Budget Document

issued by
the Honourable Donald S. Macdonald
Minister of Finance
and
Member of Parliament for
Rosedale
on the occasion of
the Budget
March 31, 1977

Department of Finance
Canada

Ministère des Finances
Canada

Budget Document

An elaboration
by the Minister of Finance
of the analysis and policies
of the Budget
March 31, 1977

Budget Document

Contents

Introduction

Canada has come a long way on the road to recovery from the inflation which engulfed us in 1973. That rise of costs and prices disrupted many aspects of our economic life, and continues to do so. Persistent efforts will be needed to control it.

One of the worst effects of inflation from which we continue to suffer is an unacceptably high level of unemployment. Everything possible must be done, short of starting new inflationary pressures, to stimulate the creation of new jobs for Canadians. Another continuing effect of inflation is the difficulty of absorbing particular price increases without a renewed, self-defeating scramble for incomes. But particular increases in the prices of some forms of energy, some foods and many imported goods must be expected this year. Canadians will have to accept these and at the same time continue to be moderate in their income demands.

In framing a budget policy in the face of these conditions, two constraints have had to be observed. The first is imposed by the government's essential commitment to hold down the growth of its spending. Within this constraint highest priority has been given to spending that will provide jobs for people. The second constraint is the need to avoid making excessive demands upon the capital markets. Within this constraint it has been possible to provide for further tax reductions in the budget.

The structure of this Budget Document is as follows. It first reviews the main developments in the international economy and discusses how the Canadian economy has evolved against the international setting. Having taken stock of where we are, the economic objectives of the federal government are then set forth in the light of current trends in inflation, output, employment and Canada's balance of payments. Important current policies directed to the achievement of these objectives are then discussed. This is followed by a description of the new policy initiatives of the budget. The Document concludes with a review of the economic and fiscal outlook that takes into account the anticipated impacts of the new measures.

The International Setting

The world economy began to recover in 1976 from the severe recession of 1974 and 1975. Real growth in the 24 member countries of the Organization for Economic Co-operation and Development (OECD) increased 5 per cent in 1976, though the expansion faltered in the second half of the year. Coming as it does after the steepest decline in the post-war period, the recovery leaves substantial levels of excess capacity and high unemployment rates in virtually all industrial countries.

The rate of inflation in the OECD area receded to about 8 1/2 per cent in 1976 from over 11 per cent the previous year. There were wide differences among the major countries. While the increase in the cost of living fell below 6 per cent in the United States and was 4 1/2 per cent in Germany, the average increase for the other OECD countries was close to 10 per cent. Despite the slack in the world industrial economies, reducing inflation has proved to be a slow and difficult process.

International payments continued to be affected by the impact of higher oil prices and by differing rates of growth and inflation among the major countries.

The oil-producing countries in total had large current account surpluses, about $42 billion in 1976, though these were much reduced from the 1974 peak of over $65 billion. Lower demand for oil and smaller increases in prices have limited the growth of their export earnings. Their imports of both military and civilian goods have increased enormously, thus contributing to the transfer of real resources that must ultimately follow the huge upward adjustment of oil prices late in 1973. The current accounts of some members of the Organization of Petroleum Exporting Countries (OPEC) came into balance or even deficit in 1976. Others continued to have huge surpluses, and consequently supplied large amounts of capital to the rest of the world.

The current account position of the industrial countries improved sharply in 1975 as a result of the recession, but deteriorated again in 1976. These changes were most apparent in the United States. The only major industrial country to have achieved a sustained surplus on current account throughout the past four years has been Germany, which also had the lowest rate of inflation.

Recognizing their close interdependence, the industrial countries have joined together in addressing the very difficult economic problems of recent years. The OECD Ministerial Council in June and the Puerto Rico summit in July agreed that persistent efforts over a long period would be needed to deal with the interrelated problems of inflation, recession and payments imbalances.

Table 1
Main Indicators of International Developments
Real Output

	1974	1975	1976	1973 to 1976
		(percentage change)		
Seven major countries				
Canada	3.2	0.6	4.6	8.6
United States	-1.7	-1.8	6.1	2.4
Japan	-1.3	2.1	6.0	6.8
France	3.9	-1.2	5.0	7.8
Germany	0.4	-3.2	5.5	2.5
Italy	3.4	-3.7	4.5	4.1
United Kingdom	-0.1	-1.8	1.0	-0.9
All OECD countries	0.3	-1.2	5.0	4.1

Consumer Prices

	1974	1975	1976	1973 to 1976
		(percentage change)		
Seven major countries				
Canada	10.8	10.8	7.5	32.1
United States	11.0	9.1	5.8	28.1
Japan	24.5	11.8	9.2	52.0
France	13.7	11.7	9.6	39.2
Germany	7.0	6.0	4.5	18.5
Italy	19.1	17.0	16.8	62.8
United Kingdom	16.0	24.2	16.5	67.8
All OECD countries	13.6	11.4	8.6	37.4

Current Account Balances

	1973	1974	1975	1976
		(U.S. $ billions)		
Seven major countries				
Canada	0.1	-1.5	-5.0	-4.3
United States	0.3	-0.6	11.7	-1.3
Japan	-0.1	-4.7	-0.7	3.8
France	-0.7	-6.0	-0.1	-6.0
Germany	4.3	9.7	3.9	4.0
Italy	-2.7	-8.0	-0.6	-2.8
United Kingdom	-2.9	-8.7	-3.7	-3.3
Total OECD	2.5	-33.0	-6.5	-22.5
OPEC	3.5	65.5	34.5	42.0
Non-oil Developing Countries	-2.5	-21.5	-32.5	-24.0

Source: OECD, Economic Outlook, December 1976 for Real Output and Current Account Balances; and Main Economic Indicators for Consumer Prices.

While high priority was attached to bringing down the rate of inflation, it was recognized that this would require patience and persistence. It was also recognized that any attempt to bring down the rate of unemployment too quickly would increase the difficulty of containing inflation and would be unsustainable.

There was a renewed determination to minimize the use of trade restrictions, recognizing that their benefits were short-lived, and their costs in terms of growth and price stability in the longer run were high.

In the event, growth in the OECD area has been below the desired moderate track in the last nine months but inflation has been reduced rather faster than expected because of weak food and commodity prices. Modest "in course corrections" to stimulate growth have been recommended, particularly for the countries which have strong balance of payments positions and better control over inflation. Modest expansionary adjustments of policy have been initiated or are under active consideration in the United States, Germany, Japan, and some smaller countries.

Common to all of these programs is the awareness that lower rates of inflation are essential if renewed growth is in fact to be achieved at a sustainable pace — not only in 1977 but for the next several years.

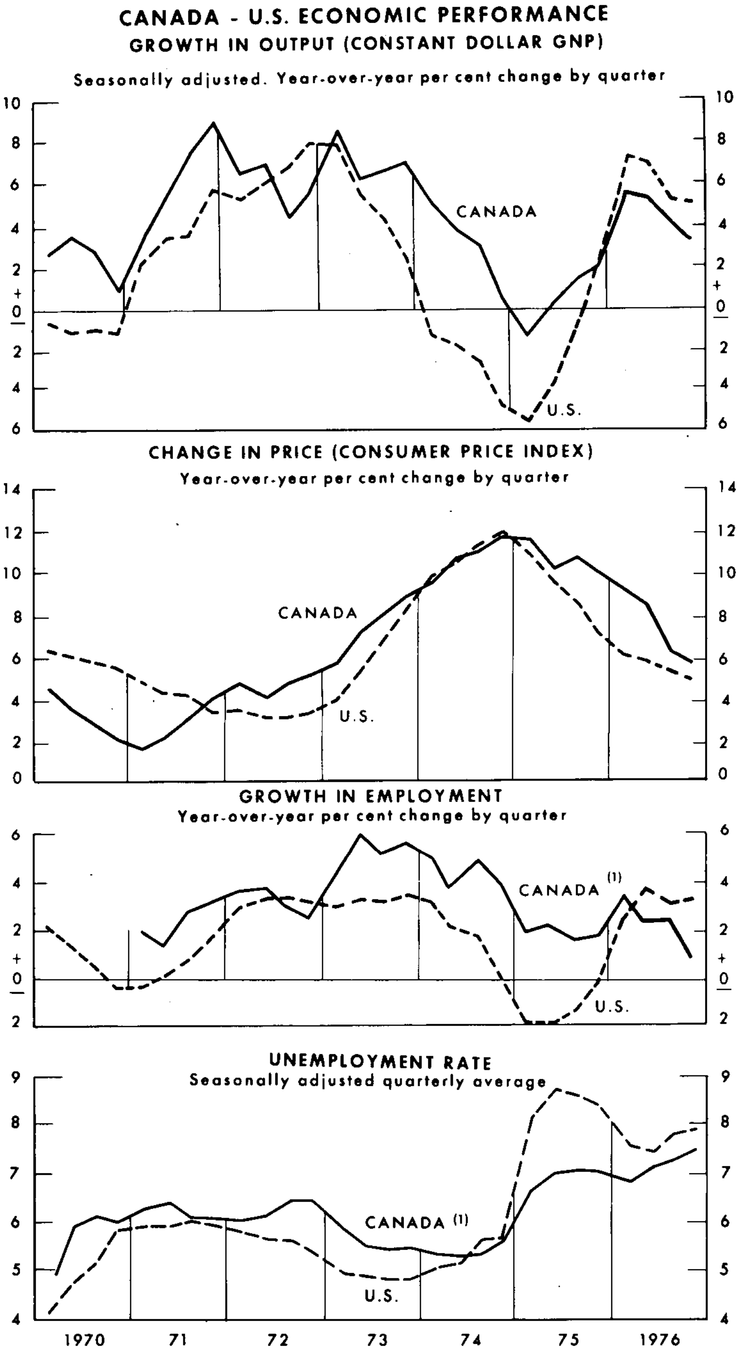
The prospects for the year ahead are for continued growth, some further improvement in price performance and some correction in external imbalances. The forecasts for individual countries show that those with the lowest expected rates of inflation have the best prospect for sustained growth and strong international payments position. Progress will be reviewed again at the forthcoming summit meeting in London.

The economic problems of developing countries continued to be severe in 1976. Despite strenuous efforts at economizing by the developing countries, their current account deficits continued at about $24 billion in 1976, even after receipts from foreign aid were taken into account. The deficits were financed by further borrowing. Their external energy bill remains very high following the increase in world oil prices. After many years of heavy foreign borrowing from governments and private sources, the developing countries have a massive overhang of external debt. The growth prospects for their export earnings are only moderately promising, given the slack in the economies of the industrial countries.

In relation to these problems, Canada continues to make a large commitment to foreign aid and to take a positive role in the established international institutions. The Conference on International Economic Co-operation, co-chaired by the President of the Privy Council, continues to be a focal point of efforts to deal with the problems. These issues will also be addressed at the London summit.

