Budget Speech

delivered by the Honourable Jean Chrétien
Minister of Finance
in the
House of Commons

November 16, 1978

Department of Finance
Canada

Ministère des Finances
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Mr. Speaker,

I welcome this opportunity to place before the House an assessment of the state of the Canadian economy and my proposals for improving our economic performance.

In recent weeks I have travelled to many parts of Canada. I have talked to many Canadians—my provincial colleagues, businessmen, labour leaders, economists and laymen. Everywhere I have been told that my budget must be responsible, that it should create an atmosphere of stability and certainty in the country and that it should aim at lowering costs, including the costs of goverment.

The General Economic Situation and Outlook

Let me begin by reviewing our current economic situation. The economy in 1978 made much progress, although the results have fallen short of my earlier expectations.

It is true that employment has risen strongly. In October, 362,000 more Canadians had jobs than a year earlier. A larger proportion of Canadians is working now than ever before, but unemployment is still too high.

The increase in the gross national product in current dollars is likely to be close to the 11 per cent I forecast in the April budget. But prices have risen by more and output has gone up by less than was forecast at that time.

The prices of the things we produce are likely to be up about 6½ per cent. The growth in output should be close to 4 per cent. We had a slow first quarter when the United States economy was depressed by the coal strike. We have not been able to catch up fully since.

The consumer price index rose more sharply than had been expected. In September, it was 8.6 per cent higher than a year earlier. This renewed outburst of inflation was not the result of any acceleration in our own incomes or our own domestic costs. It was the result of higher food prices and the decline in the dollar.

This faster rise in the CPI reduced the growth rate of real income and real purchasing power of Canadians. The result was that consumer spending rose by less than had been expected, and this was the main reason for the shortfall in growth. Consumer spending has risen this year, in real terms, by 3½ to 4 per cent. Employment is higher and personal income taxes have been cut. A special stimulus has been provided by the temporary reductions in provincial sales taxes, largely financed by my April budget. But higher prices of food and other imported consumer goods have weakened the impact of these expansionary forces.

Since the Bonn summit, several countries have taken measures to stimulate their economies. Growth is expected to be rather more rapid in 1979 than in 1978 outside of North America. But it will slow down in the United States. The outlook is for expansion in Canada at a greater rate than in the United States next year. But because our most important trading partner will be growing more slowly, it will be hard for us to reduce the slack in our economy. Moreover, our trade balance will not improve as rapidly as it should, given our improved competitive position. In these circumstances, we must get better access to the markets of other countries, especially those which continue to run very large trade surpluses. The success of the Tokyo Round of trade negotiations remains critical to us. In our bilateral relations with other countries, we will press hard for greater opportunities to trade.

We have been through a period of great disturbance in international financial markets. The American dollar has come under severe downward pressure. The United States government has taken steps to rectify the situation, including sharp increases in interest rates. Our own situation has necessarily been made more difficult by the higher interest rates that have accompanied our efforts to control the rate of monetary expansion and maintain an appropriate relationship with interest rates in other countries.

Laying the Basis for Future Growth

While recognizing the setbacks and difficulties we have encountered, I want to emphasize that Canada has made great progress since the introduction of the Anti-Inflation Program in 1975. We have been getting the fundamentals right and laying the basis for sustained growth in the 1980s.

In the last three years the Bank of Canada has gradually reduced the rate of growth of the money supply. It has set target ranges for monetary expansion, successively reduced them and consistently succeeded in staying within them.

Expenditures by all levels of government have been brought under tight control. The growth of total federal outlays has been held to less than the growth of the gross national product (GNP) since 1976-77 owing in large part to the tough leadership of my colleague, the President of the Treasury Board.

The ceiling on total outlays for next year has been established at $52.6 billion, an increase of 8.9 per cent over this year's ceiling. This increase is well below the expected growth of the GNP. Many programs will have to make do with a lower level of real resources; some activities have been eliminated. We are having to cut back on the rapid growth in our transfers to the provinces. Even so, our expenditure budget is coming under great pressure from the rising cost of our statutory programs, especially interest on the public debt. There can be no weakening in our determination to keep expenditures under tight control.

Average increases in wages and salaries have been brought down from a high of 15 per cent to 6 per cent in the last year of controls. I do not attribute all of this to our prices and incomes policy, because no doubt there would have been some slowdown in any event. But I am sure that controls made a contribution to the process. That appears to be the view of economists who have closely examined the record.

While domestic costs were being brought under better control, the decline in the exchange rate reversed the loss of competitiveness which we suffered earlier in the decade. Canadian firms are now in a good position to increase their sales in foreign markets and win back the share of our domestic markets which they had lost to foreign competitors. This is already happening. The good September trade figures suggest that we will have a record trade surplus this year of close to $4 billion.

Industrial Policy

Our manufacturing industries are benefitting most from this improvement in our competitive position. They suffered most when we priced ourselves out of world markets. The decline in manufacturing output and employment was a major concern, but the latest data show a turnabout in the past year. Manufacturing production in August was 7 per cent higher than a year ago. New orders have risen sharply. Capacity utilization is back up to 86.4 per cent, which is above the long-term average. Manufacturing employment in October was up 110,000 or 5.7 per cent over a year ago.

The government has recognized the strategic importance of the manufacturing industry and provided assistance to it in many ways—through the tax system, through the Export Development Corporation, the Federal Business Development Bank and the Enterprise Development Program. In the reallocation of government expenditures announced September 8, we set aside an additional sum of $300 million to assist industry to exploit new markets, to develop new technology and to reorganize to meet the challenges which lie ahead. This will reinforce the measures contained in the last two budgets which have provided generous tax incentives for research and development.

I am frankly skeptical about the search for a single grand industrial strategy in a competitive market system. But we must have a set of sensible industrial policies, designed to provide a healthy framework for all industries and specific incentives tailored to particular needs. This government has gone a long way to putting these in place, and I will go further tonight.

The effective process of consultation between business, labour and government launched by my colleague, the Minister of Industry, Trade and Commerce, is contributing to the further development of our industrial policies.

