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Budget Speech

Honourable Allan J. MacEachen
Deputy Prime Minister and
Minister of Finance
Member of Parliament for Highlands-Canso

November 12, 1981

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Introduction

Madam Speaker, each year budget speeches have become longer and more complex. I intend to reverse this trend. Tonight I wish to speak urgently and directly to Parliament and, through Parliament, to all Canadians. I shall be tabling a comprehensive set of budget documents which expand in substantial detail on all that I shall say this evening.

Over the past two months, energy agreements have been concluded with the three Western producing provinces. Last week agreement was reached on the Constitution. Two enormously divisive issues have been resolved and Canadians have shown once again how they can work together. Output and employment grew more over the past year than I expected at the time of my last budget. But major challenges still remain on the economic front.

We are confronted by severe inflation and extremely high interest rates. Inflation and interest rates at their present levels are bringing economic growth to a standstill and creating grave inequities among Canadians. The impact of high interest rates on homeowners, small businesses and farmers is visible and damaging. But high interest rates flow from high inflation and there can be no deep and lasting relief until inflation can be reduced. We cannot hope to insulate ourselves from interest rate policies in other countries unless our inflation rate is lower than theirs.

I have attended international meetings throughout the past year and have been struck by the growing conviction around the world that growth cannot be sustained if inflation is not sharply diminished. My concern over unemployment has been heightened by the events of recent months. But we will generate less employment, less growth and more unemployment if we attempt to live with inflation than if we resolve once and for all to see it steadily reduced.

This budget has three themes: restraint, equity and economic renewal.

The first is the need for restraint on the part of the government and restraint on the part of all Canadians. For our part, I believe we must reduce our deficit and our borrowing requirements substantially – even more than I proposed a year ago. This will take pressures off credit markets, ease interest rates and provide room for needy borrowers. The control of the money supply by the Bank of Canada is an essential element in our strategy to fight inflation, but it has to be supported by greater fiscal restraint.

While the increase in our energy revenues will make an important contribution to this objective, I have had to seek additional revenues from the personal and

corporate tax, although there is tax relief or no tax increase in this budget for the vast majority of Canadians. Most fundamentally, we are committed to restraining the growth of our spending over the next few years to less than the growth of the economy as a whole while still exercising our responsibilities for leadership and for caring.

But we also call upon all Canadians to accept the challenge of restraint, so that inflation is reduced, interest rates are brought down and growth resumed as soon as possible. I recognize that prices are now slowing down in many markets, and that incomes have not exploded as they did in 1974 and 1975. Canadians give evidence of recognizing that increases in energy prices and other real cost increases must be absorbed and cannot be automatically offset. But successive reductions in money income demands will be required year by year if declining inflation is to be achieved.

It is dramatically clear from everyday experience that excessive income demands on the part of those employed deny employment to others. Our economic projections illustrate the fact that higher money incomes add little or nothing in the short run to the real incomes of those with jobs and damage everyone's longer-run prospects for a higher standard of living.

I believe Canadians understand this. The problem is to provide assurance that behaviour which is in the collective interest of all Canadians does not lead to inequitable gains for those who refuse to constrain their demands or inequitable losses for those who do. This seems to me indeed to be the responsibility of government.

Thus the second theme of this budget is equity. I dedicate myself and this government in this and succeeding years to maintaining a fundamental sense of fairness in our society. As evidence of that dedication, I am proposing a major overhaul of the personal tax system. I am also announcing a package of relief measures for homeowners, small businesses and farmers most threatened by high interest rates.

If the first two themes of this budget are restraint and equity, the third theme must be renewal. The whole purpose of my fiscal strategy is to lay the basis for sustained growth in the future by clearing away the obstacles of high inflation and unprecedented interest rates.

This decade offers exceptional opportunities for strengthening and diversifying growth in every region of Canada. Expanded world markets, massive resource projects involving major expansion in manufacturing and transportation, a new industrial revolution based on high technology: these are the development opportunities before us.

The policies and programs of the national government are major instruments for managing and exploiting these development opportunities and ensuring that the benefits are shared fairly. Harnessing the resources of the economy is a national enterprise which includes but extends beyond the interests of particular regions or sectors.

