

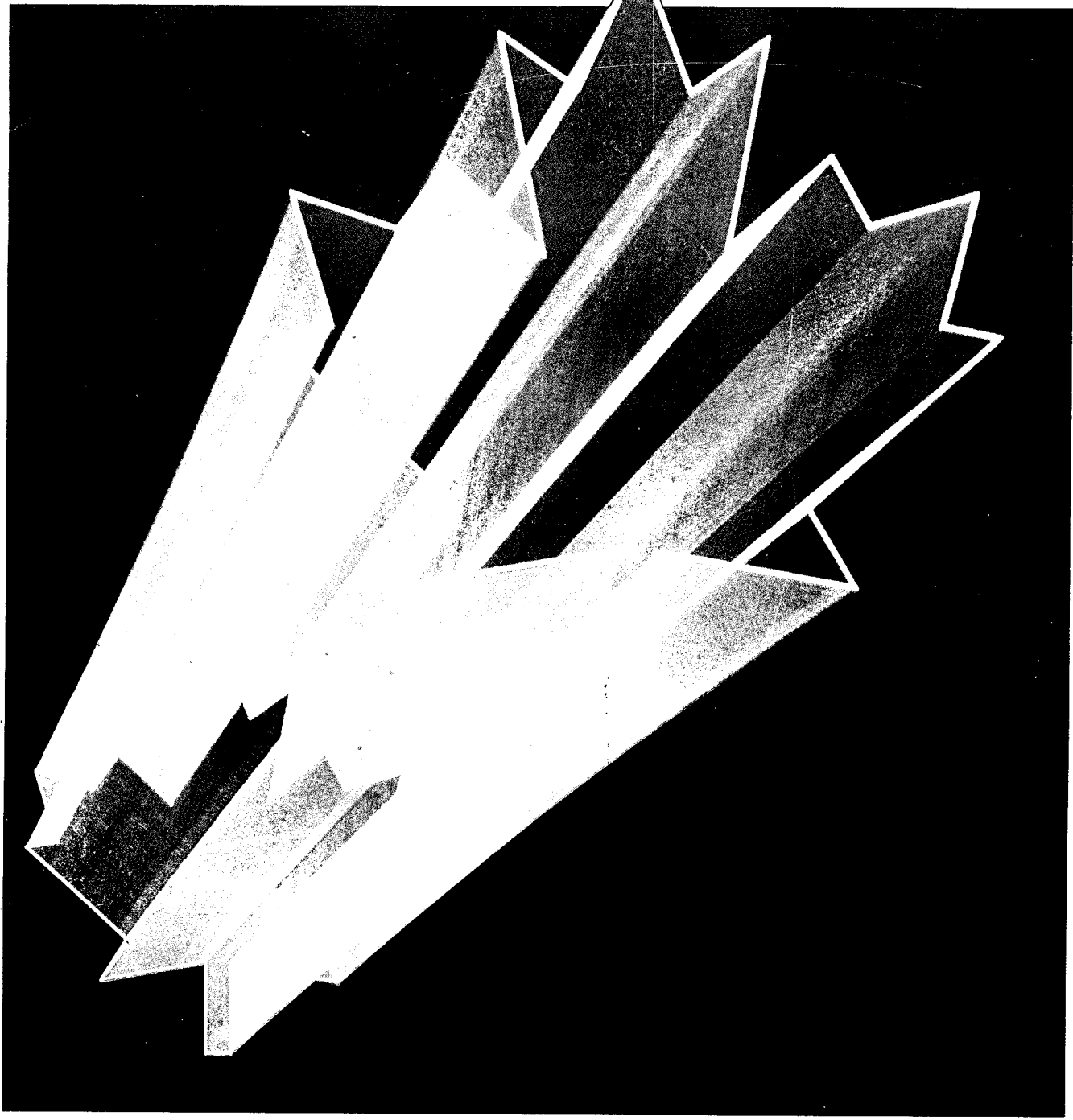
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ing Economic Renewal

The Budget Speech

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

May 23, 1985



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Securing Economic Renewal

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Minister of Finance
Member of Parliament for Etobicoke Centre
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Introduction

On September 4, Canadians voted for a new approach to Canada's problems and potential. They voted not only for a change in policies. They voted for a new approach to making public policy. In doing so, they opened the way for a fresh start, based on national reconciliation and economic renewal.

Two months later, on November 8, we charted a course of action to create growth, jobs and opportunities. I set out our guiding principles and new policy directions in an Agenda for Economic Renewal. We pledged to consult before we acted. And we pledged to act fairly.

X Today, I am putting before this House and the Canadian people a budget of opportunity. A budget to encourage private initiative. A budget to build growth and lasting jobs for Canadians.

This budget is designed to produce more efficient and more effective government. It contains the tough measures necessary to reduce the deficit.

The actions I am proposing are realistic, effective and fair. They represent a fundamental break with the past. For too long, government decided what is best for Canadians. Government set priorities, directed activity and subsidized effort. My budget calls for Canadians, not government, to choose what is best for Canada. And it challenges Canadians by rewarding success, not subsidizing effort.

X The actions in this budget are consistent with the urgent priorities for international economic renewal affirmed by the leaders of the major industrial nations at the Bonn Summit. At home and in concert with our international partners, we are working to free up the entrepreneurial spirit of our citizens, to remove obstacles to productive growth, to lower barriers to international trade, to control and reduce high deficits, and to let the dynamism of our renewed economies produce jobs and opportunities for all.

Working Together

Step by step, we have been building a clear and growing sense of harmony and purpose with our international trading partners and among all Canadians.

Since November, my colleagues and I have spoken with and listened to people from all parts of Canada. The National Economic Conference, chaired by the Prime Minister, brought Canadians together in a unique and historic forum to discuss with each other, and with government, how to achieve our shared objectives.

My colleagues and I are grateful for the enthusiastic and positive response we have had from Canadians across the country. I have personally benefited from the most extensive round of pre-budget consultations ever held. These have had an important influence on this budget.

Canadians recognize that, in this uncertain world, we must work together with patience and determination to secure economic renewal. The Prime Minister has carried this message consistently, vigorously and unceasingly – to labour leaders and business leaders; to the provincial First Ministers at the Regina Conference last February; to the National Economic Conference; to President Reagan at the Quebec Summit in March; and to the leaders of our major trading partners at the Bonn Economic Summit.

