 billion. Our spending will be more than \$1 billion lower. We said we would cut spending and control the deficit. We did what we said we would do.

Today I will announce further measures to implement the economic renewal plan set out in November 1984, measures that will restore fiscal stability by the end of the decade. This is being achieved by the most significant and far-reaching program of expenditure control ever undertaken by the Government of Canada.

These measures, when combined with those in November 1984 and May 1985, will ensure that the federal deficit is substantially reduced this year, next year and every year into the next decade.

This budget will reduce the deficit to \$29.8 billion in the coming fiscal year and, by the end of the decade, it will be cut to \$22 billion.

Financial requirements – the amount we must borrow each year to pay the bills – will be cut from \$28.3 billion in 1985-86 to \$17.9 billion in 1987-88, a reduction of 37 per cent in just two years. By the end of the decade, financial requirements will be down to \$11 billion.\*

Our national debt will no longer be growing faster than the economy.

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\* This budget implements certain accounting changes recommended by the Auditor General. Details and a full reconciliation are presented in Annex 1, the Fiscal Plan. In this section of the Budget Speech, in order to facilitate comparison with figures in the May budget, the numbers are presented on the basis of the former accounting system. In the remainder of the speech, all financial numbers are presented on the new accounting basis.

Increases in taxation contribute to this result. But fully 70 per cent of the debt reduction will be achieved by spending cuts.

The plan we set out in November 1984 is working, and working well. We are sticking to that plan.

## **A Stronger Economy**

We set out to challenge Canadians to bring about economic growth and job creation through their own initiative and effort. Canadians have responded to this challenge.

Our economic performance during the past 18 months has been much better than anyone predicted. In 1985, growth in Canada was far stronger than in any of the major European countries, twice as great as in the United States and equal to that of Japan.

Economic growth has also become more broadly-based. The forces that drove the economy in 1985 were generated right here in Canada – higher business investment, more housing starts and strong consumer spending.

Job creation has been vigorous. The unemployment rate has fallen from 11.7 per cent in September 1984 to 9.8 per cent today – the first time it has been below 10 per cent since April 1982.

The skeptics doubted we could create tens of thousands of jobs. They said cutting the deficit and creating jobs could not be done at the same time.

Canadians have made those skeptics eat their words.

Canadians haven't created tens of thousands of jobs, they've created hundreds of thousands – 580,000 new jobs.

Canadians should understand how remarkable this achievement is. During the past 18 months our rate of job creation has been more than 50 per cent higher than in the United States. Even more remarkable, Canadians have created more jobs, in absolute terms, than all the Western European countries combined – countries which together have 16 times our population.

While growth has been strong, inflation has been stable. Canadian cost performance compares favourably with that of our major competitors. Because of strong productivity growth and moderate wage increases, the competitiveness of Canadian industry has improved.

Labour-management relations have improved greatly. The proportion of working time lost through industrial disputes is at its lowest level in 20 years.

Chart 1

**Total Employment Gains Since September 1984**

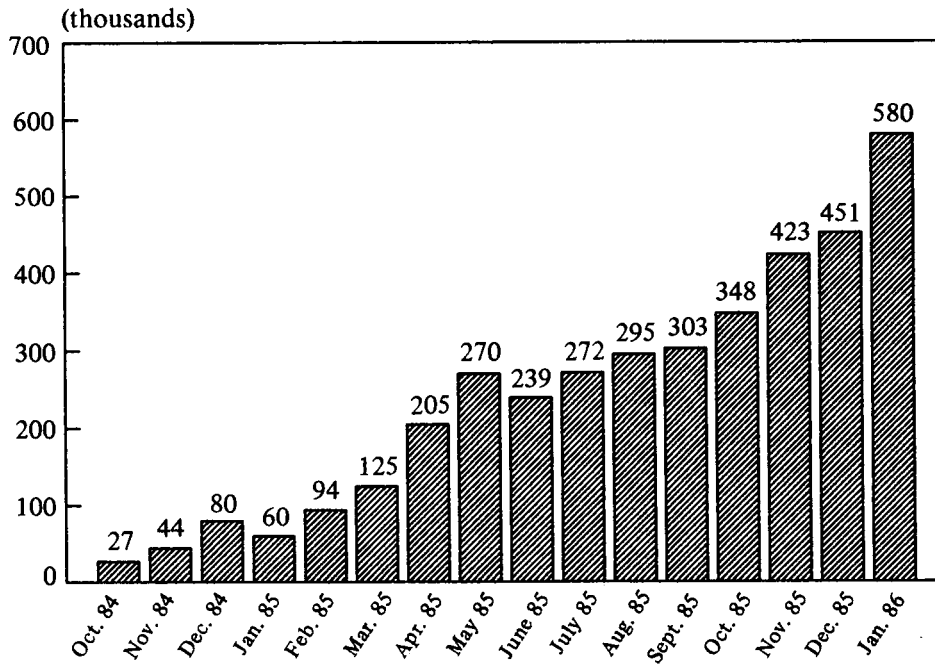
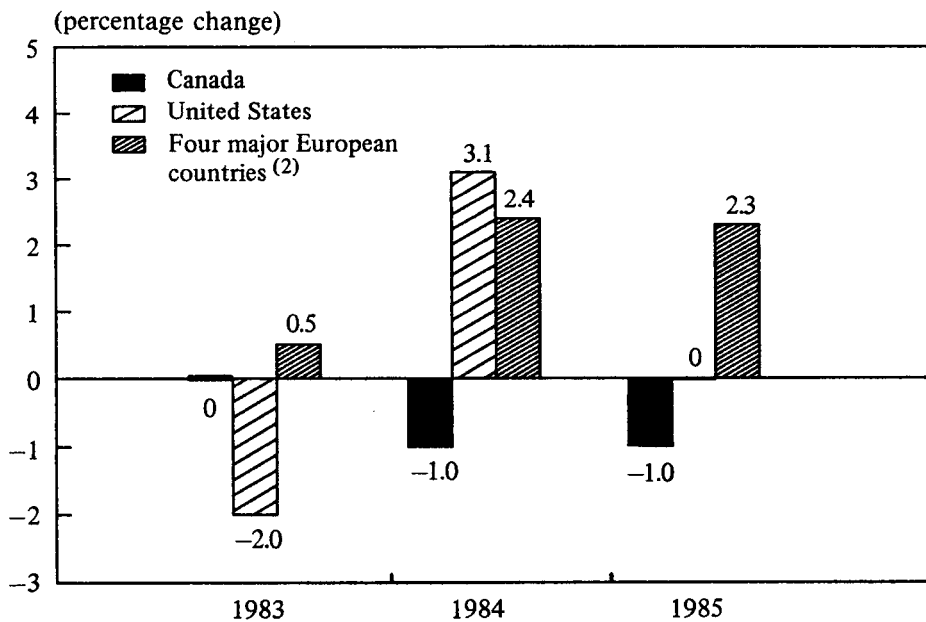


Chart 2

**Comparative Cost Performance<sup>(1)</sup>**



Source: OECD *Economic Outlook*, December 1985

(1) Rates of change of unit labour costs in manufacturing in local currencies

(2) Germany, U.K., France and Italy (weighted by proportion of Canadian exports to these countries)



## **Solving the Problems of the Past**

These are all positive signs – evidence that we are on the right track. But one major obstacle remains in our path.

