February 26, 1991

the Budget Speech

Canada

THE BUDGET SPEECH

My previous budgets have introduced a wide range of fundamental economic and fiscal reforms. Today, I will propose further far-reaching initiatives.

Our policies have been challenging for Canadians and for the government. But they are essential to help our country manage the risks and seize the opportunities of a rapidly changing economic world.

The world economy continues to grow more fiercely competitive. A relentless tide of economic change is having profound effects on people, industries and countries. While the opportunities have increased, so have the risks.

Since my last budget, rising uncertainty has taken a heavy toll on both economic confidence and performance in Canada and around the world.

- We have seen international stability shaken by military hostilities in the Persian Gulf and by political upheaval in Eastern Europe and the Soviet Union.
- Vital negotiations to open up world trade have encountered serious problems, posing large risks to Canada's trade-oriented economy.
- As in a number of other countries including the United States, our economy is now in recession. Many Canadians have lost their jobs; many others have lost confidence in the economic future.
- And this is happening at a time when some are questioning the future of Canada itself.

And yet, we must deal with the world as it is, and not as we might wish it to be.

Toward recovery

In difficult times, it is easy to lose perspective as well as confidence. But it is times like this when a clear, realistic perspective is most needed to rebuild confidence and to chart a sound, sensible course of recovery.

We must not lose sight of the fact that a strong foundation exists for optimism as we face the major challenges that lie ahead.

- Internationally, the vast majority of countries continue to express their powerful, common interest in maintaining a stable world order and in developing more reliable and open economic relationships.
- We are a resilient, resourceful country. A stronger, more confident Canada is well within our reach, if we are prepared to work for it.
- During the past year, we have made encouraging progress in reducing both inflationary pressures and interest rates. As a result, the prospects are hopeful for an economic recovery beginning in the second half of this year.

But we must also recognize that hope alone will not be enough.

A time for action

This time of uncertainty and risk is also a time for action, at home and abroad, to solve our problems and restore confidence in our future.

Abroad, Canada will continue to play its part in co-operative efforts to provide greater stability in political and economic affairs. As a vital part of this responsibility, we will continue to support the United Nations' effort to restore peace and order in the Persian Gulf. We must and we will provide the men and women of our armed forces with all the support they need to complete this task. We must also be prepared to play a constructive role in the area after hostilities end.

Here at home, we must take further decisive action to move our economy toward early recovery and sustained growth.

RECOVERY, GROWTH AND PROSPERITY

This budget sets out a **Plan for Economic Recovery** – a strong, confident recovery that not only puts the recession behind us but leads us forward to continuing growth and renewed prosperity.

Our priority is action to create the essential conditions for recovery. Ours is not a plan for increased spending. That approach has been tried in the past and failed. The key to recovery is lower interest rates. The **Plan for Economic Recovery** will bring about lower interest rates through the following actions:

- We will set out clear, achievable inflation targets. Inflation will be reduced to 2 per cent by mid-decade. The result of lower inflation and lower expectations for inflation will be lower interest rates.
- We will put government finances firmly on the course to a balanced budget. We will remove the build-up of the public debt as a source of inflationary concern.
    - The Expenditure Control Plan announced in the 1990 budget will be extended.
    - The government will legislate mandatory program spending limits.
    - We will establish a Debt Servicing and Reduction Fund solely dedicated to offsetting the costs of the public debt. By law, all revenues from the Goods and Services Tax and from privatization will flow into this fund.
- We will severely restrain the operations of government. Operating budgets will be frozen at current levels and the wages and salaries of Cabinet Ministers, Members of Parliament, all Order-in-Council appointments, and all federal public servants will be tightly restrained.

These measures reflect a fundamental commitment to strong, effective government management and control which will serve Canadians well for years to come.

They will ensure that we achieve key fiscal goals in line with the plan set out in my 1989 and 1990 budgets:

- We will eliminate new federal borrowing in financial markets after 1993-94.
- We will tightly control spending. Extending the Expenditure Control Plan will limit program spending growth to 3 per cent per year after 1991-92.
- We will hold the deficit to $30.5 billion this year and next, despite the pressures of recession. In 1992-93, with recovery and lower interest rates, the deficit will fall below $25 billion for the first time in a decade.

This budget will result in a better balance between fiscal and monetary policy. It will provide the lower interest rates and greater confidence essential to our economic recovery.

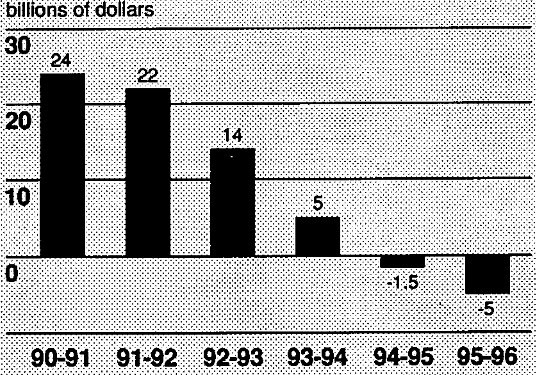
The economy will recover in the second half of this year and grow strongly in 1992.

