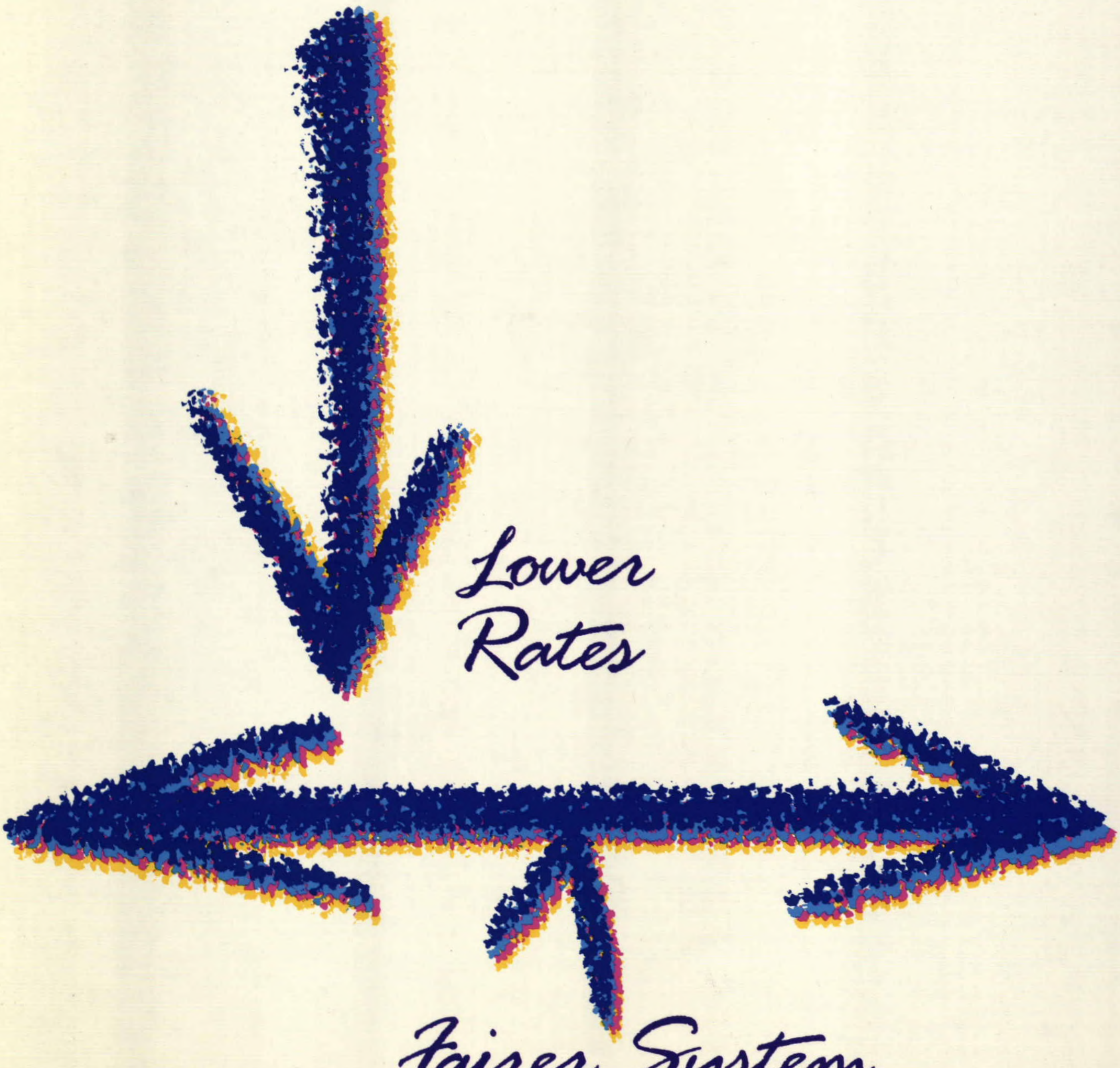
Reform 1987
Economic & Fiscal Outlook

June 18, 1987

**The Honourable
Michael H. Wilson
Minister of Finance**



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Canada

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Preface

Since September 1984 the government has been working to achieve the goal of sustained economic growth and the creation of productive jobs for Canadians. Our *Agenda for Economic Renewal* set out the government's philosophy of economic management and the directions that we would take to create opportunities for Canadians and restore vitality to the economy.

We set for ourselves the tasks of restoring responsibility to the management of the government's finances and reducing the size of government in the economy. Equally important, we began the job of creating a changed role for government in the economy, a role that would foster risk-taking and entrepreneurship, a role that would reward success rather than subsidize effort.

In the February 1987 budget, I released a document entitled *The Agenda for Economic Renewal: Principles and Progress* that showed the considerable progress that we have made in only 2 1/2 years. We have reduced the deficit substantially; we have cut in half the rate of growth of government debt; and as promised, we have accomplished this goal primarily through expenditure control and good management. Important structural initiatives in a wide range of areas have been undertaken to support and encourage a vibrant and dynamic economy.

Comprehensive tax reform is a major part of our agenda for economic renewal. The current tax system increasingly has become an obstacle to sustained economic growth. Too many private economic decisions are being made on the basis of tax incentives rather than economic incentives; incentives to work, save and invest are being eroded; our industries are being put at a disadvantage in both domestic and foreign markets. Comprehensive tax reform will address these distortions and inequities in a substantial way, strengthen incentives to save and work, and create a more efficient and a more competitive economy.

Comprehensive tax reform will be implemented in two stages. In the first stage, personal and corporate statutory tax rates will be reduced and the tax bases will be broadened. This will be followed in the second stage by the elimination of the personal and corporate income surtaxes, further personal income tax cuts and an enhancement of the refundable sales tax credit in conjunction with the replacement of the federal sales tax with a broad-based multi-stage sales tax. At this time, with important decisions still to be made about the specific sales tax option to be introduced and the timing of its implementation, it is not possible to integrate the second stage of comprehensive tax reform into our medium-term economic and fiscal projections.

In this document, therefore, I am providing detailed medium-term economic and fiscal projections that take into account the first of the two stages of comprehensive tax reform. The fundamentals of the Canadian economy are sound and there are no domestic pressures or imbalances that suggest the current expansion cannot continue. With reasonable growth in the international economy, Canada can achieve sustained economic expansion in the years ahead and make further progress consistent with our four fiscal principles and restoring health to the nation's finances.

At the same time, there are risks and uncertainties that must be recognized, and challenges that must be met. These are addressed clearly in this document. The current international situation of large fiscal and trade imbalances poses substantial risks. These must be effectively addressed by co-ordinated policy actions in the industrial countries if the world expansion is to be sustained. I am encouraged that the Group of Seven countries have agreed on the need for such positive policies, and have committed themselves to take appropriate actions. Growing protectionism in the United States and elsewhere poses a serious threat to an open world trading system and prospects for stronger world growth. I believe that the bilateral Canada-U.S. trade negotiations now under way, and our participation in the Uruguay round of multilateral GATT trade negotiations, can contribute importantly to a lessening of the protectionist risks facing Canada.

Tax reform will also contribute to meeting these challenges. By improving our international competitiveness, and strengthening the structure of our domestic economy, we will better adapt and prosper in a changing and uncertain world environment. Tax reform will allow us to continue to build an even stronger foundation for sustained economic growth and steady improvement in the economic and social well-being of all Canadians.

Michael Wilson

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1. Introduction and Overview

Since the fall of 1984, substantial progress has been made in addressing Canada's growing fiscal vulnerability in a substantive, responsible and persistent fashion. Important structural initiatives have also been undertaken to support economic renewal. But Canada's tax system has increasingly become an obstacle to a growing and vibrant economy over the longer term. Actions have been taken in successive budgets, and on other occasions, to address the shortcomings of the present tax system. Nevertheless, it has become evident that an extensive overhaul of the tax system is required if it is to contribute to economic renewal.

Comprehensive tax reform will improve the structure and performance of the Canadian economy. The economic benefits of the proposed reforms to the personal, corporate and sales tax systems are discussed in Chapter 2. Tax reform will encourage savings and investment, enhance productivity growth and improve Canada's international competitiveness. These benefits will not be realized overnight – the impact of these structural improvements on the way our economy functions will be felt in future years as more and more economic decisions are made within the environment of the new tax structure.

The international economic environment and medium-term prospects for the Canadian economy incorporating the impacts of the first stage of tax reform are set out in Chapter 3. The economic environment reflects both risks and opportunities. The outlook for 1987 has changed little from that presented in the February 1987 budget, with continued moderate growth of output and employment expected this year. Inflation is expected to remain moderate and the unemployment rate should continue to decline.

The medium-term outlook for the Canadian economy is for a sustained economic expansion. Beyond 1987, the main risks and uncertainties to the economic and fiscal outlook arise mainly from the large and persistent international imbalances. Co-ordinated action by the Group of Seven (G-7) countries to address these imbalances in a timely and concerted fashion is both a challenge and an opportunity to build a sounder world economy. Tax reform, Canada-U.S. trade negotiations, and the other structural initiatives the government has introduced, and is pursuing, will help to ensure that Canada is able to compete in an uncertain and increasingly competitive international environment.

Tax reform has an important bearing not only on Canada's economic prospects, but also on continued success in meeting the government's fiscal principles. Comprehensive tax reform will reduce the variability of federal revenues and thereby assist in fiscal planning. Chapter 4 sets out the impacts on government revenues and expenditures of the proposed changes to the personal and corporate income tax systems under stage one of comprehensive tax reform. To ensure that these changes do not hinder further progress in meeting the fiscal principles, interim changes to the existing federal sales tax are being proposed, along with initiatives to improve the management of the collection of tax liabilities. These measures are also described in Chapter 4.