When the government came to office, we encountered a debt problem of massive proportions. For 15 years, successive governments financed more and more spending by borrowing more and more money. The bills were passed to future generations. The buck was passed to us.

Well, the buck stops here. It must stop here.

Let me put this in the simplest terms possible.

For years the government borrowed billions of dollars simply to pay the interest on past loans. Interest on these loans increased from \$1.7 billion 15 years ago to \$22 billion in 1984-85. As a country, we have been mortgaging our future, year by year, and paying the interest by taking out a new loan. Every Canadian knows that this is a recipe for disaster. This is the reality with which this government has had to deal – a reality that threatened rising debt, falling confidence, a falling dollar, rising interest rates, slower growth and even higher deficits. That is the vicious circle we had to break.

### **The Expenditure Record**

That is why since November of 1984, we have acted to overhaul and streamline the operations of government. And none too soon.

Over the last decade, program expenditures had more than doubled. Discretionary spending – spending on non-statutory programs – had grown even faster. In the three years prior to this government taking office, discretionary spending grew by 43 per cent. Operating costs of government departments increased by 30 per cent. Personnel costs grew by 20 per cent.

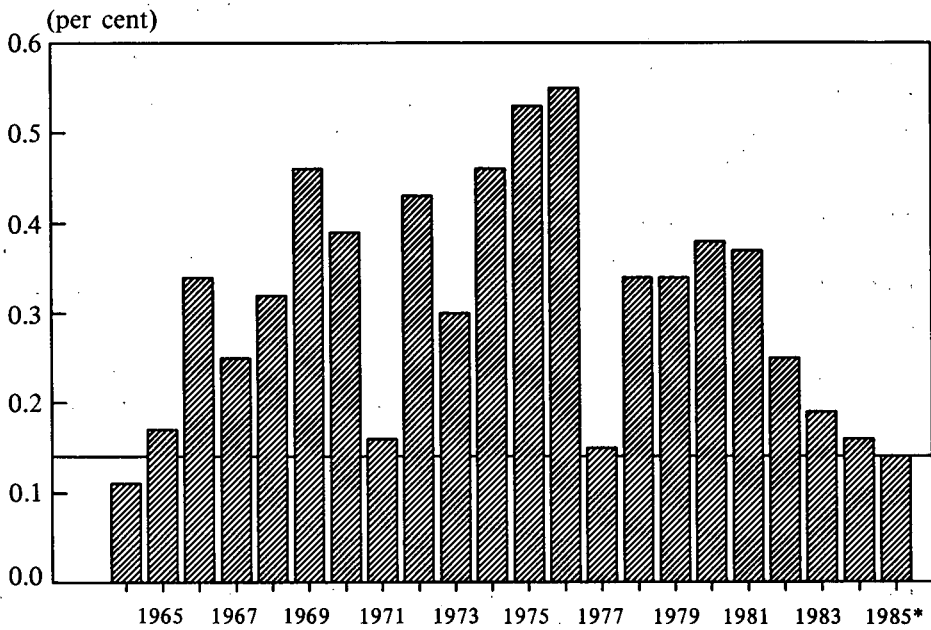
This government moved decisively to bring this spending under control.

We set in place a new, disciplined approach to government management.

- We are acting to eliminate 15,000 positions from the federal public service by the end of the decade; 5,000 will be eliminated in 1986-87.
- We reduced capital expenditures and closed diplomatic posts in foreign countries.
- We are eliminating programs, such as the Canadian Home Insulation Program, the Petroleum Incentives Program, the Petroleum Compensation Program, Katimavik and the Shipbuilding Industry Assistance Program.
- We reduced subsidies to VIA Rail, Canada Mortgage and Housing Corporation, CN Marine and the Canadian Broadcasting Corporation.
- We sold de Havilland, the Northern Transportation Company, and most of the government's interest in the Canada Development Corporation.
- We wound up several Crown corporations, including Canagrex.

Chart 3

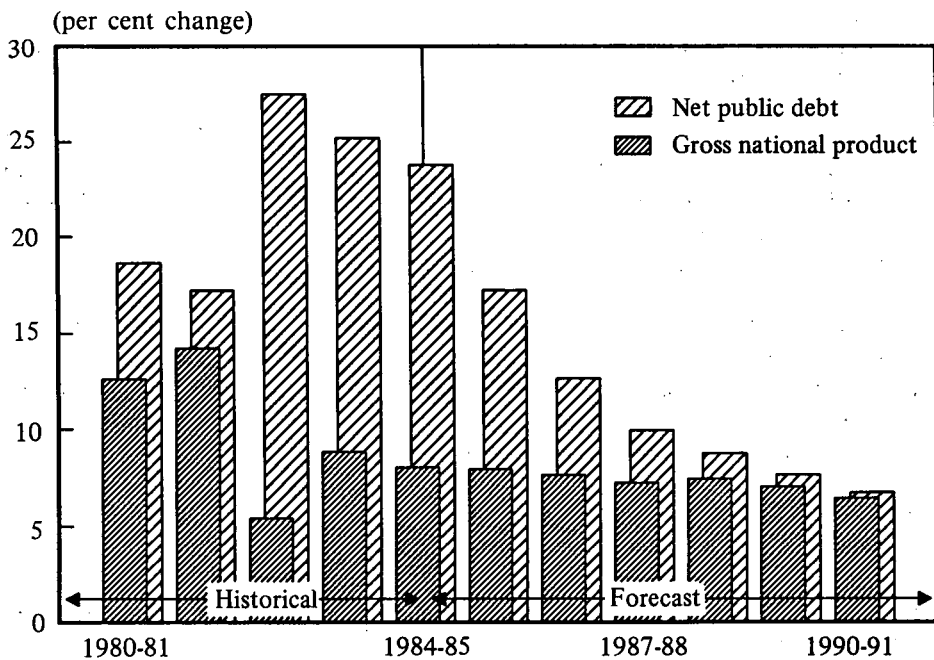
**Proportion of Time Lost Due to Work Stoppages  
1964 to 1985**



\*First six months

Chart 4

**Net Public Debt and Gross National Product**



These are not intentions. These are concrete actions we have taken. The results are clear. In this fiscal year, our actions have resulted in gross savings of \$5.8 billion – about \$560 for every Canadian household.

The government has benefited greatly from the work of the Ministerial Task Force on Program Review. Private sector volunteers worked closely with public servants in 19 study teams to examine virtually all government programs. Their task was to improve the way government operates and delivers services. The recommendations in their reports have prompted many specific actions which have reduced duplication, streamlined operations and led to meaningful savings. I am announcing today that all the study team reports will be released on March 11.

