Budget in Brief

April 27, 1989

BUDGET 89

Canada

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Department of Finance
Canada

Ministère des Finances
Canada

From the Budget Speech
April 27, 1989
The Honourable Michael H. Wilson

"This budget is about the future of Canada.

"It is about what we must do – as a government and as a people – to maintain the social programs and high standard of living that Canadians want, for themselves and for their children.

"Valued social programs, high standards of living, economic opportunity, sovereignty at home and respect abroad, responsive and responsible government – this is the Canada we must leave to our children. This is the Canada we will leave to our children, if we act together to face the most important challenge before us.

"We, as Canadians, have a serious problem: our large and growing public debt.

"In the time it takes to present my budget, that debt will grow by $3 million. By this time tomorrow, the debt will be larger by more than $80 million. In just two weeks, it will have grown by more than $1 billion.

"The sad reality of debt is that it feeds on itself. It places a nation on a treadmill. Each year, added effort is required from its citizens to produce new revenues that merely go to pay the interest on a growing debt.

"We must ask ourselves: should this enormous debt be our legacy to future generations?

"Let's be clear about what it means if we continue, year after year, government after government, to borrow and borrow just to pay the interest on that debt.

"We would be borrowing from our children, not paying our own bills.

"It's easy to borrow from future generations because they have no voice in this debate. They have no vote. Yet it is they who must live with the consequences if we do not act.

"Today we are acting. The government is bringing down a budget that will build for our future, not borrow from it."

The Honourable Michael H. Wilson
Minister of Finance

Facing the Debt Challenge

"As a government, we will act with resolve to reduce expenditures and to improve our own efficiency and operations. And all Canadians will be asked to play a greater part in dealing with this national problem.

"We recognized the seriousness of the debt problem when we came to office. We have been acting to get it under control. We have succeeded in reducing the growth of the debt from almost 24 per cent in 1984 to less than 10 per cent last year. Despite that progress, the debt continues to grow more rapidly than our national income.

"The interest payments on the debt are also increasing rapidly. Only 20 years ago, just 12 cents of every revenue dollar went to interest payments. When I became Minister of Finance four-and-a-half years ago, that figure had already increased to 32 cents. This year it is over 35 cents.

"The recent surge of interest rates, in Canada and abroad, shows just how much our huge debt has left us exposed. In just one year, the projected cost of paying the interest on the public debt has risen by more than $6 billion. This year alone, interest will cost us $39 billion. That is more than we spend in total on health care, family allowances, old age security and social assistance."

Achieving Sustained Economic Growth

"Our program of fiscal action was carried out as part of a comprehensive, long-range plan to build the economic strength essential in a fast-changing and increasingly competitive world.

"Starting in 1984, we built a strong foundation on which Canadians could achieve their economic potential.

"Since 1984, Canadians have created one-and-a-half million new jobs and our economy has expanded faster than most other industrial nations. We made this progress together as a government and as a nation because we made tough choices and took strong actions to deal with our fiscal and economic problems. But that progress is at risk because of rising inflationary pressures here and in other countries.

"If we do not act now, we will face a growing danger of higher inflation and even higher interest rates that could lead to a severe recession.

"Higher interest rates have also had a major impact on the cost of carrying our large debt. This year, to pay the interest on the public debt, it will take all the personal income tax paid by Canadians from January to mid-October.

"I know that people right across Canada feel frustrated by high interest rates. Some suggest that interest rates should be lowered by decree. But to try to deal with the symptoms of high interest rates rather than the fundamental causes would be self-defeating and ultimately very painful.

"We must have firm, measured and consistent fiscal and monetary policies that keep us moving in the right direction to get inflation and interest rates down and keep them down; realistic, responsible policies that carefully balance shorter-term risks and longer-term goals."

Action for Debt Control

"The measures in this budget reflect the seriousness of the situation we face. We have made choices, difficult choices. We have worked to ensure that the total package of measures is balanced, reflecting regional circumstances and placing the greater burden on those who are better able to carry it."