Chapter 5 updates the 1986-87 and 1987-88 fiscal situations, and provides an overview of the medium-term fiscal outlook in terms of the government's fiscal principles. It is now estimated that the deficit for fiscal year 1986-87 will be $31.0 billion, $1 billion lower than forecast in the February 1987 budget. For fiscal year 1987-88, the deficit is forecast to be $29.3 billion, the same as in the February 1987 budget.

With the current five-year expenditure plan and moderate economic growth, the medium-term outlook is consistent with the government's principles of responsible fiscal management that have guided fiscal policy since November 1984 and were reiterated in the Speech from the Throne in October 1986. The federal deficit should fall to 3.4 per cent of gross domestic product (GDP) by 1991-92, a dramatic contrast to the 8.6-per-cent level that prevailed in 1984-85. The growth of public debt is projected to decline steadily, and the debt-to-GDP ratio is expected to stabilize by 1991-92.

2. The Economic Benefits of Comprehensive Tax Reform

Introduction

Canada's tax system has become an obstacle to economic growth – tax incentives, not economic incentives, are determining too many economic decisions. It is damaging Canada's productive capacity, and putting future competitiveness and growth at risk. High personal marginal income tax rates, increasing complexity and a growing perception of unfairness are eroding incentives to greater work effort, saving and entrepreneurship so essential to a dynamic economy. These negative economic aspects of the personal and corporate income tax regimes are being exacerbated by reliance on a sales tax system that discriminates against domestic manufacturers and discourages domestic investment and exports.

The purpose of this chapter is to set out the longer-term economic benefits to be realized from comprehensive tax reform. Tax reform is designed to reduce the importance of selective tax preferences, to lower personal and corporate statutory tax rates in a consistent fashion, and to remove distortions generated by the existing sales tax system. Tax reform will proceed in two stages. The first stage focuses on a reform of the current personal and corporate tax systems. The second stage will eliminate the 3-per-cent income surtaxes, provide further personal income tax reductions and enhance the refundable sales tax credit, in conjunction with fundamental reform of the sales tax system.

The Economic Impacts of Personal Income Tax Reform

In the first stage, the central elements of personal income tax reform are:

- a reduction in marginal income tax rates and in the number of tax brackets;
- the elimination or restriction of many special tax preferences; and
- the conversion of most exemptions and deductions to tax credits.

In conjunction with sales tax reform, the personal income surtax will be eliminated and personal income taxes cut further in the second stage of tax reform.

The longer-term economic benefits of personal income tax reform will flow from the increased incentives for Canadians to work and to save. Quantitative estimates of these benefits are necessarily imprecise because they will result from structural changes in the economy, and changed behaviour on the part of individuals which will occur only over a longer period of time. Notwithstanding the difficulty of measuring such impacts precisely, macro-economic and micro-economic analyses of the personal income tax reform proposals indicate that the potential benefits for the medium- to longer-term performance of the Canadian economy are likely to be substantial.

Labour Supply Incentives

One of the main features of personal income tax reform is the reduction in marginal tax rates for the majority of Canadians. This means that Canadians will keep more, and in many cases substantially more, of each additional dollar they earn. Greater after-tax earnings will provide an incentive for more Canadians to enter the labour force and, for those already employed, to work longer and more productively.

Economic models of labour supply behaviour suggest that the tax changes included in stage one of personal tax reform will lead to significantly higher labour supply, both through higher labour force participation rates and additional hours worked per employed person. Conventional model estimates indicate that labour supply could be increased permanently by at least 0.5 per cent. This estimate, however, is on the lower end of the range of possible impacts. Higher empirical estimates of the sensitivity of labour supply to increases in after-tax wages also exist that would suggest an increase in labour supply of 1 per cent or more. The second stage of tax reform will reinforce these incentives.

Longer-term economic potential is directly related to the growth of labour supply in the economy. While the timing of increases in the Canadian labour supply resulting from the incentive effects of tax reform will depend upon employment conditions and will likely be realized only over the longer term, such increases will have an important and positive impact on Canada's economic prospects. Canada's international competitiveness will be enhanced, the trade balance will improve and more jobs will be created. Increased employment will further raise domestic demand, thereby producing a virtuous circle of higher labour supply and greater employment opportunities.

Savings Incentives

Comprehensive tax reform will strengthen personal sector incentives to save. In the first stage of tax reform, the total impact on aggregate personal savings behaviour is likely to be negligible as the positive incentive effect of lower statutory personal income tax rates is largely offset by base broadening. As the personal income surtax is eliminated and personal income taxes are cut further in the second stage of tax reform, however, there will be an increase in the marginal after-tax return to saving that will provide a significant stimulus to personal sector saving. Over all, tax reform could increase the personal savings rate by as much as 1 percentage point, or close to $4 billion in today's dollars.

A higher rate of domestic savings over the longer term should provide a larger, and less costly, pool of funds for investment activities. Increases in investment will expand the productive capacity of the Canadian economy, thereby raising productivity and enhancing competitiveness. As domestic savings move into better balance with domestic investment, the current account of the balance of payments should improve. Decreased reliance on foreign savings will act to raise national income.

The Economic Impacts of Corporate Income Tax Reform

In the February 1986 budget, actions were taken to reduce statutory corporate tax rates, eliminate the general investment tax credit, and abolish the 3-per-cent inventory allowance. Further changes to the corporate tax system being introduced in stage one of comprehensive tax reform include:

- further substantial reductions in statutory corporate tax rates; and,
- additional base broadening measures, including reductions in capital cost allowance rates, the elimination of the earned depletion allowance, restrictions on business expenses and significant measures specific to the finance, insurance and real estate industries.

In the second stage of comprehensive tax reform, the corporate income tax surtax will be eliminated, and the replacement of the existing federal sales tax system will remove significant distortions currently affecting the business sector.

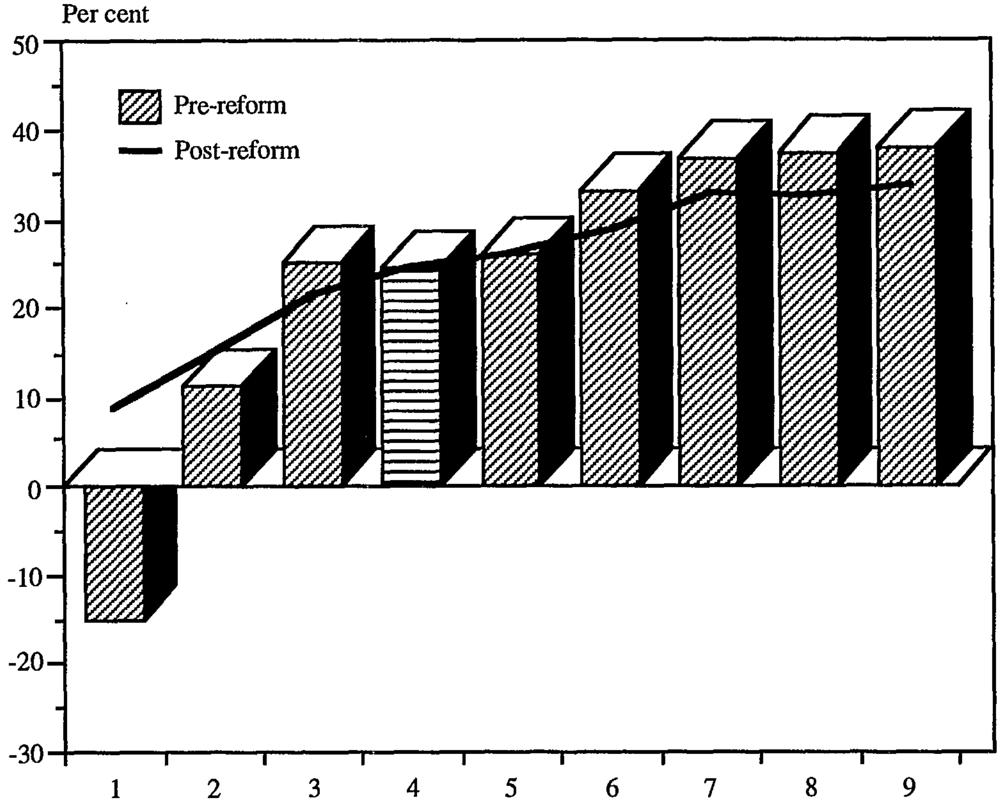
The key impact of corporate tax reform will be to reduce the variability of corporate tax burdens across industries and among capital assets. Large differences in marginal tax rates among industries mean that projects earning very different rates of return before tax can be equally profitable after tax. The reduction in the variation in marginal tax rates across sectors resulting from corporate tax reform implies that the corporate tax system will have a less distortionary effect on new investment decisions (Chart 2.1).

Corporate tax reform will also reduce the relative tax disadvantage currently affecting labour-intensive industries and firms. This is achieved as current tax incentives to substitute capital for labour in the production process are reduced. Reducing tax-induced distortions in production technologies should promote economic efficiency.

The corporate tax system affects many business decisions. Another important effect of the current system of high statutory corporate tax rates is that it encourages businesses to finance the acquisition of assets by debt rather than equity. The experience of the 1980-1982 period provides a clear demonstration of how an economy can suffer from excessive corporate leverage. The lower corporate tax rates resulting from tax reform will reduce the tax value of the

Chart 2.1

Federal/Provincial Tax Rates on New Investment for Large Corporations, by Industry Group (1)



1 - Mining
2 - Oil and gas
3 - Agriculture, forestry and fishing
4 - All sectors (2)
5 - Manufacturing
6 - Services
7 - Construction
8 - Retail trade
9 - Wholesale trade

(1) Provincial tax rates are those in effect May 1, 1987. Values are based on the assumption that provinces parallel the base-broadening measures of tax reform but do not change rates.

(2) Total non-financial sector.

interest deduction, thus increasing the relative after-tax cost of borrowing and lowering the tax incentive for debt financing relative to equity.