Restoring economic growth is essential. But we must go beyond recovery to attain our full measure of prosperity. To do this, we must find a way to get Canadians working more effectively together, in a broad national partnership to meet Canada's competitive challenges – a partnership for prosperity.

We must begin by being honest with ourselves about the challenges we face. We must see our problems as they really are.

The fundamental problem is this: our underlying ability to compete in the world marketplace has been falling behind that of our trading partners.

Chart 1
Financial requirements[1]
1990-91 to 1995-96



[1] Excluding foreign exchange transactions.

We have seen how living beyond our country's means can lead only to higher inflation, higher interest rates, less investment, lower consumer spending, slower growth and fewer jobs. All this in turn contributes to a growing burden of public debt.

It is easy to point the finger at others: business and labour at government because of the exchange rate, interest rates and taxes; or business at labour because of wage levels; or labour at business because of high executive salaries and bonuses or inadequate training.

But shifting the blame will get us nowhere. The problems are caused by us all and the solutions must involve actions and co-operation by us all. There is too much at stake for anything less than a full, national effort.

The government will take the lead in a major national exercise to bring together the ideas and the efforts of Canadians, in all walks of life and from all across our country, to strengthen Canada's ability to prosper in a tough economic world.

Before describing the budget measures in more detail, I want to be very clear about why, in a time of recession, it is necessary to call on Canadians to exercise patience and restraint.

FACING UP TO ECONOMIC REALITY

Without doubt, this is the most difficult of the seven budgets I have presented. Particularly so because of the painful economic circumstances facing Canadians today.

It is clear that the weakness in our economy continued and deepened during the last quarter of 1990. I expect the economy to stabilize by mid-year after a total decline of almost 2.5 per cent in output. The unemployment rate will exceed 10 per cent in the first half of this year and then decline as growth and employment recover.

In the months leading up to this budget, I have talked with, and listened carefully to, people from all across the country. I carried out extensive pre-budget consultations with leaders of organizations representing a variety of business, labour, social and other interests. I hear directly from individual Canadians on a continuing basis, in my visits to various parts of the country, in letters and in many other ways. I have heard the anguish of people who have lost their jobs or their businesses.

While the views that we are hearing on some of the shorter-term policy issues range widely, there is little disagreement on basic issues:

- Canadians want a strong, growing economy that provides good jobs and expanding opportunities for themselves and their children. They want a government with the financial means to maintain the essential programs that help to hold this country together.
- Canadians know that the deficit and the debt are serious problems that must be solved. They know that firm, determined action is needed to

solve these problems. And they believe this should be carried out with the least possible adverse impact on those in greatest need.

In designing our **Plan for Economic Recovery**, I have been mindful of these views. One of the best things we can do to strengthen the unity of our country is to strengthen our economic union and our fiscal position. Our approach also reflects careful sensitivity to the difficulties that many Canadians are facing today. This is evident in the fact that program expenditures will increase by 6.9 per cent in 1991-92. While this is too high in purely fiscal terms, the reason for the increase can be clearly understood in human terms.

Of a total program spending increase of $7.5 billion, here is where the bulk of the money will go: $3 billion for assistance to the unemployed; $1.6 billion for the elderly and $1.3 billion for farmers in difficulty.

We have also allocated $600 million for national defence to meet increased responsibilities in 1991-92.

These four areas will account for more than 80 per cent of the increase in program spending.

In short, the money is going where it is needed, when it is needed.

At the same time, we have acted to ensure that our medium-term goals will not be compromised, as they must not be if we are to achieve continuing economic growth.

Let there be no doubt: The actions in this budget are tough and they are challenging. And I can assure you that government and the people who work for it will feel the pinch. We will have to give better value for taxpayers' dollars.

But Canadians know that finding the solutions to Canada's economic problems will continue to demand the participation and the effort of everyone.

In this budget I am asking Canadians to share the burden of further fiscal restraint. I fully recognize the sacrifices that many Canadians have already made in the name of restraint. I know there will be some reluctance to accept the necessity for more of the same.

In earlier times, periods of economic weakness have been occasions for Ministers of Finance to put some extra money in people's pockets, spend more on programs, and worry less about the government's fiscal situation. But in earlier times, we did not have to face persistently high deficits, high public debt and the economic damage that would result from ignoring these serious problems. Let us not forget that during the last recession, Canada's deficit doubled from $14 billion to $28 billion. We are still struggling with the problems this caused.

Our public debt is forecast to reach $400 billion by mid-year – about $15,000 for every man, woman and child in Canada. The interest alone on the debt will eat up more than $43 billion next year – more than we spend on old age security, unemployment insurance and family allowances combined.

Since coming to office in 1984, the government has waged a long, uphill battle to reduce the deficit and bring the debt under better control. The growth of the debt has been substantially reduced. The deficit, though still too high, has been cut in half as a proportion of our national income.

Throughout this period, many Canadians have become increasingly concerned about what government can do for them, about the value they are getting for their tax dollars.

