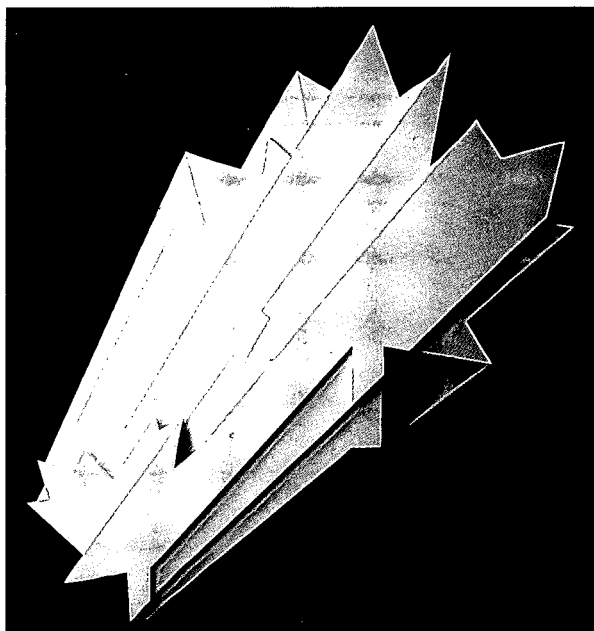


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Economic Renewal

Budget in Brief

February 1986



Canada

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Department of Finance
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Ministère des Finances
Canada

**From the Budget Speech
February 26, 1986
The Honourable
Michael H. Wilson**

"I want to speak frankly to this House and to the people of Canada."

"We have made tremendous progress together in the past 18 months. Growth has been strong. Jobs are being created in record numbers. The deficit is coming down."

"But the mounting burden of public debt continues to threaten our future. It is growing faster than our ability to pay. It must be controlled."

"Today I will announce further measures to implement the economic renewal plan set out in November of 1984, measures that will restore fiscal stability by the end of the decade. This is being achieved by the most significant and far-reaching program of expenditure control ever undertaken by the Government of Canada."

"The deficit next year will be \$29.5 billion, a reduction of 14 per cent from this year. Financial requirements next year will fall to \$22.6 billion, a decline of 22 per cent from this year's level. By the end of the decade ... financial requirements will fall to \$11 billion."

“Our national debt will no longer be growing faster than the economy.”

“Increases in taxation contribute to this result. But fully 70 per cent of the debt reduction will be achieved by spending cuts.”

“The plan we set out in November 1984 is working and working well. We are sticking to that plan.”

A Record of Action

“Since November of 1984, we have acted to overhaul and streamline the operations of government ... and set in place a new, disciplined approach to government management.”

“In this fiscal year, our actions have resulted in gross savings of \$5.8 billion – about \$560 for every Canadian household.”

“As a result of expenditure reductions, total program spending ... will be held to \$86.6 billion – lower than last year’s spending. This is the first absolute decline in total program spending in over 20 years.”

“These actions were enough to accomplish our first objective – to halt the upward spiral in our deficit. But unprecedented as they were, they were not enough to provide assurance that our annual deficits would continue to fall.”

New Expenditure Restraint

To achieve the goal of fiscal stability, the government is adopting measures to restrain government expenditures even further.

It is important that restraint start at the top. The government will ask members of the House of Commons and the Senate to accept a **reduction of \$1,000** in their salaries this year. This cut will also apply to the Prime Minister and to the Cabinet. There will be **no regular annual increase** in 1986 in the salaries of deputy ministers, assistant deputy ministers and equivalent political staff.

The government will continue its efforts to **privatize** those Crown corporations which no longer have a public policy purpose. Canadian Arsenals Ltd. will be sold before the end of this fiscal year. Several other Crown corporations are being offered for sale including Teleglobe, Canadair and Eldorado Nuclear. The government is also undertaking three significant measures to make the management of government leaner and more efficient.

- There will be a **\$500 million special reduction** in non-statutory spending for the 1986-87 fiscal year, equivalent to 2 per cent of the cost of all non-statutory government programs, with the exception of foreign aid and defence. This will reduce departmental budgets on an ongoing basis.

- After 1986-87, **operating costs in all departments** will not be permitted to rise by more than 2 per cent per year.
- A further substantial reduction in **reserves for workload increases** will force departments to absorb such increases by increasing productivity or reallocating funds.
- These initiatives will result in savings of \$850 million in 1986-87, rising to \$2.8 billion in 1990-91.

The government has requested **Canada Post** to prepare a new operating plan that will reduce its operating deficit to zero by the end of fiscal 1987-88 by improving productivity and efficiency while increasing reliability of service.

The government has also re-examined its funding commitment for **foreign aid** in light of the tight constraints being imposed on domestic programs. Growth in Canada's aid program is accordingly being reduced by \$1.5 billion over the next five years. Over this period, foreign aid will now grow, on average, by 8.7 per cent per year and remain at 0.5 per cent of GNP. The government's objective will be to reach a target for foreign aid spending of 0.6 per cent of GNP by the middle of the next decade.