To reflect Canadian priorities, certain corporate tax preferences will be retained. Research and development is essential to enhance Canada's longer-term competitiveness and to raise the economy's growth potential. Favourable tax treatment for R&D investments will continue to provide Canadians with one of the most favourable tax regimes for this type of investment of any industrial country. The incentive value of regional investment tax credits will be maintained, with the rates of credit reduced in direct relationship to lower statutory tax rates. Preferential treatment of small businesses will be continued in recognition of the contribution of these enterprises to employment growth and innovation.

The quantitative impacts of the corporate tax changes are difficult to assess precisely. The roughly $1 billion per annum shift in the federal tax burden to the corporate sector will, over the short to medium term, result in a slight increase in the user cost of capital which could be expected to generate a somewhat lower desired level of capital. Over the longer term, however, the reduced variation in effective corporate tax rates means that economic considerations will play a more important role in investment decisions than has been the case in the past. This will raise the quality of the capital stock and could lead to additional investment spending. This reduction in the variation of effective corporate tax rates could, alone, raise the level of productivity and real output in the Canadian economy by 0.3 per cent over the longer term, according to general equilibrium model estimates.

The second stage of tax reform, through the replacement of the present sales tax system and its hidden taxes on business inputs by a broad-based multi-stage sales tax, will increase significantly the incentives for corporations to invest, and will improve the competitiveness of Canadian businesses.

The Economic Impacts of Sales Tax Reform

The impacts on overall economic performance of the sales tax reform to be undertaken in the second stage of tax reform will be substantially greater than the economic impacts of the first stage of tax reform. The goal of sales tax reform is to replace the current sales tax system, with its many distortions, by a broad-based multi-stage sales tax that is more neutral in its impact on economic activity. A reformed sales tax system will interfere less with the efficient allocation of resources within the economy, and enhance Canada's international competitiveness.

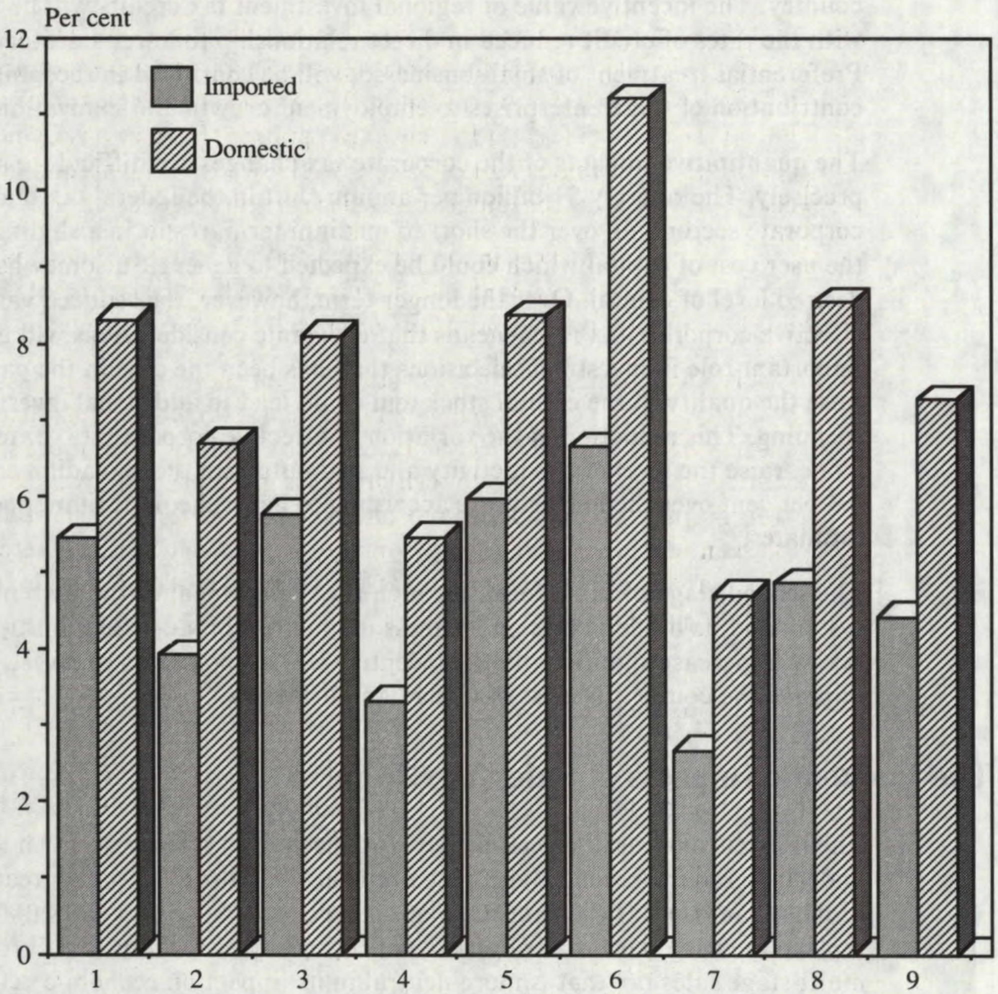
The main economic distortions in the present federal sales tax system are set out below.

Taxation of Business Inputs

- The taxation of business inputs rather than final sales has a number of serious adverse impacts on economic performance. Currently, about half of federal sales tax revenues comes from the taxation of business inputs such as office

Chart 2.2

Effective Federal Sales Tax Rates on Selected Domestic and Imported Goods



1- Tires
2- Household furniture
3- Household appliances
4- Glassware and glass products
5- Televisions, radios, stereos
6- Office machines and equipment
7- Jewellery
8- Toys and game sets
9- Cosmetics

supplies, building materials and many types of non-production business machinery and equipment. The tax on these inputs becomes a cost for other goods and services that use such inputs in their production, and thus a hidden cost in the price of almost all goods and services in the economy, even though they may not be directly subject to the tax. Because the direct and indirect tax components of the final price are different for different goods and services, depending upon how they are produced and distributed, the tax distorts relative prices and leads to a misallocation of resources.

- Taxation at an early stage of production also results in the impact of the tax on final prices (for goods that are directly taxed) being compounded. Wholesale and retail mark-ups are often applied to the tax-paid value and thus to the tax itself. Retail sales taxes apply to the final prices including federal tax, thus imposing tax on tax. In these ways, the hidden impact of the federal sales tax on consumer prices becomes greater than the tax itself.

- The taxation of business inputs raises the cost of capital goods to businesses. As a result, real investment spending is reduced, with detrimental effects on the level of potential output in the economy.

- Finally, a substantial portion of the tax on business inputs finds its way into the prices of exports. Although exports are not directly taxed, taxes on business inputs add an effective rate of about 0.9 per cent to the sales value of exports. This is equivalent to well in excess of 10 per cent of the average profit margins of Canadian exporters, and can create a substantial cost disadvantage in an increasingly competitive international marketplace, particularly when competing foreign companies do not pay taxes on their business inputs.

Preferential Treatment to Imports

- The current federal sales tax not only disadvantages exports, but it directly favours imports over domestic production. The tax bears more lightly on imports than on domestically produced goods because importers are generally not taxed on distribution and marketing costs incurred in Canada. Canadian manufacturers who incur these costs and recover them in the price of their products do, however, pay tax on them.

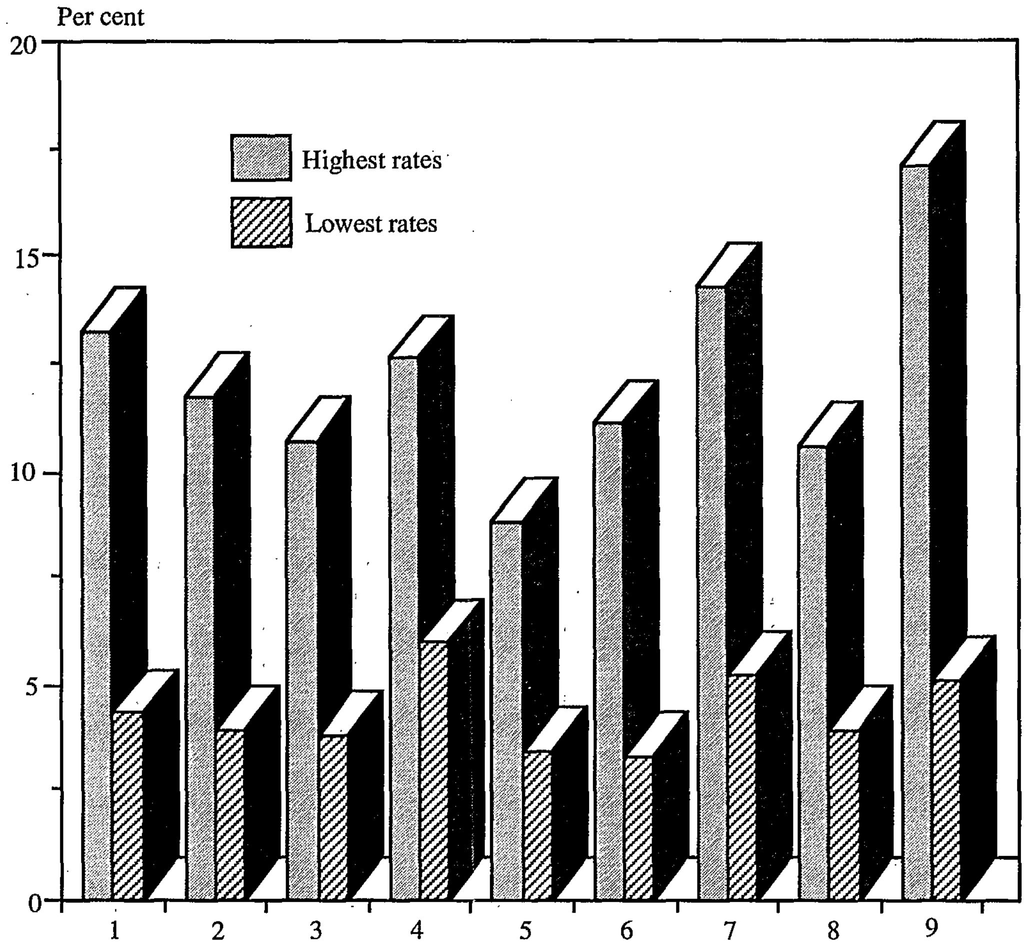
- It has been estimated that the effective rate of tax on domestic production is about one-third higher than on competing imports (see Chart 2.2). In some cases, the effective tax rate can be as much as 70 to 80 per cent higher: this is the case, for example, for household furniture, jewellery, sporting equipment, toys and games, and cosmetics.