International economic co-operation was further strengthened in 1976 through agreement on a Second Amendment of the Articles of Agreement of the International Monetary Fund. In the difficult circumstances of recent years, many countries have required greater flexibility in their exchange rate regimes. The Second Amendment, which is now in the process of ratification by Canada and other member countries, recognizes this fundamental change.

Chart 1



(1) Revised Labour Force Survey

The Canadian Economy

From an international perspective, Canada's economic performance has been exceeded by few countries. Canada's growth between 1973 and 1976 was the most rapid of the seven major OECD countries, and over twice the average rate for all the OECD countries taken together. Among the major countries, only West Germany and the United States had less inflation over this period. Chart 1 shows how much smaller was the recession in Canada than in the United States, how much stronger was the growth of employment, and how much lower was the average rate of unemployment. While inflation rates held up much longer in Canada, they have come down closer to U.S. levels.

Inflation

The underlying trend of prices in Canada has improved in line with the targets of the anti-inflation program. In fact, the increase in the consumer price index in the year ending October, 1976 was 6.2 per cent, compared with the program target of 8 per cent. For 1976 as a whole, the consumer price index averaged 7.5 per cent higher than 1975. Unusually favourable factors were at work, the most important of which was a decline in food prices. Some weakness in international commodity prices and the appreciation in the value of the Canadian dollar were also helpful. Profit margins were unsustainably low. Non-food prices decelerated, even though large increases in energy prices, utility rates and local taxes had to be absorbed. The other main price indexes for Canada also showed marked deceleration during the last year and a half.

Table 3 shows that labour income increased strongly in 1976 as it did in 1975. Labour's share of national income has risen from the relatively low levels of 1973 and 1974. Labour income increased rapidly in 1976, partly because of increased employment, but mainly because the average increase in labour income per employee was nearly as high as in 1975. Investment income and the income of unincorporated businesses have risen in the last two years about in line with the economy. Farm income has dropped sharply as a result of lower food prices and corporate profits have shown no gain from the high levels reached in 1974.

Thus profit margins and the share of profits in national income have fallen significantly in 1975 and 1976. The decline in profit margins in 1976 was primarily a reflection of slack markets in Canada and abroad, rather than the controls program. Most firms were unable to earn the margins which the guidelines permitted.

Table 2
Price Indicators

	1973	1974	1975	1976	Fourth Quarter 1975 to Fourth Quarter 1976
			(percentage change)		
Consumer Price Index					
Food	14.6	16.3	12.9	2.7	-1.1
Other goods	4.0	9.7	9.4	6.6	6.0
Services	6.2	8.0	10.7	12.2	11.4
Total	7.6	10.9	10.8	7.5	5.9
Consumer Expenditures Deflator	7.5	10.6	10.4	7.0	5.6
GNE Deflator	9.3	14.3	10.7	9.5	8.6
Wholesale Price Index	21.5	22.4	6.6	4.3	2.9
Industry Selling Price Index	11.2	19.0	11.1	5.0	4.1

Source: Statistics Canada

Table 3
National Income
(Current dollar data)

	Year-to-Year Growth				Share of National Income				
	1973	1974	1975	1976	Average 1970-76	1973	1974	1975	1976
	(per cent change)				(per cent share)				
Labour Income	15.2	18.2	15.3	15.1	73.2	71.7	71.7	73.0	74.3
Corporation Profits	39.2	25.1	-1.1	0.0	14.3	15.9	16.9	14.8	13.0
Corporation Profits Adjusted for Inventory Valuation	30.4	13.5	8.0	5.4	10.9	12.1	11.6	11.1	10.3
Investment Income	17.6	37.9	9.0	20.4	6.2	5.7	6.7	6.4	6.8
Farm Income	81.0	26.7	-0.7	-21.3	2.6	3.2	3.4	3.0	2.0
Unincorporated Business Income	9.9	6.6	13.4	12.4	7.1	7.2	6.5	6.5	6.5
Net National Income	18.0	18.2	13.4	13.1	100.0	100.0	100.0	100.0	100.0

Source: Statistics Canada

Many firms faced inadequate liquidity and rising debt-equity ratios. The low level of share prices made it difficult to raise additional funds in this form. All these factors contributed to the problem of financing the rapidly increasing costs of new investment projects.

The profit story of recent years needs careful interpretation. In a period of high inflation, profits are overstated by the inclusion of inventory valuation profits and by historic cost accounting for plant and equipment. They are understated to the extent that debt contracted at lower interest rates is serviced from inflated dollars. The most volatile element is the rapid appearance of large inventory valuation profits when inflation rates are increasing rapidly, and their diminution when inflation rates come down.

Labour income per person employed increased by 12.7 per cent in 1976 compared with 13.2 per cent in 1975. All of the indicators of pay rates actually in effect in 1976, including average hourly and weekly earnings, show only a small deceleration, because they reflect wage decisions made before the anti-inflation program was announced. During the year, however, the rate of increase was clearly coming down. This is even more apparent in Labour Canada's data on contract settlements. Table 4 shows that new settlements on a "life-of-contract basis" have come down to 8.3 per cent from 17.1 per cent in 1975. The first year of contracts is down to about 10 per cent from 21 per cent in 1975. The much more comprehensive data from the AIB, covering about 3 million unionized and non-unionized workers, show AIB-approved wage increases to date of 9.7 per cent for the first guideline year, with both the arithmetic guidelines and the approved increases falling progressively.

Table 4
Base Rates for New Settlements
Average Compound Annual Per Cent Increase
All Agreements

Period of Settlement	First 12 Months	Life of Contract
1975	21.0	17.1
1976	12.7	10.5
1976-First Quarter	16.2	14.2
-Second Quarter	13.0	11.1
-Third Quarter	12.8	9.8
-Fourth Quarter	9.8	8.3

Source: Labour Canada

Labour costs make up almost two-thirds of the average cost of producing goods and services. Changes in the labour cost per unit of output, which reflect both productivity and earnings give the best single indicator of the trend of inflation.

The rate of increase in the labour cost per unit of output in Canada has fallen from 14.6 per cent in 1975 to 10.1 per cent in 1976. On the basis of recent wage settlements and average growth in productivity, it is expected to fall to about 7 per cent for 1977.

The erosion of Canada's competitive position vis-a-vis the U.S. economy is being checked. Our competitive position is also expected to improve in relation to most other countries.

Real incomes rose substantially in the first year of the controls program, appreciably more than the 2 per cent productivity allowance. With wage increases averaging over 12 per cent in 1976, and CPI increases averaging 7.5 per cent, the average real wage increase was over 4 per cent. Turning to broader measures, real personal income per capita increased by 4.5 per cent in 1976 and real personal disposable income per capita by 3.7 per cent.

Canadians have had large increases in real incomes per person over the last several years. This experience has set up high expectations in all parts of the economy. The inflation problem is partly a reflection of this. A number of special factors enabled real incomes to increase much faster than productivity in 1976. These included the unusual drop in prices of food imported and produced within Canada, the reduction in profit margins, and small increases in import prices, reflecting both the slack in the world economy and the high level of the Canadian dollar. Canadians cannot count on the continuation of such favourable factors to assure comparable rates of increase in their real wages and real incomes.

Output, Employment and Demand

The expansion of real output began in the second quarter of 1975, continued strongly through the first quarter of 1976 and then slackened. According to the preliminary statistics, real gross national expenditure and real domestic product were both up 4.6 per cent over 1975. The recovery was uneven due to erratic swings in inventory investment and the external trade balance and because of the impact of work stoppages. Canada shared in the hesitation in the economic recovery among developed countries in the second half of 1976.

Fewer jobs were generated in 1976 than expected. The employment growth of 209,000 compares with a May, 1976 budget forecast of 250,000. The unemployment rate averaged 7.1 per cent in 1976, up slightly from the 1975 average of 6.9 per cent. However, there was a gradual weakening in labour market conditions over the course of the year; the unemployment rate increased from 6.9 per cent in the first quarter to 7.4 per cent in the fourth quarter. It reached 7.9 per cent in February of this year as the participation rate rose with the growth of employment.

A particular concern is the high level of unemployment among the young people of the country. Youth unemployment is a serious problem throughout the western world. While the rate of unemployment among adult men in Canada has remained well below 5 per cent, and is 7 per cent among adult women, the rate for young people is over 14 per cent.

Regionally, the burden of unemployment has fallen much more heavily on the Atlantic Provinces and Québec than elsewhere. The average rate in 1976 was 13.6 per cent in Newfoundland; 10.2 per cent in the rest of the Atlantic Provinces; 8.7 per cent in Québec; and 8.6 per cent in British Columbia. The yearly average fell a shade to 6.2 per cent in Ontario, still high by recent standards. In the Prairies, unemployment at 4 per cent in total was well below the national average.

The unemployment situation requires not only some general measure of economic stimulus, but also specific initiatives directed at these structural problems.

Economic growth in 1976 was led by consumer demand and housing construction. With total real personal disposable income up nearly 6 per cent in 1976, real consumer expenditure grew by over 6 per cent. Personal savings rates averaged a high 9.5 per cent.

The government's major new programs in the housing field, supported by programs at the provincial level, have had a major impact. Housing starts set an all-time record of 273,000 units, far in excess of both the 1976 policy target of 235,000 units and the rate required to achieve the medium-term goal of one million starts between 1976 and 1979. The new starts were concentrated in moderate-size, moderate-cost housing.

With the program of cutbacks taking hold, government expenditures on goods and services and capital formation grew by only 1.5 per cent in real terms in 1976, well below the 4.6 per cent growth for the economy as a whole. The most notable weakness in Canada's real growth in 1976 was lagging business investment. The lag occurred despite strength in the energy field. Real capital formation in the manufacturing and the service sectors weakened.

Despite these elements of weakness, domestic demand has been well sustained in Canada over the past three years. The 1975 recession was due primarily to the reduction of inventories and these were rebuilt only modestly in 1976. The other principal factor in the recession was the drop in exports. Responding to economic recovery in the United States and the rest of the industrialized world, they rose 9.5 per cent in 1976. But imports also rose sharply despite the decline in investment.

Table 5
Real Expenditures

	1973	1974	1975	1976
		(percentage change)		
Consumer expenditure	6.8	5.0	4.9	6.3
Government Goods & Services & Capital	3.7	6.6	4.1	1.5
Housing	10.0	-1.9	-7.4	18.8
Business investment	14.8	7.7	5.0	-2.9
Final Domestic Demand	7.3	5.4	4.1	4.5
Inventory change ($ million)	1346	2281	-307	656
Total Domestic Demand	8.0	6.2	1.8	5.3
Exports of Goods & Services	10.6	-2.3	-7.1	9.5
Imports of Goods & Services	13.7	9.3	-2.5	8.1
GNE (including residual error)	7.2	3.2	0.6	4.6

Source: Statistics Canada

Canada is now seven quarters into a period of expansion. The balance of forces points toward continuation of the expansion, but the pace may be rather moderate, particularly in the first half of 1977. With slower growth in real disposable income per capita, consumption cannot be expected to rise as rapidly as it has recently, even if personal savings rates are reduced. With the continuing policy of restraint, government expenditures cannot be a major source of increase in real final demand. As new housing expenditures have already reached very high levels, a further stimulus to final demand cannot come from that source. This leaves only business investment in inventories and fixed assets and improvement of the external balance as potential driving forces of more rapid growth.