This expenditure reduction has involved thousands of people doing their jobs quietly and efficiently outside the glare of these television lights. And the result is that discretionary program spending this year will be held to \$37.7 billion, \$530 million lower than the previous year.

Total program spending, including all statutory programs such as Old Age Security, family allowances and unemployment insurance, will be held to \$86.6 billion – lower than last year's spending.

This is the first absolute decline in total program spending in over 20 years.

These actions were enough to accomplish our first objective – to halt the upward spiral in our deficit. But unprecedented as they were, they were not enough to provide assurance that our annual deficits would continue to fall. The risks to continued growth are still there and they are too high to be ignored.

## **New Expenditure Restraint**

To reduce these risks, and to achieve our goal of fiscal stability, I am today announcing measures to restrain government expenditures even further.

First, it is important that restraint start at the top. The Prime Minister has already taken a cumulative salary cut of \$20,290 over two years. Each Minister has taken a cumulative cut of \$9,440 over the same period. The government will ask members of this House and the Senate to accept a reduction of \$1,000 in their salaries this year. This \$1,000 cut will also apply to the Prime Minister and his Cabinet.

I am announcing that in 1986 there will be no regular annual increase in the salaries of deputy ministers, assistant deputy ministers and equivalent political staff. For other executive levels, such increases will be held to a maximum of 2 per cent. To encourage excellence and prudent management, the government will award pay increases to senior executives only on the basis of merit, with greater emphasis on productivity improvement.

Second, our privatization efforts are continuing.

As we identify corporations which do not meet public policy objectives, we will either close them or sell them to the private sector where they can become more competitive, lessen the burden on taxpayers and provide better service.

As announced, Canadian Arsenals Ltd. will be sold before the end of this fiscal year. We are negotiating with the territorial governments concerning the disposition of the Northern Canada Power Commission. The remaining companies of the Canada Development Investment Corporation are still for sale. We expect to sell Teleglobe Canada in the next few months. Expressions of interest are still being received on Canadair and Eldorado Nuclear.

Third, Ottawa must become leaner and more efficient.

I am announcing a \$500 million special reduction in non-statutory spending for the 1986-87 fiscal year. This is equivalent to 2 per cent of the cost of all non-statutory government programs, with the exception of foreign aid and defence. The President of the Treasury Board will shortly announce the plan to implement this reduction. This will reduce departmental budgets on an ongoing basis.

We are implementing two other significant management measures. Operating costs in all departments will be substantially cut in 1986-87 as part of the special \$500 million reduction. Thereafter they will not be permitted to rise by more than 2 per cent per year.

In addition, government departments will be forced to absorb increases in workload by increasing productivity or reallocating funds to higher priorities. Reserves that previously existed to fund such increases are being substantially cut. The experience gained this past year gives me confidence that these tighter operating constraints can be managed.

These spending reductions will result in savings of \$850 million in 1986-87, rising to \$2.8 billion in 1990-91. These savings amount to \$80 per taxpayer next year.

All these actions force new discipline on the system – long overdue discipline. But they also expose the truth about our financial problem. The billions we can save through better management are not enough to resolve Canada's financial problems.

We must also restrain spending in a number of specific areas.

The government is determined to come to grips with the financial and operating problems of Canada Post. Over the past year the Corporation has made progress in reducing overhead costs, cutting the numbers of managers and staff and increasing productivity. It is clear, however, that the Corporation will not be in a break-even position by the end of this fiscal year, as called for in the five-year plan established by the last government.

The Marchment Committee has recommended another five years to reach the break-even point. This is not acceptable.

Following discussions with the President of Canada Post, the government has requested a new operating plan to improve productivity at Canada Post so that the Corporation will reduce its operating deficit to zero by the end of fiscal 1987-88. The government is confident that by taking further steps to improve productivity and efficiency, Canada Post and its workers can meet the objective of self-sufficiency while improving reliability of service to the people of Canada.

The government has also re-examined its funding commitment for foreign aid.

This year, Canadian aid will exceed \$2 billion – 0.5 per cent of our gross national product, well above the average of other major donor countries.

In my last budget, I spoke of the government's intention to see our foreign aid spending reach 0.6 per cent of GNP by 1990. This would have required spending increases for five consecutive years considerably above the rate of growth of our economy. Had we continued on this trend, foreign aid would have grown by over 12 per cent a year on average. Growth rates of that magnitude cannot be sustained when domestic programs are being tightly constrained. Accordingly, growth in Canada's aid program will be reduced by \$1.5 billion over the next five years. The savings will be \$83 million in 1986-87 and \$205 million in 1987-88. For the balance of this decade foreign aid will remain at 0.5 per cent of GNP. It will increase by 8.7 per cent per year, on average, bringing the total to \$3.1 billion in 1990-91. Our objective will be to reach a foreign aid/GNP ratio of 0.6 per cent by the middle of the next decade.

But direct foreign aid is not enough. Trade is also important. Less developed countries need access to our market. That is why we have taken further steps to open the Canadian market to exports from developing countries. The decision to relax the import quotas on footwear is a measure of considerable benefit to less developed countries. The Caribbean initiative through which we extend trade and other measures of assistance to the Commonwealth Caribbean is a second example of these actions.

Our nation's defence is another area where tough financial decisions are required.

The government is fully committed to a strong defence capability. This commitment has been confirmed by decisions to reinforce our military presence in Europe and to strengthen the North Warning System. It must be recognized, however, that our biggest imperative now is to reduce the deficit so that we have the economic growth and fiscal flexibility in future years to fund important programs such as defence.

To contribute to restoring fiscal balance, the rate of growth in defence expenditure will be held to 2.75 per cent, after inflation, in 1986-87. In 1987-88, and subsequent years, defence spending will grow by 2 per cent per year, after inflation. This will achieve savings of \$285 million over the next two years.

Notwithstanding this restraint, expenditures on defence will continue to increase substantially each year over the balance of this decade. Annual average growth will exceed 6 per cent, bringing our defence budget from \$9.3 billion this year to \$9.9 billion next year and \$10.5 billion the year after.

Canada will continue to meet its defence responsibilities in North America and Europe and this government will make every effort to increase our level of financial commitment as our economic and fiscal circumstances permit.

As a result of the spending cuts this government has made to date, expenditures on government programs will grow by less than inflation over the next five years. By the end of the decade, government spending on programs will fall to the same share of the economy as in the 1960s.

Over the next two years there will be virtually no growth in spending on non-statutory programs. We will spend less on these programs in 1987-88 than in 1984-85. I am unable to find any period in Canadian history when the federal government has reduced discretionary spending on this scale.