Allocation Biases

- Effective federal sales tax rates across goods produced in the Canadian economy vary widely (see Chart 2.3). There are two main reasons for this dispersion. First, the federal sales tax applies to the manufacturer's selling

Chart 2.3

Effective Federal Sales Tax Rates on Selected Domestically Produced Commodities



1- Auto parts
2- Household textiles
3- Kitchen utensils
4- Household appliances
5- Electric light bulbs, lamps
6- Office and stationery supplies
7- Sporting equipment
8- Blankets, bedsheets and towels
9- Cosmetics

price, which represents only a portion of the final selling price, and subsequent mark-ups at the wholesale and retail levels vary from product to product and result in a wide diversity in effective tax rates. There are many examples in which the effective tax rates for similar products made by different manufacturers also vary widely. Second, the base for the federal sales tax is very narrow. For example, only about one-third of the value of consumer purchases is currently subject to the federal sales tax.

- This variability in the effective tax rates across sectors, and even across manufacturers within an industry, means that economic allocation decisions are being distorted by the influence of the sales tax system. The end result is an overall loss in the economic efficiency with which Canada's resources are allocated.

Sales tax reform that eliminates these distortions will improve the structure and performance of the Canadian economy. In addition to the structural gains from sales tax reform, the move to a broad-based multi-stage sales tax will also have appreciable short- to medium-term impacts on the overall economy. Growth rates of output and employment will increase in response to increased investment spending and a positive swing in Canada's trade balance. These impacts will arise because a broad-based multi-stage sales tax will remove the tax on business inputs, treat domestic and imported goods equally, and distribute the tax load more fairly across a broader range of goods and services.

Reform of the sales tax system will enhance the competitive position of the Canadian economy. The elimination of the tax on business inputs would lower exporters' costs relative to their competitors' costs by about 0.9 per cent. The removal of the tax bias in favour of imports would improve the relative cost position of Canadian producers with respect to importers in the order of 2 to 3 per cent. For certain industries producing goods such as household furniture, jewellery, sporting equipment, toys and games and cosmetics, the benefits would be much larger. Depending on how trade prices are set in the various markets, the benefits would initially flow through either a better net trade performance or, more directly, into higher Canadian profits. This would lead to greater production opportunities, capacity expansion, job creation and higher national income.

Slightly more than one-third of the value of final expenditures on investment is now subject to federal sales tax at either the 8-per-cent or 12-per-cent rate. Therefore, the effect of the removal of the federal sales tax on investment goods and its replacement by a broad-based multi-stage sales tax would be roughly equivalent to a 4-per-cent reduction in the cost of capital. Over the longer term, the result could be an increase in the level of the desired capital stock of as much as 4 per cent. The resulting expansion of the capital stock will enhance Canada's output potential.

The proposed reforms will also generate additional savings to help finance this higher investment. Increased reliance on sales taxes and less on income taxation, accompanied by the elimination of the income surtaxes, will further increase the level of savings in the economy. Higher savings will flow from two main sources.

Household savings will increase as a result of the higher after-tax returns to savings. As well, an improved current account balance will provide a further source of national savings.

Estimates of the overall loss in real output resulting from the distortions caused by the present federal sales tax, obtained from general equilibrium model analyses, range as high as 1.5 per cent of real GDP, or about $8 billion in today's dollars. These costs arise primarily from the taxation of business inputs and the federal sales tax bias against Canadian goods in export and domestic markets. A reformed national sales tax system, free of these biases and neutral in its impact on goods and services, could yield even more substantial long-term real output gains.

The structural gains from sales tax reform will be substantial. Following the implementation of a broad-based multi-stage sales tax, there would likely be a sizeable demand stimulus from the improvement in the net trade balance and the increase in investment spending to reflect higher desired capital stocks. This will increase real GDP growth and expand employment opportunities.

For obvious reasons, the shift from a narrowly-based federal sales tax to a broad-based multi-stage sales tax will have some impact on the prices of previously untaxed goods and services. This impact would be more substantial if existing provincial retail sales taxes were replaced by a national system at the same time. This one-time increase in the prices of goods and services which are not now subject to tax will be offset, to a certain degree, by price reductions resulting from the lowering of the tax rates on currently taxable commodities. As well, for many Canadians, the increased costs would be offset or more than offset by the refundable sales tax credit, the removal of the surtax on personal income, and further personal income tax cuts. After a brief period, price trends would return to normal. As such, the one-time price adjustment should not find its way into the determination of other costs, and would not increase export prices.

3. The Economic Outlook, 1987 to 1992

Introduction

In the February 1987 budget, economic and fiscal forecasts were presented only for fiscal years 1986-87 and 1987-88. At the time, it was recognized that comprehensive tax reform would have important impacts on Canada's medium-term economic and fiscal prospects. This chapter presents economic projections to 1992 which reflect the proposals set out in the first stage of comprehensive tax reform.

International Economic Prospects in the Short Term

The prospects for the international and Canadian economies depend very much on how current world trade and fiscal imbalances evolve. The present massive trade deficit in the United States and large surpluses in Germany and Japan, combined with large government deficits in some countries such as the United States, are troubling. These imbalances, together with the increasing pressures on heavily indebted developing countries, present a serious challenge to sustaining healthy world economic growth.

Steps have been taken to address international imbalances in a co-ordinated fashion. The fiscal deficit in the United States is being reduced, although uncertainty about the pace of future declines remains. Some stimulus has been injected into overseas economies, particularly in Japan where more is promised.

In the absence of sufficient policy actions, large exchange rate realignments have been necessary and have occurred. However, relying solely on exchange rate shifts is neither satisfactory nor desirable to achieve the needed medium-term adjustments. Further policy changes are required to reduce credit demands by the U.S. government and to encourage stronger domestic demand growth in other nations.

Real output growth in Japan and the major European members of the Organization for Economic Co-operation and Development (OECD) averaged about 2.5 per cent in 1986. However, after three years of trade-led growth, the prime source of growth in 1986 shifted significantly from net exports to domestic spending in these countries. This pick-up in final domestic demand, particularly in Germany and Japan, was weaker than expected, however, and in combination with the decline in constant dollar trade surpluses, resulted in worse-than-expected overall real growth performance. Inflation in the major overseas OECD countries was very low by recent standards because of the appreciations of their currencies relative to the U.S. dollar and the decline in the international price of oil.

The outlook for the international economy in 1987 and 1988 is set out in Table 3.1. Economic performance in the major European and Japanese economies is expected to be similar to 1986, although inflation will be somewhat higher. The trade surpluses in Japan and Germany are expected to show some decline later this year and through 1988. Further declines in real trade balances will reduce output growth. Without additional policy initiatives, growth in final domestic demand, particularly in Germany and Japan, will be moderate at best. As a result, there is some risk that the pace of final domestic demand growth in overseas countries will not be strong enough to offset the impact on their real output and employment growth prospects from the expected deterioration in their trade balances. A particular area of concern is that, with uncertainty in exchange markets, expectations by businesses of further currency appreciation against the U.S. dollar will constrain investment spending in Germany and Japan.

The growth of real output in the United States is expected to be 2.5 per cent in 1987, the same pace as recorded a year earlier. In 1988 growth of real GNP of 3 per cent is expected. Behind this pattern of modest improvement in real output growth is an expectation of a pronounced shift in the composition of output from domestic demand to trade. With the growth rate of real final domestic demand projected to be well under 2 per cent in both 1987 and 1988, a continuing improvement in the constant-dollar trade account is expected to be the primary source of economic growth. This trade improvement will emanate largely from the depreciation of the U.S. dollar on a trade-weighted basis since early 1985. The nominal value of the current account balance, however, is not expected to show significant improvement until 1988, reflecting the lags in the adjustment of trade volumes to the depreciation of the U.S. dollar.

The rate of inflation as measured by the consumer price index (CPI) fell dramatically in the United States in 1986, averaging 1.9 per cent for the year and reaching 1.1 per cent by year-end. Much of this decline was accounted for by the fall in energy prices. Excluding energy, the rate of inflation in 1986 was just below 4 per cent. In 1987 and 1988 inflation should average 4 per cent, although quarterly movements in U.S. inflation may be temporarily above 4 per cent as energy prices rise and import prices begin to reflect more fully the depreciation of the U.S. dollar. To date, import prices in the United States have shown only a partial response to the depreciation of the dollar.

Financial markets in the United States in recent months have reflected the general international uncertainty about trade and fiscal imbalances. Renewed downward pressure on the external value of the U.S. dollar has emerged since the beginning of 1987, particularly relative to the Japanese yen. In response to this pressure, and to the rising U.S. rate of inflation, interest rates moved up in the United States in March and April of this year.