While the business world has been faced with very difficult conditions, some encouraging prospects lie ahead. The erosion of our competitive position is being checked. The decline in the exchange rate can be helpful. Capacity utilization rates should improve and recent efforts to improve efficiency and reduce costs should pay off in substantial improvement in productivity and profits in the period ahead. However, these factors alone are unlikely to bring about the growth of investment which is needed.

Balance of Payments

After deteriorating markedly from 1973 to 1975, Canada's current account registered a modest improvement in 1976. A sharp turnaround in the trade balance in 1976 outweighed a continued widening of the deficit on services. Merchandise exports grew by 12 per cent in volume terms after two years of decline while imports grew by less than 8 per cent. Moreover, the prices of our exports rose by more than the prices of our imports. Overall, the current account deficit was reduced by $600 million in 1976, to $4.3 billion.

The swing in Canada's current account balance in recent years from a small surplus in 1973 to large deficits more recently reflects a combination of cyclical and structural factors.

Table 6
Canadian Balance of Payments

	1973	1974	1975	1976
		($ Millions)		
Merchandise Trade				
—Exports	25,461	32,591	33,347	38,019
—Imports	22,726	30,893	33,986	36,887
—Trade Balance	2,735	1,698	-639	1,132
Services Balance	-2,991	-3,753	-4,732	-6,002
Net Transfers	352	563	406	541
Current Account Balance	96	-1,492	-4,965	-4,329
Long-term Capital Flows				
—Net Direct Investment	-35	-50	-20	-950
—New Issues of Canadian Securities	1,324	2,423	5,150	8,862
—Retirements of Canadian Securities	-737	-626	-691	-780
—Other Long-term Transactions	-167	-876	-333	416
Total Long-term Flows	385	871	4,106	7,548
Short-term Capital Flows	-948	645	455	-2,697
Net Official Monetary Movements	-467	24	-404	522

Source: Statistics Canada

Since the last cyclical peak in 1973, real growth has been higher in Canada than in any other major industrial country. Growth in Canadian demand has resulted in higher imports. On the other hand, our exports suffered from the deep recession experienced by our major trading partners.

The recovery of their economies has gone some way since 1975 and seems likely to continue this year and next. This can be expected to sustain the improvement in our trade balance.

However, the deterioration in our current account balance in recent years cannot be attributed solely to recession in the rest of the world. Structural forces have also been at work. Two-thirds of the deterioration in the current account balance between 1973 and 1976 has been in the services account. Payments for interest and dividends have risen steadily to $3.4 billion. The travel deficit has reached $1.2 billion. Our trade balance has suffered from our shrinking energy surplus. Net exports of oil and gas declined to $500 million last year from $1.4 billion in 1974. Finally, the deficit on "end products" has risen to more than $10 billion. In part this reflects cyclical factors. However, it also reflects the competition faced by Canadian manufacturers both abroad and at home. The recent period of more rapid wage and price inflation in Canada has made it much more difficult for Canadian manufacturers to compete with foreign firms at a reasonable profit. This has had serious consequences for the level of employment and the structure of our economy.

In 1976 net long-term capital inflows amounted to $7.5 billion, substantially more than required to finance the current account deficit. This was reflected in the high value of the Canadian dollar during most of the year. Provincial and municipal governments, utilities and private corporations borrowed heavily abroad to meet their large financial requirements and to take advantage of lower interest rates abroad. On the other hand, there was a large net outflow of direct investment abroad. This arose from continuing Canadian investments in other countries and the purchase by Canadians of some very large existing foreign direct investments in Canada. But a further contributing factor to the outflow has undoubtedly been the lower level of production costs elsewhere, especially in the United States.

It may be recalled that in the latter part of the 1950s and the early 1960s, the current account deficit was as large or larger in relation to GNP than in the past three years. There were the same concerns about the structure of the economy as there are now. The devaluation of the Canadian dollar in 1962 led to a sustained improvement in the balance of payments and supported the long expansion of the economy in the balance of that decade. However, this was only possible because the rate of inflation remained low. The devaluation did not lead to an upward swing of prices and costs.

The decline in the Canadian dollar which began last November came about in part because of a narrowing of the gap between Canadian and foreign interest rates, which reflected the relative decline in our rate of inflation. It also reflected a sense of uncertainty about Canada's future among foreign investors. This decline has gone a long way toward offsetting the higher costs incurred by Canadian firms. It provides them with new opportunities to compete with foreign suppliers in the Canadian market and in expanding foreign markets. It provides new incentives for investment in our export and import competing industries. These opportunities offer promising prospects for reducing the deficit in our trade in manufactured goods, lessening reliance on foreign capital and providing new impetus in the short run to the expansion of output and employment in Canada.

But these benefits from the decline in the Canadian dollar will be realized only if domestic costs and prices are kept in check. The immediate impact is to increase the prices of goods and services to Canadian consumers. If this leads Canadians to demand higher money incomes to protect themselves, the opportunity for a lasting improvement will be lost.

Economic Objectives

This review of recent economic developments in Canada makes clear that a significant start has been made in dealing with deep-lying inflation, the lack of growth and the imbalance in international payments. The analysis also clarifies the necessary directions of policy.

First, it will be necessary to maintain the underlying trend to lower inflation. Continued progress will not be easy. There may be setbacks as the prices of food and energy rise and as the decline in the exchange rate has its effect. As a result, real incomes will have to grow more slowly and this will have to be accepted.

A second objective is the steady growth of output, not only to provide jobs for a growing labour force but to reduce unemployment as well. If overall activity expands too quickly, it will bring with it new inflationary pressures. But the more immediate danger is that growth will continue to be too slow. The particular need is for strong renewed private investment, both to boost the recovery and to provide the productive capacity which will be needed in the future.

Progress in respect of these two objectives will also encourage and be reinforced by a sustained improvement in the balance of payments.

The federal government recognizes and accepts a major responsibility in the achievement of these interdependent goals. This responsibility rests on its taxing and spending powers, its control over money and banking and its jurisdiction over external trade and payments. On a temporary basis, the government has had recourse to mandatory controls over prices and incomes. In recent months a number of new initiatives have been taken to improve the performance of the economy.

But in a market economy and a federal state the responsibility for the economy rests on others as well. All Canadians have a contribution to make. Both political and economic power are widely dispersed in this country, reflecting Canada's diversities and protecting fundamental liberties. All those who share power share the responsibility that goes with it for the attainment of the country's economic goals.

This is well illustrated in the recent record of economic and fiscal co-operation between the federal and the provincial governments. That record provides reassuring evidence of the continuing flexibility of Confederation while contributing directly to the solution of immediate economic problems.

Regular meetings of Finance Ministers have provided a forum for a sharing of views and a pooling of knowledge on the economic situation and outlook in

Canada and its regions and on the fiscal position of all governments. As the taxing and spending powers of provinces have grown, it has become increasingly important that their fiscal policies and those of the federal government should broadly reinforce each other. The evolving practices of federal-provincial consultation have made this possible. More specifically, both levels of government have shared the objective of restraining the growth of government expenditure within the context of the anti-inflation program, and have in fact moved closely in parallel in the achievement of this target.

A new development in federal-provincial co-operation has been the application of the anti-inflation guidelines to the provincial and municipal public sectors, in most cases by formal agreements between the two levels of government. This co-operation has been important to the success of the anti-inflation program, as it will be to the decontrol process.

Finally, the past year has brought about the successful renegotiation of the federal-provincial fiscal arrangements. The new arrangements extend and improve the system of equalization payments under which the federal government brings the yield of the tax systems of the less prosperous provinces up to the national average. By permitting all provinces to provide national standards of service to their citizens, equalization expresses tangibly the advantages of Confederation. The main new elements were the arrangements for financing hospital insurance, medical care and post-secondary education. Previously, the federal government paid about half the costs incurred by the provinces. Those payments have been replaced by unconditional grants and the transfer of taxing powers. The provinces will thus be able to obtain the full benefit of providing these services as efficiently as possible in their own circumstances.

Power and responsibility also reside in the private sector of the economy. Under the market system, private firms make most of the decisions on new investments. Private firms seek new markets both at home and abroad in competition with each other and with foreign suppliers. It is essentially the private sector which develops the new resources and new technologies that support and enhance the standard of living. Governments can provide assistance and incentives, but experience has shown that these decisions are best left in private hands. The efforts of private firms, their judgment and their confidence in the future, are essential to economic progress.

The setting of prices, wages and other incomes is widely dispersed throughout the private and public sectors, except in the extraordinary and temporary circumstances of mandatory controls. The decisions made when controls are removed can be critical in reinforcing the gains achieved by the anti-inflation program. All Canadians will have a part to play in that process. A particular responsibility will rest with the leadership of the labour movement at every level in this country, as well as with private firms and organized groups of all kinds.

The government has set out in the Discussion Paper *The Way Ahead* its views of how responsibility will have to be shared in the post-control society. It is consulting with business, labour and other groups. Similar initiatives are being taken by some provincial governments. Greater understanding of what can realistically be achieved and of what constitutes responsible behaviour will contribute to realizing the full economic potential of this country, reducing conflict and confrontation and lessening the need for government intervention in the economy.

Specific Areas of Public Policy

The budget refers to five of the specific areas of public policy on which the government is focussing at this time. They are energy, the controls program, job creation, the restraint of government expenditure and the broad setting of monetary and fiscal policy.

Energy

The energy area, and oil and gas in particular, will continue to pose a challenge for Canadians. In the past, Canada was fortunate enough to have ready and assured access to cheap energy supplies at home and abroad.

Beginning in 1973, the situation changed dramatically, and it would be wishful thinking to expect any reversal of that trend. In these new circumstances, the federal government's objectives are to increase domestic supplies and cut energy demands.

Canadian consumers have been shielded from the full effects of the recent international price increases by the government's policy of restraining the price of domestic oil and subsidizing consumers of imported oil. This policy has the effect of equalizing Canadian prices at a level well below those prevailing elsewhere. The government has made it clear, however, that this is only a temporary program, to provide time to adjust to the new realities.

Discussions with the provinces are being held again this spring to determine the amount of the next price rise, and the challenge will be to achieve a balance between longer-term energy objectives and the capacity of the economy to absorb further price increases at a time of inflation, unemployment, and severe international competition.

Higher oil and gas prices result in substantial transfers of income from consumers to producers. This is inevitable. The impact will be cushioned by the system of equalization payments. Actions such as the recent loan by Alberta to Newfoundland can also be helpful.

The increased revenues of producers provide the resources for exploration and development. Evidence to date suggests that the industry is in fact reinvesting a very large share of its increased revenues. The federal government encourages this reinvestment through incentive provisions in the Income Tax Act.