And working together, we have made progress.

We have achieved a measure of federal-provincial harmony absent for many years. We have brought a new spirit of co-operation to government relations with business, with labour and with other groups. We have restored Canada-United States relations to the status worthy of two sovereign nations who are not only close neighbours but who share similar goals and ideals. And we have refurbished Canada's image around the world as a secure and reliable partner. We have begun, at home and abroad, a process of reconciliation and rejuvenation.

A Record of Action

We can point with pride to our record of action in the past eight months. Consider some of these achievements:

The Minister of Employment and Immigration is implementing a series of employment and training initiatives with the full support and co-operation of provincial governments and groups in the private sector. I will be committing additional funds to support these programs.

The Minister of Regional Industrial Expansion has moved to establish Investment Canada in place of the Foreign Investment Review Agency. This has already provided a clear signal to investors around the world that Canada is once again "open for business".

The Minister of Energy, Mines and Resources has concluded energy accords with both Newfoundland and the western producing provinces. These historic agreements mark an end to a decade of federal-provincial bitterness and lost opportunity for Canada. They signal a new beginning that will benefit Canadians in all regions of this country.

We are acting vigorously to support our ability to excel as a trading nation. The Minister for International Trade is seeking the views of Canadians on how best to secure access to our traditional markets and expand our trade.

The Minister of the Environment, working with her provincial counterparts and the private sector, has made significant progress in the fight against acid rain.

The President of the Treasury Board has announced a new deal and a fair deal with the public service unions: a deal that among other things proposes to remove taxpayer subsidies from the financing of public service pensions by establishing the plan on a sound financial basis.

The Minister of State for Finance has proposed far-reaching and comprehensive reforms to the rules governing financial institutions in Canada. These proposals will promote competition, increase the availability of business financing and strengthen consumer protection.

We have extended eligibility for the spouses' allowance for the elderly to an additional 85,000 low-income widows and widowers. We have embraced the concept of employment equity that Judge Abella recommended to provide women and minority groups a fair chance at realizing their full potential. We have made progress in advancing the hopes and aspirations of aboriginal peoples and in eliminating discrimination under the Indian Act.

We are moving to modernize the Criminal Code and the divorce laws. And we have initiated a long-overdue study of Canadian broadcasting policy, a vital element of our cultural sovereignty.

In all these areas, and in others, we have consulted, we have listened and we have acted. Today, it is time to take further actions to secure our future.

Economic Outlook

The outlook for sustained and balanced growth in the world economy is better than it has been in years. But that optimism must be tempered by certain realities. There are signs that the American economy is slowing. High deficits continue to put pressure on interest rates worldwide. Protectionist pressures threaten the open trading system that has done so much to increase world prosperity.

In Canada, our economy grew strongly in 1984. Real growth was 4.7 per cent, the highest since 1976. Inflation averaged 4.4 per cent, the lowest since 1971. Inflation has since fallen below 4 per cent.

Interest rates have declined. The prime rate is below 11 per cent for the first time since 1978. Mortgage rates have declined substantially. Longer-term mortgages are beginning to appear – a sign of growing confidence.

Investment is expected to expand strongly this year. I expect that inflation will continue to be subdued through 1985 and beyond; real economic activity will likely expand by more than 3 per cent this year – about the same as the average for the major industrial nations.

Our recent performance and immediate prospects are encouraging. More than 200,000 jobs have been created since this government took office; the recorded increase in employment last month was the highest in five years. This is very positive, but it is still not good enough. The unemployment rate has recently fallen

but remains just below 11 per cent. There are still close to 1.4 million Canadians unable to find work. We can, we must, and we will do better.

The federal government has accepted the responsibility to lead the way in meeting this challenge. But this is more than just a challenge for the government. What is needed is a national effort by the people of Canada. Everyone must participate.

Working together, we can build new confidence in the future of this country. Confidence is rising. It shows in higher consumer spending and growing business investment plans. Our job is to reinforce that confidence through our actions in this budget and to encourage Canadians to accept the challenge of economic renewal.

Securing Economic Renewal

To meet this challenge, I will be proposing a large number of measures in this budget – too many to mention all of them or to provide full details in this speech. Additional information is contained in the Budget Papers I am tabling today. I encourage Honourable Members and others to refer to this material.

X The actions I am proposing are consistent with the comprehensive economic strategy that we set out last November. They are designed to deal with the two major problems facing Canada today: high unemployment and our spiralling national debt. High deficits constrain our ability to promote growth and create jobs. High unemployment in turn contributes to even higher deficits.

This budget addresses the vicious circle of unemployment and debt with a range of measures carefully balanced to support economic renewal now and into the future.

We confronted a major problem of rising deficits when we took office last September. This year, in the absence of any action by the government, the deficit would have risen to more than \$38 billion. The actions taken in this budget, together with those introduced in November, will reduce this year's deficit by \$4.4 billion to \$33.8 billion. Next year, the deficit would have been over \$40 billion. Our actions will reduce that deficit by more than \$8 billion to a level of \$32.7 billion.

I believe that larger reductions at this time would not be prudent in light of current economic conditions. Instead, I am proposing actions which control the deficit now while ensuring that significant reductions will occur over the balance of the decade.

I am implementing a clear and realistic medium-term plan to control our debt. That plan requires tough actions to be taken now. There will be expenditure reductions and tax increases. The impact of these actions, and those taken in November, will continue to grow. Our actions will directly reduce the annual deficit at the end of the decade by more than \$20 billion. Between now and then, our actions will cut a total of \$75 billion from the projected increase in the public debt.

These actions represent an unprecedented response to control the dangerous trend of rising debt.

But this budget does much more than restore fiscal responsibility to government finance. The strategic rebalancing of priorities in this budget constitutes a major step in the direction of securing a prosperous economic future. We will promote growth and job creation by encouraging private initiative, improving government effectiveness and controlling our national debt.

Encouraging Private Initiative

Our priority goal is jobs for Canadians.

Maintaining the jobs we have and creating the jobs we seek requires a strong and healthy business sector. In particular we need to recognize that small and medium-sized businesses across the country are the most dynamic forces for growth and employment.