Much of this financial market response may be an over-reaction to recent U.S. inflation performance and uncertainty over the prospects for the U.S. trade and fiscal imbalances. The dollar's weakness is in part related to the disappointment

Table 3.1

International Economic Prospects in the Short Term

	1986	1987	1988
	(annual percentage changes unless otherwise specified)		
United States			
Real GNP	2.5	2.5	3.0
Final domestic demand	3.6	1.3	1.5
Volume of net exports (billions of 1982 dollars)	–147.8	–122.3	–68.5
CPI	1.9	3.5	4.2
Employment	2.3	2.0	1.6
Current account balance ($ billions)	–140.6	–148.8	–131.0
90-day commercial paper rate(1) (per cent level)	6.7	6.4	6.4
AAA corporate bond rate (per cent level)	9.0	8.8	8.6
Major Overseas OECD countries			
Real GNP/GDP			
Europe(2)	2.4	2.3	2.2
Japan	2.5	2.7	3.3
Inflation (CPI)			
Europe(2)	2.3	2.9	3.1
Japan	0.6	0.3	1.5
Oil price assumption			
West Texas Intermediate at Chicago (U.S. dollars per barrel)	15.50	17.70	17.70

(1) Annual average yield basis

(2) Weighted average of Germany, France, the United Kingdom and Italy

over lack of progress in reducing the U.S. trade and fiscal deficits. However, in volume terms the trade balance is improving and improvements in the nominal current account deficit should be forthcoming. As well, the fiscal deficit is also declining from its peak in fiscal year 1986 and continued progress is expected. The increase in the rate of inflation largely reflects the unwinding of the temporary effects of lower energy prices in 1986 and the once-and-for-all increase in import prices due to the large depreciation of the U.S. dollar. Underlying cost increases remain moderate. Furthermore, domestic demand growth in the United States is weak, so growing credit market pressures are not evident.

These factors suggest that the U.S. interest rate increases in recent months may be unwound. In the forecast it is assumed that U.S. short-term interest rates decline slightly from their May 1987 average levels by year-end, and then remain fairly flat through 1988.

For commodities, the expected international environment is one in which prices in aggregate are expected to rise slightly from their present, generally depressed, levels. Depressed international grain prices are expected to continue, reflecting the excessive subsidization of agriculture in a number of countries. There is substantial volatility in international oil prices at present. For forecasting purposes, the oil price is assumed to average about $18 (U.S.) per barrel in 1987 and 1988.

Recent Canadian Economic Developments

With a real output growth rate of 3.1 per cent in 1986, Canada was the fastest growing economy of the major OECD countries. Yet the pace of growth through the year was uneven, and certain sectors and regions were hard hit by adverse international developments.

The pattern of output growth during 1986 was heavily influenced by swings in inventory investment. A rapid buildup of inventories during the first half of the year was followed by a much smaller increase on average in the second half and a decumulation of inventory stocks in the final quarter of the year. While a strengthening profile of final domestic demand and the volume of net exports through the year acted to partly buffer the influence of the inventory swings on real output, the pace of total output growth slowed significantly in the second half of the year. However, with the adjustment to the unsustainably high inventory accumulation likely completed before the end of the year, the economy is poised for a return to higher growth. Monthly GDP data for the first quarter of 1987 indicate a sharp increase in economic growth.

The pattern of economic growth across sectors and regions also varied substantially in 1986, reflecting largely adverse international developments for two key commodities, oil and grain. Oil prices had fallen by more than 50 per cent from late 1985 to mid-1986, and export prices for natural gas had also declined substantially. In response, there was an early and substantial cutback in employment and investment by the petroleum sector. Similarly, world grain prices fell sharply, with price levels in 1986 at their lowest levels in 10 years, having declined more than 20 per cent from 1985 levels alone. This created substantial economic difficulties and uncertainty in the main grain-producing regions of the country. Besides impacting significantly on regional economic performance in 1986 and early 1987, these developments accounted for a sizeable proportion of the increase in Canada's current account deficit.

From a deficit of $0.6 billion in 1985, Canada's current account balance deteriorated significantly in 1986 to an $8.8 billion deficit. As noted above, sharp declines in international prices for oil, natural gas and grains, and continuing weakness in other primary product prices were important factors in this deterioration. Large currency realignments against overseas currencies also played a sizeable role by raising the price, and hence nominal value, of imports from overseas countries.

Canada continues to have an impressive record of job creation. The 2.9-per-cent expansion of employment in 1986 was the strongest rate of increase since 1980 and by far the fastest rate of employment growth among the major industrial countries. And there have been further strong gains to date in 1987. Indeed, from July 1986 to May 1987 employment expanded at a 3.7-per-cent annual pace. Canada also has one of the fastest growing labour forces among the major OECD countries. The labour force grew by 1.8 per cent in 1986. While this strong labour force growth has dampened somewhat the influence of job creation in reducing the unemployment rate, significant progress is nevertheless being made. The unemployment rate in May was 9.1 per cent, down from 10.0 per cent at the end of 1985 and a peak of 12.8 per cent during the 1981-1982 recession.

Inflation, as measured by the consumer price index, was close to 4 per cent in 1986 for the third consecutive year. The impact of substantial price declines for refined petroleum products was offset by increases in food prices, indirect taxes, and housing costs. Import prices were also significantly higher, reflecting the decline of more than 10 per cent in the trade-weighted value of the Canadian dollar against the currencies of our major trading partners from early 1985 to the end of 1986. Wage costs remained moderate, with wage settlements averaging 3.4 per cent in 1986, and the Canadian economy has experienced good productivity growth during the recovery.

Paralleling developments in the international economy, Canadian financial markets have recently shown considerable volatility. From recent peak levels reached just prior to the February 1986 budget, short-term Canadian interest rates had fallen roughly 4 percentage points by the end of 1986. The substantial strengthening of the Canadian dollar early in 1987 presented the opportunity for a further decline in Canadian rates of over 1 percentage point by March. However, since March, increases in U.S. interest rates have led to some upward pressure on short-term Canadian interest rates, with rates moving back to levels prevailing at the end of 1986.

Canada's Short-Term Economic Prospects

The updated economic outlook for 1987 is very similar to that presented in the February 1987 budget. Economic activity in Canada is expected to expand at a moderate pace over the year, with some declines in both inflation and the unemployment rate, and relatively stable conditions in financial markets. Recent output and employment data strongly confirm this view, and suggest that growth will be considerably stronger than was expected by many private sector forecasters in early 1987.

The short-term economic outlook for the Canadian economy is summarized in Table 3.2 and Chart 3.1. Real gross domestic product (GDP) is expected to grow by 2.8 per cent this year and by 3.0 per cent in 1988. While these average annual rates of growth are slightly less than that recorded in 1986, the pace of expansion through this year and next will be significantly stronger than last year. The average annual pace of growth from the end of 1986 to the end of 1988 is expected to be double the 1.6-per-cent increase in real GDP registered from the fourth quarter of 1985 to the fourth quarter of 1986.

Table 3.2

Canadian Economic Performance and Outlook: Main Economic Indicators, 1986 to 1988

	1986 (actual)	1987 (forecast)	1988 (forecast)
	(percentage change unless otherwise indicated)		
Expenditures (volumes)			
Gross domestic product (GDP)	3.1	2.8	3.0
Consumer expenditure	4.0	2.7	3.1
Residential investment	13.2	6.6	−3.9
Business non-residential investment	−0.8	1.6	4.9
Machinery and equipment	5.4	4.4	5.3
Non-residential construction	−7.7	−1.9	4.5
Government expenditure	0.5	1.8	1.0
Final domestic demand	3.1	2.6	2.4
Inventory change (billions of 1981 dollars)	3.8	1.5	2.9
Exports	3.1	2.9	2.5
Imports	5.1	0.7	1.7
Net exports (billions of 1981 dollars)	16.4	19.4	20.8
Current account balance (billions of current dollars)	−8.8	−7.6	−8.3
Housing starts (thousands of units)	200	209	192
Prices and costs			
CPI	4.1	3.9	3.8
GDP deflator	2.8	3.5	3.7
Average wage settlements	3.4	3.5	3.7
Labour market			
Labour force	1.8	1.9	1.8
Employment	2.9	2.3	2.1
Unemployment rate (per cent level, fourth quarter)	9.4	9.1	8.9
Incomes			
Personal income	6.9	6.2	6.0
Corporate profits	−4.9	10.2	16.6
Personal savings rate (per cent level)	11.3	10.5	9.5
Financial market assumptions			
90-day commercial paper rate (per cent level)			
Nominal	9.2	7.8	7.6
Real(1)	5.1	3.9	3.8
McLeod Young Weir average of long-term corporate bond rates (per cent level)			
Nominal	10.8	10.6	9.4

(1) Real interest rates are defined as the nominal rates minus the percentage change in the consumer price index.

Output growth in the Canadian economy over the short term is expected to be led by non-energy investment and a rebound in inventories from the low levels of late 1986. The latest Private and Public Investment Intentions (P&PI) survey by Statistics Canada suggests that non-energy investment will rise 6.2 per cent this year, or about 3 per cent in real terms. The prospects for energy investment are expected to offset some of this strength. A rebound in inventory accumulation to more normal levels over this year and next will also be a significant contributor to real output growth.

Housing activity has been very strong recently, with monthly housing starts averaging 222,000 (at annual rates) since mid-1986. Activity in this market is anticipated to continue to be robust, with housing starts expected to average 200,000 in 1987 and 1988. The strength in this market reflects the impact of strong employment and income growth, buoyant consumer confidence and relatively favourable financial conditions. The rapid pace of housing starts means that a considerable part of the pent-up demand for housing that accumulated earlier in the 1980s is now being satisfied.

Consumer expenditure growth is expected to be solid, but more moderate than experienced in recent years. The very rapid growth of spending on consumer durables since 1983 has now largely satisfied the built-up demand that existed for these goods after the 1981-1982 recession. The pattern of domestic spending is expected to shift away from durables, especially automobiles, and move to other goods and services.

Government expenditures on final demand are expected to grow much more slowly than total output, reflecting actions by both levels of government to restrain growth in government spending.