Even in a period of overall restraint, the federal government is incurring substantial expenditures in pursuit of energy self-reliance. In oil and gas, the efforts to increase domestic supplies for Canadians include the government's investment in the Athabasca tar sands, frontier exploration through Petro-Canada and Panarctic, the development of new technology in heavy oils recovery and support for new transportation facilities.

In nuclear energy and aid for provincial electrical utilities, federal outlays and commitments exceed $2 billion. The federal government has encouraged households and business firms to reduce consumption and a program of improving insulation has been established to meet the special needs of Nova Scotia and Prince Edward Island.

The federal government will continue to seek ways to achieve essential energy objectives in the most effective and least costly fashion. The prospect of higher prices for energy emphasizes the need for better conservation practices.

The Controls over Prices and Incomes

The controls over prices and incomes introduced on October 14, 1975 have helped to bring down the rate of inflation. However, while there is no pressure of excess demand which would drive up prices and costs, and inflationary expectations have subsided to some degree, the rate of inflation has not yet been brought down to an acceptable level. Canadians are now faced with the need to pay more for food, energy and imports generally. If controls were suddenly removed now, there is a danger that rates of cost and price increases would begin to escalate again. This would put in jeopardy the sustainable growth of output and employment. The gains that have been made in building the base for future prosperity would be threatened.

At the same time, mandatory controls over prices and incomes cannot become a permanent feature of the economic life of this country. The scheduled expiry of the Anti-Inflation Act on December 31, 1978 requires that plans be made in advance to ensure as smooth a transition as possible to the post-control era. The objective is the creation of conditions in which controls can be removed without interrupting the continued progress towards the country's economic goals.

A number of alternative methods of decontrol have been examined. The government believes that the best approach would be the phased approach based upon the timing of pay agreements and fiscal years. This is generally favoured by the provinces. A starting date for the process of decontrol would be selected. Employees would remain subject to the compensation guidelines to the end of their guideline year in which the starting date falls. The date on which each group's guideline year begins is fixed under the program. Groups of employees would emerge from controls over a period beginning with the starting date. The process would be similar to that by which groups became subject to controls after October 14, 1975. The groups which were "first in" would generally be "first out". Because each group would remain subject to controls for their guideline year in which the starting date falls, there would be no advantage in delaying wage negotiations.

Compensation plans covering more than one year would be subject to mandatory controls only for the year in which the starting date falls. Subsequent increases would be settled by the normal processes. As they moved out of mandatory controls employers and employees would have to be aware of the continuing need for restraint consistent with the economic realities.

All firms will remain subject to the price and profit controls throughout their fiscal year in which the starting date falls. Because fiscal years, like compensation plans, end at different dates during the year, the ending of price and profit controls at the ends of fiscal years would also provide for a process of phasing out. However, it would be important to ensure that the procedure for removing mandatory restraint of compensation was adequately balanced by the process of lifting the mandatory price restraint.

The government intends to issue a discussion paper in the near future which will provide a fuller description of the planned method of decontrol. It will also set out proposals for an agency which will have the responsibility for public education about inflation, for monitoring the course of prices, wages, profits and other forms of income, public and private, and for drawing attention to increases which appear to be inconsistent with the goal of bringing down the rate of inflation. The discussion paper will also make suggestions for improvements in the structure of the economy which will make it less susceptible to inflation; included here will be a discussion of labour-management relations and public sector compensation policy. Finally, the paper will outline proposals regarding improved procedures for consultation between the government and economic interest groups, and discuss formal machinery for this purpose.

Following the publication of the paper, the government will consult further with the provinces and with the leaders of business, labour and other groups. The objective will be to reach the broadest possible measure of understanding of what will be required in order to keep the rate of inflation coming down during the process of decontrol and in the post-control period.

Within this framework, there will be a particular need to consider a possible date for beginning the decontrol process. On the basis of all the factors at work, the government believes that a starting date prior to the second anniversary of the program on October 14, 1977 would not be feasible or desirable. A recent initiative on the part of business and labour groups, however, has raised the prospect of sufficient support emerging for a program of voluntary restraint as to warrant consideration of a somewhat earlier date. That could affect the question of timing. This prospect will be fully explored in the further round of consultations intended to follow the publication of the discussion paper. In the meantime, all parties should proceed with wage and price determination in the expectation that controls will continue in effect for some time unless replaced by firm understandings which produce similar results.

Direct Job Creation

It is apparent that Canada's unemployment situation requires not only some measure of economic stimulus, but also specific initiatives directed at structural unemployment problems.

Some of these problems arise from the rapid growth and changes in the structure of the Canadian labour supply. Particularly noteworthy has been the tremendous increase of young people and adult women in the Canadian labour force in the last few years. This is one of the reasons why the level of unemployment associated with the same level of demand pressure on the economy has tended to rise. A further structural aspect is revealed in the particularly high unemployment in certain regions.

While recognizing that governments cannot assume all the responsibility for dealing with these problems, the federal government has given a high priority to direct job creation, even in the situation of general expenditure restraint.

In the field of direct job creation, the government has already launched an employment strategy featuring the major new programs of Canada Works and Young Canada Works. The impact of these programs will build up rapidly through this summer and into next winter. While the programs provide some stimulation to all parts of Canada, they are geared to have a greater impact in regions of higher unemployment. The programs provide scope for initiatives by local public and private groups; they emphasize local arrangements in determining priorities. A large number of jobs is created in relation to the program cost. They provide solid value for the funds expended. A good response has arisen in the first call for Canada Works proposals, confirming the government's expectation that the programs are an effective way of creating jobs quickly. The original commitment to this employment strategy for fiscal 1977-78 is $358 million, over and above the expenditure on regular manpower programs.

Given the particular need to create employment in the regions where the problems are most severe, and to do more to deal with serious unemployment among young people, the government has decided to expand the programs substantially by adding $100 million. This will bring the government's commitment to the employment strategy to $458 million in 1977-78, and the total expenditure on manpower programs to $1.2 billion.

Table 7 indicates the allocation of these funds to various programs. The expanded employment strategy will create about 600,000 man-months of employment. It will have a significant impact in reducing the number of unemployed.

Table 7
Employment Strategy
Fiscal Year 1977-78

	($ Millions)
Canada Works and Young Canada Works	300
Local Initiatives Program	47
Summer Job Corps and Student Summer Employment	46
Increased Funding for Training	28
Local Employment Assistance Program	23
Other	14
Total	458

The Control of Government Expenditure

The expenditures of all levels of government have been increasing for many years both in absolute terms and in relationship to the economy as a whole. As the following table shows, consolidated government expenditures as recorded in the National Accounts amounted to 22 per cent of the GNP in 1950. They rose to 30 per cent in 1960 and 36 per cent in 1970 and reached 42 per cent in 1975.

This rapid growth in the size of government has provided schools, roads and hospitals for a greatly increased population, supported older people, families with young children, those without jobs and those unable to work, assisted particular sectors of the economy and regions of the country and aided developing countries abroad. Governments have had to respond to the increasing complexity of modern society and its rapid urbanization. These trends have been apparent throughout the industrialized world.

A policy of limiting the growth of public expenditure in line with the trend growth in the GNP was announced in the June, 1975 budget, prior to the announcement of the anti-inflation program. It has become an integral part of that program, because the growth of government expenditure has played a part in the inflationary process.

Table 8
Government Expenditures
(National Income and Expenditure Accounts)

	1950	1960	1970	1975	1976
			(% of GNP)		
Federal	12.8	17.6	17.8	21.9	21.1
Provincial	6.7	9.2	16.5	19.2	19.3
Local	4.9	7.4	9.5	8.8	8.8
Hospital	–*	–*	2.8	3.1	3.2
Canada and Quebec Pension Plans	–	–	0.2	0.5	0.6
Less Inter-governmental Transfers	-2.3	-4.5	-10.3	-11.7	-11.3
Total Government Expenditures	22.1	29.7	36.4	41.8	41.5

*Prior to 1961 Hospitals were treated as part of the private sector.

Source: Statistics Canada

The restraint over government expenditure contributes to the fight against inflation in several ways. It fosters greater productivity and efficiency, which are needed as much in the public as in the private sector. It leaves more real resources available for export, investment and private consumption. It reduces the need for higher taxes and provides the scope for tax cuts which relieve the upward pressures on costs.

The results of government restraint are now showing in the statistical record. In 1976, total government expenditures declined as a percentage of GNP, most evidently at the federal level. At the provincial level, large retroactive salary payments in 1976 concealed a similar change in direction. Further declines are expected in 1977.

For the federal government alone, the slowdown in expenditure growth is also revealed in total outlays for fiscal 1976-77 on a Public Accounts basis in Table 9 (as distinct from the somewhat different conceptual and statistical measurements and time periods of Table 8).

Table 9
Federal Government
Total Outlays
(Public Accounts)

	1973-74 Actual	1974-75 Actual	1975-76 Actual	1976-77 Estimate	1977-78 Forecast
			($ Millions)		
Budgetary Expenditures	22,839	29,245	33,979	39,200	41,900
Loans, Investments & Advances	1,693	2,238	3,305	2,200	2,550
Total Outlays	24,532	31,483	37,284	41,400	44,450
% Increase	22.7	28.3	18.4	11.0	7.4
% of GNP	20.0	21.8	23.1	22.4	21.7

Total outlays, which include both budgetary expenditures and loans, investments and advances, are now estimated at $41,400 million in 1976-77. This is $750 million less than the estimate of $42,150 million contained in the May, 1976 budget.

These savings in total outlays in 1976-77 will be carried through into 1977-78. The reserves for supplementary estimates in 1977-78 have been reduced to make room for tax reductions. As a result, the target figure for outlays for the fiscal year ahead is $44,450 million. This is $650 million less than the expenditure plan announced by the President of the Treasury Board when tabling the Main Estimates and represents a year-over-year increase of only 7.4 per cent. The small increase reflects in part the new financing arrangements for health and higher education but, even when allowance is made for this special factor, the increase would be only 9.8 per cent. This is lower than the expected growth of GNP and lower than the 11 per cent increase predicted in the last budget. These savings have come from the general success of the restraint policy rather than cuts in specific programs.

Monetary and Fiscal Policy

In present circumstances, the task of monetary and fiscal policy is to encourage a growth of nominal demand which is consistent with the expansion of employment and the winding down of inflation. In line with these goals, the Governor of the Bank of Canada in his recent annual report has confirmed the Bank's strategy of progressively moderating the rate of monetary expansion. The Governor noted that the rate of monetary expansion had been below the target range of 8-12 per cent. The reductions in Bank Rate in three stages from 9 1/2 per cent to 8 per cent were intended to bring the growth of the money supply back on course. There has been a general decline in interest rates. Recent experience has shown once again that the best way to get interest rates down is to bring the rate of inflation down.