Energy

There is good news from another critical sector of the economy—energy. The massive increase in world energy prices in the early 1970s created severe difficulties for all consuming nations. Because we are relatively rich in energy, we have been able to cushion the shock by phasing in higher prices gradually. At the same time, we have provided generous incentives to spur the development of new energy sources and we have put in place a number of conservation measures to restrain demand.

Our policies are working. In contrast to the perspective only two years ago, the outlook for energy self-reliance and the sector's contribution to our economic performance are most encouraging.

This is true of all the main energy sources, but particularly of oil and gas.

According to the National Energy Board, domestic oil shipments to Montreal can continue until at least 1995 and exports of light oil could be maintained at 55,000 barrels per day for three years. Compared with the Board's 1977 forecast, the new figures indicate the basis for an improvement in our trade balance of more than $2 billion in total over the next three years.

Honourable Members will be aware that the National Energy Board is holding hearings on the supply and demand for natural gas and is expected to report in February. There is mounting evidence that our reserves of natural gas are significantly more than estimated just a few years ago. The indications are that there may be more than enough to meet our foreseeable domestic needs. But the whole magnitude of our reserves remains to be determined. Primary emphasis must be laid on expanding the use of gas in Canada, and this in itself will displace imported oil. The favourable trade effects of the new gas outlook will be sustantial. For example, an additional 500 millions cubic feet per day, whether used to displace imported oil or for exports, would improve our trade surplus by $500 million a year.

Growing Confidence in the Economy

All of these developments are building the greater confidence in our medium-term prospects which I found in my pre-budget consultations. There is a growing faith that Canada can launch itself on the sort of sustained expansion which I portrayed for the February meeting of First Ministers.

We should not underestimate the strength of the expansionary forces that are at work. A powerful stimulus to sound economic growth is now coming from a more competitive dollar. This will not only improve our trade performance: it will also lead to more investment as Canadian firms increase their productive capacity and modernize their equipment in order to take advantage of the new opportunities.

A recent survey showed that 300 large corporations are planning to increase their spending on plant and equipment next year by 16 per cent. Allowing for rising costs, this represents a substantial increase of about 8 per cent in the volume of investment. I welcome this evidence that firms are pressing ahead in 1979 with the investments we will need in the 1980s. We should do all we can to encourage this development. We must respond to the particular problems confronting individual sectors of the economy. We must strengthen our efforts to encourage investment and growth in the less favoured regions.

The Outlook for Costs and Prices

Our most immediate challenge, however, is to hold onto the gains we have been making in our competitive position, as we come to the end of mandatory controls over prices and incomes. Decontrol is not an easy business at the best of times; our phased approach was designed to reduce the chances of a post-control bulge. It is all the more difficult when we have been through a surge in the cost of living, caused not by any acceleration in our domestic costs, but by the rise in food prices and the fall in the dollar.

These unfavourable influences are coming to an end. We have already seen some decline in food prices in August and September which brought about a welcome pause in the rising cost of living. A great deal more stability is expected from now on if crops are normal around the world.

There is good reason to believe that the major adjustment in the exchange rate that was required to restore our competitive position has been completed.

This can only have a lasting effect if the feedback on the domestic economy from the higher price of imports and export-related goods does not result in a fresh outbreak of large, leap-frogging wage and price increases in Canada.

Steadier food prices and a steadier exchange rate will mean that we have every chance of a much lower rate of inflation emerging even though we will probably see a jump in the cost of living for October. This will be mainly because of the ending of provincial sales tax cuts. But that should be no more than a temporary interruption of the trend unless we Canadians become unreasonable in our income demands.

In the last year, wage increases in Canada have been lower than those in the United States. So far, post-control wage settlements are showing only a very modest acceleration. I commend labour and management for the responsibility they have shown; increased competitiveness means more jobs. The federal and provincial governments agreed in February that compensation in the public sector should follow rather than lead the private sector.

While I urge Canadians to exercise self-discipline in their income demands, I would stress the fact that Canadian workers have done well in the last three years. Real disposable income per employee in Canada has increased by over 7 per cent. In the United States real disposable income per employee has declined by nearly 2 per cent in the same period.

Even so, there is some risk that we will launch ourselves again on a price-wage spiral which will undo all the progress we have made. We must reduce the rate of inflation to 6 per cent as soon as possible, but it will not be good enough to stabilize the rate of inflation at that level. Inflation must keep on declining if we are to expect really good economic performance.

Fiscal Policy Choices

I have now spelled out in some detail the economic background to this budget as I see it. In considering what action I should take on taxes, the obvious question is how much room do I have.

A wide range of views on this question has been put to me in my recent talks. I have been urged to cut taxes massively in order to stimulate the economy. Given the expansionary forces which are already at work, I do not think this would be wise, particularly when our cash requirements are so high.

On the other hand, I have been told that I should do nothing to add to the $9.7 billion of cash requirements already forecast for 1979-80. But action is needed now to encourage investment, to respond to the needs of sectors and regions, and to keep our costs competitive, while reducing our cash requirements from the present high level.

I believe I have some room because of the efforts we have made to reduce our expenditures. I think we should share these savings with the public.

I would like now to turn to the tax measures that I am proposing tonight. Let me begin with personal income taxes.

Personal Income Tax

Mr. Speaker, an outstanding feature of our personal tax system is the inflation indexing of personal income tax exemptions and brackets. Canada is one of the very few industrialized countries that provide such indexing. Since its introduction in 1974, indexing has reduced the taxes paid by Canadians by billions of dollars.

I would like to announce that the indexing factor for 1979 will be 9 per cent. As a result, for example, the total personal exemptions for a family of four will increase by $490 to $5,970. This indexing adjustment will also increase the $200 child tax credit to $218 per child payable in the spring of 1980.

Indexing will reduce federal taxes paid by Canadians by about $1.2 billion for the 1979 taxation year. It will also reduce provincial income taxes in those provinces with tax collection agreements by some $400 million. As a result of these built-in reductions, Canadians will pay a lower share of their total income in taxes next year.