Some improvement in the volume of net trade is forecast but the nominal current account deficit this year and next is expected to be similar to that recorded in 1986. Weakness in final domestic demand growth in the United States, particularly in automobile sales and construction, and ongoing international surpluses of natural gas and grain, together with depressed prices for these commodities, are important factors expected to impede a significant improvement in the current account position in the near term. The international competitiveness of the Canadian economy will be crucial in determining the pace at which the current account deficit is reduced over the next few years.

The pace of output growth this year and next is expected to generate an environment in which both job creation and labour force growth will continue to be strong and the unemployment rate will continue to decline. From the end of 1986 to the end of 1988, over 550,000 new jobs are expected to be created. This should permit a gradual decline of the unemployment rate to below 9 per cent by next year.

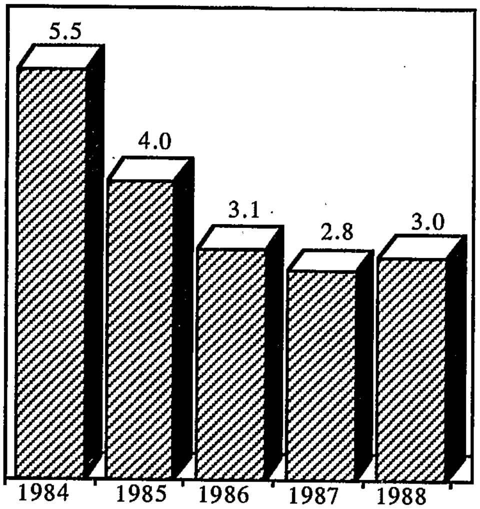
Inflation is expected to be just below 4 per cent this year and next, and then decline to 3 per cent over the medium term. Underlying cost increases should continue to be moderate, but some upward pressure on prices will come from indirect tax increases and housing. In contrast to the large inflation differential in

Chart 3.1

Economic Performance and Prospects in Canada: 1984-1988

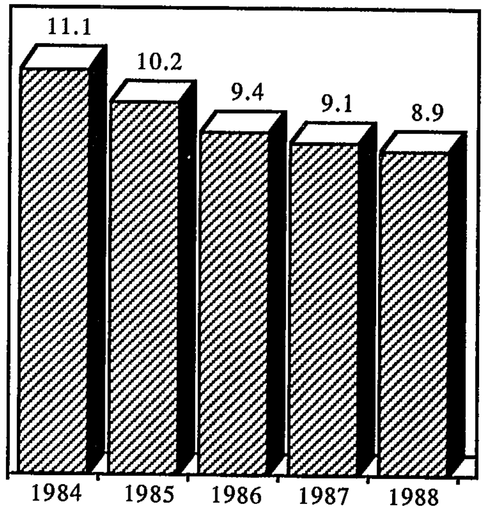
Growth Rate of Real GDP

per cent



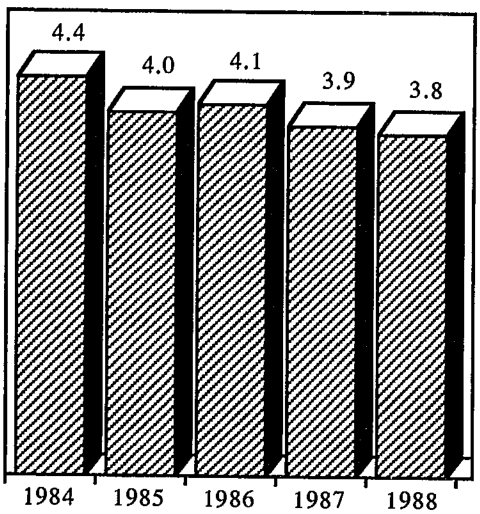
Unemployment Rate - Fourth Quarter

per cent



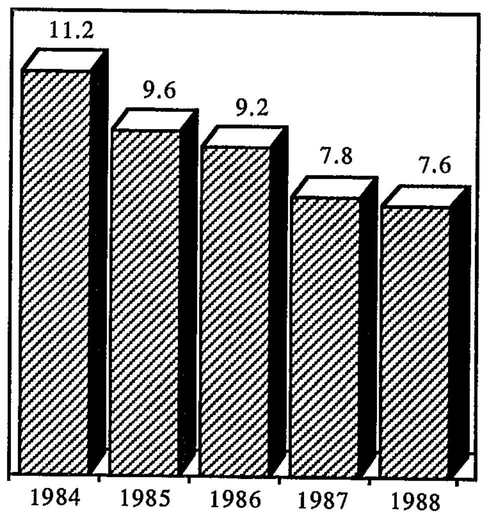
Inflation Rate (CPI)

per cent



90-Day Commercial Paper

per cent



Note: Figures for 1987 and 1988 are forecasts.

favour of the United States in 1986, the Canadian rate of inflation is forecast to move below the U.S. inflation rate by 1988.

Interest rates are assumed to decline slightly from the levels prevailing in May 1987. The 90-day commercial paper rate is expected to average 7.8 per cent this year, the same level as forecast in the February 1987 budget, and then decline to 7.6 per cent in 1988. The yield on industrial bonds is expected to decline more significantly by 1988, in part due to anticipated developments in U.S. financial markets, but also reflecting the forecast improvement in relative Canadian inflation performance and the continued progress in reducing fiscal deficits in Canada. Nevertheless, after accounting for inflation, interest rates are expected to remain considerably above average historical levels over the next two years.

Sectoral and regional economic performances diverged significantly in 1986. The dramatic fall in oil and grain prices had significant adverse impacts on output and employment in the Prairie and Atlantic provinces, while strengthening domestic and international demands for manufactured goods bolstered growth in Central Canada. The recent firming of prices for oil and some other commodities, in conjunction with the significant realignment in the value of the Canadian dollar against overseas currencies, should lead to a greater degree of balance in sectoral and regional economic performance this year and next, although depressed international grain prices will continue to seriously constrain farm incomes, particularly in Western Canada.

A number of recent economic indicators, which are presented in Chart 3.2, point to a broadening of economic activity across regions and sectors. The P&PI Investment Intentions survey by Statistics Canada indicates greater balance in business spending plans across sectors and regions in 1987 than was observed in 1986. As well, employment growth improved substantially in the Western and Atlantic regions during the latter part of 1986 and the early part of 1987, while remaining strong in Central Canada, particularly in Quebec. Over the next 18 months, all regions should share more fully in Canada's expected employment and output growth.

In 1987 and 1988, the Canadian economy is expected to continue its strong economic performance relative to other major industrial countries. Real GDP growth in Canada is expected to be slightly above the average for the OECD countries in both years. Job creation in Canada will also continue to outpace that in other major OECD countries. While the inflation rate in Canada is expected to be slightly above the OECD average, the differential between inflation in Canada and our key trading partners should narrow significantly from that observed in 1986.

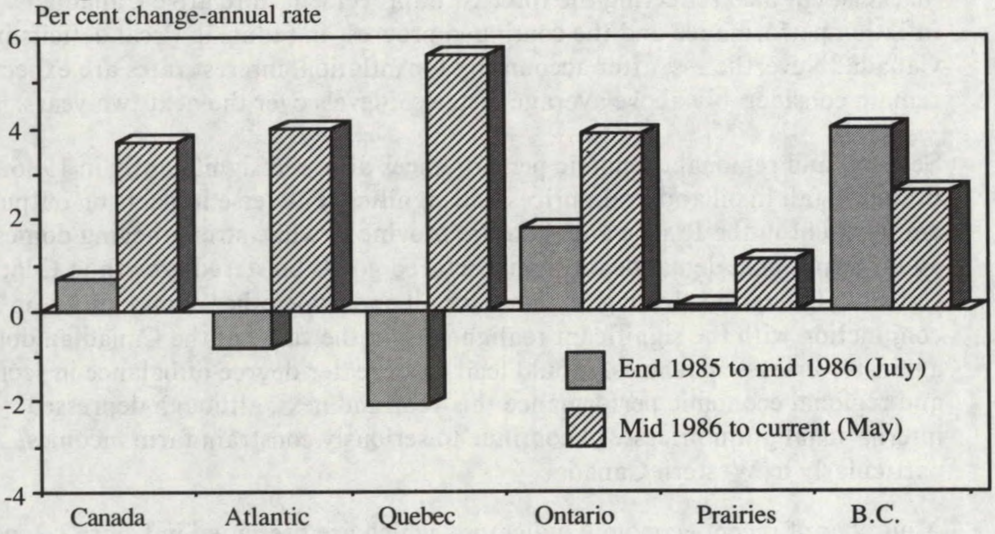
Medium-Term Economic Risks and Uncertainties

Canada's economic prospects into the early 1990s will be importantly influenced by both economic policies at home and by progress and stability in the international economic environment. The prospects for such progress and stability

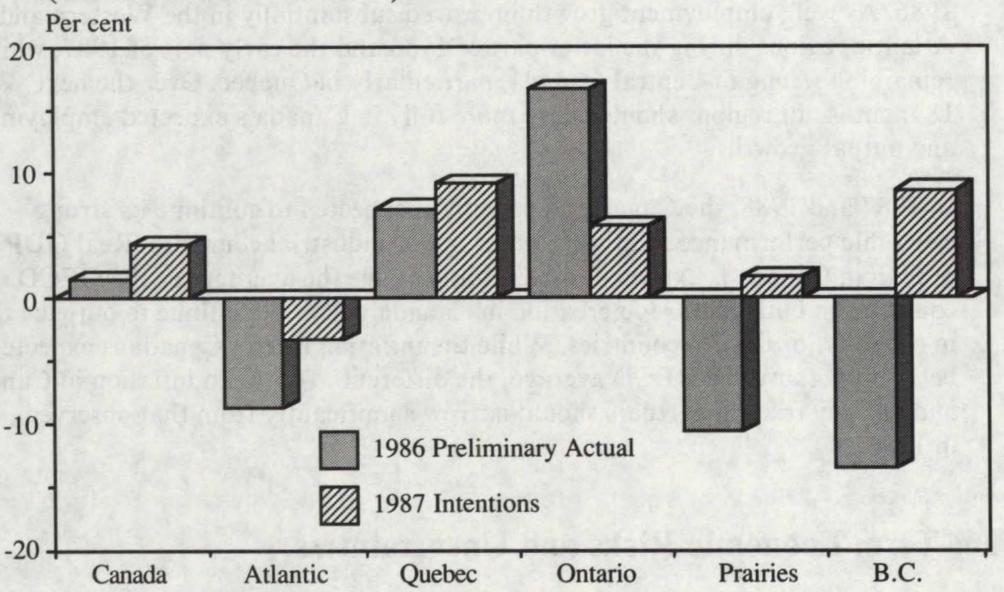
Chart 3.2

Indicators of Recent Regional Economic Performance

Regional Employment Growth Since December 1985



Regional Growth in Business Capital Expenditure* (In Current Dollars)



* Private and Public Investment Intentions Survey, Statistics Canada, March 1987.

will be affected by how the major current trade and fiscal imbalances evolve. While there are risks associated with the current international situation, there are also opportunities for the major industrial countries to implement policies in a co-ordinated fashion to better ensure a sustained expansion.