While the overall fiscal strategy has not been formulated in terms of a numerical guideline, the advantages of avoiding wide swings in the stance of policy are recognized. The November, 1974 budget provided substantial stimulus to help maintain the growth of demand and it limited the severity of the recession in Canada. The stance thus set for 1975-76, and the deficit which it entailed, were basically maintained in 1976-77. When the slack in the economy is taken up, the deficit will be reduced. However, to attempt to cut deficits too soon would threaten the recovery.

A series of expansionary fiscal steps has taken effect in recent months, including the reduction of personal income taxes as a result of indexation, the reduction of unemployment insurance premiums, and expanded direct job creation programs. The extent of the further stimulus required has been determined in the light of the government's interrelated objectives. Rapid economic growth could not be sustained if it led to more inflation and a worse balance of payments situation. It is also important to avoid placing too much pressure on the capital markets at a time when private investment is being encouraged and when other borrowers may be looking to the domestic capital market for an increasing portion of their financing needs.

The starting point in considering the type of fiscal stimulus to be provided has been the commitment to expenditure restraint. Within this restraint further resources have been allocated to the creation of new jobs. The main stimulus, however, will take the form of tax reductions.

Budget Measures

A number of specific objectives have guided the choice of the measures put forward in the budget:

*Encouraging investment in the private sector.

*Revitalizing Canadian equity markets as a source of new business financing.

*Augmenting the flow of internally generated funds within business to offset the effects of both lagging profits and the distorting impact of inflation.

*Encouraging small business and venture enterprises.

*Fostering growth in those regions of Canada which have lagged behind in developing economic strength.

*Sustaining consumer demand.

*Relieving the burden of taxation borne by Canadians, particularly those with modest incomes who are most affected by inflation.

*Simplifying the tax system.

Investment and Regional Growth

The recent weakness in capital investment and the structural and regional character of the current unemployment have been described.

Investment Tax Credit

The government has introduced a number of tax incentives in the past to encourage capital investments in general and a strong manufacturing sector in particular. One existing incentive is the 5 per cent investment tax credit introduced in 1975 and scheduled to expire on June 30 of this year. Under the present rules, investments in new buildings, machinery and equipment which are acquired for use within Canada primarily in a manufacturing or processing business, in the extraction and production of petroleum or minerals, or in logging, farming, or fishing, qualify for the credit. It has proved to be an important incentive during the difficult economic circumstances of the past two years and will continue to be needed in order to support the investment necessary to strengthen the current recovery.

The investment tax credit will be extended for a further three years. Qualified investments made before July 1, 1980 will now be eligible for the credit.

In addition, it will be expanded in two ways.

First, recognizing the importance of maintaining a vigorous research effort in Canada, current and capital expenditures on scientific research and development made after March 31, 1977 and before July 1, 1980 will be eligible for the credit. Research and development are important in maintaining the international competitiveness and productivity of Canadian industry. The investment tax credit, coupled with the existing fast write-off for research costs, should increase the efforts of Canadian businesses in this direction.

Second, an increase in the amount of the credit will apply to investments made in the slower-growth regions of Canada. In areas designated under the Regional Development Incentives Act — that is, in Saskatchewan, Manitoba, Northern Ontario and all RDIA designated regions in Québec other than the Gaspé region — the rate of tax credit will be raised to 7 1/2 per cent. In the Atlantic Provinces and the Gaspé region, which are also designated in their entirety under RDIA and where the problems are most acute, the rate of the credit will be raised to 10 per cent. The higher credits will be in effect for qualified investments made after tonight and before July 1, 1980.

The proposed extension and enrichment of the credit is estimated to cost $385 million in the next 12 months.

Frontier Oil Exploration

In present circumstances a fuller knowledge of Canada's petroleum and natural gas production potential is essential. To date, however, there has not been the level of exploration activity in Canada's frontier areas, particularly in deep water, to provide this knowledge. There are a number of reasons for this including the high costs of offshore exploration, the attractiveness of drilling for more accessible reserves, and an absence of any major new discoveries. Geologists have indicated, however, that the formations in Canada's frontier areas suggest the possible existence of further significant oil and gas deposits. An incentive to encourage exploration in these areas of Canada is appropriate at this time.

Additional encouragement will be provided to taxpayers in respect of drilling costs in excess of $5 million incurred in connection with an exploratory well. The well must be located in Canada, including the continental shelf, and the expenses must be incurred between March 31, 1977 and April 1, 1980.

The incentive will take the form of an additional earned depletion entitlement of 66 2/3 per cent of qualifying drilling costs. A taxpayer will be entitled to offset this additional depletion against income from any source, whereas normal depletion is deductible only to the extent of 25 per cent of resource profits. This latter feature should attract the participation of investors who have not previously been involved in resource exploration.

Rail Transportation

In order to assist the necessary expansion of rail transport facilities, particularly for the movement of grain and coal in Western Canada, track and grading expenditures made after March 31, 1977 and before April 1, 1980 will be eligible for capital cost allowance at a rate of 8 per cent instead of the current rate of 4 per cent. In addition, the cost to a mining company of constructing a railway spur line will be given the same treatment as the cost of constructing a road to transport ore from a mine site. Both of these proposals involve changes to existing regulations.

Equity Investment and Business Finance

Other measures are proposed in the budget to encourage savings and investment. A particular concern has been the financing of investment through new equity issues. Activity in Canadian equity markets has declined in the past two years due to such unsettling factors as the world recession, oil-price increases, inflation, and poor corporate earnings. Individuals and institutions have moved to fixed-income securities. Markets are generally unreceptive to new equity issues. For many corporations, their equity base has been reduced to a level which will not permit further borrowing needed for business expansion.

The Canadian markets have failed to rebound to the same extent as markets in other industrialized countries. Although the general stimulus measures proposed in the budget should have positive effects, additional measures are needed to increase the return on equity investments and thereby generate new sources of investment funds.

Dividend Tax Credit

There will be a major increase in the dividend tax credit. Starting January 1, 1978, the amount of dividends received from taxable Canadian corporations will be grossed-up by one-half, as opposed to the current one-third, and taxpayers will be allowed to claim against tax a credit equal to this higher amount.

This measure will provide benefits in a progressive manner in that the net tax on each dollar of cash dividend received will decline by a larger dollar amount the lower the income of the taxpayer. This is shown in the table included in the Supplementary Information. The table also illustrates how this measure will improve the return on equity investments. The proposed increase in the dividend tax credit should thus make it more attractive for investors in all income brackets to return to the equity market.

The federal revenue loss from this measure is estimated to be $120 million in the first full year of operation and the measure will also affect provincial tax revenues.

Corporate Surplus

The increase in the dividend tax credit and the maturing of the capital gains tax introduced in 1972 make it possible to greatly relax the many complex rules designed to prevent surplus stripping, i.e., the avoidance of tax on the distribution of corporate surplus. Most surplus-stripping techniques involve trying to convert a dividend distribution into a capital gain on the sale of a company's shares. The tax burden on these different forms of income will now be sufficiently similar to permit the abandonment of most of these complex rules.

There is a need for simplification of the provisions of the Act dealing with the distribution of corporate surplus. Furthermore, the rules, particularly those relating to designated surplus and deficiencies, often hamper constructive business reorganization and expansion.

The designated surplus provisions will be repealed effective April 1, 1977. At the same time, most of the paid-up capital and debt deficiency rules will also be eliminated and the corporate law concept of paid-up capital will be substituted. In addition, the existing provisions relating to 1971 undistributed income and 1971 capital surplus on hand will be substantially phased out over a transitional period. While the need for rules to prevent surplus stripping is reduced, this need is not entirely eliminated. Therefore, anti-avoidance provisions will remain in the Act but their scope will be very considerably narrowed. Further details of these and related changes are included in the Supplementary Information.

These proposals taken together represent a major reform. Complexity will be significantly reduced and problems of administration and compliance will be considerably eased. Efficiency of business operation should be improved through the removal of artificial impediments to decision making. In turn, this should encourage increased productivity and investment in new enterprises.

It will be particularly beneficial to small businessmen, who do not have access to or who cannot afford sophisticated tax advice. They will be able to operate and expand their businesses in a much simpler and more efficient manner.

Capital Losses

A further budget measure concerns an individual's ability to deduct net capital losses against income from other sources. Currently, such losses can be offset against $1,000 of other income in a year. Effective this year, the $1,000 offset will be doubled to $2,000. This will result in a reduction of federal tax of $45 million for the 1977 taxation year.

Capital Gains

Currently, the Income Tax Act exempts the first $1,000 of interest and dividend income from tax. In order to further encourage individual investment, taxable capital gains realized on the sale of Canadian securities will be eligible for inclusion in the present $1,000 deduction for interest and dividend income effective this year.

Non-Resident Withholding Tax

Another source of funds for expansion and investment is the foreign capital market. Borrowings from abroad will continue to be required by both governments and industry. Currently, there is an exemption from non-resident withholding tax for interest payable on government and long-term corporate bonds issued before 1979. Several provinces, and many firms engaged in large expansion projects, have pressed for an early extension of this expiry date in order to make long-term investment plans and commitments. The exemption will be extended to such securities issued before 1983.

Stock Dividends

Many public corporations are anxious to proceed with expansion plans. At the same time, some part of their profits must be devoted to maintaining a stable dividend record. In periods of lagging profits and tight liquidity, the need to pay cash dividends can frustrate investment intentions. To assist in this regard, effective April 1, 1977, dividends received from public corporations in the form of shares will no longer be treated as income, taxable when received, but will be treated as capital gains, taxable only when these shares are sold. This measure will permit companies to maintain their dividend performance and yet retain their funds for expansion.

Inventory Adjustment

Widespread concern has been expressed about the effects of inflation in distorting the measurement of income reported on financial statements and the related tax consequences.

These concerns have prompted the search for an accounting system which fully recognizes the impact of inflation. Accounting bodies and other interested groups are engaged in studies and discussions to this end. The government has been following these developments closely and is an active participant in certain areas where it can play a useful role. It intends to continue to support this process, which has an importance that extends well beyond the concerns of the business community alone.

Any comprehensive tax measures in this area should await the development of appropriate accounting systems and the consideration of the full range of issues involved. At the same time, the liquidity problems facing business are urgent. These problems arise from the higher costs of financing the replacement of depreciable assets and inventories.

With regard to depreciable assets, the generosity of the current capital cost allowance system and the investment tax credit combine to provide a substantial offset to the effects of inflation. There are no corresponding offsets in the case of inventories and therefore this problem has been addressed in the budget.

An adjustment based on the current practices of valuing inventories will be introduced. It will take the form of a deduction in calculating business income each year of 3 per cent of the opening value of qualifying inventories. The adjustment will be allowed for fiscal periods which commence after December 31, 1976 and will be available to both incorporated and unincorporated business.

This measure will reduce federal revenues by $300 million in the first full year of operation and will also affect provincial tax revenues.

This measure does not represent a comprehensive response to the problems caused by the interaction of inflation and taxation on business income. However, it will provide a broad measure of relief and thereby enhance the flow of internally generated funds available for business expansion. It also has the considerable merit of being simple to use and requires no fundamental change in accounting practices.