Expenditure Measures

Major reductions in program spending have been achieved. When fully implemented, these will total about $2.5 billion a year. As a result of these and earlier actions, program spending has declined from 19.5 per cent of GDP five years ago to 16 per cent this year. By 1993-94, it will fall further to just over 15 per cent, the lowest level in a quarter of a century.

Some major actions:

National Defence: Previously planned spending increases will be restrained to save a total of $2.7 billion over the next five years. The basic parameters of the White Paper remain government defence policy, but that policy will need to be implemented more slowly. As a result of these decisions, the government will close or reduce in size 14 military bases and stations across the country. The government is not proceeding with acquisition of nuclear-propelled submarines.

Official Development Assistance: Spending will decline from $2.8 billion last year to $2.4 billion this year. From that base, it will grow according to a formula which will increase assistance as a percentage of GNP through the medium term. Savings will amount to almost $1.8 billion over the next five years. Canada's aid contribution will continue to be among the most generous of the developed world.

Rail Passenger Service: VIA Rail's growing subsidy – $641 million last year – will be reduced over the next four years. VIA has been asked to bring forward a new business plan covering various options including: an increase in fares; service reductions; and closure, sale or transfer of substantial parts of the system. Assistance to provide service to remote communities will continue.

Child Care: As part of the child care strategy announced in December 1987, the government is providing $2.3 billion over the next seven years to increase tax assistance for families with pre-school children and children with special needs. However, the government is not in a position to proceed at the present time with its proposal to accelerate the creation of child care spaces. It will act during this mandate to meet its child care objectives. In the interim, the government will continue to share costs of child care services under the Canada Assistance Plan.

Transfers to Provinces: The government will reduce the growth of transfers under the Established Programs Financing arrangements by one percentage point beginning in 1990-91. These transfers will continue to be protected so that their rate of growth will not be less than inflation. There will be no change in the equalization program which provides substantial payments to lower-income provinces to assist them in providing services to the public.

Other expenditure reductions affect the operations of government, business subsidies and other transfers, and payments to Crown corporations.

"We are committed to continue to restrain program spending. This will require sustained efforts to manage within the expenditure framework set out in this budget."

Regional Development: The budget establishes a sustainable funding framework for regional development spending. Overall funding will increase over the next five years but regional agency budgets will be constrained in the short term.

Privatization of Crown corporations which are no longer required to meet public policy objectives will continue. An immediate priority will be sale of the government's remaining share of Air Canada. Evaluation of other candidates for sale will be stepped up.

Crown Corporations: Canada Post is now operating on a profitable basis. This reflects the government's commitment to more efficient and business-like performance by the Crown corporations it continues to hold. Canada Post will begin to pay a dividend to the government. The scheduled two-cent increase next January in the price of a first-class stamp will be reduced to one cent.

Repayment of Social Transfers: Individuals with net incomes exceeding $50,000 will repay, through the tax system, old age security and family allowance benefits. This measure will be phased in over three years. It will affect only about 4 per cent of the 3 million seniors who receive old age security pensions and about 14 per cent of the 3.8 million family allowance recipients. The measure maintains the universal character of these transfer programs. Everyone eligible will continue to receive benefits.

Revenue Measures

"Nobody likes tax increases. But the debt is a major problem today because in the past we have not paid for the entire costs of programs. Because of that, we must pay more now."

Corporate Tax: To ensure that all large corporations pay at least a minimum amount of tax each year, a new Large Corporations Tax will be levied on corporate capital employed in Canada in excess of $10 million. Although small firms are not subject to this tax, other adjustments will slightly increase the effective rate of tax on smaller taxpaying companies.

Other changes to tighten up the corporate income tax system will eliminate the after-tax financing advantages of leasing rules and stop abuse of dividend rental arrangements.

The personal income surtax on all individuals increases by 2 percentage points beginning July 1, 1989. An additional federal surtax of 3 per cent will be applied to high-income individuals at the same time. It will affect taxpayers with annual income in excess of about $70,000. These individuals will now pay 8 per cent in surtax.