I will be tabling this evening a major policy document on economic development for Canada in the 1980s. The government intends to consult with the provinces, business and labour concerning the five priority areas of economic development policy set out in the document – industrial development, resource development, transportation, export promotion and human resources. In this decade of development we must work together to renew the foundation for the fair sharing of wealth and opportunity that binds us together as Canadians.

Equity and Incentives in the Tax System

Madam Speaker, I turn now to my tax proposals.

Many Canadians find our tax system unfair, and I agree with them. They realize that taxes are necessary to pay for important government services, but they feel that rates of tax are too high. They sense that others, the well-advised or the wealthy, very often pay less than their fair share.

A study of selective tax preferences available to individual taxpayers, which I am tabling tonight, shows that the revenues lost through selective write-offs, exemptions and deferrals are massive. Over \$47 billion of personal income escaped tax in 1979. If these preferences were eliminated, rates of tax could be halved without reducing federal revenues. Some higher-income individuals are able to reduce their tax rate to well below that paid by lower-income Canadians. Some can escape paying taxes entirely. This is unacceptable.

A cutback of tax preferences will permit a lowering of tax rates. Madam Speaker, the simple truth is that if only half of income is taxed the rates have to be twice as high to yield the same revenue. Lower tax rates will improve the incentives to work, save and invest. These incentives will be direct, easy to understand and available to all. Lower tax rates will also reduce the tendency for taxpayers to devote wasteful effort and money in finding artful ways of avoiding tax. For these reasons I propose to end a number of special tax preferences, to restrict others, and to lower marginal tax rates.

Specifically, I am eliminating tax deferrals through income-averaging annuities and the capital gains reserves and also repealing general averaging. In their place I am introducing a new forward-averaging provision. I am ensuring that a number of employee fringe benefits such as low-interest loans and employer-provided automobiles are properly taxable. I am reducing the tax deferral for investment income that accrues but is not received for an extended period. In addition, I am ending the deduction for carrying charges in excess of the related investment income. The details of these and other changes, which mainly affect high-income individuals, are given in the budget documents.

The revenue gained by these measures allows me to reduce tax rates over a broad range of taxable incomes for 5.8 million Canadians. Tax rates will be reduced for all taxable incomes over \$11,120. At the top income levels, the marginal rate of federal tax will be reduced to 34 per cent. This means, Madam Speaker, that the maximum tax on each additional dollar of income will be

about 50 cents on average depending on the province, compared with about 64 cents at present. This will also effectively limit the top tax rate on capital gains to 25 per cent.

I am also proposing tax reductions which will benefit lower income families. I am doing this by modifying the federal tax credit. This special credit is currently 9 per cent of tax with a minimum cut of \$200 and a maximum of \$500. This credit will now be set at \$200 for *all* individuals, but married taxpayers will be able to claim an additional \$200 for their dependent spouse. This means that for more than 620,000 lower-income families, the entitlement to the federal tax credit will be doubled to \$400.

Indexation of the personal income tax system will be retained. As a result the personal exemptions for a family of four will rise from \$7,230 to \$8,110 next year. The child tax credit will be increased from \$261 to \$293 per child. In total, indexing will benefit all individuals and provide a tax reduction worth over \$3 billion next year.

As a result of indexing and the measures I have announced, a typical family of four will be able to earn about \$15,000 in 1982 without paying any federal tax. The net effect of the restrictions on tax preferences and lower tax rates will be to increase tax revenues. But these increases will come from those most able to pay. They will be concentrated among those who took advantage of the provisions now terminated. The majority of other taxpayers will see their taxes reduced, many significantly.

The corporate sector must also contribute to the reduction of the federal deficit in the fight against inflation. Lower inflation and lower interest rates will produce a more favourable economic climate for business in Canada. The major changes affecting corporations are a reduction of the depreciation write-offs in the year the property is acquired and a two-year extension of the surtax on large corporations. However, the surtax will be halved to 2.5 per cent in 1983. Even with these changes the Canadian tax system will provide significant incentives for investment and will continue to compare favourably with those in other industrialized countries.

In addition to these changes, I am proposing a number of measures to address the particular problems of small business. As part of this package I am exempting them from the corporate surtax. I am also increasing the limit for the low tax rate for small business corporations to \$200,000 per year, and I am making the special benefits for small manufacturing corporations more readily available.