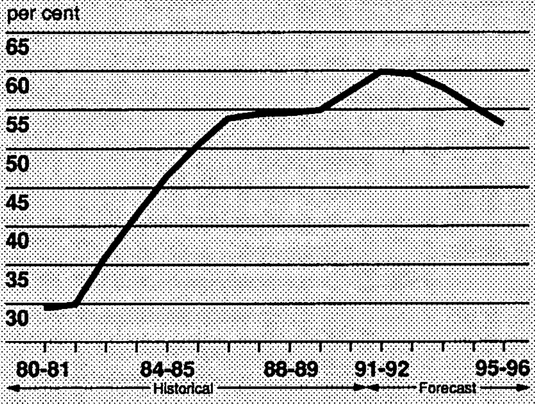
This is not surprising. In 1984, the federal government was handing out $1.33 in programs and services for every dollar it collected in taxes. That was no bargain. We are now paying the price, over and over again, for too many years of consuming more government services than we were willing to pay for – and borrowing to make up the difference.

We must get off this treadmill.

Decisions made in the 1970s and early 1980s that led to the massive debt of the 1990s have taken away many of the choices that Canadians and their governments might want to make today – choices about supporting priority programs and services or reducing taxes.

In my 1989 budget, I set out a medium-term fiscal plan to sharply reduce the deficit and bring an end to new government borrowing in financial markets by 1994-95. My 1990 budget reaffirmed this plan and introduced a program of expenditure control to meet it. However, revenues are now lower than forecast; expenditures are higher because of the weak economy; debt charges are substantially higher.

Chart 2
The debt-to-GDP ratio: 1980-81 to 1995-96



If we did nothing to deal with this worsening fiscal situation, the deficit would be significantly higher than forecast over the next five years and the public debt would increase by at least $25 billion more in the same period. This would aggravate all of the fundamental problems that must be solved if we are to ensure a strong recovery. And if we increased our spending still further, the debt problem would be just that much worse.

- Instead of lower inflation and lower interest rates, we would be sowing the seeds of higher inflation, higher interest rates and, unavoidably, higher taxes.
- Instead of making more room for productive, job-creating investment, we would be crowding out that investment.
- Instead of restoring the government's capacity to do the things Canadians want and need to build a stronger economy and a stronger country, we would be weakening that capacity.
- Instead of building greater confidence in Canada's ability to deal with its problems, we would be assaulting that confidence in a direct and irresponsible way.

While the detailed policy choices facing the government are difficult, there is no doubt about the broad course that we must continue to follow. We must stay the course we set out in 1984 and that we reinforced in 1989.

ACTION FOR RECOVERY AND PROSPERITY

The first challenge is to ensure that interest rates continue to come down. This is the key to our **Plan for Economic Recovery**.

We are making real progress in the battle against inflation. As a result, interest rates have declined more than four percentage points since their peak last May. But we must now build a stronger level of certainty that a further easing of monetary conditions can be achieved and sustained.

Restoring the financial stability of government is essential to build that certainty.

Extending the Expenditure Control Plan

Sustained expenditure restraint is the key to deficit reduction and debt control. Government program expenditures must carry the burden of restraint.

In the 1990 budget, the government introduced a two-year Expenditure Control Plan that affected a broad range of government spending, with some important exceptions.

The Expenditure Control Plan will be extended. Exemptions will be continued for income support programs for seniors, families and veterans, unemployment insurance, as well as the Equalization program and Canada Assistance Plan payments to lower-income provinces. Indian and Inuit programs will also be exempted.

Under the Expenditure Control Plan:

- We will extend the existing 5-per-cent cap on the growth of Canada Assistance Plan payments to the fiscally stronger provinces of Ontario, British Columbia and Alberta for three additional years.
- The existing freeze on total per capita cash and tax transfers to the provinces under Established Programs Financing will also continue through 1994-95. These transfers will continue to grow with provincial populations.
- A number of other programs will remain frozen, including payments under the *Public Utilities Income Tax Transfer Act*, payments to Telefilm Canada and concessional loan financing by the Export Development Corporation.
- Science and technology programs and cash payments under Official Development Assistance will grow by 3 per cent per year.

- The existing 15-per-cent reduction in planned funds for new social housing will continue.
- Grants and contributions to businesses, interest groups and individuals will be reduced by $75 million next year and $125 million thereafter.

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In summary, programs which are exempt from the extension of the Expenditure Control Plan, accounting for 60 per cent of program spending, will grow at an average annual rate of 3.9 per cent from 1991-92 to 1995-96. All other program spending will grow at an average annual rate of 1.7 per cent.

In view of our difficult fiscal circumstances, the government has decided to reconsider a number of recent decisions.

- We will withdraw the previously announced contribution of $88 million to the Toronto Ballet Opera House, in line with the decision of the Ontario government.
- Expenditures under the Green Plan will be spread over six years instead of five.
- Funding for the Canadian Jobs Strategy will be reduced by $100 million in 1991-92.
- We will delay the provision of financial support for the construction of concert halls in Edmonton and Montreal.
- The cultural research institute in Montreal will be delayed.