I have a further announcement to make with relation to personal income tax. Taxpayers are currently permitted an employment expense deduction of 3 per cent of wage and salary income with a maximum deduction of $250. I am proposing to double the maximum for this deduction from $250 to $500 for 1979 and subsequent taxation years.

This change will benefit most working Canadians. It is estimated that it will reduce their taxes by $270 million in 1979-80.

Honourable Members expressed concern at the time of the last budget over the taxation of registered retirement savings plan (RRSP) proceeds. This concern was directed toward the situation where both parents die, leaving behind minor or disabled children. I undertook to review the situation. I now propose that the provisions be amended for the benefit of these children.

Unemployment Insurance Premiums

Employees and employers will also benefit from a cut in unemployment insurance premiums. On behalf of my colleague, the Minister of Employment and Immigration, I am pleased to announce that the weekly employee rate for 1979 will be reduced from $1.50 per $100 of insurable earnings to $1.35. The employer rate will be reduced from $2.10 to $1.89. The effect of this will be to increase take-home pay and reduce costs to employers by about $300 million in 1979. The built-in reductions in personal income tax, the increase in the employment expense deduction, and the cut in unemployment insurance premiums will improve the take-home pay of Canadians by about $2 billion in 1979. The great majority of Canadians now recognize the inflationary impact of too rapid a rise in money incomes. I am confident that they will take into consideration these improvements in disposable income in setting their income demands over the year ahead.

Tax Structure Changes

Mr. Speaker, I come now to important structural tax changes. A stable tax system is essential for economic growth and development. It must be equitable. It must reward initiative and enterprise. Defects in the system and unchecked abuses lead to unfairness. Special tax incentives that miss their target do more harm than good. For these reasons, tax system stability cannot mean leaving the system unchanged.

We have to keep the tax system under constant review. I am releasing tonight two major studies made by my officials. One is a study that lay behind the decision of the government to introduce the refundable child tax credit. The second makes a comprehensive comparison of the Canadian and United States tax systems. Mr. Speaker, this second study destroys a myth. It shows conclusively that the Canadian personal tax system compares most favourably with that of the United States. I have also found that our business taxes are fully competitive. Our system is basically sound. There is, however, need for certain changes—some of a relieving nature and some not.

Commodity Taxes

First, certain changes are needed in federal sales and excise taxes. Some tax measures designed to conserve energy are not working as they should.

In my view the special 10 per cent excise tax on marine engines and private aircraft and the 5 per cent tax on motorcycles are having adverse economic effects. The contribution of these taxes to energy conservation has been minimal. I therefore propose to eliminate them, effective this evening. At the same time, I want to put all non-commercial users of gasoline on the same basis. I am therefore extending the special 7 cents a gallon excise tax on gasoline to aviation fuel for non-commercial uses.

To encourage energy conservation, storm doors, windows and automatic timer-control devices were exempted from federal sales tax. These exemptions have proven extremely difficult to control and to administer. For example, most glass used in new construction is now exempt from tax, even though it is less energy-efficient than solid-wall construction which is taxable. The exemptions will therefore be withdrawn effective tonight. Also, the sales tax exemption for insulation materials will apply only to items with genuine insulating properties. Solar-powered water heaters will be exempted from tax. These measures will increase the effectiveness of the government's energy conservation program.

Air Transportation Tax

An air transportation tax is currently used to help finance a widening range of airport services. Unfortunately, the costs of these services have been increasing rapidly. I have been asked by my colleague, the Minister of Transport, to take steps to improve cost recovery. For flights within Canada and to the United States, I am therefore proposing an increase in this tax to 15 per cent of the air fare, with a maximum of $15. For international flights, the tax will be increased to $12 with provision for a subsequent increase to $15. This is another step in an ongoing process to shift the costs of airport services from the general taxpayer to those who use the airports. These increases will come into effect after March 31, 1979.

Tariffs

I am not proposing to make any tariff changes in this budget, partly because the multilateral trade negotiations are now at a critical stage. However, I do expect to be introducing in the near future a new schedule of tariff rates for fruits and vegetables.

I announced in my last budget that we were entering into negotiations on these products with our trading partners, following an exhaustive study of the industry by the Tariff Board. These negotiations are well advanced and should be concluded shortly.

Corporation Income Tax

Let me turn now to several important structural changes in the area of corporation taxes.

As a result of tax benefits introduced by this government over the past few years, small businesses in Canada enjoy very favourable tax treatment. Small Canadian-controlled private corporations pay federal income tax at less than half the normal corporation rate. The dividends they pay qualify for the generous dividend tax credit. As a result, the total tax on income from small incorporated businesses is below the level of personal tax on the same amount of wage and salary income.

Mr. Speaker, the very generosity of the measures makes it essential to ensure that they are effectively targetted. Some individuals have rearranged their affairs simply to make their personal, professional and investment income eligible for taxation at the low small business rate. It would be wrong to allow such practices to continue.

I am introducing changes to the Income Tax Act to ensure that the application of the low corporate tax rate is reserved for those small businesses for whom it is really intended. These will include those engaged in manufacturing, processing, mining, construction, farming, fishing, logging, transportation, wholesale and retail trade and other businesses as may be prescribed. In this way the generous tax incentives will be maintained for small businesses that need capital to expand and create jobs. The new measure will apply to taxation years starting next year.

I have also concluded that it is essential to amend the Income Tax Act to change the treatment of income debentures and term preferred shares. These securities are currently treated as equities for tax purposes, even though they are essentially debt obligations. As a result, income earned on such securities by banks and other financial insitutions is tax-exempt. For the most part they are used for the financing of a relatively small number of multinational and large Canadian corporations. Their use has resulted in a very substantial loss of revenues to the federal and provincial governments. This has been of concern not just to me but also to my provincial colleagues.

The proposed amendments will generally apply to any such securities issued after tonight. They will not apply to issues outstanding or committed. Nor will they affect the tax treatment of common and ordinary preferred shares.

I am proposing other structural changes of a technical nature in the Notice of Ways and Means Motion which I am tabling tonight. One of the more important of these is a broadening of the deductibility of security underwriting expenses.

Sectoral and Regional Policy

Mr. Speaker, a strong industrial structure is vital to Canada's future. I have benefitted greatly from the sectoral consultations I have already referred to.