Small Business

The government attaches great importance to the contribution small business makes to the Canadian economy. There is ample evidence of this in the tax law. The small business deduction, for example, which was substantially expanded in the last budget, provides a direct benefit to small business of more than $700 million annually. The venture capital review, which was announced in the budget last year, was devoted in part to the search for solutions to the financing problems of small business. This analysis revealed that no single tax measure could resolve them.

Many of the problems of the small businessman are a part of the larger problem to which the measures referred to above are directed. Substantial benefits will flow to small business from the proposals for the extension and increase of the investment tax credit, the increase in the dividend tax credit, the inventory adjustment and the other measures directed towards investment. Further measures are proposed in the budget.

Employee Stock Options

Smaller, and particularly newer companies, very often find it difficult to attract and retain people with the necessary executive skills because they do not have enough financial resources to match the higher salaries offered by larger enterprises.

A change in the tax treatment of employee stock options will alleviate this problem. At present, when a taxpayer exercises a stock option granted by his employer, the difference between the fair market value of the shares acquired and the price payable under the option is taxed as ordinary income. A special tax treatment for stock option plans established for employees of Canadian-controlled private companies will be introduced effective April 1, 1977. Under this proposal, the difference between the option price paid for the shares and their sale proceeds will be taxed as a capital gain and then only when the shares are disposed of. This proposal will not apply to an employee who is a controlling shareholder of the company or is related to a controlling shareholder. The stock option will permit this type of company to reimburse its key employees in a way that does not impair its working capital.

Election of Capital Gains Treatment

An important impediment to venture capital investment is the tax uncertainty relating to investments in new enterprises. Under the existing rules, certain investors face the possibility that any gains on their investment will be taxed fully as ordinary income rather than as a capital gain. To remove this uncertainty, a taxpayer will be permitted to make a permanent, lifetime election to have capital gains treatment in respect of his investments in most types of Canadian securities. This option will not be available to security dealers, banks, trust companies or similar financial institutions.

Part IV Refundable Tax

Another problem for investors in small or new businesses arises out of the tax levied under Part IV of the Income Tax Act. This is a refundable tax payable by a private corporation on otherwise exempt dividend income to prevent its use as a tax shelter for the portfolio dividend income of wealthy individuals. The imposition of this tax acts as a hindrance to venture capital corporations which are prepared to take minority positions in other businesses.

The Part IV tax will be limited, for taxation years commencing after 1976, to those situations where the inter-company shareholding is in the nature of a portfolio investment. This will remove a disincentive for private companies to make significant investments in other companies and will facilitate joint ventures.

Business and Farm Expansions

When business assets are sold, any capital gain is subject to tax even when the funds received are used to purchase similar assets in the same business. A typical transaction of this type occurs when a commercial business moves from the centre of a city, or when a farmer sells his farm and buys another. The existing tax treatment of such voluntary replacements is an impediment to desirable relocations by businessmen and farmers. Effective April 1, 1977, there will be a deferral of tax on any capital gain or recapture that arises from the voluntary sale of land, buildings and certain other productive assets to the extent that the proceeds are reinvested in similar assets.

Metric Conversion

The conversion to the metric system involves extra costs for businessmen and employees. A number of measures will be introduced to alleviate this burden. Employees obliged to purchase duplicate measurement-sensitive tools will be allowed to claim a refund of one-half the cost of such tools for a five-year period commencing April 1, 1977. Conversion parts for scales used by retailers will be exempt from sales tax and conversion parts not made in

Canada will be allowed duty-free entry. Smaller metric scales purchased by retailers will be subject to sales tax at only half of the regular rate. Capital outlays incurred by retailers for replacement of such metric scales will be allowed as an expense for income tax purposes. These latter provisions will extend for a four-year period commencing April 1, 1977.

Personal Income Tax Measures

A series of steps has taken effect in recent months either as a result of specific decisions or in response to the provisions of existing legislation to improve the disposable income of Canadians. These have included the reduction in personal income taxes as a result of indexation and the reduction of unemployment insurance contribution rates.

Further action is proposed both to sustain personal expenditure and to provide some relief to Canadians who are particularly affected by the higher prices of necessities.

Federal Tax Credit

The existing federal tax credit will be enriched. The rate of the credit was recently changed from 8 per cent to 9 per cent as a result of the new fiscal arrangements with the provinces. The maximum credit is $500 per taxpayer and the minimum of $200 ensures that the greater benefit from the credit goes to lower income taxpayers.

For the 1977 and subsequent tax years, taxpayers will be allowed to claim an additional credit of up to $50 in respect of each dependent child under 18 years of age resident in Canada. The limit of $500 will continue to apply to the enriched credit. The additional reduction, like the present tax credit, can only be applied to reduce federal tax payable and does not affect provincial tax liabilities.

For taxpayers with children, the additional tax reduction will have the effect of partially or totally filling any gap between the value of the existing tax credit and the $500 limit. For example, a taxpayer with two children, whose current tax credit is $350, will be able to claim a full additional credit of $100 in respect of his children. The application of the $500 limit restricts the benefits of this measure to those taxpayers below a taxable income threshold of about $23,000. It provides most benefit to taxpayers with larger families and modest incomes. In addition, it eliminates federal tax liability for a significant number of low-income taxfilers. This measure is estimated to save taxpayers $275 million in the 1977 taxation year.

Employment Expense Deduction

Prior to 1972 only a few specified expenses were deductible by employees for income tax purposes. In 1972, as part of tax reform, the government enacted the employment expense allowance of 3 per cent of wage and salary income with a maximum deduction of $150, thus giving recognition to expenses incurred in working without requiring taxpayers to keep receipts.

Since 1972, inflation has eroded the value of this deduction. The limit will therefore be increased to $250 effective for the 1977 and subsequent taxation years. The proposed increase exceeds that which would have been produced by simply indexing the current limit. This measure is estimated to reduce the federal tax liabilities of taxpayers by $115 million in the 1977 taxation year and will also affect provincial tax liabilities.

Tables included in the Supplementary Information show the combined benefits to typical taxpayers from these two measures. Their effect, together with the existing provisions of the income tax system, will be to completely eliminate the federal tax on married taxpayers with two children and earnings of less than $7,360. The comparable income level for a family with four children is $8,295.

For 1977 the full-year tax saving from the child credit and employment expense deduction will be reflected in the source deduction tables starting July 1 of this year.

Other Income Tax Measures

A number of proposals in the budget deal with special problems. Detailed information on the proposed changes in the income tax is included in the Ways and Means Motion and the Supplementary Information. However, some of these measures are referred to below.

The Registered Home Ownership Savings Plan (RHOSP)

The RHOSP provides assistance to taxpayers, particularly young couples, to accumulate savings for the purchase of a home, and more than 400,000 Canadians have established plans. However, the plan has been criticized for permitting an unwarranted tax advantage to those families who either currently own a home or have no intention of acquiring one. In order to prevent misuse of the plan, a number of changes will be made:

1) The taxpayer will not be permitted to make a deductible contribution to a RHOSP after 1977 if the spouse with whom the taxpayer is living owns a home.

2) Home furnishings will be excluded after this year from property qualifying for the tax-free application of RHOSP funds.

3) The tax-free rollover of funds from a RHOSP to a Registered Retirement Savings Plan will be discontinued, effective immediately.

4) A maximum limit of 20 years will be introduced for the use of RHOSP funds for the purchase of a home.

In addition, several relieving changes will be introduced to deal with particular problems that taxpayers have experienced with RHOSPs. One such change will permit a deduction for contributions to a RHOSP in the year in which a home is purchased. Relief will also be provided for taxpayers who close out their RHOSPs with the intention of purchasing a home but are unable to do so.

The Registered Retirement Savings Plan (RRSP)

Current income tax provisions require a taxpayer, upon reaching the age of 71, to use the funds accumulated in the RRSP to purchase a life annuity, the receipts from which are taxable as received each year. The only alternative permitted is to withdraw the accumulated funds in a lump sum and be taxable on the full amount in the year of withdrawal. Many people have argued that these alternatives are too restrictive. Currently, the government is embarked on a review of the entire range of issues relating to retirement income, including the comparability of treatment of RRSPs and Registered Pension Plans. This particular problem will be considered as part of that review.

A change is proposed in the provisions relating to RRSPs established for a spouse. It is designed to discourage the misuse of a spousal plan as a means to gain short-term tax advantage, rather than to provide a retirement income for the spouse. Effective April 1, 1977, contributions to a spouse's RRSP by a taxpayer will be taxed in the contributor's hands, rather than in the spouse's hands, if such funds are withdrawn within three years from the year in which they are contributed.

Life Insurance

The present system of taxation of life insurance companies was introduced in 1969 when, subject to minor exceptions, the industry became liable for a profits tax for the first time. It has taken several years to assess the new tax system for life insurance companies. It is now apparent that major changes are in order to ensure that all insurance companies bear their fair share of tax in the future.

A comprehensive description of the changes introduced in the budget affecting life insurance is included in the Supplementary Information. However, some of these changes affect individual policyholders and are summarized below.

15 Per Cent Tax on Investment Income Destined for Policyholders

Under Part XII of the Income Tax Act, insurance companies are obliged to pay a 15 per cent tax on any investment income which will eventually be distributed to policyholders. This tax was imposed so that it would not be more attractive to save money through the ownership of a life insurance policy or certain annuities than through other forms of savings. However, when the government introduced the $1,000 exemption for interest and dividend income, the balance between competing forms of savings may have been upset. Therefore, the Part XII tax will be repealed and the investment income on life insurance policies and annuities will be allowed to accumulate tax-free for the benefit of the policyholder. However, the policyholder or annuitant will eventually be subject to tax on this income as described in the next paragraph.

Taxation of Policyholders

Under the present tax regime, no portion of life insurance proceeds is taxable when received as a result of the death of an individual. Alternatively, where a policyholder cashes in a policy he is now taxable on the excess of its cash surrender value over his premiums (net of policy dividends) paid by him on the policy. This represents the untaxed savings element of the policy. Life insurance proceeds on death will be taxed in the same manner. That is, tax will be imposed on the policyholder on the assumption that he had surrendered his policy just prior to death. A value will be established for each policy as of its next anniversary date to ensure that only the savings element of the policy accumulated after that anniversary date is taxed on the death of a policyholder. Many policies will not be subject to tax at all. Of those that are, only a small proportion of the proceeds will be taxable.

Policy Loans

When an insurer advances funds to a policyholder against the cash surrender value of that policy, the advances are actually prepayments of the policyholder's entitlement under his policy contract. Until now, the industry and policyholders alike have treated these prepayments as loans. Effective in 1978, it will be made clear that for tax purposes these advances are not loans but merely prepayments of the policyholder's entitlement and therefore that the charge paid to the insurer by the policyholder in respect of the advance is an additional premium.

Refunds and Late Payments

The government intends to increase the rate of interest on both underpayments and overpayments of income tax. The existing rate of 6 per cent is clearly unrealistic in present circumstances. Starting in 1978 the rate will be set by reference to the prime rate charged by chartered banks.