If we are to stimulate the creation of new businesses and the expansion of existing ones, we must increase our investment in productive activities. We are major savers, but too few of us are willing to invest a part of our savings in new ventures. It is through capital investment that new ideas get implemented, new activities are generated and new jobs are created. I believe Canadians understand this. I believe they will respond to the challenge of taking a direct stake in the future if they are encouraged by government, not discouraged.

I want to encourage risk-taking, but in a way that lets the investor choose where to invest. I do not want to further distort the tax system by measures that tell Canadians where and how to invest. This government wants individual Canadians to pick the winners within a tax framework that rewards success.

I am therefore proposing a major change in the taxation of capital gains.

Individual Canadians will be granted a lifetime capital gains exemption of half a million dollars. All capital property will qualify for the exemption. The lifetime exemption limit will be phased in over six years beginning this year.

The full exemption will be available immediately for capital gains realized on the sale of farm property. Based on my consultations with the farming community, I believe this to be the most effective way to provide the necessary assistance to this vital sector of the economy.

This measure will encourage more Canadians to invest in small and large businesses. It will help Canadian companies to accelerate their return to a healthy financial position by attracting new equity investment. It will assist smaller businesses in raising capital to pursue new ideas and new directions. It will help raise capital for research and development.

Most important, this is a broadly-based incentive that allows individual Canadians to decide where to put their money and how to create wealth, economic activity and jobs. This is central to our philosophy. The decisions should and will be made by individuals across Canada, not by politicians or public servants here in Ottawa. This is a measure designed to unleash the full entrepreneurial dynamism of individual Canadians.

With this measure we are sending a clear signal to Canadians across this country: invest in Canada's future; help build the strong and prosperous country we all seek; help create those jobs. This government wants Canadians to enjoy the rewards of those efforts.

Lack of access to start-up capital has been a constraint for many small and medium-sized businesses.

I am announcing measures to encourage greater investment in smaller businesses by pension funds. Registered retirement savings plans will also be eligible to invest in private Canadian corporations with which they deal at arm's length. This will encourage the redirection of significant amounts of capital from one of the fastest growing pools of savings in the country into a sector of our economy that needs financing to create more jobs.

An innovative venture capital initiative has been taken by organized labour in the province of Quebec, in co-operation with the Quebec government. The Solidarity Fund is managed by the Quebec Federation of Labour and has been used effectively to maintain and create jobs in Quebec, by investing in small and medium-sized businesses. Tax assistance to individuals investing in the fund has been provided by the Government of Quebec. This initiative deserves support, not only in Quebec but across Canada. Because of the unique nature of this initiative, the federal government will provide a tax credit for individual investors in the Solidarity Fund in Quebec or in any similar funds that receive provincial tax assistance.

A further key to growth and more jobs is investment in research and development. Technological change is the driving force behind economic progress. We must keep pace in order to compete both at home and in foreign markets. A strong R&D performance has a vital role to play in meeting this challenge. It is an ongoing priority of this government to encourage a much-improved R&D performance in Canada.

I propose to assist small companies in a significant way by refunding 100 per cent of the tax credit which they earn on their first \$2 million of qualifying R&D each year. This full cash refund will be of most use to start-up companies which have particular problems attracting investment capital.

I am also announcing changes to the definition of qualifying R&D expenditures that will respond directly to the real needs and requests of the R&D community.

The capital gains exemption will also aid the growth of high-technology firms. As a consequence of these measures, I have decided that the flow-out of the scientific research tax credit to investors will be terminated as of today. There will be appropriate transition rules.

The Western Energy Accord has already led to strong signs of revival in the petroleum industry. This historic agreement will free up one of our most dynamic industries to create economic growth, new oil and gas security and job opportunities across Canada. To support the renewed growth of the energy sector, I am pleased today to table Notices of Ways and Means Motions that will give effect to the fiscal measures announced in the agreement.

In these three areas – small business, research and development and energy – the government has clearly identified the components of economic growth most likely to result in the greatest and fastest response.

The capital gains exemption will give small businesses a boost to expand. There are more than 700,000 small businesses in Canada. If each of these firms created just one new job, the impact would be dramatic.

If other Canadians start up new companies, more jobs will be created. And if our R&D incentives result in new inventions and more competitive companies, still more jobs will result. The energy sector has much room to grow, creating jobs across Canada.

The challenge is there. The opportunity is there. I am confident that Canadians will seize that opportunity and lead the way to a competitive and vibrant economy.

As we become more competitive, it will be critical to ensure that international markets remain open to our products. More trade means more jobs. That is why the government is working hard on several fronts to improve Canada's trade position. The Prime Minister and President Reagan have opened the door to a more productive trading relationship between Canada and the United States. Canada is in the vanguard of countries pushing for the early start of a new round of multilateral trade negotiations. Here at home we are working closely with the provinces and consulting carefully with business and labour. We must develop negotiating positions which carry their full support and maximize for Canada the benefits of trade liberalization.

All these actions will help to create job opportunities. As these new opportunities arise, we must ensure that Canadians, and particularly our young people, have the skills and training to seize them.

X At the Regina First Ministers' Conference the Minister of Employment and Immigration announced a new and innovative approach to training and employment – an approach which will lead to career development, not just short-term jobs. This approach is based on greater private sector and local participation. It was unanimously endorsed by provincial governments and has received broad support from private sector and community groups across the country. We have allocated \$900 million to these programs this year. Agreements are now being negotiated so that they can be implemented as quickly as possible. I am announcing today that for 1986-87 the government will allocate an additional \$900 million to these programs. This commitment now will provide greater certainty to those designing and implementing these programs. This should help get them off the ground and operating more quickly.

I am also announcing that the government will soon launch a major review of the unemployment insurance program. Our objective is to improve and simplify the unemployment insurance system to make it fairer and to ensure that it promotes flexible adjustment in the labour market. I want to emphasize that we are not undertaking this review with an objective of reducing federal contributions to the unemployed.

Pending the completion of this review by the end of March 1986, I am announcing today that the government intends to maintain the current entrance requirements and to prevent any increase in unemployment insurance premium rates for 1986.

Holding the rates to their current level will avoid imposing a heavy tax on lower-income employees and labour-intensive businesses, particularly in the small business sector.

We also need to have a hard and thorough re-examination of the corporate tax system.