The recommendations of the 23 industry task forces and the report of the Second Tier Committee have been carefully reviewed in my department. The supplementary material contains a summary and analysis of the tax proposals in these reports. In response to the recommendations, I wish now to propose measures to improve efficiency, to lower costs and to promote a better distribution of economic activity across regions.

Investment Tax Credit

My first proposal concerns the investment tax credit. Since 1975 this credit has supported expansion and modernization of business. It is scheduled to expire on June 30, 1980.

I am now proposing to extend the credit indefinitely. This will provide benefits to manufacturing, the resource sector, farming and fishing.

But I want to go further. I therefore propose that the basic rate of the investment tax credit be raised from 5 to 7 per cent, effective immediately.

I also want to give increased support to regional development. For investments in areas designated under the Regional Development Incentives Act, other than in the Atlantic Provinces and the Gaspé, the credit will be raised from 7.5 per cent to 10 per cent. These areas include most of Quebec, all of Northern Ontario, Manitoba and Saskatchewan, parts of Northern Alberta and British Columbia and all of the Yukon and Northwest Territories. For Atlantic Canada and the Gaspé, the investment tax credit will be doubled from 10 to 20 per cent.

The importance of transportation was strongly emphasized by First Ministers last February. A modern and efficient transportation system is fundamental to prosperity throughout this vast country. I am therefore proposing that investment in equipment for rail, air, water and long-haul road transportation now qualify for the basic 7 per cent investment tax credit.

All these changes in the investment tax credit will confer benefits of $500 million in the first full year of application.

Research and Development

A common theme of the industry task forces to which I have already referred was the importance of adequate incentives for research and development.

The government has already moved a long way in this direction. A 100 per cent write-off of these expenditures has been in place for many years. The March, 1977, budget introduced tax measures to extend the investment tax credit to both current and capital expenditures on R&D.

In April of this year I provided a new 50 per cent deduction for firms which increase their R&D. The government has also announced a package of direct grants and subsidies for industrial R&D.

I am proposing to do more. The basic investment tax credit for R&D will be doubled, from 5 to 10 per cent. In the Atlantic Provinces and the Gaspé this credit will be 20 per cent. However, I want to provide a special measure of assistance for small business corporations. These corporations in all parts of Canada will qualify for an R&D tax credit of 25 per cent.

Resource Taxation

Let me turn now to the resource industries, and mining in particular.

Federal and provincial Finance and Resource Ministers have just concluded an in-depth review of the tax situation in mining. The federal tax system has been found to be basically sound. However, some changes could be introduced to spur the development of new ventures. I want to take the lead here. Following our recent meetings, I feel confident that provinces will do their part.

I propose that the current write-off for development expenditures in mining incurred after tonight be raised from 30 to 100 per cent.

Furthermore, I am proposing that for new mines, the costs of associated townsites and social assets earn depletion. I am also extending indefinitely the fast write-off for pollution control equipment, which will be of particular benefit to mining.

The regional increases in the investment tax credit are also of special value to this sector.

I want to assure the industry of the federal government's intention to pursue the spirit of federal-provincial cooperation established during the review. It is not my intention to initiate tax system changes that would create uncertainty. Nor will I offset the benefits from tax reductions that provinces may introduce.

In the area of oil and gas, there has been a significant response to the incentive for drilling funds. This incentive expires on June 30, 1979. I have concluded that we must continue to encourage a high level of exploration activity. I therefore propose that the incentives be extended to December 31, 1981.

Pulp and Paper

I am anxious that the pulp and paper industry take advantage of the very favourable situation created by the lower value of the Canadian dollar. It should use this opportunity to modernize and so guarantee its future competitiveness. The federal government and a number of provincial governments are working together to reduce the high cost of wood supply. They are also studying ways to strengthen and modernize the industry.

Two of the measures in this budget will contribute to these efforts. The increase in the investment tax credit, and its enrichment in slower-growth regions, will be of considerable benefit to the pulp and paper industry. In addition, the indefinite extension of the two-year write-off for water pollution abatement equipment is particularly helpful.

Housing

I want to announce two measures to reinforce the government's support for housing. First, the tax incentive for multiple-unit residential buildings will be extended for one year. Second, developers will be allowed to deduct the carrying charges incurred after tonight on their land inventory.

Manufacturers' Sales Tax

I now come to one of the most important tax measures in my budget. I am proposing to reduce the 12 per cent manufacturers' sales tax to 9 per cent, effective tonight. This will affect all goods now subject to the 12 per cent rate with the exception of alcoholic beverages and tobacco. Gasoline is not subject to the 12 per cent ad valorem rate and will not be affected. Construction materials will continue to be taxed at the low 5 per cent rate.

This sales tax measure will reduce taxes payable at the manufacturers' level by $280 million this fiscal year and by $1 billion in 1979-80.

In accordance with standard practice, my colleague, the Minister of National Revenue, has asked me to give notice that no claims will be entertained for refunds of tax in respect of goods on which the 12 per cent tax has been paid.

Unlike provincial sales taxes which apply at the retail level, the federal tax is levied on sales by manufacturers and importers. I want this cut to be passed on to consumers. That is why I have made a cut of significant size with no terminal date. Experience suggests that such tax cuts are passed on. I am appealing to manufacturers, wholesalers and retailers to make sure that the consumer gets the benefit. As well, I am asking the Department of Consumer and Corporate Affairs, the Anti-Inflation Board and the Centre for the Study of Inflation and Productivity to monitor the situation closely. Consumers themselves, by seeking out competitive price reductions, can help to make this measure effective.

Impact on the Economy

I estimate that the cut in the sales tax will reduce the increase in the consumer price index by one-half of one per cent. This comes on top of the proposed postponement of the oil price increase and the reduction in the gasoline excise tax which will have a similar impact.

These measures will have a direct effect on wage costs through cost-of-living clauses in wage contracts. More important, a somewhat lower rate of price increase will be helpful in moderating new settlements. The cut in income taxes as a result of indexing, the improved employment expense deduction and the reduction in unemployment insurance premiums will also help to relieve the pressures for large increases in money incomes.