It is important to recognize that medium-term projections are not forecasts; rather, they represent views of possible economic outcomes that are consistent with the economic and policy assumptions embedded in them. Different, but perhaps equally plausible, assumptions can lead to quite different economic projections. Clearly, medium-term projections at present will be influenced by assumptions about government policy decisions in the United States, Germany, Japan and elsewhere.

The basic assumption about the international environment embedded in the medium-term projection is that the major international imbalances improve gradually, without significant disruptions to the international economic system. The depreciation of the U.S. dollar that has already taken place, combined with the improving growth in domestic demand in the main overseas OECD economies, is projected to lead to steady improvements in the U.S. trade position. While Gramm-Rudman-Hollings deficit targets will not likely be achieved, a substantial reduction in the U.S. deficit is expected in fiscal years 1987 and 1988, and the U.S. administration has committed itself to sizeable further declines in the deficit over the medium term. Furthermore, the G-7 countries have agreed to implement policies in a co-ordinated fashion that should further reduce current international imbalances.

The resulting improvement in trade and fiscal imbalances, and the positive perception of government policies, should contribute to an environment in which real interest rates will moderate. In this medium-term international projection, lower real interest rates will make the debt burdens of less developed countries easier to manage. Steady, moderate growth in the global economy should also set the stage for some firming of commodity prices.

If progress in reducing present international imbalances is not continued, the consequences for the international economy would be severe. For example, failure of the U.S. government to achieve substantial deficit reduction, weak domestic demand growth in overseas countries and lack of progress in re-balancing trade flows among the largest industrialized countries could well set the stage for an environment in which the U.S. dollar falls sharply, U.S. protectionism increases, international interest rates rise, and the risks of financial disruption arising from the international debt burdens of the developing countries increase.

Such developments would threaten the prospects for sustained world economic growth. Recent signs of improvement in the U.S. trade and fiscal imbalances, however, coupled with strengthening domestic demand and declining real net trade surpluses in Japan and Germany, suggest that the required adjustments are under way. Success in pursuing co-ordinated policy measures is being influenced by the realization that failure to act could seriously threaten international economic prospects. In the light of recent economic developments and policy actions, a balanced assessment of medium-term international economic prospects suggests that a moderately optimistic projection is the most likely.

Canada's Medium-Term Economic Prospects

The fundamentals of the Canadian economy are healthy. Although the Canadian economy is now in its fifth year of expansion, the typical domestic signs of a tiring recovery – rising inflation and costs, excessive inventories, and weakness in housing markets – are not present. With strong consumer confidence, firming investment spending and a stable policy environment, Canada's prospects are good for continuing, and relatively strong, output and employment growth. This should permit ongoing, gradual declines in the unemployment rate throughout the medium term.

Stage one of comprehensive tax reform will enhance the medium- to longer-term economic potential of the Canadian economy. The changes to the personal and corporate income tax systems will increase incentives to work and invest, and will improve the quality of the capital stock, thereby enhancing productivity. These beneficial impacts will, however, be realized only gradually.

The second stage of tax reform, which includes replacing the existing sales tax system while enhancing the refundable sales tax credit, eliminating the income surtaxes and further reducing personal income taxes, will complement and extend the stage one incentives to increased labour supply and saving. But the major economic impact of the second stage of comprehensive tax reform will be its strongly beneficial effects on the competitiveness of Canadian industry and the incentives for Canadian industry to invest. Comprehensive tax reform will lead to a more efficient allocation of resources in the Canadian economy, a more competitive economy in the global marketplace, and increased potential for growth and job creation in the 1990s.

The highlights of the Canadian medium-term projections are set out in Table 3.3 and Chart 3.3. Real GDP growth should average 3 per cent over the period 1989 to 1992, allowing the unemployment rate to fall below 8 per cent by the 1990s. The Canadian economy should continue to show a favourable performance on unit labour costs, and this should help to stabilize the underlying inflation rate around 3 per cent. A favourable global competitive position for Canadian corporations and some recovery in commodity prices should allow ongoing improvements in the current account and generate sufficient profit growth to finance substantial capital spending. In an environment of moderate international interest rates and good Canadian inflation performance, there would be scope for further declines in Canadian interest rates over the medium term.

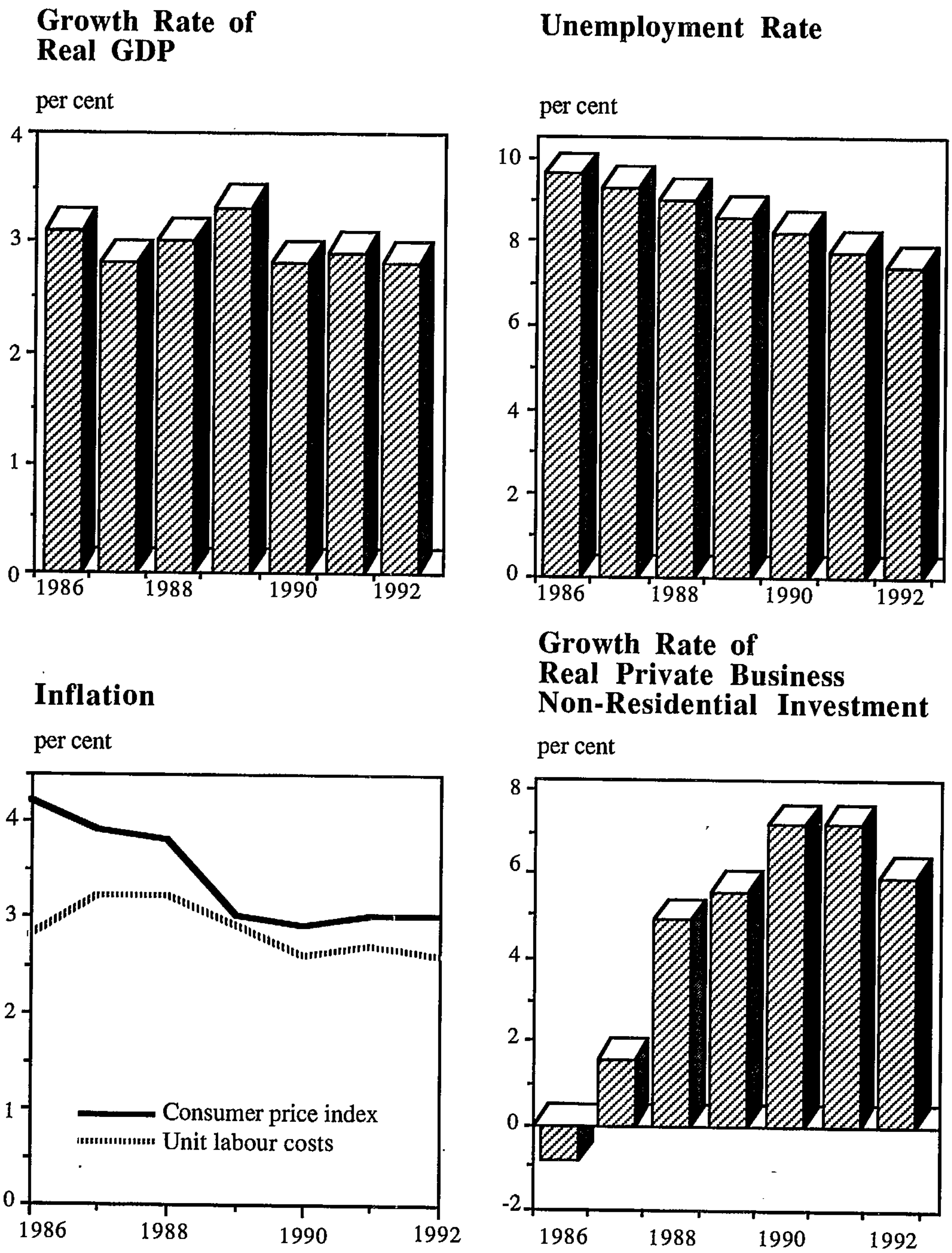
Table 3.3

Medium-Term Economic Outlook: Main Economic Indicators

	1986	1987	1988	Average 1989-1992
	(per cent change unless otherwise specified)			
Real GDP	3.1	2.8	3.0	3.0
Employment	2.9	2.3	2.1	2.2
Unemployment rate (per cent level, fourth quarter)	9.4	9.1	8.9	8.0
Inflation (CPI)	4.1	3.9	3.8	3.0
90-day commercial paper rate	9.2	7.8	7.6	7.2

Chart 3.3

Canada's Medium-Term Economic Prospects: Key Indicators



4. The Fiscal Implications of Stage One of Comprehensive Tax Reform

Introduction

Events in the 1970s and 1980s have shown just how sensitive federal revenues can be to both economic developments and policy changes. Some of this sensitivity reflects the influence of economic factors on government revenues, such as swings in commodity prices and the 1981-1982 recession. In addition, however, discretionary changes to the tax system during the 1970s and early 1980s, and important tax developments abroad, have significantly increased the variability of the federal government's revenues. This variability has impaired the government's ability to undertake both its short- and medium-term fiscal planning. Indeed at times it has forced the government to make unintended mid-year corrections that can be disruptive to fiscal planning.