There is something seriously wrong when investment decisions are dictated by the tax system rather than by good business sense. I am therefore tabling with this budget a discussion paper aimed at making the corporate income tax fairer and more effective in supporting economic growth. This paper describes how the same amount of revenue as in the current system could be raised in a simpler manner by eliminating a number of tax incentives and, in return, lowering the federal corporate tax rate by 7 percentage points. The effect would be to promote growth and job creation by allowing investment to be allocated more efficiently.

Improving Government Effectiveness

The measures I have just announced will encourage private initiative throughout our economy and provide new opportunities for Canadians to innovate, create and build. They will spur economic growth and increase employment.

Canadians have been telling us for years that there is too much waste, too much inefficiency and too much overlap of programs in Ottawa. They know that a healthy and vibrant private sector must be supported by a government that is lean, efficient and effective.

I will be proposing measures to streamline the operations of government, restrain its growth, rationalize a number of programs, increase fairness in the tax system and implement pension reform. I will also be proposing fundamental changes to the budget process.

Better Government Management

A Ministerial Task Force on Program Review, in co-operation with business and labour leaders in the private sector, is undertaking the most comprehensive and detailed examination of government programs ever carried out by a Canadian government. The purpose is to eliminate unnecessary activities, get rid of unproductive duplication and increase efficiency in government activities so that service to the public is improved.

I am tabling today, on behalf of the Deputy Prime Minister, the first report of the Ministerial Task Force. This report sets out the decisions the government has taken so far in response to the recommendations of the study teams.

Among other things, the study teams looked closely at the cost of tax incentives. They questioned whether particular incentives are worth the revenue loss that must be made up by other taxpayers. This is an important issue. In order to

provide a basis for informed discussion, I will shortly be releasing a detailed accounting of the cost of targeted tax measures. In providing this information to Canadians, I am particularly pleased to be continuing the initiative introduced by the Minister of Justice when he held this portfolio in 1979.

The study team examining services and subsidies to business pointed out that undue stacking of benefits can result when investments receive both tax incentives and government grants. I am proposing measures to reduce the undesirable effects of this giving with both hands.

The study team also recommended that many of the items currently exempt from the federal sales tax should be included in the tax base. The current exclusions are often imprecisely defined and lead to competitive distortions among manufacturers producing essentially similar products.

I am therefore announcing that, effective July 1, a range of items will no longer be exempt from the federal sales tax. These include candy and confectionery, soft drinks, pet foods, certain goods related to energy efficiency, and beauty and health goods. Over time, distortions were created as many of these items were excluded from the sales tax base. I will also be removing, effective July 1, the existing differential between the tax for off-site and on-site construction materials. Due to changing construction practices, the differential is no longer appropriate.

The government also places a high priority on rationalizing the current structure of Crown corporations. Crown corporations with a commercial value but no ongoing public policy purpose will be sold. The government announced last week an agreement in principle to sell the Northern Transportation Company Limited. The sale is expected to be completed by the end of June. In the near future the government also expects to sell Teleglobe Canada, Canadian Arsenal Limited and its interest in the Canada Development Corporation. Crown corporations with no commercial value and no effective public policy purpose will be dissolved and others, where appropriate, will be absorbed within existing departments. As a first step, up to 13 Crown corporations in these categories have been identified.

I am also announcing, on behalf of the President of the Treasury Board, measures to tighten the government's own belt and increase the effectiveness with which taxpayer dollars are spent. The government has already proposed that the guarantee of automatic indexation for public service pensions be replaced by a new formula. This would relate inflation protection to the earnings of the pension fund on a comparable basis to private sector pension funds, thus eliminating the financial risks to taxpayers in the future.

The government is also proposing to end the guarantee of full indexation for pensions of Members of Parliament and Senators, effective January 1, 1986. A joint committee of the House of Commons and the Senate will be established shortly to review all aspects of parliamentary pensions.

The President of the Treasury Board has embarked on an aggressive program to improve the government's management of its cash and of its inventory of real property.

The public service was projected to increase by 15,000 in the next six years. Instead, action will be taken to bring about a decrease of 15,000 by the end of this period – a difference of 30,000.

These measures will require difficult decisions by public service managers. But we are confident that they will adjust to achieve greater productivity and efficiency with a minimum amount of disruption in service to the public.

More Effective Economic Programs

Government is not only too big, it also reaches too far into almost every corner of the economy. It over-regulates some industries and over-protects others. In trying to facilitate investment, government too often distorts it. Instead of encouraging strength, many actions perpetuate inefficiency. Too often, government frustrates entrepreneurship and discourages initiative.

We must re-examine a number of programs, remove obstacles to growth, cut waste, improve effectiveness and make better use of limited resources. I am announcing today a number of specific program changes to achieve those objectives.

Transportation expenditures will be reduced by \$75 million this year and \$200 million next year. The operation of VIA Rail in the Windsor to Quebec City corridor will move toward full cost recovery.

In keeping with the philosophy of greater reliance on market incentives, the government is moving to reduce the use of grants and other subsidies. Industrial subsidies will be reduced by \$100 million this year and \$150 million next year. Agricultural expenditures will be lowered by \$50 million a year.

The projected increase for official development assistance will be reduced next year by \$50 million. This will not compromise the government's commitment to increase our foreign aid to 0.6 per cent of GNP by 1990. To assist the Canadian business community in actively pursuing third world projects of a developmental nature, the government will establish a new trade and development facility.

In energy, we will effect savings of more than \$150 million this year and \$900 million next year. The Petroleum Incentives Program will be phased out by December 31, 1987. Since the CANDU technology is now well established, federal funding for Atomic Energy of Canada Limited's R&D program will be reduced over a six-year period. The priority that AECL assigns to health and safety research will be maintained.

The heavy water plants in Glace Bay and Port Hawkesbury are recognized as striking symbols of government waste and mismanagement. They cost the taxpayers of this country more than \$100 million per year to produce a product for which there is no demand. We will move immediately to close the plants, but we will not abandon the people or the region of Cape Breton.

Workers at the plants will receive generous severance benefits and will be assisted in seeking new employment. Atomic Energy of Canada Limited will be announcing further details of these measures shortly.

To promote more productive, durable development in Cape Breton, the government is taking two important steps.

We are introducing immediately an enriched tax incentive for new investment in Cape Breton. This will be achieved by significantly broadening the application of the existing 50-per-cent investment tax credit to include a wide range of investments. This will mean that almost all new investment in Cape Breton will be free of corporate income tax for 10 years.