I therefore believe that this budget will make a significant contribution to the containment of our domestic costs in the post-control era. This will enable us to take full advantage of the improvement in our competitive position that we have achieved.

My budget measures will, of course, provide a more direct stimulus to growth. Investment will be stimulated by the enriched investment tax credit. Consumption will benefit from the increase in the real spending power of Canadians as a result of the income and sales tax cuts.

I am projecting an increase in real output next year of between 4 and 4½ per cent. I would expect the number of jobs to increase by at least 250,000. I expect that the consumer price index will average 6½ per cent above the 1978 level, but the increase from the fourth quarter of this year to the fourth quarter of next year should be under 6 per cent.

My revenue forecasts are based on an increase of 11 per cent in the current dollar value of the gross national product.

The Fiscal Position

Mr. Speaker, I would like now to table projections of the government's revenues and expenditures, the Notice of Ways and Means Motion, supplementary information giving details of the measures proposed tonight, and the two studies I mentioned earlier. I would also like to ask for the consent of the House to include in Hansard the usual tables on the government's accounts together with the explanatory notes.

This fiscal year I expect financial requirements, excluding foreign exchange transactions, to total $12.1 billion. The increase from the $11.8 billion forecast in September is due to the sales tax cut and other measures announced tonight.

I am forecasting financial requirements for 1979-80 of $10,750 million. This is an increase of $1,050 million from my previous forecast of $9.7 billion. The loss of revenues from the measures I have announced tonight which had not been reflected in the previous forecast amounts to $1,380 million. But there is some offset arising from the favourable impact of these measures on the economy and from other minor adjustments since the last forecast.

The financial requirements in 1979-80 will thus decline by $1,350 million or 11 per cent from this year's level. If account is taken of the special factors relating to Canada Savings Bond interest, financial requirements would increase by about $350 million. The deficit on a national accounts basis is forecast to increase by $200 million.

These financial requirements are large, but their size must be kept in perspective. They are lower than this year and they are being incurred at a time when unemployment and interest rates are high. Moreover, the provincial governments are providing rather less stimulus than in the past, mainly because of the substantial surpluses of the resource-rich Western Provinces. With faster growth in the private sector in prospect over the medium-term, coupled with continuing expenditure restraint, significant reductions in the deficit can be expected.

I am confident that our financial requirements this year and next can be met without causing undue pressures on financial markets.

Concluding Remarks

Mr. Speaker, in the last three years Canadians have worked hard and responsibly to regain our competitive position in world markets. We are starting to reap the benefits. Our costs are now competitive and we have seen recently a great improvement in our balance of trade and a firming of investment plans.

At the February First Ministers' meeting and in discussions among government, labour and business an important consensus has developed. All sectors have come to recognize that to build a strong economy we must be competitive in international markets.

So, tonight I have brought down a budget to build further confidence and to ensure continued competitiveness.

Everyone agrees that the future is very good for Canadians. Our resources, our people, our institutions, and our freedom make us the envy of the world. Of course, there are problems. There always will be. But the potential for even greater prosperity is there, and I am confident that Canadians are prepared to act responsibly so we can continue to enjoy one of the highest standards of living anywhere, and to pass on to future generations a free, united and prosperous country.

Table 1
Government of Canada
Summary Statement of Transactions
Public Accounts Presentation

	1977-78 Actual	1978-79 Forecast[1]	1979-80 Forecast[1]
		($ millions)	
Budgetary transactions			
Revenues	32,846	35,200	38,150
Expenditures[2]	−42,882	−47,300	−51,100
Surplus or deficit (−)	−10,036	−12,100	−12,950
Non-budgetary transactions			
Loans, investments and advances[2]	−1,217	−1,000	−1,500
Annuity, insurance and pension accounts	1,626	1,975	2,820
Other transactions	1,357	−975	880
Net source or requirement (−)	1,766	—	2,200
Financial requirements (Excluding foreign exchange transactions)	−8,270	−12,100	−10,750
Foreign exchange transactions	1,007	3,021[3]	
Total financial requirements	−7,263	−9,079[3]	

(1) Numbers in these columns should be interpreted as mid-points of ranges of estimates.
(2) Total outlays are composed of budgetary expenditures plus loans, investments and advances.
(3) These figures reflect actual foreign exchange transactions to the end of October. No forecast is made of foreign exchange transactions in the balance of the period. The source of funds provided by Foreign Exchange Transactions in the first seven months of 1978-79 is largely accounted for by net sales of foreign exchange by the Exchange Fund Account. The EFA's holdings of foreign exchange result from purchases in the exchange market and from borrowing in foreign currencies by the government. This foreign currency borrowing amounted to $3,586 million in Canadian dollars from April 1, 1978 to October 31, 1978.

Table 2
Government of Canada
Fiscal Position
Public Accounts Budgetary Revenues

	1977-78 Actual	1978-79 Forecast[1]	1979-80 Forecast[1]
		($ millions)	
Personal income tax	13,440	14,280	16,130
Corporation income tax	5,828	6,220	6,785
Non-resident tax	503	540	580
Customs duties	2,312	2,780	3,120
Sales tax	4,427	4,650	4,435
Other duties and taxes	2,450	2,260	2,180
Total tax revenues	28,960	30,730	33,230
Non-tax revenues	3,886	4,470	4,920
Total budgetary revenues	32,846	35,200	38,150

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

Table 3
Government of Canada
Summary, Extended National Accounts Presentation

	1977-78 Actual	1978-79 Forecast[1]	1979-80 Forecast[1]
		($ millions)	
National Accounts Transactions[2]			
A. Revenues[3]	35,940	39,195	42,670
B. Expenditures[4]	−45,271	−49,725	−53,400
Surplus or deficit (−)	−9,331	−10,530	−10,730
Loans and other transactions			
A. Loans, investments and advances	−1,413	−640	−1,230
B. Cash vs Accrual	1,965	−1,180	1,010
C. Other transactions	509	250	200
Net source or requirement (−)	1,061	−1,570	−20
Total financial requirements (Excl. foreign exchange transactions)	−8,270	−12,100	−10,750
Foreign exchange transactions	1,007	3,021[5]	
Total financial requirements	−7,263	−9,079[5]	

[1] Numbers in these columns should be interpreted as mid-points of ranges of estimates.
[2] Referred to as 'Current transactions' in earlier budget speeches and issues of the Public Accounts. The change is intended to avoid inconsistency with standard National Accounts terminology.
[3] 'Total revenue' plus 'Capital consumption allowances' as per Statistics Canada's *National Income and Expenditure Accounts*.
[4] 'Current expenditure' plus 'Gros capital formation' as per Statistics Canada's *National Income and Expenditure Accounts*.
[5] These figures reflect actual foreign exchange transactions to the end of October. No forecast is made of foreign exchange transactions in the remainder of the period.