It is also my intention to move the federal manufacturers' sales tax to the wholesale level and to reduce the general sales tax rate accordingly.

I would also like to announce reductions in unemployment insurance premium rates. The rate for employees will be reduced from \$1.80 per \$100 of insurable earnings to \$1.65. The employer rate will be reduced to \$2.31.

In summary, the changes I am introducing tonight will bring about a major improvement in our tax system. They will raise needed revenue to reduce the federal deficit, ensure that the tax burden is shared equitably by all Canadians and minimize the detrimental impact of high tax rates on the efficient operation of our economy. I believe that these are goals that all Canadians can support.

Relief for Those Most Affected by Interest Rates

Beyond the restoration of equity and incentive to the tax system, Madam Speaker, and the tax reductions which flow to millions of Canadians from the changes I am proposing, I would like to direct further relief to those most affected by high interest rates.

Abnormally high interest rates have had particularly adverse impact on many small businesses. I am thus extending the small business development provision for one more year for firms in financial difficulty. The benefits of the measure will be extended to farmers, fishermen, and other unincorporated businesses as well. The measure will provide relief in respect of interest costs above 6 per cent. This extension is in addition to the other tax measures I have announced to benefit small businesses.

Farmers who cannot afford to keep operating at current interest rates will be able to obtain loans from the Farm Credit Corporation at a special rate of $11 \frac{3}{4}$ per cent, 5 percentage points below the normal FCC lending rate. I have set aside \$50 million to allow FCC to make these additional loans and to pay for the cost of the interest rebate.

I am also greatly concerned over the distress of homeowners having to renew their mortgages at higher interest rates, and over the shortage of rental accommodation. I have sought ways of honouring the government's commitment to protect those most in need. I announce tonight that the government has set aside a further \$350 million to fund the following measures.

Those homeowners who have a reasonable amount of equity in their home can obtain relief by deferring part of the higher interest. The government is prepared to guarantee the interest deferred, within limits, when mortgage payments exceed 30 per cent of gross income.

Those homeowners whose mortgage debt would reach unduly high levels as a result of interest deferral need further assistance. In those cases, the government proposes to pay for all or part of the interest deferred.

In order to encourage the construction of rental housing, the government will provide interest-free loans of up to \$7,500 per unit for 15,000 units allocated to tight markets across Canada.

My colleague, the Minister responsible for Canada Mortgage and Housing Corporation, will provide very shortly the details of these programs. He will also submit a bill to Parliament to obtain legislative authority for these measures and to make other changes to the National Housing Act.

I want financial institutions, especially banks, to do more. I particularly want them to ensure that ample funds will be available to smaller borrowers at the lowest possible margin of cost over the rates which they pay to their depositors.

Other Spending Priorities

There are other areas where additional spending is needed, Madam Speaker. We are prepared to provide substantial amounts of money to meet high priority needs. In tabling our economic development strategy for the 1980s we are providing a definitive blueprint to guide the economic renewal upon which this budget is predicated. We intend, Madam Speaker, to see that the required resources are directed in support of these priorities and their realization.

Large increases in our Defence and Foreign Aid spending result from our international commitments. In my view, it would be imprudent and shortsighted to go back on these commitments in the interest of budgetary restraint. In the case of defence, we have a commitment to NATO to achieve 3 per cent real growth in our defence expenditure in order to strengthen the security of the Alliance. With rapid increases in costs, this means that our defence spending will grow by 17 per cent this year and over 18 per cent next year.

In the case of foreign aid, we have reaffirmed at recent Summit meetings our commitment to reach the target of 0.5 per cent of GNP by 1985. We must recognize not only the strong claims on humanitarian grounds to assist the poorest countries of the Third World, but also that foreign aid is in our own longer term self-interest in an increasingly interdependent world.

Federal-Provincial Fiscal Arrangements

In other areas, however, we have had to seek some savings in order to achieve our target of fiscal restraint. Some restraint must be applied to our transfers to the provinces so they grow no more rapidly than our expenditures generally. There has been great concern, Madam Speaker, that I was about to threaten the survival of our post-secondary education institutions or to destroy medicare, which, as Minister of National Health and Welfare, I introduced and saw passed in this House. These fears are without foundation. The proposals which I will be tabling tonight will enable us to achieve the desired savings without affecting federal contributions to the financing of provincial medical care, hospital care and post-secondary education programs.