The government is also reducing the rate of growth of **defence spending** by 1 per cent in each of the next two fiscal years. This will result in savings of \$285 million. Notwithstanding this restraint, expenditures on defence will continue to increase substantially each year over the balance of the decade.

As a result of the spending cuts made to date, there will be virtually no growth in spending on non-statutory programs over the next two years. The government will spend less on these programs in 1987-88 than in 1984-85.

By the end of the decade, government spending on programs will fall to the same share of the economy as at the beginning of the 1960s.

Restructuring Social Benefits

Since November 1984, the government has taken a number of actions to reform social programs based on the twin tests of social and fiscal responsibility. Over the coming months, the government will continue to improve the structure of key social programs. Further measures will be proposed in the next budget to reform the system of social expenditures and related tax provisions. Such measures will:

- maintain universal access,
- direct more resources to those most in need,
- improve the opportunities for individuals to become self-reliant, and
- reduce the after-tax value of benefits going to higher-income Canadians who do not need assistance.

Following the steps taken in the May 1985 budget to reform pension arrangements and tax assistance for retirement savings, the budget proposes new measures to give retired

Canadians who have RRSPs more flexibility in the investment management and withdrawal of their retirement savings.

Improving the Tax System

Corporate Income Tax

The budget implements the first phase of the restructuring of the corporate income tax, based on the proposals in the May 1985 budget.

- The **3-per-cent inventory allowance** will be eliminated effective February 26, 1986.
- The **general investment tax credit** will be phased out starting next year.
- The **20-per-cent investment tax credit** will remain to encourage investment in Atlantic Canada and the Gaspé Peninsula.
- The **Cape Breton investment tax credit** will remain at 60 per cent and will be improved.
- The **special investment tax credit for manufacturing investments** in designated areas will be extended past its termination date at the end of this year at a reduced rate of 40 per cent.
- **Corporate tax rates** will be reduced over a three-year period beginning July 1, 1987 from 36 per cent to 33 per cent of taxable income.

- The **tax rate for manufacturing companies** will fall from 30 per cent to 26 per cent by 1989.
- The federal tax rate for **small business** will fall from 15 per cent to 13 per cent.

As a result of these changes, there will be an increase in the number of profitable corporations paying tax.

A new discussion paper, to be released later this year, will propose further reductions in tax preferences and further tax rate reductions.

The budget also proposes a number of changes to corporate and personal income taxes to tighten the system and prevent erosion of the tax base. These include:

- the introduction of new “at-risk” rules for **limited partnerships**,
- new provisions governing **salary deferral arrangements**,
- limits on the deferral of tax through deductions for **unpaid remuneration**,
- changes to the **married exemption** allowed in the year of marriage, and
- the introduction of reporting requirements for **treasury bill income**.

In addition, the budget proposes important changes to the **tax treatment of dividends** which simplify the tax system for small business while ensuring that more high-income individuals pay regular tax on dividend income.

Turning the Deficit Corner

“Reductions in government spending and the elimination of tax preferences ... in themselves are not enough to overcome our fiscal problem ... and ... bring about fiscal stability by the end of the decade. To accomplish that goal, we must start paying the full cost of present government programs and a share of the interest burden built up over past years.”

The budget therefore announces the following tax increases:

- **A 3-per-cent surtax on federal personal income taxes** commencing July 1, 1986. The existing personal surtax will expire as scheduled.
- **A 3-per-cent surtax on all corporations** effective January 1, 1987. The current surtax on large corporations will expire at the end of 1986.
- **An increase of 1 percentage point in the federal sales tax**, effective April 1, 1986.
- **An increase in excise taxes and duties on alcohol and tobacco** of 4 per cent and 6 per cent respectively, effective midnight, February 26, 1986.

The net effect of all tax measures announced in the budget will be to raise \$1.5 billion in 1986-87 and \$2.4 billion the following year.

Sales Tax Reform

“The problems with the current sales tax system are well known ... It is time to act on this issue, to bring our sales tax system into line with today’s realities.”

A concrete proposal for sales tax reform will be put forward at an early date for public discussion.

“Our intention is to move to a new system that will encourage growth, improve equity, and yield revenues sufficient to replace the federal sales tax, to end the surtaxes I have announced today and to provide adequate offsets for low-income Canadians.”

Reinforcing Priorities

“This government has acted to restore fiscal responsibility in Canada ... but in some cases, we must spend more, to help those in need today and to help build the foundation for a better future. In a careful and effective manner, we intend to reinforce our basic priorities.”

Helping Those in Need Today

To provide more timely assistance to low-income families and to reduce the need for tax discounting, the government is proposing to advance payment of the **child tax credit**. A prepayment of \$300 per child will be paid in

November 1986 to families whose income in 1985 was \$15,000 or less. Almost one million families will benefit from this measure.

Commencing this tax year, the government will provide a **refundable sales tax credit** of \$50 per adult and \$25 per child, for families and individuals with incomes below \$15,000. About four million families and individuals will benefit from this measure.

The budget proposes to increase the **disability deduction** by \$250, effective this year, to provide increased support for disabled Canadians. This will provide increased support to 185,000 disabled Canadians.