Reforming government management

From the outset, we have recognized that fiscal responsibility by the government means fiscal responsibility in the government. Operating costs have been tightly restrained since 1984 and have actually declined in real terms. This was achieved by reducing the size of the public service, eliminating programs and improving efficiency.

This effort has been intensified in recent years. Since December 1989, operational restraint measures have been implemented to achieve total savings of $6 billion over a five-year period. Budgets for travel, vehicles and equipment, supplies and office space have been cut. Government construction projects in the National Capital Region have been delayed.

We recognize that Canadians expect the government to bear its share of restraint. And we recognize that politicians and federal public servants must demonstrate leadership and resolve in helping the country through this difficult period. We are therefore taking further actions to restrain costs and improve efficiency.

- The ministerial pay of the Prime Minister and Cabinet members will be frozen for one year.
- The wage budgets of departments will not be adjusted in 1991-92 for any increases in costs arising out of new collective agreements. Departments will have to absorb any such higher costs from within existing budgets. Each increase of 1 per cent in average wage settlements across the public service could lead to a loss of about 2,000 jobs.
- Over the next three years, the government is not prepared to contemplate wage increases beyond 3 per cent at an annual rate.
- Rates of salary increase for the executive category in the public service, deputy ministers and heads of Crown corporations will be limited to a level no higher than the average of negotiated settlements in the federal public service.
- The salaries of Members of Parliament and the Senate, which currently increase at the rate of inflation minus 1 per cent, will now increase at a rate which is the lesser of this formula or the average of negotiated settlements in the public service.
- We will eliminate layers of management and reduce the number of senior managers in the public service by 10 per cent.

- Capital spending and non-wage operating budgets will be frozen at 1990-91 levels.

We will continue to seek an agreement with public service unions on a work force adjustment policy that will permit the contracting-out of government services where this is shown to be cost-effective. If such an agreement cannot be negotiated, we will introduce legislation to permit contracting-out.

This program of restraint will generate savings of $3.6 billion over the next five years.

Let there be no doubt: the government and the people who work in government will be doing their part.

Details of these and related measures will be announced shortly by my colleague, the President of the Treasury Board.

Wage policy

I want to deal briefly with the approach the government is taking in its wage-setting policies. Continuing wage restraint is a key element of our **Plan for Economic Recovery**.

As a leading employer, the government has a responsibility to ensure that public sector wage settlements do not add to inflationary pressures in the economy. To this end, the government has exercised restraint in federal contract settlements, while maintaining the principles of collective bargaining. Wage settlements since 1987 have been lower than those concluded in the private sector and by provincial and municipal governments.

However, given the seriousness of the fiscal situation, the government believes it must exercise further restraint in concluding wage settlements with its own employees. In taking this step, the government wishes to stress that federal employees are not being singled out for restraint. All Canadians face difficulties during the present period of recession. In the past two months alone, more than 140,000 jobs were lost in the economy. In the current situation, the government must cut back in all areas of spending, including wages.

All levels of government have a responsibility to restrain their expenditures. Let us remember that we all serve the same taxpayer – the same taxpayer who must pay the price when our spending gets out of line. And we will all share the benefits of reducing government spending – the benefits of lower interest rates, stronger growth and lower taxes.

Pay restraint is particularly important at the provincial and municipal levels, including education and health services. Wages and salaries in these sectors account for 45 per cent of all expenditures. Wage settlements in these sectors have been running ahead of inflation and our ability to pay. Some provinces have already introduced programs to limit the pay increases of their employees. It is vitally important that all provinces take part.

Wage settlements in the private sector have also been contributing to inflationary pressures. Reducing these pressures will help to lower costs and improve our competitive position. This will lead to more growth, new jobs and higher incomes.

Other management and efficiency initiatives

In addition to the measures I have described, the government will proceed with a number of other actions to streamline operations and encourage efficiency as part of our **Plan for Economic Recovery**.

Revenue Canada will take steps to improve the collection of tax revenues owed to the government. Changes will also be introduced to permit the recovery from tax refunds of debts owing to the government.

New cost-recovery measures will be developed in the areas of transportation services and border crossings.

Privatization and Crown corporations

Since 1984, the government has privatized or dissolved more than 20 Crown corporations and improved operations of those remaining. As a result, the number of Crown corporation employees has been reduced by close to 80,000 since 1984-85. In the coming year, the government will continue to divest itself of investments no longer required as instruments of public policy.

The privatization of Petro-Canada will proceed now that legislation has passed. Legislation will soon be introduced to enable the government to proceed with the sale of its shares in Telesat Canada. The government intends to privatize CN Exploration, a subsidiary of CN.

The Canada Oil and Gas Lands Administration will be disbanded and its responsibilities transferred to other departments. Petro-Canada International Assistance Corporation will be dissolved. With these actions, the last remaining institutions set up under the National Energy Program will be wound up.

The use of Special Operating Agencies will be extended to improve service and efficiency and cut costs, particularly in activities delivering services to the public and to departments. Organizations or functions to be converted to this status include the Canadian Grain Commission, Race Track Supervision, and the Intellectual Property Directorate of Consumer and Corporate Affairs. Further candidates for conversion to Special Operating Agencies will be announced in due course by the President of the Treasury Board.