Chart 5

### Real Federal Program Spending

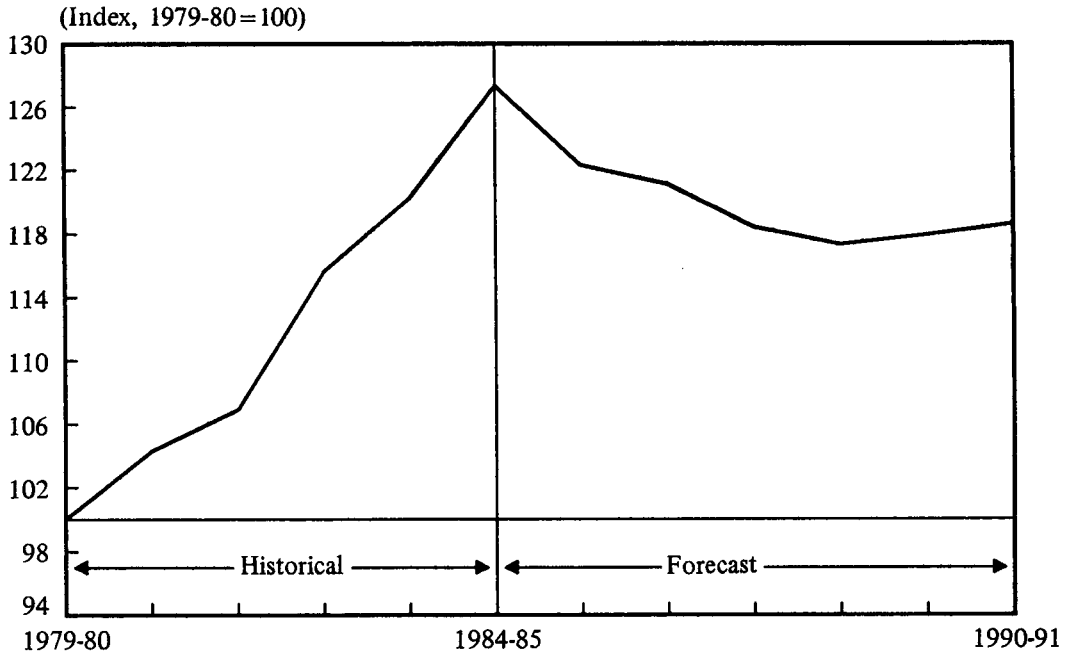
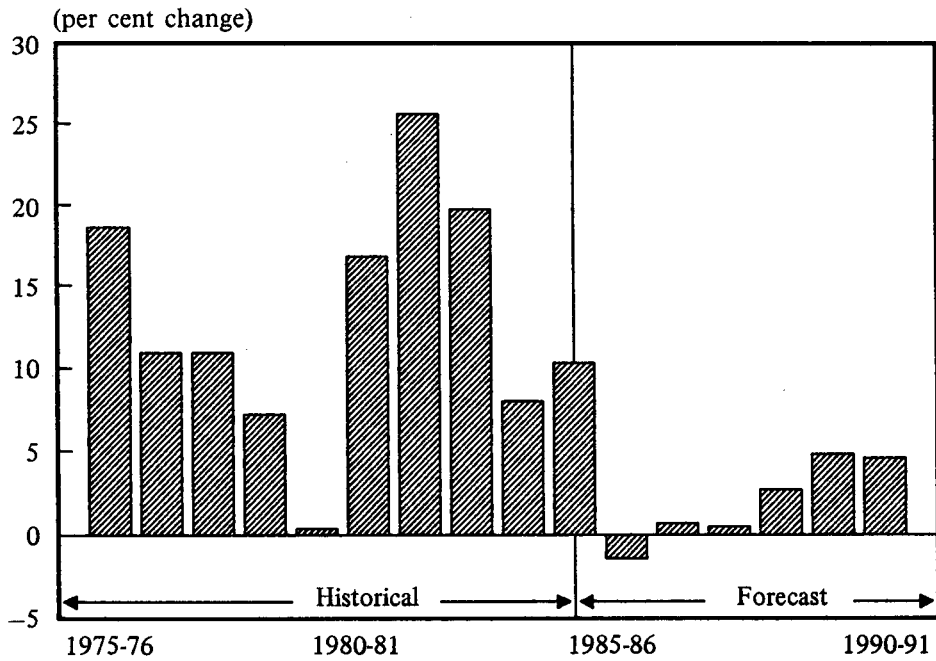


Chart 6

### Non-Statutory Expenditure Growth



So far I have talked of cutting spending on non-statutory programs. Let me now address the issue of statutory spending.

The Government of Canada will spend \$53 billion this year on social programs. At the same time, related tax expenditures such as the child care expense deduction, the child tax credit and the age exemption total \$3.5 billion.

The vast bulk of these expenditures goes to finance four major programs:

- Approximately \$12 billion is for unemployment insurance benefits and employment initiatives;
- \$13 billion goes to income security for the elderly;
- \$2.5 billion is for family allowances; and
- \$12.6 billion in cash is transferred to the provinces for health, education and welfare. The total contribution, which also includes tax transfers, is about \$20 billion.

In November 1984, the government announced its intention to reform social programs based on the twin tests of social and fiscal responsibility.

Since that time, we have taken a number of actions:

- We reformed family benefits in a way that maintains the principle of universal access, targets more resources to those most in need and frees up savings for other priorities.
- We restrained the rate of growth of transfer payments to the provinces for health care and post-secondary education.
- We provided supplementary equalization payments for all six equalization-receiving provinces in 1985-86 and for Manitoba in 1986-87.
- We appointed a commission to examine the unemployment insurance system and will be receiving its report this Fall.
- We extended support to widows and widowers, aged 60-64, who are in need.

We are especially proud of the steps we have taken to improve pensions for Canadians, through the most significant reform of pension arrangements undertaken in years. The pension debate dragged on for a decade. This government has delivered results.

We have introduced legislation to ensure for the first time that workers can take their pensions with them when they change jobs, that they can retire early if they wish and that surviving spouses will be provided for. We are making it possible for many regular part-time workers to join pension plans.

We have concluded a vitally important agreement with the provinces on the Canada Pension Plan. As a result, the financing of the CPP will be put on a sound financial basis and its benefits expanded to meet changing needs.

We are also moving to achieve parity in tax assistance for retirement saving between employees and the self-employed, many of whom are owners of small businesses. I will be releasing draft legislation on registered retirement savings plan limits and related issues within weeks.

In this budget, I am proposing new measures to give retired Canadians who have RRSPs more flexibility in the investment management and withdrawal of their retirement savings.

Over the coming months the government will continue to improve the structure of key social programs. We will consider the recommendations of the Forget commission on unemployment insurance. We are examining the recommendations of the Macdonald commission. In my next budget, I intend to propose further measures to reform our system of social expenditures and related tax provisions. Such measures must respect several basic principles. They must maintain universal access. They must direct more resources to those most in need. They must improve the opportunities for individuals to become self-reliant. And they must reduce the after-tax value of benefits going to higher-income Canadians who do not need assistance.

Some have called for major cuts in social assistance. This government is not prepared to dismantle social programs. The best ways to reduce the cost of social measures are to make sure that spending and tax assistance are targeted effectively and to reduce the need for such support – by keeping the economy growing and creating jobs so that greater opportunities are provided to those Canadians now in need.

## **Improving the Tax System**

A continuing priority of this government is to improve the tax system. Improvements are necessary to spread the tax burden more equitably, to ensure that incentives are effective and to protect government revenues.