Commodity Taxes

The sales tax changes proposed in the budget are intended for the greater part to facilitate compliance and administration. They are outlined in the Supplementary Information and in the Ways and Means Motion.

However, three modifications in the sales tax are referred to here. First, it is the government's intention to exempt from federal sales tax certain producers of craft products which are of significance to Canadian culture and heritage. Consultation with the crafts industry will be necessary before determining which groups will be exempted. A second change concerns the exemption from sales tax for the output of small manufacturers. Where annual sales are less than $3,000, manufacturers are not required to pay sales tax on their products. This avoids the necessity of tax collection in circumstances where the costs of compliance and collection exceed the potential revenues. The exemption will be raised from $3,000 to $10,000. Third, several energy conserving items will be prescribed as exempt from sales tax including certain additional insulating materials.

Reference should also be made to the present status of the review of the commodity tax system which was initiated with the tabling of the Discussion Paper on Federal Sales and Excise Taxation at the time of the June, 1975 budget.

Since the tabling of this document, some 200 major submissions have been received and discussions have been held with those parties who wished to present their views to the members of the interdepartmental review group. It is clear that a very substantial proportion of those who have chosen to make their views known to the government have reservations about the proposal to convert the present manufacturers' sales tax to a wholesale tax, i.e., to one imposed upon sales to retailers.

The recommendation which was encountered most frequently in submissions was to improve the sales tax at the present manufacturers' level. The improvements most often suggested were the following:

(i) the licensing of importers so that they become liable for tax on their sales in Canada;

(ii) the expansion of the definition of "manufacturer" to include those persons who are private branders or who perform marginal manufacturing operations on goods bought for resale, so that tax becomes payable on their sales; and

(iii) the provision of an effective appeals mechanism.

While this approach has the considerable merit of maintaining in large measure the structure with which taxpayers have become familiar, it suffers from some very serious defects. For example, the proposal to license all importers is tantamount to adopting a wholesale tax for importers, while leaving the tax on domestic producers at the manufacturers' level. This would not likely be acceptable to Canada's GATT partners. It would also be difficult to establish a quasi-wholesale tax on a selective basis in order to bring certain classes of persons within the taxing ambit of a manufacturers' tax. Finally, because goods are marketed at different trade levels, neutrality or non-discrimination under a manufacturers' tax would require very substantial reliance upon notional values. Such values are quite incompatible with an effective appeals mechanism.

These considerations make it difficult to accept the recommendation to improve the commodity tax system while retaining it at the present manufacturers' level. In consequence, the matter should be given further detailed consideration. To facilitate that consideration, the report of the Commodity Tax Review group will be tabled in the House of Commons shortly in order that all concerned may have access to the detailed analyses contained in that report. The report will be referred to an appropriate standing committee of the House, in order that the government may benefit from the committee's assessment before it decides on the most appropriate course of action.

Tariff Changes

In 1973 tariffs were reduced temporarily on a wide range of consumer products in order to moderate the upward pressure on prices. The measure was extended by the last budget to June 30, 1977. The reductions applied to such food products as sugar, prepared cereal foods, biscuits, certain vegetables and some fish products. In the non-food sector, the cuts covered such products as drugs and pharmaceuticals, kitchen and dinnerware, hand tools, photographic equipment and sporting goods.

Most of these reductions will be continued until June 30, 1978. However, in view of serious import competition, the tariffs on light fixtures will revert to their previous levels on July 1 of this year. The temporary reductions on refined sugar will also be modified as of the same date to provide Canadian refiners with the net amount of protection recommended by the Tariff Board. This means that the tariff on refined sugar will be increased by one-fifth of a cent per pound.

Extension of the reductions is not expected to injure Canadian industry. In case problems do arise, authority is again being sought to withdraw by Order in Council any reductions which have serious effects on employment or production in Canada.

The continuation of these temporary tariff reductions will not detract from Canada's position in the current multilateral trade negotiations in Geneva. Canada will be negotiating on the basis of the tariff rates which appear in the schedules to the General Agreement on Tariffs and Trade rather than the rates now in effect on a temporary basis.

An existing tariff provision accords free entry to goods imported by Canadians returning from extended periods of residence abroad. An amendment will restrict free entry to articles valued individually at $7,500 or less in order to prevent abuses of this provision.

In the last budget, compressor sets and electricity generating sets from Britain and Ireland were made subject to the Most-Favoured-Nation tariff. At that time, it was announced that the Department of Finance would conduct a review of the 2 1/2 per cent British Preferential rate on other machinery. This review has identified certain other machinery and related equipment where Canadian manufacturers are facing serious difficulties due to competition from imports from Britain under the preferential rate. Such imports from Britain and Ireland will therefore be made subject to the 15 per cent M.F.N. tariff immediately. However, when machinery within these categories is not available from Canadian sources the duty can be remitted under the Machinery Program. A number of other tariff changes are referred to in the Ways and Means Motion.

Two policy issues are being referred to the Tariff Board for study. The first is the coverage of tariff item 69605-1 which provides duty-free entry for a wide range of scientific apparatus, preparations and other goods imported by or for qualified users, such as religious, educational and scientific institutions and public hospitals. This item was recently amended in Bill C-15 as it related to scientific preparations. When it became evident that this amendment was not having the desired effect, temporary relief was provided by Order in Council under the Financial Administration Act. The item will be further amended to give statutory effect to the Order in Council pending review of the item in its entirety by the Tariff Board.

The second study will concern the tariff treatment accorded to hobby equipment, antiques and other collectors' items. As an interim measure, duty-free provisions for antiques will be amended to cover articles more than 50 years old.

Continued study will be given to according duty-free entry to traditional ethno-cultural costumes when imported by ethno-cultural groups. The precise scope of any such measure will be determined after consultation with interested parties.

Efforts to help developing countries improve their export earnings are a priority in the current Geneva negotiations. Most developed countries already have, or are about to implement concessions to this end. Certain amendments to the Customs Tariff will give immediate effect to tariff reductions which Canada has offered to the developing countries. Products covered include processed coffee, bulk orange juice concentrate, bananas, wood veneers and hand-hooked carpets.

In general the multilateral trade negotiations are not moving ahead as rapidly as originally envisaged. They are expected to become more active later this year. These are important negotiations. Canada's growth and prosperity are heavily dependent on foreign trade. To reap the benefits of scale and specialization and to improve productivity, the manufacturing and processing industries need better access to large foreign markets.

Many businessmen and workers are concerned that reductions in Canadian tariffs and other trade barriers will create economic dislocation. The government is considering how best to ensure that economic adjustments needed to adapt to a more liberal international trading environment are carried out without undue hardship to Canadian firms and workers. However, Canada cannot afford to adopt a protectionist attitude towards imports. Canadian trade barriers will have to be lowered in return for concessions by other countries.

The government is consulting with provincial governments, Canadian producers and manufacturers, labour unions and other interested parties concerning the negotiations. These consultations will intensify in the coming months. Canadian businessmen should identify not only the problems they may face from increased competition from imports, but also the benefits which should be sought for their exports. In these wide-ranging negotiations, which will set the trade rules for the 1980s, Canada will be looking for substantial reductions in other countries' tariff and non-tariff barriers.

The Economic and Fiscal Outlook

The measures contained in the budget will help to quicken the pace of economic recovery. Consumer spending will be sustained and investment stimulated. If domestic costs are kept under control, the decline in the exchange rate will enable Canadian firms to compete on a more equal footing with their competitors abroad. With sustained growth in the economies of Canada's trading partners, a further improvement in the trade balance and a reduction in the current account deficit can be expected. Output in Canada will thus begin to rise again at the annual rate of 5 per cent or more as is needed to bring down the rate of unemployment, but the rate of growth is expected to pick up during the course of the year.

Given the time lags involved, this may not happen at once. For 1977 as a whole, the gross national product is likely to be 4 per cent or more higher in volume and 11 per cent higher in value than in 1976. Employment is expected to be about 150,000 higher on average this year than last but the increase between late 1976 and late 1977 could be as high as 250,000.

At present the cost of living is being affected by renewed increases in food prices and by higher energy prices. The decline in the exchange rate is also having its effect on the prices paid in Canada. But as long as cost increases, especially increases in labour costs, keep coming down, the underlying trend towards lower inflation will reassert itself.

The government's fiscal position, on both the Public Accounts and National Accounts bases, is displayed in the standard summary budget tables in this section of the document. The tables show actual figures for fiscal year 1975-76, estimates for 1976-77, and the forecast for 1977-78. The fiscal year is just on the point of closing and the estimates for 1976-77 are still very preliminary.

In 1976-77, it is now estimated that financial requirements excluding foreign exchange transactions will amount to $5.35 billion. This compares with the $4.5 billion forecast in the budget of last May. As noted in the discussion of government expenditures, outlays were lower than forecast last May by some $750 million. However, this saving on outlays was more than offset by the shortfall of revenues from the original budget forecast. Somewhat lower levels of certain economic variables, including corporate profits, than anticipated last May contributed significantly to the revenue shortfall. A larger part of the shortfall, however, was due to an overestimate of the elasticity of the personal income tax to its tax base. The correction of this upward bias in forecasting methods, and the resulting downward revision in the rate at which personal income tax revenues are expected to grow in the future, obviously has continuing implications. It is one of the reasons why financial requirements are no longer expected to decline between 1976-77 and 1977-78, as anticipated at the time of last May's budget.

For 1977-78, total financial requirements excluding foreign exchange transactions now are expected to increase to $6.4 billion. The tax reductions in the budget have directly added some $1.17 billion to financial requirements and are, of course, one cause of the low rate of growth of budgetary revenue. Revenues are also reduced by the new federal-provincial fiscal arrangements, as are expenditures. The transfer of personal income tax points to the provinces reduces the expected rate of growth of personal income tax revenues in 1977-78 by 11 1/2 percentage points. On a cash basis, the reduction in federal revenues as a result of the new arrangements is approximately $700 million greater than the reduction in expenditures in 1977-78. This net transfer to the provinces increases in subsequent years. Even if federal outlays are adjusted upwards to eliminate the effect on expenditures of the new fiscal arrangements, the share of federal outlays in GNP would still show a reduction in 1977-78.

In 1976-77 and 1977-78, the federal government's fiscal position on the National Income and Expenditure Accounts basis displays rather similar trends to the position on the Public Accounts basis. The 1976-77 deficit on the National Accounts basis is expected to rise from $4.5 billion in 1976-77 to $5.7 billion in 1977-78.

In addition to the basic Public Accounts and National Accounts tables presented below, a number of supplementary tables on the fiscal position are included in the Appendix. The components of budgetary revenues are shown in the first table. This is followed by the Extended National Accounts presentation, introduced last year, which provides information on the factors involved in the difference between the National Accounts balance and total financial requirements. The remaining supplementary tables provide a reconciliation of the differences between the revenues, expenditures and non-budgetary transactions on the Public Accounts and Extended National Accounts bases.