The privatization program has been implemented to date through the Office of Privatization and Regulatory Affairs. Privatization remains a priority of the government. In keeping with our desire to streamline government operations, the functions of this agency will be redeployed. Ongoing and future privatizations will be managed by the Department of

Finance under the responsibility of the Minister of State (Finance and Privatization).

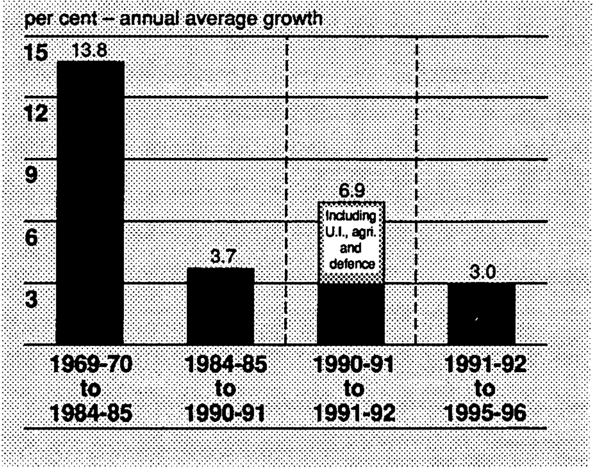
Legislating spending limits

The expenditure restraint measures in this budget are crucial to our Plan for Economic Recovery. These measures build on a record of discipline that has reduced annual program spending growth to 3.7 per cent in the past five years compared with 13.8 per cent per year in the previous 15 years.

Having proven that we can manage spending responsibly, we can now provide Canadians with further assurance that future program spending will not get out of control again as it clearly was before 1984.

The government intends to impose mandatory, legislated limits on annual program spending for the next five years. By setting these limits in law, we will ensure that this budget's program spending track will be met. Flexibility will be provided only to meet a very limited set of contingencies that will be defined in the legislation.

Chart 3
Growth in Program spending



This law will bring a significant change to the way government manages its expenditures. While the legislation will not preclude the introduction of new programs to meet new needs, it will mean that the government will have to fund new programs from within the total legislated spending ceiling.

The government will consult on the precise form this important legislation should take. I will release a draft bill in the next few weeks and at that time provide further details of the consultation process. Final legislation will be introduced later this year.

Allocating GST revenues to meet the debt challenge

The GST has improved the competitive position of Canadian-made goods in both Canadian and foreign markets. We have finally brought an end to the outdated manufacturers' sales tax and the damage it inflicted on growth and job creation in Canada.

I have been particularly encouraged to hear the positive response from a number of export-oriented industries already seeing the benefit of the new tax system. I am pleased, too, at the progress we have been able to make towards a harmonized system with the provinces. First Quebec and now Saskatchewan have decided to adopt the GST structure. This will pay dividends as businesses in those two provinces take advantage of the investment incentives the GST offers. The fact that provincial and federal taxes will be collected by a single administration will mean lower costs for taxpayers. Even more important, small business will be a big winner as the costs of compliance are reduced.

The competitive advantages offered by the GST are clear. At a time when Canada needs to fight hard to maintain its position in the world economy, it is all the more important for other provinces to harmonize their sales tax with the GST. It is good for the provinces. It is good for Canada.

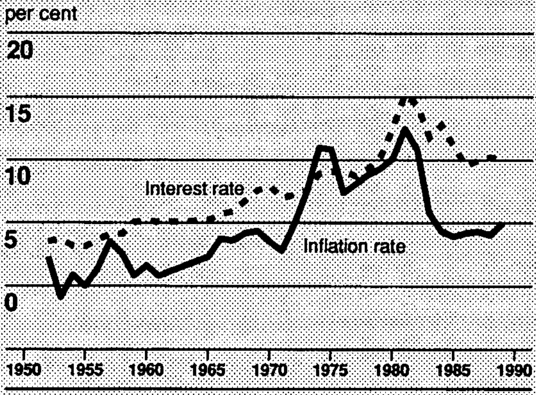
I am well aware that many Canadians have expressed concern that revenues from the GST might be used to finance new spending programs instead of helping to reduce the deficit. While the legislated spending limits I have just described should ease concerns about new spending programs, an additional safeguard will be provided.

As part of our **Plan for Economic Recovery**, we will ensure that all GST revenues are allocated solely to the effort to bring the public debt under control. This will be done through legislation to establish the Debt Servicing and Reduction Fund into which all GST revenues will flow. Private contributions for debt reduction and other specified revenues, such as those from privatization, will also flow into the fund. An annual audit of this fund by the Auditor General will be presented in the Public Accounts of Canada.

Establishing national inflation targets

The government and the Bank of Canada have made a clear commitment to achieving price stability in order to promote stable growth, equity and prosperity in Canada. To achieve this, our **Plan for**

Chart 4
Canadian inflation versus Canadian long-term government bond yield



Economic Recovery includes further action to reduce inflationary pressures.