Table 4
Government of Canada
Revenues and Expenditures
National Accounts Basis

	1977-78 Actual	1978-79 Forecast(1)	1979-80 Forecast(1)
		($ millions)	
Revenues			
Direct taxes, persons	17,245	18,360	20,620
Direct taxes, corporations	5,229	5,730	6,375
Direct taxes, non-residents	544	610	670
Indirect taxes	9,153	9,735	9,705
Other current transfers from persons	14	15	15
Investment income	3,163	4,080	4,535
Capital consumption allowances	592	665	750
Total revenues	35,940	39,195	42,670
Expenditures			
Current goods and services	11,317	12,400	12,750
Transfer payments to persons	13,515	14,750	15,525
Subsidies	2,501	2,450	2,450
Capital assistance	382	525	675
Current transfers to non-residents	700	800	825
Interest on the Public Debt	5,472	6,950	8,250
Transfers to provinces	9,741	10,125	11,100
Transfers to local governments	390	375	400
Gross capital formation	1,253	1,350	1,425
Total expenditures	45,271	49,725	53,400
Surplus or deficit (–)	–9,331	–10,530	–10,730

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

Table 5
Government of Canada
Revenues, Public Accounts and
National Accounts Reconciliation

	1977-78 Actual	1978-79 Forecast[1]	1979-80 Forecast[1]
		($ millions)	
Budgetary revenues—			
Public Accounts	32,846	35,200	38,150
Deduct			
Post Office revenues and deficit	−1,237	−1,320	−1,360
Deficit of government business enterprises[2]	−200	−135	−140
Excess of accruals over collections			
Corporate income tax	−495	−430	−350
Oil export charge	−33	−5	−15
Add			
Government pension and social security receipts[3]	4,997	5,425	5,705
Capital consumption allowance	592	665	750
Miscellaneous adjustments[4]	−530	−205	−70
Total revenues—			
National Accounts	35,940	39,195	42,670

(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, these 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 6
Government of Canada
Expenditures, Public Accounts and National Accounts Reconciliation

	1977-78 Actual	1978-79 Forecast[1]	1979-80 Forecast[1]
		($ millions)	
Budgetary expenditures—			
Public Accounts	42,882	47,300	51,100
Deduct			
Transfers to funds and agencies[2]	−3,295	−3,275	−3,950
Post Office expenditures	−1,237	−1,320	−1,360
Deficit of government business enterprises[3]	−200	−135	−140
Add			
Expenditures of funds and agencies[2]	1,595	1,870	1,650
Government pension and social security disbursements[4]	4,995	5,520	5,530
Capital consumption allowance	592	665	750
Miscellaneous adjustments[5]	−61	−900	−180
Total expenditures—			
National Accounts	45,271	49,725	53,400

(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, these 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 conceptual 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 7
Government of Canada
Non-Budgetary, Public Accounts and Extended National Accounts Reconciliation

	1977-78 Actual	1978-79 Forecast(1)	1979-80 Forecast(1)
		($ millions)	
Non-budgetary transactions—			
Public Accounts	1,766	—	2,200
Deduct			
Loans and advances to funds and agencies	-196	360	270
Government pension and social security accounts	-1,638	-1,870	-2,830
Excess of accruals over collections			
Corporate income tax	495	430	350
Oil export charge	33	5	15
Miscellaneous adjustments(2)	601	-495	-25
Loans and other transactions—			
Extended National Accounts	1,061	-1,570	-20

(1) Numbers in these columns should be interpreted as mid-point 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.

Notes to Fiscal Tables

Comparison of Current 1978-79 Forecast with April 10, 1978 Budget Forecast
(Tables 1 and 2)

The current forecast of 1978-79 Budgetary Revenue of $35,200 million is $800 million below the level forecast in the April 10, 1978 budget. Some $435 million of this change represents the estimated impact of measures introduced since the April budget. The 3 per cent cut in the manufacturers' sales tax rate is estimated to reduce 1978-79 revenues by $280 million, while other changes in the budget cause a $30 million reduction. The reduction in the gasoline excise tax which took effect on August 25, 1978, the impact on the oil export charge revenues of the planned deferral of the January 1, 1979 oil price increase and the May 1978 small business tax measures are estimated to have reduced 1978-79 revenues by $125 million. (The child benefits tax changes announced August 24, 1978 are estimated to have little or no net impact on revenues in 1978-79).

The balance of the change in forecast revenues, some $365 million, reflects changes in economic assumptions, and revisions as a result of analysis of revenue collections data for the 1977-78 fiscal year which became available after April together with analysis of the revisions to national accounts economic series released in June by Statistics Canada. The largest changes resulting from these factors were a downward revision of personal income tax revenues reflecting, most importantly, analysis of final 1977-78 data, and an upward revision of customs import duties reflecting an upward revision of the forecast value of imports. Non-tax revenues were revised upward reflecting somewhat higher interest rates on government cash balances and higher cash balances than had been assumed at the time of the original forecast.