Since November 1984, the government has taken steps to protect the integrity of the personal and corporate tax systems.

- We ended the abuse of the scientific research tax credit.
- We eliminated tax shelters based on investments in yachts, recreational vehicles and similar properties.
- We halted income-splitting through interest-free loans between family members.
- We stopped the so-called “carve-out” transactions in the oil and gas sector.
- We prevented the use of trusts to distribute investment income tax-free.
- We terminated the use of partnerships in corporate takeovers to increase tax deductions.
- We tightened foreign property investment rules to prevent abuse.

We are also implementing a minimum tax of 25 per cent to ensure that high-income Canadians pay their fair share of tax.

Last May, I issued a discussion paper entitled “*The Corporate Tax System: A Direction for Change*”. The thrust of that proposal was to reduce selective tax preferences and move to broader-based incentives through lower tax rates.



Today, I am implementing the first phase of this restructuring. The following measures will enhance economic performance, provide incentives based on results and contribute to deficit reduction.

- The 3-per-cent inventory allowance will be eliminated effective today.
- The general investment tax credit will be phased out starting next year.
- The 20-per-cent investment tax credit will remain to encourage investment in Atlantic Canada and the Gaspé Peninsula. This credit will be extended to include investments in adjacent offshore areas.
- The Cape Breton investment tax credit will remain at 60 per cent and will be improved. Smaller investments will qualify and the rate of refundability will be increased, as recommended by the Cape Breton Advisory Committee.
- The special investment tax credit for manufacturing investments in designated areas will be extended past its termination date at the end of this year at a reduced rate of 40 per cent.
- Corporate tax rates will be reduced over a three-year period beginning July 1, 1987. By 1989, the basic federal corporate rate will have been reduced from 36 per cent to 33 per cent of taxable income.
- Manufacturing companies will continue to have a lower tax rate, falling from 30 per cent to 26 per cent by 1989.
- The federal tax rate for small business will fall from 15 per cent to 13 per cent.

The effect of all these measures will be to generate an additional \$765 million of net revenue during the period of transition to 1988-89. As a result of these changes, there will be an increase in the number of profitable corporations that pay tax.

These actions are the first phase of corporate tax reform. I will release a new discussion paper later this year. It will propose further reductions in tax preferences and further tax rate reductions, consistent with the principles set out in the May 1985 budget paper.

As well, I am proposing a number of other changes to corporate and personal income taxes to tighten the system and to prevent erosion of the tax base.

- New at-risk rules for limited partnerships will be introduced. These rules will restrict limited partners' claims to tax credits and business losses to the amount of their investment that is actually at risk. The new rules will cut back tax-motivated arrangements that can lead to high-income individuals and profitable corporations significantly reducing their taxes.
- New provisions governing salary deferral arrangements will be introduced to ensure that tax cannot be unduly deferred by delaying the receipt of compensation.
- The ability to defer taxes by claiming deductions for unpaid remuneration will also be limited.

Chart 7

**Budgetary Expenditures as a Percentage of GNP,  
1961-62 to 1990-91**

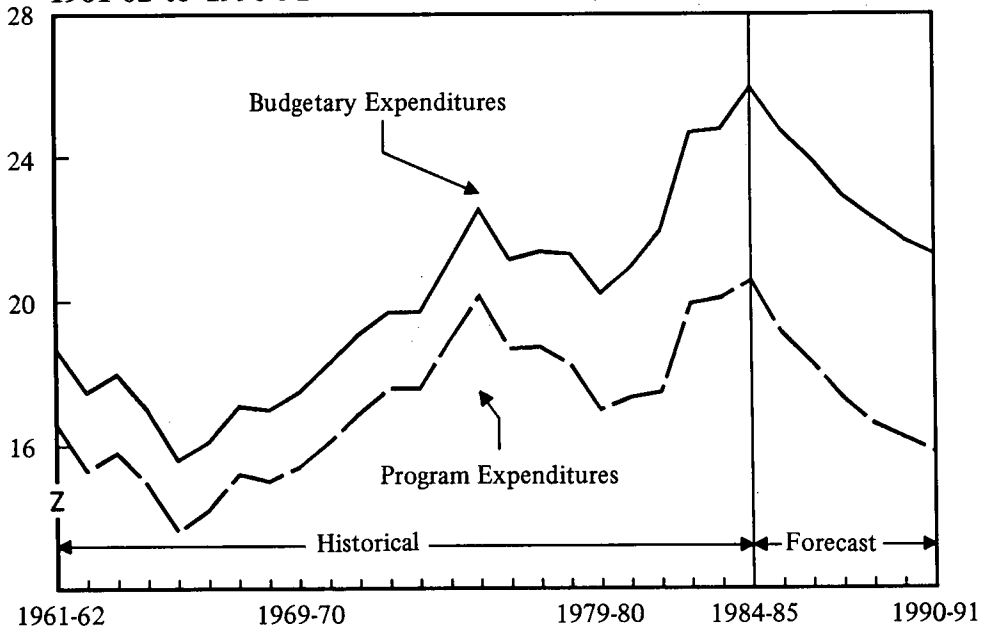
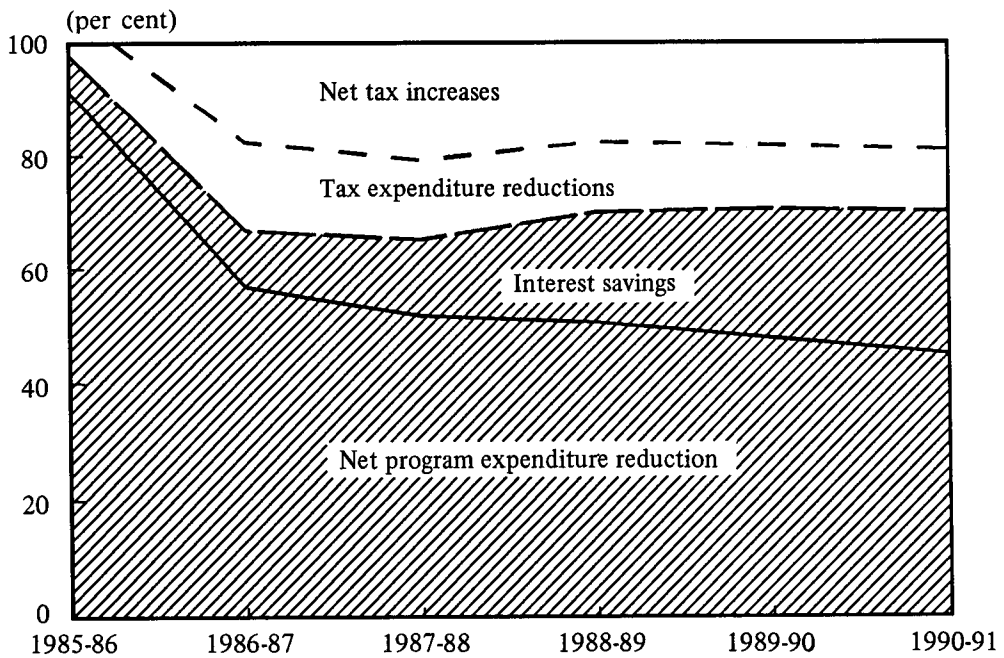


Chart 8

**Sources of Deficit Reduction**



- The married exemption claimed for a spouse will be based on the spouse's income for the whole year, rather than from the date of marriage.
- Measures will be introduced to ensure reporting of treasury bill income. I will be announcing, within the next few weeks, proposals to simplify the interest accrual rules.