The benefits of price stability are enormous. Stable prices will strengthen our ability to compete. They will protect those least able to protect themselves, such as the working poor, the elderly and others on fixed incomes. They will result in lower interest rates by removing the inflation risk premium that lenders demand, thus making home ownership more affordable for Canadians. They will lower the cost of capital, and particularly risk capital, to Canadian businesses. Price stability will help to avoid the wasteful "boom and bust" cycle that rising inflation triggers in the economy.

As the budget papers point out, Canada's inflation for most of the postwar period has compared favourably with other industrialized countries, including Germany. From 1950-1973, our inflation rate averaged only 2.8 per cent – better than Japan's performance. There are no insurmountable barriers to attaining price stability.

Accordingly, I am announcing today, with the Governor of the Bank of Canada, that we are establishing intermediate inflation targets to serve as key steps on the way to price stability. We are committed to lowering inflation gradually to 2 per cent by 1995 and to making further progress toward price stability thereafter.

Reducing inflation requires reducing inflation expectations. The adjustment to price stability can be significantly eased by providing the public with specific targets and a clear timetable so that people know what to expect. To rely only on market pressures to bring down inflation expectations, risks an unnecessary period of economic weakness. A smoother and more rapid downward adjustment of inflation expectations will permit a substantial narrowing of interest rate differentials with the United States.

Reinforcing fiscal stability

The measures in this budget will ensure that expenditure restraint continues to make a major contribution to the restoration of fiscal stability. In my 1990 budget, there were no new taxes. In this budget, there are two specifically targeted revenue-raising measures.

Financing unemployment insurance

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The unemployment insurance program is one of the most important elements of Canada's social safety net. In recognition of this, it is required by law that the Unemployment Insurance Account be maintained in a healthy condition on a self-financing basis.

Premium rates were set in 1989 for a three-year period beginning in 1990 on the basis of economic conditions expected at that time. At the current rate of contributions, the unemployment insurance fund would move from a surplus at the end of 1990 to a deficit of $6 billion by the end of 1992 because of higher than expected benefit payments.

We have seen the consequences of failing to act quickly to prevent debt problems from building up. Responsible stewardship requires that we take the necessary steps to ensure the fund remains self-financing. Accordingly, the unemployment insurance premium rate will rise by 55 cents per $100 of insurable earnings to $2.80 for employees. For employers, the rate will increase to $3.92. These measures will take effect July 1, 1991. The after-tax cost of the increase for employees with the maximum insurable earnings will be $2.70 per week.

Increased tobacco taxes

Our national strategy to reduce tobacco use addresses all aspects of the problem of tobacco consumption. In particular, it is aimed at discouraging young people from beginning to smoke. It includes initiatives in areas such as public awareness, advertising and crop substitution.

This strategy has worked to reduce the use of tobacco by Canadians. Studies show that tobacco taxes are particularly important in discouraging younger Canadians from smoking.

Effective midnight tonight, the excise tax on cigarettes will be increased by three cents per cigarette. The excise tax on other tobacco products will be increased proportionately. These increases will also apply to existing inventories of tobacco products.

As a result of an expected continuing decline in tobacco use by Canadians, revenues generated by the measures are also expected to decline in the years ahead. In light of the damage to health caused by smoking, this is one kind of revenue erosion that I am pleased to accommodate. As a result of these measures, it is estimated there will be about 100,000 fewer teenage smokers.

Provincial capital and payroll taxes

Over the past decade, the provinces have made increasing use of payroll and capital taxes as revenue sources. This has raised two issues for the federal government: whether the federal government should pay provincial payroll taxes; and the impact of increasing provincial capital and payroll taxes on federal corporate tax revenues.

After a review of the issues, I am announcing our intention to continue to pay voluntarily provincial payroll taxes of general application; and to limit the deductibility of provincial payroll and capital taxes from federal corporate income tax.

This limitation will be phased in to allow sufficient time for businesses and provincial governments to adjust, and will be the subject of consultations before it is implemented. It will treat payroll and capital taxes on the same basis as income taxes. This will remove the bias in favour of those deductible business taxes which have substantially eroded federal corporate income tax revenues in recent years.

Small business will be protected from the impact of the change. No additional revenue will result for the federal government, but the reliability of federal corporate income tax revenues will be protected.

Assisting disabled Canadians

Since coming to office in 1984, the government has taken major steps to promote equal opportunities for Canadians with disabilities. The Prime Minister has appointed a Minister responsible for the Status of Disabled Persons; we have passed the *Employment Equity Act*; and we have put in place fairer, more generous tax assistance.

In short, this government has done more than any other to improve opportunities and to enable Canadians with disabilities to participate more fully and more fairly in the work place, in their communities and at home.

To build on the progress that we have already made, I am today announcing further positive steps to assist disabled Canadians:

- The disability tax credit will be increased from \$575 to \$700 as of the 1991 taxation year.
- The definition of expenses eligible for the medical expense tax credit will be broadened and will include the cost of part-time attendants in the home.
- Costs incurred by employers in modifying their premises to accommodate disabled persons will become fully deductible in the year they are incurred.
- Benefits provided by employers to disabled persons to enable or assist them to work will no longer be taxable.