The Minister of Regional Industrial Expansion will soon announce the appointment of a private sector advisory committee to recommend new initiatives to the federal and provincial governments to promote economic development and productive employment in Cape Breton.

The approach we are following in Cape Breton reflects the basic philosophy of this government with respect to the problems of adjustment in both the private and public sectors. We simply cannot afford to continue supporting non-competitive economic activity. To do so drains resources and energy from more productive, job-creating activity. But we must ensure that adjustment takes place in a humane way.

This philosophy also underlies the approach the government is taking to assist individuals in isolated and remote communities. Tax relief for severance compensation will be offered, on a case-by-case basis, to employees affected by a company closure in isolated communities. Northern allowances are being reviewed and, after public consultation this summer, I will establish a permanent regime.

More Effective Social and Cultural Programs

When resources are increasingly limited, we must also adjust social programs so that benefits are targetted to those most in need and funds are freed for other social priorities. Nowhere is this more apparent than with regard to child benefit

Child Benefits

I am announcing today a restructuring of benefits provided through the tax system to families with children. These changes respond to suggestions made by many individual Canadians, social groups and the Standing Committee on Health, Welfare and Social Affairs. Beginning in 1986, the child tax credit, which is delivered to low-income families, will be increased significantly and will reach a level of \$524 per child in 1988 – an increase of \$140. The income level at which the child tax credit begins to phase out will be lowered. Starting in 1987, tax exemptions for children will be reduced over a three-year period so that the exemption for children aged 18 and under will equal the value of family allowances.

Erratum — The Budget Speech

Page 12, last sentence of last paragraph (under Child Benefits) should read:

“Starting in 1987, tax exemptions for children will be reduced over a three-year period so that the exemption for children **under age 18** (Not aged 18 and under) will equal the value of family allowances.”

These changes achieve a number of important goals. The universal family allowance is maintained. Support to lower-income families will be increased and child benefits will be made more progressive. Our child benefit system will become more effective and fair but the changes will be implemented in a gradual way to ease the impact on those who will receive less.

Improved Pensions

Adequate incentives and fairness in the structure of our private pension system are essential to ensuring that Canadians prepare for their retirement in a self-reliant manner.

After a decade of discussion about pension policy, I am proceeding to implement major reforms. These are far-reaching changes. They will make fundamental improvements in the ability of Canadians to build decent pensions in a fair and flexible way.

I will be introducing legislation to improve minimum standards for private pension plans under the federal *Pension Benefits Standards Act*. The measures improve rules for vesting, portability and survivor benefits. They will be of particular benefit to women. These proposals are the result of extensive consultations with provinces to ensure a high degree of uniformity in pension benefits across the country – another excellent example of federal-provincial co-operation.

The changes that I am announcing will ensure that more workers will have the opportunity to join pension plans and the right to participate in the management of pension funds. They will provide workers with rights to their pension benefits after two years of plan membership and ensure that such benefits will be portable. They provide for equal pensions for women and men retiring under identical circumstances. Provision will be made for survivor benefits and for splitting of pensions between spouses upon marriage breakdown.

I am not proposing to legislate mandatory inflation protection at this time. There are many uncertainties about the future costs of various proposals for inflation protection and there is no consensus on how best to achieve it. However, the government will encourage all firms under federal jurisdiction to adjust pensions for inflation on a voluntary basis. They will be required to report publicly on the adjustments made and the source of funds used for that purpose.

The government will monitor the situation closely and continue discussions with provinces, business and other interested groups with a view to taking additional action to protect the purchasing power of pensions.

I also propose to reform the system of tax assistance for contributions to private pension plans. The current system discriminates among people in different types of pension plans. Starting in 1986 the limits on RRSP contributions will increase each year until 1990, at which time equity will be restored between RRSPs and other types of pension plans. Persons who do not fully use their allowable RRSP contribution in any year will be able to make up the difference within a seven-year

period. This will provide Canadians with access to a much more flexible and comprehensive pension system.

These new measures will significantly improve opportunities to build decent retirement incomes for the growing number of Canadians in small business, farming and the professions.

Support for the Disabled

At the National Economic Conference the point was made strongly that the tax definition of disability is too narrow. I intend to broaden the definition of disability for income tax purposes. I expect 120,000 individuals to benefit from this change.

Cultural Measures

The arts and cultural sector plays a vital role in preserving and developing our intellectual heritage. It is not only a source of pride for Canadians, it is also an important source of jobs, as was pointed out at the National Economic Conference. I am announcing, in collaboration with the Minister of Communications, the formation of a special task force to propose initiatives to encourage the private sector to increase its support for the arts.

In response to representations that have been made, I am also announcing tax changes to permit Canadian visual artists to write off the cost of their inventories and to assist them in donating their own works of art to charitable institutions.

Voluntary Sector

The voluntary sector will benefit from two initiatives in this budget. I am proposing changes to make it easier to donate gifts of property to charities and to protect the charitable status of organizations carrying on non-partisan political activity in support of their charitable goals.

Improving Tax Fairness

Many Canadians have questioned the fairness of the tax system and of tax administration. This is a matter the government views with great concern. Our tax system rests on a foundation of self-assessment and voluntary compliance. If Canadians feel that the system is unfair, this foundation will erode.

The greatest source of concern is the ability of some high-income individuals to take advantage of existing tax incentives to shelter virtually all of their income. There is no question that such tax planning is legitimate, and that the incentives serve valid objectives. Canadians nevertheless feel frustrated when some high-income individuals pay little or no tax. I share this frustration.

I will therefore be introducing a minimum personal income tax, beginning in 1986, to ensure that high-income Canadians pay their fair share. I am tabling today a paper that explores three alternative ways of imposing a minimum tax. I will use this consultation process to encourage the provinces to adopt the same system in order to maintain uniformity and consistency across the country.

In addition, I am moving to curtail the tax-shelter financing of certain types of property, including yachts, recreational vehicles and hotels when used in certain circumstances. I am also proposing to end the tax advantages of splitting income through interest-free or low-interest loans among family members. Transitional rules will ensure that the new rules are introduced fairly.

Building on the significant initiatives introduced by the Minister of National Revenue, I am proposing a number of further measures to achieve fairer tax administration consistent with the Charter of Rights and Freedoms. Additional protection will be provided for taxpayers in the area of search and seizure, audits and examinations, and demands for tax information.