The government's expenditure ceiling is set in terms of Total Outlays, which is the sum of Budgetary Expenditures and Loans, Investments and Advances. As announced by the Minister of Finance and the President of the Treasury Board on September 8, 1978, the level of Total Outlays for 1978-79 has been reduced to $48,300 from the April ceiling of $48,450 million. However, within this total, Budgetary Expenditures have been revised up $400 million from April, while Loans, Investments and Advances have been revised down $550 million. The figure for Total Outlays includes reserves for revisions of the estimated costs of statutory programs and for supplementary estimates. At the beginning of the fiscal year, the appropriate division of these reserves between Budgetary Expenditures and non-budgetary Loans, Investments and Advances, is somewhat uncertain. In addition, it is now apparent that loan requirements, notably net loans to CMHC, will be lower than originally expected. A number of factors, including higher public debt charges resulting from foreign borrowing to supplement exchange reserves and from recent interest rate increases, have caused forecast Budgetary Expenditures to increase although the increase has been offset in some measure by the cuts in certain specific 1978-79 program costs announced in August and September.

The decrease in Budgetary Revenues of $800 million together with the increase of $400 million in Budgetary Expenditures results in a forecast Budgetary

Deficit which is $1,200 million higher than the deficit forecast in April. The $550 million reduction in loan requirements, together with a $275 million reduced source from the annuity, insurance and pension accounts (reflecting higher unemployment insurance benefits) and a $325 million reduced requirement for other transactions has partially offset the increased Budgetary Deficit, resulting in a forecast of Financial Requirements (excluding foreign exchange) which is $600 million higher than that forecast in April.

1979-80 Fiscal Outlook—Public Accounts Basis
(Tables 1 and 2)

Financial Requirements (excluding foreign exchange transactions) in 1979-80 are forecast to be $10,750 million, $1,350 million below the 1978-79 level. Underlying this Financial Requirements forecast are forecasts of 8.4 per cent growth in Budgetary Revenues to a level of $38,150 million, 8.0 per cent growth in Budgetary Expenditures to $51,100 million and an increased net source of $2.2 billion from non-budgetary transactions. The Budgetary Revenue forecast assumes growth in nominal GNP of approximately 11 per cent.

The levels of, and annual percentage changes in, the major components of Budgetary Revenues are shown below.

	1977-78 Actual	1978-79 Forecast		1979-80 Forecast	
	$ millions	$ millions	% change	$ millions	% change
Personal income tax	13,440	14,280	6.3	16,130	13.0
Corporation income tax	5,828	6,220	6.7	6,785	9.1
Non-resident tax	503	540	7.4	580	7.4
Customs duties	2,312	2,780	20.2	3,120	12.2
Sales tax	4,427	4,650	5.0	4,435	−4.6
Other duties and taxes	2,450	2,260	−7.8	2,180	−3.5
Total tax revenues	28,960	30,730	6.1	33,230	8.1
Non-tax revenues	3,886	4,470	15.0	4,920	10.1
Total budgetary revenues	32,846	35,200	7.2	38,150	8.4

The 13.0 per cent rate of growth of personal income tax revenues is influenced by the fact that 1978-79 revenues are reduced by $760 million through transfers to provinces and to Quebec taxpayers associated with the temporary provincial retail sales tax cuts. The 1979-80 yield of the tax is reduced $270 million by the higher level of the employment expense deduction, and there is a net reduction of $655 million due to the changes in child benefit provisions announced in August. On the other hand, 1979-80 revenues are raised by the fact that the tax payable on the large amount of CSB interest cashed in November 1978 will affect tax collections mainly in the first months of the 1979-80 fiscal year.

Following a projected increase of 6.7 per cent in 1978-79, corporation income tax revenues are forecast to increase 9.1 per cent in fiscal year 1979-80. The first year, or first full year, impact of tax measures introduced in March 1977, October 1977 and April 1978 has lowered expected revenue growth in 1978-79, as has the large increase in the use of income debentures. The measures in this budget are estimated to cause a net reduction in 1979-80 corporation tax revenues of $75 million.

The actual decline in sales tax revenues, of course, reflects the 3 percentage point rate reduction which is estimated to lower revenue by $1,015 million in 1979-80 compared with $280 million in the last part of 1978-79.

Other duties and taxes are forecast to decrease by 3.5 per cent in 1979-80, following a decline of 7.8 per cent in 1978-79. Falling oil export charge revenues and the impact of the 3 percentage point reduction in the special excise tax on gasoline are the principal factors causing these declines.

Non-tax revenues are projected to increase 10.1 per cent in 1979-80 compared to the projected 15.0 per cent increase in 1978-79. The dominant revenue source in this category is return on investments which is projected to increase at a 6.2 per cent rate in 1979-80, compared to a projected 22.2 per cent rate in 1978-79. The large 1978-79 increase reflects higher interest rates and increased government cash balances.

Budgetary Expenditures and non-budgetary Loans, Investments and Advances sum to the $52,600 million ceiling announced on September 8 in the joint statement by the Minister of Finance and the President of the Treasury Board. The increase in this Total Outlays ceiling is 8.9 per cent. Budgetary Expenditures are forecast to increase by 8 per cent and Loans, Investments and Advances by 50 per cent. The large increase in loan requirements basically reflects the return to a more normal level of net requirements by CMHC following the abnormally large repayments by that corporation in 1978-79 resulting from the sale of mortgages by CMHC from its existing holdings.

The source of funds provided by the annuity, insurance and pension accounts is expected to increase by $845 million over the 1978-79 level. By far the largest factor in this increase is a projected swing to surplus in the unemployment insurance account, reflecting the savings in unemployment insurance benefits from the tightening of entrance requirements and reduction in benefit levels which will result from Bill C-14. These savings are partially offset by the 10 per cent reduction in employer/employee premium rates.

Other transactions are expected to provide a net source of $880 million in 1979-80, a swing of $1,855 million from the previous year. The most important single factor here is the decline in the level of Canada Savings Bond interest encashments.

Canada Savings Bond Interest Encashment

In 1978-79, a total of $2,300 million in regular interest coupons, compound and bonus interest on the maturing SR and S24 series of Canada Savings Bonds is expected to be cashed. Approximately $2,050 million of this interest had been charged to budgetary expenditures in previous years, as public debt charges are calculated on an accrual basis. In 1979-80, bonus interest totalling an estimated $630 million will become payable on Canada Savings Bonds issued prior to November 1974 and still outstanding. Approximately $550 million of this amount will have been charged to Budgetary Expenditures prior to 1979-80.