Excise levies on cigarettes increase by $4 a carton and the taxes on cigars will be increased proportionately, effective April 28, 1989. The tax on manufactured tobacco will rise at the same time by $4 per 200 grams and by an additional $1.30, effective October 1, 1989. The excise tax on gasoline rises by 1 cent per litre, effective April 28, 1989 and by another 1 cent per litre January 1, 1990. The excise tax on leaded gasoline rises by an additional 1 cent per litre, effective April 28, 1989.

Federal sales tax rates increase by one percentage point on alcoholic beverages and tobacco products effective April 28, 1989, on telecommunications services (June 1, 1989) and on construction materials (January 1, 1990). The federal sales tax rate on all other taxable goods rises by one and a half percentage points, effective June 1, 1989.

The existing refundable federal sales tax credits for adults and children will be doubled. By 1990 they will be $140 for adults and $70 for children. The income threshold up to which the full credit is provided will be raised in 1990 from $16,000 to $18,000.

Unemployment Insurance payments will be fully financed by employer and employee premiums beginning January 1, 1990. The maximum increase in after-tax premiums for workers in 1990 will be less than $1.40 a week.

The fiscal impact of these measures amounts to more than $5 billion this year and $9 billion next year. This year they will almost offset the rise in interest costs and leave a deficit of $30.5 billion. Next year the deficit will drop to $28 billion. The debt-to-GDP ratio will stabilize next year and in five years the deficit will be cut in half. On the basis of accounting standards used in preparation of budgets in the United Kingdom and the United States, we would then have a balanced budget.

Federal Sales Tax Reform

"The replacement of the existing federal sales tax is a key element of the government's strategy to safeguard essential programs and strengthen Canada's economy. The present tax is widely recognized as being fundamentally flawed. It is hidden, unfair and damaging to our economy."

A new tax called the Goods and Services Tax (GST) will replace the existing federal sales tax on January 1, 1991 at a rate of 9 per cent on the vast majority of goods and services consumed in Canada. Basic groceries, prescription drugs and medical devices will not be taxed. Residential rents, child care, legal aid and most health, dental and educational services will be tax-exempt. Special measures will be adopted to minimize the compliance burden for small businesses.

The 9 per cent rate will provide sufficient revenues to:

- replace the existing federal sales tax, including the extra sales tax revenues raised in this budget;
- allow complementary income tax reductions for middle-income households; and
- fund a new Goods and Services Tax Credit that will involve a further, substantial expansion in the current sales tax credit. The government's goal is to assure that families earning less than $30,000 per year will be better off as a result of the implementation of sales tax reform.

Assistance will be provided to home buyers who might face an affordability problem as a result of the tax change.

"Sales tax reform will provide a more stable foundation on which the government can maintain vital public services and effectively manage the problem of Canada's debt. It will bring an overall improvement in the fairness of the tax system. It will make federal sales taxation more visible to the consumer. And it will result in major gains in economic output in the range of $9 billion a year – gains that will be felt in all sectors of the economy and all regions of Canada."

Conclusion

"As Canadians, we want a Canada that is able to protect and strengthen the fundamental values that define us as a nation.

"We want:

- a Canada, caring and compassionate, with the capacity to maintain the social and cultural programs and other important public services that Canadians need;
- a Canada, economically strong and fully competitive with the world's trading nations, that continues to create good jobs and opportunities for all its people in the 1990s and beyond;
- a Canada, progressive and adaptable, able to meet priorities such as skills training and the protection of the environment;

- in short, a Canada that can guarantee a rising standard of living and better quality of life to pass on to the next generation.

"That is our responsibility as a government; that is surely our goal as Canadians.

"That is why this budget is about building for the future, not borrowing from it. That is why this budget deals firmly with the major obstacle to that future – the problem of our growing debt. This budget is designed to overcome that obstacle. The measures in it are tough because they match the challenge that we are facing.

"These measures pale by comparison with the price we would all pay if we fail, and the far greater price our children would pay if we allow our problem to become their crisis.

"Four years ago we brought forward a plan to build a better future for Canada. We knew that to stay on that course would require a sustained national effort. Together we have made great progress. Our future success will depend on the will of the government to continue making tough choices, and on the understanding and commitment of Canadians to join in building this stronger Canada."