The government is committing up to \$100 million a year for the next three years to target training programs to **social assistance recipients** and help them find employment. These funds will be matched by the provinces.

Farm Financial Assistance

To preserve a viable farm sector, the government is adopting a new Farm Financial Assistance Policy. Under this policy:

- the government will increase resources to the Farm Credit Corporation over the next two years to establish **commodity-based mortgages**;
- legislation will be introduced to establish **Farm Debt Review Panels**; and

- the government will create a **Rural Transition Program** to assist farmers who must seek alternative employment.

These measures represent an additional financial commitment to Canadian farmers of \$65 million this year and \$130 million next year.

The Minister of Agriculture will also be announcing measures to assist **tobacco farmers** to diversify into other crops.

The government will extend the existing **3-cent-a-litre fuel tax rebate for primary producers** for one year to January 1, 1988. The Minister of National Revenue will be announcing new guidelines to simplify the calculation of the rebate.

Investing in the Future

Trade

The government is pursuing more open bilateral and multilateral trading arrangements.

The importance to Canada of ensuring that foreign markets remain open to Canadian exports and that Canadian companies take maximum advantage of markets abroad cannot be overstated.

To do that, it is important to ensure a fiscal environment that allows lower and more stable interest rates and a tax system that

promotes competitiveness and efficiency. The deficit reduction plan and the proposed corporate and sales tax reforms forecast in this budget will support Canada's trade initiatives.

By acting now on these three fronts, we can ensure that Canadian firms will be able to take full advantage of market opportunities in years to come.

The government is prepared to facilitate the establishment of international banking centres in Montreal and Vancouver. This would be consistent with our desire to broaden our trade and business interests in Europe and the Pacific Rim.

Research and Development

To support investment in university-based research and development and to establish a new partnership between the private and public sectors in R&D, the government proposes:

- to provide a secure funding base for the Natural Sciences and Engineering Research Council, the Medical Research Council and the Social Sciences and Humanities Research Council by adding \$300 million to this base over the balance of the decade.
- further, by matching private sector contributions to the councils dollar for dollar to a maximum annual increase of 6 per cent.

Training and Adjustment

The **Canadian Jobs Strategy** helps workers adapt to a fast-changing labour market. Programs are targeted at building the skills necessary to help young people obtain a first job and to assist women re-entering the labour market. The budget allocates \$800 million to the Canadian Jobs Strategy in 1987-88.

The budget also announces federal funding of up to \$125 million over a four-year period to finance a new **Program for Older Worker Adjustment**. This program will assist older workers who lose their jobs and have no immediate prospects for re-employment.

Small Business

Several measures in the budget reinforce the government's support for small business – the most important source of jobs in Canada today.

- The tax rate on small business income will be reduced from 15 per cent to 13 per cent, beginning July 1, 1987. The tax rate on small business manufacturing income will be reduced from 10 per cent to 8 per cent.
- The 12 1/2-per-cent dividend distributions tax will be repealed effective January 1, 1987.

- The tax rules providing deductions for allowable business investment losses will be broadened.
- The ceiling of the **Small Business Loans Act** will be increased to \$2.5 billion, more than doubling the amount of guaranteed loans available to small businesses.

Atlantic Enterprise Program

To enhance the rate of private sector job creation in the Atlantic and Gaspé regions the government is launching a major new initiative, the **Atlantic Enterprise Program**. Private sector lenders will be encouraged to make loans for business start-up or expansion. Up to \$1 billion of these loans will be **guaranteed** to a substantial extent by the federal government.

Northern Development and Indian Affairs

To promote northern development and encourage the economic self-reliance of native peoples, the budget announces the following measures:

- a new, permanent system of **tax benefits for housing and travel** for residents of the north and isolated posts, effective January 1, 1987.
- a \$50 ceiling on the **air transportation tax**, in recognition of the distances involved in northern travel.

- the introduction of amendments to the Indian Act to allow bands to levy municipal-type taxes on Indian lands.
- the extension, for the 1986 tax year, of the Indian Remission Order which relieves tax on certain employment income.
- the allocation of up to \$40 million in 1986-87 to extend the Indian Community Human Resource Strategies program for a second year.

Building a Sense of Community

To encourage the work of **the voluntary sector** in building a sense of community, the government will continue to examine a number of measures to encourage charitable donations, and will work with the voluntary sector to find an appropriate and effective solution.

The government is also committed to supporting **the artistic and cultural communities in Canada**. To this end, the budget announces the allocation of an additional \$75 million per year beginning in 1986-87 to fund a number of specific cultural initiatives.

Conclusion

"This government has demonstrated its resolve to restore fiscal responsibility to Canada. We are doing this in a way that is

consistent with the commitment we made to Canadians in November of 1984. Our objective, then and now, is to solve the problems of the past in order to create jobs today and into the future."

"Cutting the deficit is not an end in itself. It is the means to an end. It is the means to achieve lower interest rates, higher growth and more jobs."

"The actions we have taken reflect the priorities we set out in November 1984 and acted on in May 1985."

"We will continue to act with consistency and determination. Canadians can look to the future with confidence."