We will continue to move forward with necessary and effective change in the tax system in a responsible, moderate way. This approach is reflected in our commitment to a minimum tax for Canada and in the discussion paper on the corporate income tax. But I have deliberately not launched a process of massive tax reform as a solution to the problem of tax fairness or any other problem. We must not and we will not risk creating the kind of uncertainty and instability that could undermine the effort to get Canadians investing strongly in opportunities that will lead to growth and jobs.

Improving the Budget Process

Finally, I am tabling a discussion paper that proposes significant reforms to the budget-making process, including a fixed period each year for presentation of the annual budget. This would provide greater certainty for planning and decision-making for Parliament, for the federal government, for provincial governments and for the private sector. It would provide the opportunity for more complementary economic and fiscal policy-making by governments.

Controlling the National Debt

The actions I have taken will revitalize the private sector and make the federal government a more effective partner in pursuing economic renewal. For this partnership to truly flourish, however, we must restore order to our financial position.

In November, I estimated that the deficit for 1984-85 would be \$34.6 billion. Final figures for 1984-85 are not yet available, but my current estimate is that the deficit will be just under \$36 billion. I expect that government expenditures will be lower than projected. But revenue projections have not been met.

When I began to plan the budget for this year, I was looking at estimated deficits that would have continued to rise, even with continued growth in the economy and even after the actions I took in November. This was quite clearly unacceptable.

It is important that Canadians understand the magnitude of the deficit and debt problem and why it poses serious risks to our ability to achieve sustained economic growth.

The public debt is simply the sum of all past deficits. It took 100 years to accumulate a debt of \$18 billion. Now, less than two decades later, the debt is approaching \$200 billion.

Like any borrower, the Canadian government pays interest on this debt. And like any borrower, the government has been affected by high interest rates. Interest charges have risen from about \$8 billion per year in the late 1970s to \$22 billion last year. They have become the fastest growing component of government expenditures.

The government has been borrowing additional funds to pay these interest charges. That is why our debt is spiralling out of sight. If we do not show the resolve to deal with this problem, the result will be paralysis of the Government of Canada.

This is the vicious circle we are now in. At some point we must begin to pay the bills for current services and not pass them on to our children.

If we fail to act now and maintain our present borrowing pattern, annual interest charges at the end of the decade could approach \$50 billion.

Where would we find this money?

We might try to borrow it. But that just continues to build up future problems. At some point, the bills come due.

We could simply print it. But to do so would guarantee an outbreak of inflation and rising interest rates that would damage confidence, investment and growth in the same way it did in the 1970s and early 1980s. This would be an abdication of responsibility. I will not do that.

Ultimately, we would be forced to find the money through drastic cuts in government services and major tax increases. Many government programs would be in jeopardy. This is also unacceptable.

Some say that faster economic growth will solve our fiscal dilemma. It is an important part of the solution. And the measures I have introduced will boost economic growth. But growth alone will not solve our problem. If we are to get off this deficit treadmill, we must also slow down the debt spiral through lower deficits and lower interest rates.

We all know that lowering interest rates is easier said than done.

It is true that interest rates in Canada are heavily influenced by interest rates in the United States. And as we deal with our fiscal problem we must be mindful of how quickly and how deeply the United States is prepared to cut its own deficit. But Canadian interest rates also depend on our own fiscal actions.

A key action to control interest rates is to maintain our vigilance against inflation. And that means acting to reduce our annual deficits, so that Canadian and foreign investors can be assured that future governments will not resort to the printing press to inflate our debt away.

Most Canadians agree that we must restore fiscal order. But they rightly feel that this process must start by eliminating waste and inefficiency in government, and that any further actions that are necessary must be balanced and fair.

The measures I have outlined to put our own house in order, together with the actions announced in November, represent a significant step in getting control of government spending. Program expenditures are expected to increase by slightly more than 2 per cent this year and next year – the lowest rates of increase in almost two decades. The government's non-statutory program expenditures, excluding defence and foreign aid, will actually decline by more than \$1 billion next year – the first such decline in more than two decades.

This is an impressive start. But it is not enough. Over the past decade, the financial position of the Government of Canada has worsened at an accelerating pace. As a percentage of gross national product, budgetary expenditures rose by 3.7 percentage points in the past decade. During the same period, budgetary revenues as a percentage of gross national product have dropped by 3.5 percentage points. There is a built-in structural imbalance that contributes to an ever-widening gap between revenues and expenditures. With each passing year, government policies that tend to widen this gap have become less and less sustainable.

With total spending that now exceeds \$100 billion, we cannot make significant savings without examining transfer programs. These programs now account for over \$40 billion and are growing rapidly. One of the key factors in this growth is the automatic indexation of transfer programs to the consumer price index, regardless of the income situation of the recipient.

The purpose of indexation has been to protect Canadians from the effects of rising prices. But it has become increasingly clear that Canadians must also find a way to protect themselves against rising deficits and the soaring national debt.

Accordingly, I propose to modify indexation for old age security payments and family allowances. Beginning January 1, 1986, these payments will be indexed only for the annual increase in the consumer price index greater than 3 per cent. No payment will be reduced as a result of this measure. Any increase in inflation above 3 per cent will be fully compensated.

By maintaining the principle of indexation, we are assuring Canadians that if serious inflation breaks out again, these payments will be protected by this potent

form of insurance. The government will review the adequacy of payments in light of future circumstances and will increase them as resources permit.

Indexation to the full consumer price index will continue for the guaranteed income supplement and for payments to veterans.

To spread the burden of expenditure reduction fairly, the government will also be seeking to limit the rate of growth of transfers to provinces to yield annual savings of \$2 billion by the end of the decade. There will be no absolute reduction in federal transfers. Even after this adjustment, federal transfers to provincial governments will grow significantly over the balance of this decade. In 1990-91, they would represent about the same share of total program expenditures as they do today.

With this budget and the action taken in November, we have reduced every area of government spending. It is only reasonable that transfers to provinces, which account for 19 per cent of program expenditures, should be included. I made a commitment to my provincial counterparts last fall that I would not reduce these transfers in the current fiscal year and that commitment will be honoured. I will meet with provincial Finance Ministers this fall to discuss the full range of issues relating to federal-provincial fiscal arrangements. I will wish to discuss at that time how quickly and how best we can move to secure the savings the government intends to achieve.