I am proposing to eliminate compensation for the 1972 revenue guarantee which was included in the Established Programs Financing arrangements in 1977.

I am proposing a revised and improved equalization system to replace the system that will expire on March 31, 1982.

I would stress again that transfers to the provinces over the next five years are still projected to grow at least as fast as the rest of our expenditures.

Moreover, the tax changes I have proposed will automatically increase provincial revenues, and I trust provinces will agree with me that the proposals are desirable. Indeed, the increase in provincial revenues during the first two years of the new arrangements will virtually offset the reduction in transfers due to the elimination of compensation for the 1972 revenue guarantee.

I am very hopeful that the provinces and the interested communities will find my proposals equitable. In the pursuit of restraint, I am asking no more of the provinces than I have imposed on the Government of Canada.

Other Areas Where Savings Can Be Achieved

Under the new expenditure plan the envelopes are set in the expectation that most new programs will have to be financed by reducing the cost of existing programs. But I would like to mention specific areas where we are planning significant savings.

We have been able to reduce the amount allocated to the Energy envelope and we have deferred certain expenditures from the Western Development Fund. The larger part of the Western Development Fund remains within the Economic Development envelope, and will be dedicated to the improvement of the Western transportation system. The remaining portion of the Fund has been transferred to the Social Affairs envelope, for use in improving the housing conditions and economic opportunities of our native peoples.

On October 16, the Post Office became a Crown Corporation. The new corporation has been instructed to eliminate the postal deficit by 1985-86. The increase in postal rates which has already been announced will begin this process. Further increases are likely to be required, but the major contribution should come from better service and improved efficiency.

We are, of course, extremely conscious of the need to reduce the costs of government. One step in this direction is the development of better ways of managing the government's physical assets such as land and buildings. We are also asking the Treasury Board to identify a \$100 million reduction in overhead costs. This will reinforce the ongoing search for greater efficiency which is reflected in the fact that the authorized size of the public service this year is less than it was in 1975-76.

Finally, I would note that we expect a very sharp reduction in the growth of our interest costs from 38 per cent this year to less than 5 per cent in 1985-86. This is one of the major benefits of our efforts to reduce the deficit.

Summary of the Fiscal Plan

I would now like to table the budget documents:

- Budget in More Detail
- Budget Papers and Notices of Ways and Means Motions

- The Current Economic Situation and Prospects for the Canadian Economy In the Short and Medium Term
- Fiscal Arrangements in the Eighties – Proposals of the Government of Canada
- Analysis of Federal Tax Expenditures for Individuals
- Economic Development for Canada in the 1980s

I will be proceeding in the usual way with the introduction of bills to amend the tax laws.

I would ask the consent of the House to include in Hansard the standard table which provides the projections of the government's fiscal position.

The new spending targets contained in this budget grow less rapidly than the economy as a whole. As a percentage of GNP they decline from 20.6 per cent in 1981-82 to 19.2 per cent in 1985-86. On a comparable basis, the new outlays targets represent a lower percentage of GNP in each year than those shown in the last budget. This is clear evidence of intensified restraint. There are some who will still argue that we are spending too much. But it is not good enough to call for greater restraint and at the same time resist reductions in specific programs.

The new energy taxes, which are included in the Notices of Ways and Means Motions I am tabling tonight, will yield \$900 million more in 1982-83 and \$1.5 billion more in 1983-84 than the energy revenues projected in last year's budget.

The income tax changes I have announced tonight will increase our revenues by \$1.4 billion in 1982-83 and by about \$2 billion in 1983-84.

A year ago, I anticipated that our deficit as measured by our financial requirements for 1980-81 would be \$12.2 billion; in the event it was \$10.1 billion, about \$2 billion less. I now expect that the deficit this fiscal year 1981-82, will also be much lower – \$9.8 billion compared with the \$11 billion projected a year ago.