Whether in the design of tax policies or in the development of legislation and new programs for individuals with disabilities, the government has benefited from extensive consultations with groups representing the views and interests of Canadians with disabilities. The government will continue to work with these groups to improve the effectiveness of the tax system in meeting the needs of disabled Canadians.

THE PROSPERITY CHALLENGE

I want to turn now to the challenge of ensuring Canada's prosperity. It is a continuing challenge, but also an increasingly urgent one.

The key to prosperity is to increase our productivity, for this is what will determine our earning power in the years ahead. Despite strong economic growth in the past six years, the growth in our manufacturing productivity was the poorest among the Group of Seven industrial nations.

In our increasingly competitive world, there is no room for complacency; and there is no safe hiding place for uncompetitive industries or countries. We must adapt to the new world reality or fall behind in the effort to preserve and enhance our future prosperity.

This competitive challenge was central to the Agenda for Economic Renewal introduced by the government in 1984. The wide range of economic and fiscal actions taken to implement that agenda have provided a better framework for building new competitive strength.

But there are growing concerns from Canadians about our ability to compete. These concerns relate to the broad economic environment, including inflation, interest rates and the exchange rate, and to the structural problems with our productivity performance, including the effectiveness of our investments, the burden of government and the climate for business.

Governments have a responsibility to create an environment favourable to the growth of competitive enterprise. In this budget we are acting to restore fiscal balance and attain price stability.

This will strengthen our ability to compete in a tough economic world.

Our ability to compete abroad begins at home. We must maintain and strengthen our economic union. In this and other areas, governments must step up the pace of structural reform. I have been working with my provincial colleagues to develop shared approaches to basic economic issues. One of the key questions to be faced is this: How much government are people willing to pay for? In our discussions, we are already looking at the rising costs of government and at overlap and duplication. In addition, the Prime Minister has asked the Economic Council of Canada to carry out a major study of the impact of governments on competitiveness.

As a further positive step, I propose to encourage greater investment in Canadian equity markets by making changes to the tax environment affecting pension plans. The aim will be to eliminate the existing bias in favour of debt investments by pension funds. This will encourage a larger source of capital for equity investments with the potential to make Canadian business more competitive. The government will discuss these proposals fully with interested parties.

But more needs to be done to assure our future prosperity. We need to look hard at the quality of our investments in infrastructure, machinery and equipment, training, education, and research and technology. There are signs that in some areas, such as private sector spending on training and research, we are not doing enough. In other areas, such as education, our level of spending compares well with international standards but our performance appears to be falling behind. In these and other areas, the co-operative efforts of Canadians in both the public and private sectors will be crucial to our competitive success.

This is not an issue only for business, labour and government. All Canadians have an enormous stake in strengthening Canada's competitive ability. The perspective of workers, consumers – people involved in every aspect of economic life – will be a valuable part of the process of identifying the problems and developing solutions.

To help assure our future prosperity, the government will launch a national effort to build a new partnership for prosperity that draws fully on the talents and efforts of Canadians in every sector of economic life. As a first step, we will release a discussion paper in the spring to help focus public debate toward the building of a broader consensus on the problems we face and the development of solutions.

FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS

This budget has important implications for federal-provincial fiscal arrangements, and particularly for the system of major transfers: Equalization, Established Programs Financing and the Canada Assistance Plan. These programs account for more than 90 per cent of the funds transferred by the federal government to the provinces to help pay for a variety of programs and services.

For decades, the federal government has provided large and growing financial support to the provinces. Next year alone, total federal transfers to the provinces will reach $36.9 billion, including both cash and tax transfers. These transfers are simply too large to exempt from our expenditure restraint program. The deficit is a national problem and it demands a national solution.

The federal government is not asking more of the provinces than it is doing itself. Major transfers to the provinces, including both cash and tax transfers, will grow on average by about 3.7 per cent per year from 1991-92 to 1995-96. All other federal program spending will grow by 3.4 per cent.

I recognize that limiting the growth of transfers under Established Programs Financing raises concerns about the ability of the federal government to continue enforcing national medicare principles under the *Canada Health Act.* Legislation will be introduced to ensure that the federal government continues to have the means to enforce these national medicare principles. The principles of the *Canada Health Act* will not be compromised.

The measures in this budget bring the growth of federal-provincial transfers into line with current fiscal realities. But it is also time to ask ourselves whether the system of transfers and tax arrangements can be reformed to better meet the emerging challenges, priorities and needs of the 1990s and beyond.

In recent months, my provincial colleagues and I have been working together to address Canada's fiscal and economic problems. I have already referred to our discussions on the question of overlapping spending. We are also working in a co-operative way on a number of important taxation and fiscal transfer issues.

Reform of the major transfer programs

The federal government will consider reforms to the major transfer programs within the fiscal framework set out in this budget. We want to ensure that, in the future, the system of transfers:

- provides for the sharing of the opportunities and benefits of Confederation;
- supports a more efficient and competitive Canada; and
- maintains the principles and standards that are the basis of Canadian citizenship while respecting provincial flexibility.

All Canadians have a stake in these reforms, and we will be considering how best to seek their views.