We have looked hard at areas for expenditure reduction. We have started with our own operations and we have restructured programs in a balanced and effective way. We have put in place a plan that will meet the need for sustained reduction of deficits over the medium term. We have tried to be fair to individuals and to other governments. We have delivered on our commitment to take actions that will achieve net expenditure reductions of \$15 billion in 1990-91. And we have done so in a balanced way that is sensitive to the regions of the country.

This restructuring is very significant. But it is not enough to make a meaningful start on restoring a healthy fiscal balance. I have therefore, reluctantly, accepted the necessity of increasing taxes.

I am proposing the following changes:

The automatic indexation of excise levies on alcoholic beverages and tobacco products is being terminated. Effective today the excise levy on alcoholic beverages will increase by 2 per cent. Effective this afternoon the levy on tobacco products is being increased by 25 cents on a package of 25 cigarettes. I recognize this increase is substantial, but I have taken into account the serious health hazards and high public health costs related to smoking.

The Canadian Ownership Special Charge of 0.7 cents per litre on transportation fuels will be removed June 1. In its place, the excise tax on transportation fuels will increase by 2 cents per litre, effective September 3. I am delaying this increase until after Labour Day in order to avoid any impact on the tourist season and on Canadians planning holiday travel this summer.

The rates of federal sales tax will be increased by one percentage point, effective January 1, 1986.

I am also proposing a number of income tax changes.

- The modified indexation factor applied to personal transfer payments will also apply to the tax system. Beginning next year, the indexation of personal exemptions and tax brackets will reflect only the annual increase in the consumer price index greater than 3 per cent.
- The \$50 federal personal tax reduction will be eliminated next year.
- A temporary deficit-reduction surtax will be imposed on higher-income individuals and large corporations. For individuals, the surtax will extend from July 1, 1985 to December 31, 1986. It will be levied at an annual rate of 5 per cent of basic federal tax in excess of \$6,000 and a further 5 per cent of basic federal tax in excess of \$15,000. This surtax should not increase tax liabilities for individuals with gross incomes less than about \$40,000. For large corporations, the surtax will extend from July 1, 1985 to June 30, 1986 and will be levied at a rate of 5 per cent of federal tax payable.
- A two-year tax will be imposed on the capital of large banks and trust companies, effective in 1986. The purpose of this measure is to ensure that they bear an appropriate part of the tax load at a time when deficit reduction is a high priority.
- Effective today contributions to a registered home ownership savings plan will no longer qualify for preferential tax treatment. Plans will cease to be tax-exempt at the end of 1985, but individuals will be able to withdraw the accumulated funds for any purpose with no tax liability. There is currently more than \$2 billion in such plans. I am confident that, with the measures I have announced to provide incentives to growth and job creation, a substantial portion of these funds will find their way into entrepreneurial and job-creating investments, as well as providing a boost to housing and consumption.

Balance and Impacts

The overall impact of the tax increases must be assessed in the context of the budget as a whole. Net tax increases will amount to \$200 million this year and \$1.8 billion next year. Coupled with the expenditure reductions I reported earlier, the total direct impact of our actions since November will be to reduce the estimated deficit by \$4.4 billion this year, to a level of \$33.8 billion. For next year, the total direct impact of our actions in November and today will be to reduce the estimated deficit by \$8.3 billion, to a level of \$32.7 billion. The rate of increase in the accumulated debt will drop from 23.2 per cent last year to 14.6 per cent next year.

It is more misleading than helpful to present a precise view of the deficit five years from now. Small changes in economic growth or interest rates can have large impacts on the deficit, even in the short run. For example, a 1-per-cent change in interest rates would have an impact of \$1.1 billion on next year's deficit. Such effects compound over time. It would be foolhardy to fine-tune policy to precise estimates that we know are uncertain and will inevitably be proven wrong. What is important is the credibility of our medium-term strategy. Canadians need to have confidence that we will reduce deficits and control the ultimate level of the debt. The measures I announced in November and today will ensure that the annual deficit is more than \$20 billion lower than it would otherwise have been by the end of the decade. About 80 per cent of that reduction will be on the expenditure side. Most importantly, these measures will cut \$75 billion from the projected debt over that same period.

Given reasonable international economic conditions, these measures should ensure that the growth of the debt is brought back into line with the growth of the economy. This is a major improvement over the situation that confronted this government eight months ago. At that time we were faced with a debt that would continue to grow at a rate far greater than that of the economy long into the future. In a resolute fashion, we have taken the steps to reverse that dangerous trend and put our financial affairs on a responsible course.

On balance, I am confident that the measures I have proposed today will enhance economic growth and employment in the short run. Over the medium term they establish a sound foundation for sustained economic growth and job creation.

I am tabling the documents I have referred to earlier, as well as other related papers, and Notices of Ways and Means Motions covering tax and tariff measures.

Conclusion

If I have a preoccupation with any one economic target, it is with the good, satisfying and durable jobs that Canadians, and particularly young Canadians, want and need.

X

This budget is about jobs.

If I believed that higher deficits and a more rapidly rising debt would help create those jobs, I would gladly increase the deficit to achieve that goal. But it hasn't worked in the past. It won't work now.

The economic problems facing this country are not easy to solve. But solve them we must if we are to succeed in this competitive world.

Let us not delude ourselves. Achieving full economic renewal will take sustained effort and time.

This budget is realistic. It is fair. It tackles our problems as they exist and as this government faced them on taking office last September. When we set out the problems and our directions for solving them in November, we were not building illusions. We were honest with Canadians. We accepted our mandate for change and we made clear that implementing and adjusting to change would test the strength and the resolve of all of us.

We promised to act, but first we promised to consult fully and openly with Canadians in reaching the decisions that I have presented to you today.

We received good advice from Canadians on a great many issues and that advice is reflected in this budget.

We have acted to control and reduce deficits in a balanced and careful way that will not tip the economy off its current course of growth. But we have acted with firmness and determination because without control of our accumulating debt, our economy would be unable to produce the satisfying jobs we need.

We have carefully balanced the measures in this budget so that costs and benefits will be fairly shared. The budget brings forward a number of measures and proposals designed to improve social programs and increase tax fairness.