When interest encashments exceed (fall short of) interest accruals in a given year, the government is faced with a cash requirement (source) which is recorded in the interest and debt accounts component of 'other non-budgetary transactions'. Thus, encashment of previously accrued regular, compound and bonus interest on the SR and S24 series is expected to give rise to a non-budgetary requirement of $2,050 million in 1978-79, and encashment of previously accrued bonus interest in 1979-80 is expected to give rise to a non-budgetary requirement of some $550 million in 1979-80. Previously accrued regular and compound interest on CSB series maturing in November 1979, and interim compound interest coupons on certain series, will also become payable in 1979-80. At the same time, in both 1978-79 and 1979-80 it is expected that interest accruals will exceed interest encashment by significant amounts on other CSB series, thus providing a source of funds to the government.

In total, the difference between interest accruing and interest cashed on Canada Savings Bonds provided a non-budgetary source of funds of $827 million in 1977-78, is estimated to give rise to a non-budgetary requirement of $1,395 million in 1978-79 and is projected to provide a source of some $300 million in 1979-80. (The latter projection depends on the fraction of the current CSB issue assumed to be sold in 'compound interest bonds' form. It is thus subject to considerable uncertainty.) The lack of an exact matching of interest accrual and encashment on the non-CSB portion of government debt (marketable bonds and treasury bills) can also give rise to a non-budgetary source or requirement of funds, although the effect is much smaller than for CSBs due to the lack of compound and bonus provisions on these other securities.

The year-to-year change in CSB interest accrual/encashment thus accounts for a $2.2 billion increase in Financial Requirements between 1977-78 and 1978-79, and for a $1.7 billion reduction between 1978-79 and 1979-80. Thus, apart from these CSB interest accrual/encashment effects, Financial Requirements will increase from 1977-78 to 1978-79 by $1.6 billion, and will increase from 1978-79 to 1979-80 by $350 million.

Direct Borrowing by Government Agencies

Direct market borrowings by agent Crown corporations which have been authorized to borrow under their respective statutes are not included in Government of Canada Financial Requirements. In 1977-78, the Export Development Corporation (EDC) borrowed $341 million directly, Eldorado Nuclear borrowed $40 million and Petro-Canada repaid $30 million. Over the first seven months of this fiscal year, EDC borrowed $350 million. In the projection of requirements for 1978-79 and 1979-80, it is envisaged that such direct borrowing will continue. In addition, the 1978-79 requirements for loans to the Central Mortgage and Housing Corporation are reduced due to the sale of mortgages by CMHC in that year.

Government Expenditures

Since 1976-77, the federal government has set its spending ceiling in terms of Total Outlays, the sum of Budgetary Expenditures and non-budgetary Loans, Investments and Advances. The following table shows the level of Total Outlays, the growth rate of Total Outlays and Total Outlays expressed as a percentage of current dollar GNP for the corresponding fiscal year.

Federal Government Total Outlays
Public accounts basis

	1975-76 Actual	1976-77 Actual	1977-78 Actual	1978-79 Forecast	1979-80 Forecast
			($ millions)		
Budgetary Expenditures	33,978	39,011	42,882**	47,300	51,100
Loans, Investments and Advances	3,310	2,171	1,217	1,000	1,500
Total Outlays	37,288	41,182	44,099	48,300	52,600
Percentage Increase	18.5	10.4	7.1**	9.5	8.9
Percentage of GNP*	21.7	21.0	20.5**	20.3	19.9

* GNP for corresponding fiscal year.
** Savings of approximately $700 million in 1977-78 Budgetary Expenditures resulted from the partial replacement of cash transfers to provinces by the transfer of additional tax points under the Established Programs Financing arrangement. Adjustment for this change would increase the 1977-78 growth in Total Outlays to 8.8 per cent, and the Total Outlays/GNP ratio to 20.8 per cent.

Another common measure of federal government spending is the sum of current expenditures (in the form of expenditures on goods and services, transfers to other levels of government, interest on the public debt, transfers to provincial and local governments, etc.) and gross capital formation as shown in the National Income and Expenditure Accounts. Fiscal year data on this basis are shown below.

Federal Government Expenditures
National income and expenditure accounts basis

	1975-76 Actual	1976-77 Actual	1977-78 Actual	1978-79 Forecast	1979-80 Forecast
			($ millions)		
Total Expenditures on a national accounts basis	36,505	40,343	45,271	49,725	53,400
Percentage increase	18.5	10.5	12.2	9.8	7.4
Percentage of GNP*	21.2	20.6	21.1	20.9	20.2

* GNP for corresponding fiscal year.

It will be noted that the rates of increase of expenditures as measured in the national accounts are similar to the rates of increase of Total Outlays for all years except 1977-78 and to a lesser extent, 1979-80. The higher increase in national accounts expenditures in 1977-78 largely relates to two differences in the coverage of these alternative expenditure measures. National accounts expenditures include unemployment insurance benefits on a current basis. With the rise in the unemployment rate, these payments increased by 21 per cent from $3,457 million in 1976-77 to $4,168 million in 1977-78. Total Outlays include (in Budgetary Expenditures) the government contribution to the Unemployment Insurance Account (UI). This contribution is based on the experience of the account in the calendar year ending three months before the start of the fiscal year in question, and is affected by changes in the employer/employee contribution rates as well as by unemployment rates. The government contribution to the UI account fell 20 per cent from $1,728 million in 1976-77 to $1,379 million in 1977-78. The second difference in coverage which proved important over this period is the fact that national accounts expenditures do not include government outlays in the form of loans. A reduction in loans between 1976-77 and 1977-78 contributed to the lower growth rate of Total Outlays in 1977-78.

In 1979-80, these two differences in coverage work in the reverse direction leading to a slower growth rate for national accounts expenditures than Total Outlays. The reductions in UI benefits which will take effect in 1979 affect national accounts expenditures immediately but will not reduce the government contribution to the UI account, and thus Total Outlays, until 1980-81. In addition, the large increase in the loans component of Total Outlays does not affect national accounts expenditures.