To a large extent we did better in those years because the economy was growing faster than I had expected. Now I have set myself the task of cutting back the deficit in the next two fiscal years, and this will be more difficult because the economy is growing more slowly. Specifically, I propose to reduce our financial requirements to \$6.6 billion in 1982-83 and \$5.5 billion in 1983-84.

Conclusion

Madam Speaker, I believe that the economic strategy contained in the budget is the surest, fairest response to the economic problems which confront us. It will not provide a quick fix; such magic is not available. It is only with care, determination and persistence that our economic and social goals can be realized. But we can now reasonably expect that the rate of inflation will gradually come down from the peak levels reached this summer. Already we have seen some decline in interest rates over the past few weeks. We can look forward to continuing declines in interest rates as the rate of inflation slows. That is the fundamental solution to the problems faced by homeowners and farmers and small business, though the specific measures of relief I have announced tonight will be helpful in the period of transition.

During this period, growth is likely to be slower and unemployment higher than we would like to see. But only a decline in the rate of inflation and the rate of interest can lay the basis for renewed and sustained growth in the future.

I recognize, of course, that we live in an uncertain world. We could do worse than I have projected, for reasons which lie totally outside our control or because the self-defeating battle for higher incomes becomes more intense. I am sure we would do worse if we lost our resolve to keep on fighting against inflation. Such a retreat would not only lead to more inflation and higher interest rates, it would damage our prospects for sustained economic growth in the future. I have been urged by some to worry less about inflation and minister to unemployment and growth. There are siren qualities to these entreaties that could well lead us onto the rocks.

We could also do a good deal better than I have projected. Inflation would come down more rapidly if international prices drop and if larger gains in productivity can be achieved. It certainly would if Canadians were prepared to take smaller increases in their money incomes, either in the expectation that prices will rise less rapidly or in order to keep their jobs. Excessive income demands can obviously make it more difficult for employers to maintain their operations when markets weaken. We are beginning to see cases where jobs are being preserved by the giving up of some contractual benefits. This seems to me a fairer way of sharing the burden. But everyone would be better off if more restraint had been shown in the first place.

I have been urged by some to resort to income and price controls to bring down inflation and to exchange controls to prevent depreciation of the dollar. But I am sure that Canadians do not want this much intervention by the government in their affairs except in an emergency. Exchange controls simply won't work. Many are bound to regard price and income controls as unfair, and therefore incompatible with my commitment to equity. The AIB controls helped resolve the emergency situation of 1975, but did not solve the underlying problems. This time we need a more lasting solution.

The key which can open the door to our future is a change in our attitudes and expectations. We will move much more quickly to non-inflationary growth if the conviction spreads that we are heading back towards stable prices and lower interest rates. The whole process will be much easier if everyone feels he is being treated fairly. That is why I have put so much emphasis on restraint with equity. I have also emphasized the promise of renewal. There are great opportunities for us to exploit. It is time to overcome our anxieties and regain our confidence in ourselves and in Canada.

**The Fiscal Plan
Government of Canada
Summary Statement of Transactions⁽¹⁾**

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
	(millions of dollars)					
Budgetary transactions						
Revenues	45,398	54,310	64,960	74,525	82,655	91,745
Expenditures	-58,066	-67,650	-75,450	-84,075	-92,635	-101,950
Surplus or deficit (-)	-12,668	-13,340	-10,490	-9,550	-9,980	-10,205
Non-budgetary transactions						
Loans, investments and advances	-523	-650	-850	-1,075	-1,265	-1,350
Specified purpose accounts	2,781	3,720	3,550	3,910	4,705	5,420
Other transactions	293	495	1,205	1,170	560	-230
Net source or requirement (-)	2,551	3,565	3,905	4,005	4,000	3,840
Financial requirements (excluding foreign exchange transactions)	-10,117	-9,775	-6,585	-5,545	-5,980	-6,365
Total outlays⁽²⁾	58,589	68,300	76,300	85,150	93,900	103,300

⁽¹⁾ For comparability, budgetary revenues and expenditures for 1980-81 and 1981-82 are adjusted to treat Canada Post revenues and expenditures as if this agency were under Crown corporation status throughout the period. The budgetary deficit and financial requirements are unaffected as a result of these adjustments.

⁽²⁾ Total outlays are composed of budgetary expenditures plus loans, investments and advances.