The actions in this budget reflect our faith in people, in the ingenuity and the drive of individual Canadians to seize opportunities and to invest in their own future. We have brought forward measures which encourage Canadians to invest, on their own initiative, in the building of new and existing enterprises.

This budget is far-reaching in its impact. It is a clear break from the past.

We Canadians understand more and more the limits of what governments can do. It is now time to show what we can do – individually and together – when the opportunity is there.

That is why the Agenda for Economic Renewal in November focused on providing the conditions for productive economic growth rather than attempting to impose or to direct that growth. That is why this budget places the emphasis on rewarding success rather than subsidizing effort.

People working together provide the enduring strength of this nation. This budget builds on that strength.

**Summary of the Fiscal Impact
of Discretionary Changes Since September**

	1985-86	1986-87	1990-91
	(billions of dollars)		
Discretionary tax revenue changes			
November statement			
Tax revenue reductions	-0.2	-0.2	0.0
Tax revenue increases	0.4	0.6	0.2
Total	0.2	0.4	0.2
May budget			
Tax revenue reductions	-1.2	-3.1	-6.0
Tax revenue increases	1.4	4.9	10.1
Total	0.2	1.8	4.1
Total revenue changes	0.4	2.2	4.3
Discretionary expenditure changes⁽¹⁾			
November statement			
Expenditure reductions	-3.5	-3.2	-4.0
Expenditure increases	1.5	0.4	0.5
Total	-2.0	-2.8	-3.5
May budget			
Expenditure reductions	-2.0	-3.5	-8.2
Expenditure increases	0.2	1.0	0.4
Total	-1.8	-2.5	-7.8
Total program expenditure changes	-3.8	-5.3	-11.3
Reduction in debt interest charges	-0.2	-0.8	-4.5
Total expenditure reductions	-4.0	-6.1	-15.8
Total discretionary change to the deficit	-4.4	-8.3	-20
Cumulative impact on federal debt	-4.4	-12.7	-75

⁽¹⁾ Includes some cost recovery measures.

List of Budget Measures*

- I. Encouraging Private Initiative
 - A. Taxation Measures
 - 1. Personal Income Tax
 - a) Capital Gains Tax Exemption
 - b) Labour-Sponsored Venture Capital Funds
 - c) Investment in Small Business by Pension and Other Retirement Income Plans
 - d) Non-Resident Withholding Tax
 - e) Housing Loans
 - 2. Energy Taxes
 - a) Implementing the Western Accord
 - b) Successor Rules for Resource Expense Deductions
 - c) Definition of Canadian Exploration Expense
 - 3. Corporate Income Tax
 - a) Research and Development
 - b) Small Business Bonds
 - c) Special Investment Tax Credit
 - d) New Tax Incentive for Investment in Cape Breton
 - e) *The Corporate Income Tax System* Discussion Paper
 - f) *A Corporate Loss Transfer System* Discussion Paper
 - B. Labour Market Initiatives
- II. Improving Government Effectiveness
 - A. Improving Government Management
 - 1. Ministerial Task Force on Program Review
 - 2. Rationalization and Privatization of Crown Corporations and Other Federal Investments
 - 3. Pensions of Members of the House of Commons and Senators
 - 4. Cost Reductions Due to Better Management
 - a) Reduced Inflation Allowances
 - b) Public Service Rationalization
 - c) Reduced Contingencies
 - d) Improved Cash Management
 - e) Surplus Property Disposal
 - f) Increased Cost Recovery

B. Improving the Effectiveness of Economic Programs

1. Introduction and Summary of Savings
2. Agriculture
3. Energy
4. Aid and Export Financing
5. Fisheries
6. Industry Support
7. Training
8. Transportation
9. Trade and Development Facility
10. Streamlining Special Tariff Programs
11. Private Participation in Export Financing

C. Improving the Effectiveness of Social and Cultural Programs

1. Child Benefits
2. Pension Plans
3. Tax Incentives for Retirement Saving
4. Assistance for the Disabled
5. Assistance for Artists
6. Registered Charities

D. Improving the Fairness of the Tax System

1. Minimum Tax on Individuals
2. Investment Tax Credit
3. Tax Shelters
4. Income Splitting

E. Improving the Effectiveness of the Tax System

1. Income Tax Investigation and Enforcement Powers
2. Interest on Payments and Refunds
3. Source Deductions
4. Power to Make Retroactive Regulations
5. Excise Act Administration
6. New Sales Tax Assessment and Appeal Provisions
7. Return of Excess Tax Charged
8. Refunding Provisions in the *Excise Tax Act*
9. Investigation and Enforcement

F. *The Canadian Budgetary Process: Proposals for Improvement – A Discussion Paper*

III. Controlling the National Debt

A. Expenditure Reductions

1. Modified Indexation of Transfers to Persons
2. Transfers to Provincial Governments

B. Revenue Increases

1. Personal Income Tax
 - a) Modification of Personal Income Tax Indexation
 - b) Temporary Surtax on High-Income Individuals
 - c) Elimination of Federal Tax Reduction
2. Temporary Surtax on Large Corporations
3. Temporary Capital Tax on Larger Financial Institutions
4. Registered Home Ownership Savings Plan
5. Alcohol and Tobacco Taxes
6. Removal of Federal Sales Tax Exemptions
7. Federal Sales Tax Rate Increase
8. Tax Changes Affecting Motive Fuels
9. Prefabricated Construction Goods

IV. Other Tax and Tariff Changes

A. Tax Changes

1. Northern Allowances and Severance Pay in Isolated Communities
2. Guaranteed Shares
3. Tax Payments Through Banks
4. Life Insurers' Reserves
5. Cable TV Equipment
6. Inducement Payments and Reimbursements
7. Dues to Parity or Advisory Committees
8. Prizes and Awards
9. Allowable Reserves of Banks
10. Inventory Allowance
11. Tourist Literature
12. Wholesale Tax on Pre-recorded Video Cassettes
13. Other Excise Tax Amendments

B. Customs Tariff Amendments

V. Expenditure, Revenue and Deficit Impacts of the Budget Measures

Table 1: Summary of the Fiscal Impact of Discretionary Changes Since September

Table 2: Total Expenditure Reductions and Cost Recovery

Table 3: Federal Revenue Impact of Budget Tax Changes

* Explanatory information on these measures is provided in the *Budget Papers*.