With the indexing of the personal income tax providing an automatic federal tax cut of more than $900 million, and with the net transfer of fiscal resources to provinces under the new federal-provincial fiscal arrangements, financial requirements and the National Accounts deficit would have stayed rather high in 1977-78 even in the absence of the tax reductions put forward in the budget. In other words, the federal fiscal stance prior to the measures remained quite expansionary. The increases in financial requirements and in the National Accounts deficit in the forecasts presented below, which take account of the measures announced in the budget, reflect a fiscal policy stance which provides a moderate injection of further stimulus to the economy in 1977.

Table 10
Government of Canada
Summary Statement of Transactions
Public Accounts Presentation

	1975-76 Actual	1976-77 Estimate(1)	1977-78 Forecast(1)
		($ millions)	
Budgetary Transactions			
Revenues	29,956	32,595	34,740
Expenditures(2)	-33,979	-39,200	-41,900
Surplus or Deficit (-)	-4,023	-6,605	-7,160
Non-Budgetary Transactions			
Loans, Investments and Advances(2)	-3,305	-2,200	-2,550
Annuity, Insurance and Pension Accounts	1,021	2,310	1,850
Other Transactions	1,712	1,145	1,460
Net Source or Requirement (-)	-572	1,255	760
Financial Requirements (Excluding Foreign Exchange Transactions)	-4,595	-5,350	-6,400
Foreign Exchange Transactions	-190	610(3)	
Total Financial Requirements	-4,785	-4,740	

(1) Numbers in these columns should be interpreted as mid-points of ranges of estimates. No forecast is made of the cash requirements of the Exchange Fund Account.
(2) Total outlays are composed of budgetary expenditures plus loans, investments and advances.
(3) This figure reflects transactions to the end of February.
Note: Direct market borrowing, of $40 million in 1975-76 and $390 million in 1976-77, by agent corporations, specifically Petro-Canada and the Export Development Corporation, which have been authorized to borrow under their respective statutes, are not included in Government of Canada financial requirements.

Table 11
Government of Canada
Revenues and Expenditures
National Accounts Basis

	1975-76 Actual	1976-77 Estimate(1)	1977-78 Forecast(2)
		($ millions)	
Revenues			
Direct Taxes, Persons	15,974	18,865	19,475
Direct Taxes, Corporations	5,145	5,080	5,600
Direct Taxes, Non-Residents	484	520	575
Indirect Taxes	8,045	8,560	9,190
Other Current Transfers from Persons	7	10	10
Investment Income	2,229	2,650	3,000
Capital Consumption Allowances	442	500	550
Total Revenues	32,326	36,185	38,400
Expenditures			
Current Goods and Services	8,841	9,950	11,050
Transfer Payments to Persons	11,011	12,075	13,725
Subsidies	3,013	2,375	2,525
Capital Assistance	287	310	325
Current Transfers to Non-Residents	562	575	625
Interest on the Public Debt	3,725	4,650	5,350
Transfers to Provinces	7,480	9,295	8,900
Transfers to Local Governments	147	180	225
Gross Capital Formation	1,246	1,250	1,375
Total Expenditures	36,312	40,660	44,100
Surplus or Deficit (–)	–3,986	–4,475	–5,700

(1) Numbers in this column are based on the official national accounts statistics, issued by Statistics Canada, for the first three quarters of the fiscal year, and on Department of Finance estimates for the final quarter.
(2) Numbers in this column should be interpreted as mid-points of ranges of estimates.

The government borrowed a total of $4,850 million in the capital markets in the past fiscal year. The thrust of debt management policy during this period was to increase reliance on marketable securities as a source of borrowed funds and to broaden the market for Government of Canada marketable securities, including Treasury Bills.

Amounts totalling $2,290 million and $1,760 million were raised through the issue and sale of marketable bonds and Treasury Bills respectively, while only $800 million or 17 per cent of the total amount of funds raised in the capital markets was through sales of Canada Savings Bonds. In fiscal 1975-76, by comparison, about $2,650 million or 57 per cent of the total amount of funds raised in capital markets was through sales of Canada Savings Bonds.

During the past fiscal year marketable bond issues were tailored to meet the portfolio preferences of investors outside the banking system. Treasury Bills became more competitive in yield with other money market securities. As a result a substantial increase occurred in general public holdings of Government of Canada marketable bonds and Treasury Bills. The financing of the government's borrowing requirements in fiscal 1976-77 did not prevent the Bank of Canada from controlling the growth of the money supply.

It is anticipated that the proportions of new funds raised in capital markets through the issue and sale of Canada Savings Bonds, Treasury Bills and marketable bonds in fiscal 1977-78 will be broadly comparable with fiscal 1976-77. These financing plans should not impede the Bank of Canada's efforts to maintain growth rates of key monetary aggregates within the appropriate target range.

APPENDIX

Government of Canada Fiscal Position Supplementary Tables

Table 1
Public Accounts
Budgetary Revenues

	1975-76 Actual	1976-77 Estimate(1)	1977-78 Forecast(1)
		($ millions)	
Personal Income Tax	12,709	14,885	15,620
Corporation Income Tax	5,748	5,210	5,760
Non-Resident Tax	481	450	500
Customs Duties	1,887	2,045	2,350
Sales Tax	3,515	3,975	4,440
Other Duties and Taxes	2,753	2,620	2,460
Total Tax Revenues	27,093	29,185	31,130
Non-Tax Revenues	2,863	3,410	3,610
Total Budgetary Revenues	29,956	32,595	34,740

(1) Numbers in these columns should be interpreted as mid-points of ranges of estimates.

Table 2
Summary, Extended National Accounts Presentation

	1975-76 Actual	1976-77 Estimate(1)	1977-78 Forecast(2)
		($ millions)	
Current Transactions			
A. Revenues	32,326	36,185	38,400
B. Expenditures	-36,312	-40,660	-44,100
Surplus or Deficit (-)	-3,986	-4,475	-5,700
Loans and Other Transactions			
A. Loans, Investments and Advances	-2,836	-2,022	-2,245
B. Cash vs Accruals	2,068	795	1,319
C. Other Transactions	159	352	226
Net Source or Requirement (-)	-609	-875	-700
Total Financial Requirements (Excluding Foreign Exchange Transactions)	-4,595	-5,350	-6,400
Foreign Exchange Transactions	-190	610(3)	
Total Financial Requirements	-4,785	-4,740	

(1) Estimates for Current Transactions items in this column are based on the official national accounts statistics, issued by Statistics Canada, for the first three quarters of the fiscal year, and on Department of Finance estimates for the final quarter.

(2) Numbers in this column should be interpreted as mid-points of ranges of estimates. No forecast is made of the cash requirements of the Exchange Fund Account.

(3) This figure reflects transactions to the end of February.

Table 3
Revenues, Public Accounts and National Accounts Reconciliation

	1975-76 Actual	1976-77 Estimate(1)	1977-78 Forecast(1)
		($ millions)	
Budgetary Revenues — Public Accounts	29,956	32,595	34,740
Deduct			
Post Office Revenues and Deficit	-913	-1,120	-1,237
Deficit of Government Business Enterprises(2)	-158	-175	-190
Excess of Accruals over Collections			
Corporate Income Tax	-938	-58	-88
Oil Export Charge	-127	-10	-25
Add			
Government Pension and Social Security Receipts(3)	4,094	4,887	5,228
Capital Consumption Allowance	442	500	550
Miscellaneous Adjustments(4)	-30	-434	-578
Total Revenues — National Accounts	32,326	36,185	38,400

(1) Numbers in these columns should be interpreted as mid-points of ranges of estimates.

(2) In the Public Accounts, deficits of government business enterprises are a charge to budgetary expenditures whereas in the National Accounts, these deficits are deducted from remitted profits of other government business enterprises.

(3) In the Public Accounts, the government pension and social security receipts and disbursements are treated as non-budgetary transactions whereas in the National Accounts, these transactions are included in government revenue and expenditure.

(4) These miscellaneous adjustments arise as a result of conceptual differences between the two forms of presentation. These items represent, for example, the proceeds from the sales of existing capital assets; budgetary revenue items offset against budgetary expenditures; imputed items; and, an adjustment for the treatment of revenue in the supplementary period.

Table 4
Expenditures, Public Accounts and National Accounts Reconciliation

	1975-76 Actual	1976-77 Estimate[1]	1977-78 Forecast[1]
		($ millions)	
Budgetary Expenditures — Public Accounts	33,979	39,200	41,900
Deduct			
Transfers to Funds and Agencies[2]	-1,938	-3,000	-2,850
Post Office Expenditures	-913	-1,120	-1,237
Deficit of Government Business Enterprises[3]	-158	-175	-190
Add			
Expenditures of Funds and Agencies[2]	1,375	1,394	1,537
Government Pension and Social Security Disbursements[4]	4,036	4,343	4,872
Capital Consumption Allowance	442	500	550
Miscellaneous Adjustments[5]	-511	-482	-482
Total Expenditures — National Accounts	36,312	40,660	44,100

(1) Numbers in these columns should be interpreted as mid-points of ranges of estimates.

(2) In the National Accounts, budgetary appropriations to various funds and agencies are replaced by the expenditure actually made by the funds and agencies.

(3) In the Public Accounts, deficits of government business enterprises are a charge to budgetary expenditures whereas in the National Accounts, these deficits are deducted from remitted profits of other government business enterprises.

(4) In the Public Accounts, the government pension and social security receipts and disbursements are treated as non-budgetary transactions whereas in the National Accounts, these transactions are included in government revenue and expenditure.

(5) As in the case of revenues, the miscellaneous adjustments arise as a result of conceptal differences between the two forms of presentation. These items represent, for example, reserves and write-offs; purchase of existing capital assets, budgetary revenue items offset against budgetary expenditure; expenditures of reserve accounts and revolving funds; imputed items; and, an adjustment for the treatment of expenditures in the supplementary period.

Table 5
Non-Budgetary, Public Accounts and Extended National Accounts Reconciliation

	1975-76 Actual	1976-77 Estimate(1)	1977-78 Forecast(1)
		($ millions)	
Non-Budgetary Transactions — Public Accounts	572	-1,255	-760
Deduct			
Loans and Advances to Funds and Agencies	-469	-178	-305
Government Pensions and Social Security Accounts	955	2,249	1,780
Excess of Accruals over Collections			
Corporate Income Tax	-938	-58	-88
Oil Export Charge	-127	-10	-25
Miscellaneous Adjustments(2)	616	127	98
Loans and Other Transactions — Extended National Accounts	609	875	700

(1) Numbers in these columns should be interpreted as mid-points of ranges of estimates.

(2) As in the case of revenues and expenditures, the miscellaneous adjustments arise as a result of conceptual differences between the two forms of presentation. These items represent, for example, the adjustments for the treatment of revenues and expenditures in the supplementary period; the change in the reserves and revolving funds; and the adjustment required to bring financial requirements of entities included in the national accounts government sector in line with the requirements of these entities which are met through the Consolidated Revenue Fund.