I am also proposing important changes in the tax treatment of dividends. The dividend tax credit will be reduced from one-half to one-third of the cash dividends received by individuals from tax-paying Canadian companies. As a parallel measure, the 12 1/2-per-cent dividend distributions tax for small business will be repealed. This will permit a major simplification of the tax system for small business. It will also preserve the integration of the corporate and personal taxes on income earned by small business corporations. These changes will be effective January 1, 1987.

The lower dividend tax credit will continue to provide a significant incentive for investment by Canadians in Canadian dividend-paying companies, but it will now ensure that more high-income individuals will pay regular tax on dividend income. Accordingly, I am also proposing that, effective this year, the taxation of dividends from taxable Canadian corporations under the minimum tax be based on the actual amount of cash dividends received.

## Turning the Deficit Corner

To this point I have described the government's expenditure control record and our plans to reduce government spending further. I have outlined our plans to bring forward proposals for comprehensive changes to social transfers and related tax provisions. I have proposed the first phase of corporate tax reform and eliminated or reduced a number of tax preferences.

These actions imply great change. Federal spending on programs as a share of the economy will be cut back to the level at the beginning of the 1960s – prior to the “fly now, pay later” regime of more recent years. But these measures in themselves are not enough to overcome our fiscal problem. Spending cuts alone cannot bring about fiscal stability by the end of the decade.

To accomplish that goal, we must start paying the full cost of present government programs and a share of the interest burden built up over past years.

I am therefore announcing the following tax increases:

- A 3-per-cent surtax will be imposed on federal personal income taxes commencing July 1, 1986. The existing personal surtax will expire as scheduled.
- The current surtax on large corporations expires at the end of 1986. It will be replaced by a 3-per-cent surtax on all corporations effective January 1, 1987.
- The rates of federal sales tax will be increased by 1 percentage point effective April 1 this year. I will be announcing in a few minutes details of an innovative measure which will make the effect of the federal sales tax more progressive by providing important benefits for low-income Canadians.

- Finally, excise taxes and duties on alcohol and tobacco will be raised by 4 per cent and 6 per cent respectively, effective midnight tonight.

The net effect of all the tax measures I am announcing today will be to raise \$1.5 billion in 1986-87 and \$2.4 billion the following year.

These tax increases will make greater demands on Canadians. But they also put the size of our debt problem into clearer focus. In recent years our annual deficit has exceeded \$30 billion. Every year the deficit remains near \$30 billion another \$3 billion of interest charges is added to the next year's spending. These tax increases help us hold the line. But they are only part of a comprehensive debt control program, 70 per cent of which will be achieved through expenditure reductions.

Let me now address the question of federal sales tax reform. Like the debate on pensions, discussions on a better sales tax system have been going on for a long time. The problems with the current system are well known. It results in serious inequities among competing business firms. It puts Canadian manufacturers at a competitive disadvantage relative to importers. It results in hidden taxes on exports. Canada is now the only industrialized country in the world that still imposes a sales tax at the manufacturers' level.

It is time to act on this issue, to bring our sales tax system into line with today's realities.

My officials have for some months been examining the value-added tax. They are also looking at alternative systems, including a business transfer tax, which involve less administrative complexity and paper burden.

I expect to complete a review of the options in the very near future and put forward a paper with a concrete proposal for public discussion at an early date. Our intention is to move to a new system that will encourage growth, improve equity, and yield revenues sufficient to replace the federal sales tax, to end the surtaxes I have announced today and to provide adequate offsets for low-income Canadians.

I have already reported on the fiscal impact of the measures in this budget. The budget also implements revisions to the government's accounting practices in response to recommendations made by the Auditor General. Details are provided in the Fiscal Plan tabled with the budget. I recommend this document to Honourable Members and all others who wish to have full details on the government's fiscal situation.

On the revised accounting basis, the deficit next year will be \$29.5 billion, a reduction of 14 per cent from this year. Financial requirements next year will fall to \$22.6 billion, a decline of 22 per cent from this year's level. By the end of the decade, with moderate economic growth averaging 2 3/4 per cent per year, financial requirements will fall to \$11 billion.

## **Reinforcing Priorities**

This government has acted to restore fiscal responsibility in Canada. In many cases, we are going to spend less. In every case, we are spending smarter and making better use of scarce resources. In some cases, we must spend more, to help those in need today and to help build the foundation for a better future. In a careful and effective manner, we intend to reinforce our basic priorities.

## **Helping Those in Need Today**

The plight of low-income Canadians is of major concern to this government.

Last May we increased the child tax credit to provide greater assistance to low-income families.

Until now, our poorest families have had to wait until they receive their income tax refund to receive the credit. This has led to many of them seeking the services of tax discounters. To provide more timely assistance to low-income families and to reduce the need for tax discounting, the government is proposing to advance payment of the child tax credit. A prepayment of \$300 per child will be paid in November 1986 to families whose income in 1985 was \$15,000 or less. Almost one million families will benefit from this measure.

I am also announcing a fundamental innovation to the income tax system to benefit low-income Canadians, many of whom are elderly. Commencing this year, the government will provide a refundable sales tax credit of \$50 per adult and \$25 per child, for families and individuals with incomes below \$15,000. About four million families and individuals will benefit from this measure. This progressive measure represents a major expansion of our refundable tax credit system and a significant improvement in our tax system.

For many months the government has been working with provincial governments to target training and employment programs to those Canadians who depend on welfare. We believe that the best assistance we can provide to such Canadians is a meaningful job. Provincial governments share this view. As a result of our consultations the government is committing up to \$100 million a year for the next three years to a special program to help social assistance recipients find employment. These funds will be matched by the provinces.

I also propose to increase the disability deduction by \$250, effective this year. This will provide increased support to 185,000 disabled Canadians.

There is another group in society which is now suffering particularly hard times and which needs our help.

Our farmers are caught in a vicious squeeze of low prices and rising costs. Many are facing an intolerable debt burden. This is not just an economic problem – it is a social problem that must be addressed. Accordingly, to preserve a viable farm sector, the government is adopting a new Farm Financial Assistance Policy.

The government will increase resources to the Farm Credit Corporation over the next two years. The Corporation will establish a new financial instrument to be known as a commodity-based mortgage. For those farmers with substantial debt problems, but with reasonable long-term prospects, this mortgage will be available at a basic interest rate of 6 per cent. The principal of these loans will be linked to farm commodity prices. The loans will offer eligible farmers long-term, stable financing at a cost related to their revenues.