Discussions on the updating and renewal of the Equalization program are already well under way, and will be carried forward as an integral part of this broader process.

Federal-provincial tax collection agreements

A number of my provincial colleagues have expressed concern that federal-provincial tax collection agreements do not provide enough flexibility for them to meet their own social and economic priorities. Some have suggested that provinces should have the right under these agreements to levy provincial tax on taxable income, rather than on basic federal tax. Indeed, the possibility of establishing separate tax collection systems has been raised by some provinces.

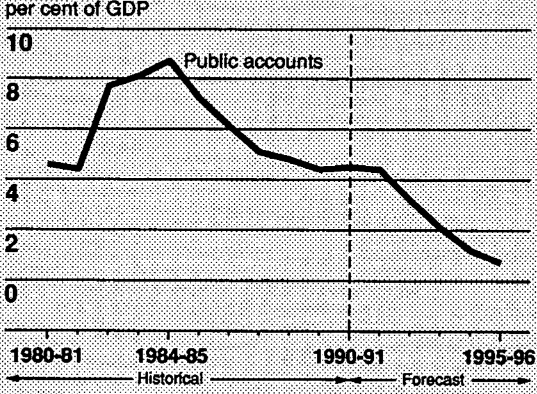
Given the importance of these and related issues, the federal government will seek the views of individual Canadians and tax professionals. We will release a discussion paper in the spring to explore reforms to the tax collection agreements. The objective will be to assess whether the flexibility of these agreements can be enhanced while maintaining the competitive benefits of a tax collection system that is simple, and consistent, and that enhances the accountability of governments. Following these consultations, we will put forward specific proposals.

ECONOMIC OUTLOOK

Our **Plan for Economic Recovery** will help ensure that Canada will be a stable, attractive place for investment in new growth, jobs and opportunities for Canadians.

The components of our **Plan for Economic Recovery** reinforce each other. Lower deficits and less government borrowing will mean more favourable conditions for lower inflation and interest rates. This in turn will help to reduce the deficit by spurring stronger growth and reducing the interest costs of carrying the public debt.

Chart 5
The deficit
1980-81 to 1995-96



The economic recovery will begin in the second half of this year and accelerate next year.

- Inflation will decline. The inflation rate will decline to 3 per cent by the end of next year and average just over 2 per cent in the three years thereafter. Canada's inflation rate will be significantly less than that of the United States. This will strengthen the fundamentals of our economy and our ability to compete. It will also further ease the pressure on monetary policy.
- Interest rates will continue to fall. Short-term interest rates are assumed to decline to an average of 9.5 per cent for 1991, well below the 1990 average of 13 per cent. This will contribute to a rebound in consumer spending and housing starts.
- Strong economic growth will be secured. Real output will expand by 3.5 per cent in 1992 and average 4 per cent in the medium term. Real personal disposable income will grow steadily throughout the period. Employment growth will begin in the second half of this year and will strengthen in the years ahead.

I am tabling the budget document including Notices of Ways and Means Motions. Details of the measures are included in the document.

I will also introduce a bill seeking borrowing authority for the 1991-92 fiscal year.

I am asking that an order of the day be designated for consideration of those motions.

CONCLUSION

Mr. Speaker, this is a strong budget – a budget for economic recovery.

It deals resolutely with our fiscal challenges.

It imposes strong disciplines on government spending.

It requires vigourous restraint in government operations.

It sets out a clear path toward lower inflation and lower interest rates.

It is designed to give Canadians confidence that we are facing directly our immediate economic and fiscal problems.

But it does more than that. It establishes a clear direction as to how we must face the more fundamental problems undermining the competitive position of our economy, and it is sensitive to those in greatest need.

In short, it will provide leadership and direction in our economic affairs at a time when Canadians are asking fundamental questions about the future of our country.

Our **Plan for Economic Recovery** is different from those in previous recessions.

Our plan does not have the government throwing large amounts of money at problems. Those are band-aid solutions.

This government is dealing in a fundamental way with the problems that it can directly influence. This is the best way to generate a positive environment in which Canadians can live and work.

It asks Canadians to do the same in the more positive environment which the plan will foster.

But I would add something else, Mr. Speaker. Too often Canadians complain that some other region of the country or some other group is doing better than they are. The challenge to all Canadians is to do what each of us can do to strengthen our country.

At this time of great stress in our national unity, it is important to put aside jealousies and defeatism and start working together for our country.

Canada has come a long way in 123 years. Let's not sell ourselves short. Let's start thinking positively and take heart from our past success.

We have forged a country that is the envy of the world – a tolerant and open society with the world's second highest standard of living.

This prosperity was put at risk by abandoning the traditional Canadian value of paying our way.

I believe that this budget will help us regain some of the key elements that brought us strong growth in the past – low inflation, responsible financial management and a desire to work together to succeed.

The realization of this can rekindle our pride and give us a solid basis for hope and confidence in the future – hope that is important at this time in our history. For a strong economy will strengthen our national unity – and faith in our national unity will reinforce our economic strength.

We all wish to see a strong, united and prosperous Canada. Our **Plan for Economic Recovery** will help us achieve that goal.