The Minister of Consumer and Corporate Affairs will introduce legislation to establish Farm Debt Review Panels to provide advice and assistance in restructuring farmers' debt.

We will also take measures to ease the transition of farmers who must seek alternative employment. A new program will offer such farmers job counselling, retraining and interim financial assistance.

These measures represent an additional financial commitment to Canadian farmers of \$65 million this year and \$130 million next year.

The Minister of Agriculture will also be announcing measures to assist tobacco farmers to diversify into other crops.

The government will extend the existing 3-cent-a-litre fuel tax rebate for primary producers for one year to January 1, 1988. Farmers and other primary producers are now required to keep detailed records of "on-highway" and "off-highway" fuel use in order to calculate their rebates. The Minister of National Revenue will shortly announce new guidelines to simplify the calculation so as to reduce paper burden.

These initiatives are designed to help those in need today. But even though resources are scarce, we believe it is equally essential to make other investments now which will lay the foundation for future growth and jobs.

## **Investing in the Future**

### **Trade**

A major area is trade.

This government has invited the government of the United States to enter into negotiations toward a more secure and enhanced bilateral trade relationship. Similarly, preparations are under way for Canada's active participation in the next round of multilateral trade negotiations to commence this Fall. I am strongly encouraged by the positive response of Canadian business and industry to the trade challenge this government has initiated. This response shows that Canadians do not shrink from fair competition. Canadians realize that trade gains lead to job gains. Today more than three million jobs are linked to our export performance.

I cannot overstate the importance to Canada of ensuring that foreign markets remain open to Canadian exports and that Canadian companies take maximum advantage of markets abroad. Exports of goods and services account for close to 30 per cent of Canada's gross national product. We must also ensure that the Canadian market remains open and that Canadian companies are prepared to meet import competition.

To do that, it is important to ensure a fiscal environment that allows lower and more stable interest rates and a tax system that promotes competitiveness and efficiency.

Our deficit reduction plan and proposed tax changes will support our trade initiatives.

The reform of the corporate income tax proposed in this budget will reinforce our trade initiatives by encouraging businesses to pursue profitable opportunities on the basis of economic factors as opposed to tax considerations. Sales tax reform will remove the biases in the current tax that hinder the efforts of domestic producers to compete at home and abroad.

This budget demonstrates that our fiscal problem is now in hand. Tax reforms will be implemented over time. Similarly, trade negotiations take time and their results will be implemented only over a number of years. By beginning to act now on these three fronts we can ensure that Canadian firms will be able to take full advantage of market opportunities in years to come.

Trade in services is becoming increasingly important. Representatives from the Canadian financial community have raised with me the prospect of attracting more international banking business to Canada by designating certain Canadian cities as international banking centres.

Some time ago, the Department of Finance commissioned a study of such centres. That study, which I propose to make public shortly, drew attention to certain drawbacks to the concept of international banking centres. It also drew attention to possible changes which could enhance the international competitiveness of our banks.

The government is prepared to facilitate the establishment of international banking centres in Montreal and Vancouver. This would be consistent with our desire to broaden our trade and business interests in Europe and the Pacific Rim. I will be undertaking discussions with the banking community and provincial governments in order to pursue this objective.

## **Research and Development**

A second priority is investment in knowledge.

The crucial importance of knowledge to Canada's future requires a new partnership between the private and public sectors. The federal government plays a major role in supporting university-based research and the development of highly qualified personnel in Canada. One channel for this support is through the operations of the Natural Sciences and Engineering Research Council, the Medical Research Council and the Social Sciences and Humanities Research Council. The government proposes to provide a secure funding base for these councils by adding \$300 million over the balance of the decade.

We are also prepared to increase this base funding up to 6 per cent by matching, dollar-for-dollar, private sector contributions to the councils. This could provide an additional \$700 million over the next five years. But the partnership created between the private sector and university researchers is just as important as the dollars. Contacts between the business and academic communities would be improved. And Canada would benefit from the more vigorous and co-ordinated application of scientific knowledge to our industrial needs.

## **Training and Adjustment**

Continued economic growth also requires investment in training so that workers can adjust to new conditions and take advantage of new opportunities.

The Minister of Employment and Immigration is implementing the new Canadian Jobs Strategy in co-operation with the provinces and industry. This innovative and successful approach combines training and job creation to help workers adapt to a fast-changing

labour market. Programs are targeted at building the skills necessary to help young people obtain a first job and to assist women re-entering the labour market. This budget allocates \$800 million to the Canadian Jobs Strategy in 1987-88.

The position of older workers deserves special consideration. I am announcing federal funding of up to \$125 million over a four-year period to finance a new Program for Older Worker Adjustment. This program will assist older workers who lose their jobs and who have no immediate prospects for re-employment. The Minister of Labour is developing this initiative in co-operation with the provinces and the private sector.

### **Small Business**

Small business is the most important source of jobs in Canada today. This government has done much to support small business.

In my first budget I brought forward a number of measures to encourage investment in small business by individuals and by pension funds. I provided tax incentives for investments in labour-sponsored venture capital funds. I extended the small business bond program and increased the value of the refundable tax credit for small firms carrying out research and development. I introduced a lifetime capital gains exemption to encourage enterprise and risk-taking by rewarding successful investment in Canada's future. We will continue that support.

Several measures in this budget reinforce our support for small business. Specifically:

- The tax rate on small business income will be reduced from 15 per cent to 13 per cent, beginning July 1, 1987. The tax rate on small business manufacturing income will be reduced from 10 per cent to 8 per cent.
- The 12 1/2-per-cent dividend distributions tax will be repealed, effective January 1, 1987.
- Tax rules providing deductions for allowable business investment losses will be broadened.

In the May budget I announced measures to allow pension funds to invest in small business ventures. Draft rules were made public for comment last November. The final rules to implement these changes will be available shortly and will respond to many constructive comments that have been made during the consultations.

The government also proposes to more than double the amount of guaranteed loans available under the Small Business Loans Act. This will raise the ceiling to \$2.5 billion and allow small businesses even greater access to the financing they need to grow and create jobs.

### **Atlantic Enterprise Program**

As I reported earlier, economic conditions have improved substantially in Canada. Nevertheless, certain regions of the country are continuing to experience longer-term structural economic difficulties. This is particularly true of the Atlantic region. To enhance the rate of private sector job creation in the Atlantic and Gaspé regions, I am announcing a major new initiative, the Atlantic Enterprise Program.



Under this program, private sector lenders will be encouraged to make loans for business start-up or expansion. Up to \$1 billion of these loans will be guaranteed to a substantial extent by the Government of Canada. The Atlantic Enterprise Program will also provide access to lower cost financing through interest rate buy-downs. This program is another example of how the government, working together with the private sector, can spend smarter. Together we will generate significant financial assistance so that Atlantic Canada can share in our national prosperity. The Minister of Regional Industrial Expansion will be announcing the details of this program shortly.

### **Northern Development and Indian Affairs**

The government will bring forward measures which promote northern development and encourage the economic self-reliance of our native peoples.

- A new, permanent system of tax benefits for housing and travel will apply to residents of the north and isolated posts, effective January 1, 1987. This will achieve equity between employees and the self-employed.
- In recognition of the vast distances involved in northern travel, the budget proposes a \$50 ceiling on the air transportation tax on domestic flights, offset by a one percentage point increase in rates.

The Minister of Indian Affairs and Northern Development will introduce amendments to the Indian Act which will allow bands to levy municipal-type taxes on Indian lands.

In addition, the Indian Remission Order which relieves tax on certain employment income will be extended for the 1986 taxation year.

I am also announcing that for 1986-87, the government will allocate up to \$40 million to extend the Indian Community Human Resource Strategies program into a second year.

### **Building a Sense of Community**

These initiatives – in trade, technology, training and economic development – are designed to promote growth. But nations are not held together by dollars and cents. Nations are held together by intangibles – by shared values and experiences.

One of these values is public service through private initiative.

No Canadians share more than those in the voluntary sector. Volunteers have not only built a sense of community in Canada; they have built bridges to people in less fortunate lands.

The government wants to encourage this sense of participation. We are continuing to examine a number of measures to encourage charitable donations and will work with the voluntary sector to find an appropriate and effective solution.

The government also desires to help foster the arts. I am pleased to announce the allocation of an additional \$75 million per year beginning in 1986-87 to fund a number of specific cultural initiatives. These will benefit people whose creativity finds expression in the motion picture and book publishing industries, in the performing arts and in the music and recording industries. The Minister of Communications will be announcing the specifics of these initiatives.

## Budget Process

I would like to say a few words about the budget process. The May budget made proposals to improve the process. This budget is being presented in February in line with my proposal for a regular budget date. A parliamentary committee has examined the budget process and made useful suggestions. I will be responding to their report in detail in due course. This government has also enhanced the role of parliamentary committees in examining tax and budget matters and has increased consultation. All concerned share the view that legislation arising from budgets should be available as soon as possible and be passed into law within a reasonable period of time. I will be bringing forward legislation arising from this budget expeditiously. The first item of legislation will be the bill seeking \$22.6 billion of borrowing authority for 1986-87. This amount corresponds to the financial requirements forecast for next year.

In this budget I have referred to a number of areas that form an important part of the government's agenda for future budgets. Proposals will be developed to improve social expenditures and related tax provisions, to pursue the further restructuring of the corporate income tax and to reform the sales tax. I look forward, as these proposals are presented, to receiving comment on them from parliamentary committees and other interested Canadians.

I am tabling Notices of Ways and Means Motions covering tax and tariff measures.

## Economic Outlook

Let me turn now to the economic outlook for Canada.

The actions we have taken and the actions we are taking in this budget provide a basis for sustained growth over the balance of the decade.

I am projecting real growth of 3.7 per cent for 1986, one of the highest rates of growth among the industrialized countries. In 1987, the economy is expected to grow by a further 3 per cent – the fifth consecutive year of sustained growth. Inflation will remain steady around 4 per cent. And the Canadian economy will continue to create jobs at a substantial rate. Because of strong labour force growth, progress in reducing the unemployment rate will be steady but less dramatic. By the end of this year I anticipate an unemployment rate of about 9.6 per cent, falling to 9.0 per cent by the end of 1987.

## **Conclusion**

**This government has demonstrated its resolve to restore fiscal responsibility to Canada.**

**We are doing this in a way that is consistent with the commitment we made to Canadians in November of 1984. Our objective, then and now, is to solve the problems of the past in order to create jobs today and into the future.**

**We are reducing the crushing burden of interest payments that has accompanied a decade of uncontrolled growth in our debt. Just as Canadians seek to pay down their personal debt to use the savings for better things, we are doing the same in government, creating room to respond to the nation's needs.**

**Cutting the deficit is not an end in itself. It is the means to an end. It is the means to achieve lower interest rates, higher growth and more jobs.**

**The actions we have taken reflect the priorities we set out in November 1984 and acted on in May 1985:**

- **to release the creative spirit of individuals from the heavy hand of government;**
- **to enhance our capacity to compete by promoting trade, investment and technology;**
- **to play a constructive role in the global community;**
- **to assist individuals to adjust to a changing world;**
- **to help Canadians who need assistance.**

**This is what we promised. This is what we are delivering. We will continue to act with consistency and determination. Canadians can look to the future with confidence.**

## Summary Statement of Transactions

	1984-85	1985-86	1986-87	1987-88	1990-91 <sup>(1)</sup>
	(billions of dollars)				
<b>Budgetary transactions</b>					
Revenues	70.9	78.0	87.3	94.0	114
Expenditures	109.1	112.3	116.7	120.0	136
Deficit	38.2	34.3	29.5	25.9	22
<b>Non-budgetary receipts</b>	8.4	5.4	6.9	8.3	12
<b>Financial requirements<sup>(2)</sup></b>	29.8	28.8	22.6	17.7	11
<b>Net public debt</b>	199.1	233.4	262.8	288.8	360
percentage change	23.8	17.2	12.6	9.9	6½
percentage of GNP	47.3	51.4	53.8	55.1	56
<b>Gross national product</b>	420.9	454.0	488.7	524.1	641
percentage change	8.0	7.9	7.6	7.2	6½
<b>Memorandum:</b>					
Budgetary deficit on old accounting basis	36.9	33.8	29.8	27.9	22

*Note:* Figures may not add due to rounding.

<sup>(1)</sup> Based on the mid-range economic projection.

<sup>(2)</sup> Excluding foreign exchange transactions.

*Source:* *The Fiscal Plan* Table 4.2.

## Deficit Reduction Actions by Budgetary Component

	1985-86	1986-87	1987-88	1990-91	Cumulative 1985-86 to 1990-91
(billions of dollars)					
<b>Net spending cuts</b>					
Programs	4.3	5.8	7.7	12.0	49.9
Induced interest savings	0.3	1.0	2.0	6.7	18.7
<b>Total</b>	<b>4.6</b>	<b>6.8</b>	<b>9.7</b>	<b>18.7</b>	<b>68.6</b>
Tax expenditure cuts	0.4	1.6	2.1	2.9	11.8
Net other tax changes <sup>(1)</sup>	-0.3	1.8	3.1	5.1	17.1
<b>Deficit Reduction</b>	<b>4.7</b>	<b>10.2</b>	<b>14.9</b>	<b>26.7</b>	<b>97.5</b>
(per cent)					
Percentage breakdown					
Net spending cuts	98	67	65	70	70
Tax expenditure cuts	9	16	14	11	12
Net other tax changes <sup>(1)</sup>	-7	18	21	19	18
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Debt reduction (billions of dollars)</b>	<b>4.7</b>	<b>14.9</b>	<b>29.8</b>	<b>97.5</b>	<b>97.5</b>

*Note:* Figures may not add due to rounding.

<sup>(1)</sup> Includes the Western Energy Accord tax measures.