The experience of the 1980s has highlighted disturbing trends in the tax structure that have reduced the predictability and stability of federal revenues. In particular, developments have tended to weaken the relationship between what is earned as income and what is counted as income for tax purposes, as well as between what is counted as income for tax purposes and what is actually paid in tax. This problem has resulted from the proliferation of selective tax preferences, and their increased use by taxpayers to minimize their tax payable. While economic factors will always influence revenue collections, comprehensive tax reform will help reduce the variability and improve the predictability of federal tax revenues, enhancing the overall environment for fiscal planning.

The lower personal and corporate statutory tax rates, elimination of selective income tax preferences and broader income tax bases proposed in the first stage of comprehensive tax reform have three main fiscal implications. They will:

- reduce the variability of the federal government's revenues;
- affect the medium-term projections for the federal deficit; and,
- require related actions to ensure that the first stage of tax reform is consistent with the government's principles for responsible fiscal management.

Improving Fiscal Stability with Stage One of Tax Reform

Over the past decade the flow of revenues from the tax system has become less stable and more difficult to predict. In part, these problems have been attributable to adverse economic developments, such as large swings in commodity prices in the late 1970s and mid-1980s, and the substantial impacts of the 1981-1982 recession on income, tax bases and revenues.

In addition, however, decisions taken by governments have altered the tax structure in a way that, on balance, has led to a narrowing of tax bases and upward pressure on tax rates. The proliferation of selective tax preferences has ongoing implications for the predictability and stability of federal tax revenues:

- First, tax preferences directly reduce tax bases. To maintain revenue collections, tax rates must be raised. Moreover, since the government is not always able to anticipate accurately the use of these preferences, they directly impair the overall predictability of federal revenues and create uncertainty in fiscal planning.

- Second, the increasing use of tax preferences has substantially altered the relationship between taxes paid and income earned, both across and within sectors. Thus, even with a given aggregate level of income in the economy, changes in the composition of that income can have dramatic impacts on federal revenue collections. This is an important source of difficulty in predicting revenues. These types of compositional shifts were prevalent in the first half of the 1980s. For example, increasing proportions of transfer and investment income in total personal income – both of which are effectively taxed at lower rates than salary income – acted to reduce personal income tax collections over the period 1981 to 1984.

- Third, the interaction between high tax rates and narrow tax bases has encouraged increasingly aggressive tax avoidance activities which have further eroded tax bases. This is evident in the increased trading in corporate losses between taxable and non-taxable firms that has taken place in recent years.

If left unchecked, base erosion would have continued through the 1980s, putting upward pressure on tax rates to ensure ongoing progress in meeting fiscal objectives. While the government has attempted to address this problem through various tax initiatives in recent years, the prospect of further pressures arising from both domestic and international factors has become more serious.

For example, the sales tax base is highly vulnerable to erosion. The narrow base of the federal sales tax itself provides incentives for producers to seek tax-exempt status for their own goods. The breadth and variety of current exemptions from sales tax has prompted several court challenges seeking exempt status for goods that are now taxable. As well, the increasing tendency for businesses to restructure their operations through marketing companies in order to reduce sales tax liabilities, particularly in the light of recent jurisprudence, also puts the existing sales tax base at considerable risk.

In addition, reductions in statutory corporate tax rates in the United States and other countries mean that there is increased potential for real income-generating activities to shift abroad, as well as for changes in financial transactions that would allocate more taxable income to lower-rate jurisdictions. The result of such shifts would be a further significant erosion of the government's corporate tax revenues.

The initiatives proposed under stage one of comprehensive tax reform will considerably improve the stability and predictability of federal tax revenues. The broadening of the tax bases and the elimination of selective tax preferences, together with the lowering of tax rates, closer convergence of the top personal and corporate statutory tax rates and general anti-avoidance rules will address the prospective erosion of tax bases that would undoubtedly have occurred in their absence.

Direct Revenue and Expenditure Impacts of the Personal and Corporate Tax Measures

Panel A of Table 4.1 presents the direct revenue and expenditure impacts of the personal and corporate tax measures in the first stage of tax reform.

The changes to the personal income tax system will lower statutory tax rates significantly, broaden the personal tax base by reducing tax preferences, improve the fairness of the tax system and relieve about 850,000 lower-income Canadians from federal personal income tax through the conversion of exemptions to credits. On balance, these proposals will result in a reduction in federal personal income tax liabilities for the vast majority of Canadians. Most of the personal income tax proposals will be fully implemented in the 1988 taxation year but the adjustment of the withholding tables on July 1, 1988 means that there will be large refund payments in fiscal year 1989-90. By 1991-92, the tax reform proposals will reduce personal income tax revenues by approximately $2 1/2 billion per annum.

Similarly, the changes to the corporate income tax system will reduce statutory corporate tax rates and broaden the corporate tax base by about 20 per cent. The variation in average effective corporate tax rates across industries will be reduced significantly. In total, the corporate tax changes will increase the corporate tax share of total federal revenues. Corporate tax revenues are about $500 to $600 million higher in fiscal years 1988-89 and 1989-90 as a result. As the measures become fully phased in, the increase in corporate tax revenue will grow to about $1.5 billion by 1991-92.

The total direct revenue impacts of the personal and corporate tax measures would, in the absence of other measures, result in an increase in the deficit of $1.2 billion in 1988-89 and $3.2 billion in 1989-90, as the tax measures are almost fully phased in over a two-year transition period. Beyond this transition period, the revenue effects of these tax changes will contribute to an increase in the deficit of about $1 billion per annum. As well, these measures will directly increase the deficit by an additional $350 to $400 million per year through higher expenditures under the equalization program and because of higher Established Programs Financing cash payments to the provinces due to changes in the value of tax points.

Table 4.1

Fiscal Implications of Stage One of Tax Reform

A. Total Direct Revenue and Expenditure Impacts of the Personal and Corporate Tax Measures	1988-89	1989-90	1990-91	1991-92
		(millions of dollars)		
Revenue impacts				
Personal income tax				
Conversion of exemptions to credits and marginal tax rate reductions	−2,185	−5,910	−4,600	−4,905
Base-broadening and other measures	480	2,070	2,255	2,495
Net personal income tax reductions	−1,705	−3,840	−2,345	−2,410
Corporate income tax				
Tax rate reductions	−635	−1,545	−1,645	−1,665
Base-broadening measures	1,165	2,170	2,810	3,190
Net corporate income tax increases	530	625	1,165	1,525
Total net revenue reductions	−1,175	−3,215	−1,180	−885
Expenditure impacts				
Increased payments under Established Program Financing and Equalization	340	360	385	395
B. Related Revenue Measures				
Changes to the federal sales tax (FST) and the refundable sales tax credit				
Shift in federal sales tax to wholesale level for selected items and change in the treatment of marketing companies	295	310	315	330
10-per-cent tax on specified telecommunication and cable services	870	945	1,000	1,055
Tax at general rate on paint and wallpaper	60	60	65	65
Increase in refundable sales tax credit by $20 per adult and $10 per child	−120	−150	−155	−160
Net increase in FST revenues	1,105	1,165	1,225	1,290
Tax liability management				
Acceleration of source deductions and quarterly instalments of personal income tax		1,100		
Acceleration of sales and excise tax payments	1,600			
Total revenue increases resulting from tax liability management	1,600	1,100		
Total net revenue increases	+2,705	+2,265	+1,225	+1,290
Deficit implications of stage one of tax reform	−1,190	1,310	340	−10

Related Actions to Ensure Responsible Fiscal Management

An important principle of tax reform is that the fiscal impact of the reform should be basically neutral. Because sales tax reform will be implemented in a second stage, responsible fiscal management requires raising additional revenues from the existing sales tax system. These revenue increases are outlined in Panel B of Table 4.1.

Until the new sales tax system can be put in place, the government is proposing a number of interim changes to the existing federal sales tax. These measures will alleviate some of the major competitive distortions that now exist and reduce opportunities for tax avoidance. Together with increased revenue resulting from corporate tax reform, the measures will raise additional revenues to finance personal income tax reform. The measures include:

- moving the point of tax from manufacturers to marketing companies where the marketing company is related to the manufacturer, to reduce opportunities for unfair tax avoidance;
- moving the point of tax for certain products to the wholesale level to reduce the competitive advantage of imported goods;
- extending the sales tax to most telecommunications services at a rate of 10 per cent (charges for residential telephone lines will be exempt) and increasing the rate of tax for cable television services from 8 per cent to 10 per cent; and,
- taxing paint and wallpaper at the general sales tax rate, rather than the lower rate that applies to construction materials.

In addition, the government will be increasing the current refundable sales tax credit from $50 to $70 per adult and from $25 to $35 per child. The higher credits will be reduced by 5 per cent of family net income in excess of $16,000.

On balance, these measures are estimated to increase revenues by $1.1 to $1.3 billion per annum.

The government is also proposing, as part of tax reform, a number of new measures directed at strengthening compliance and improving administration. As part of its efforts to administer the tax system more efficiently on behalf of all taxpayers, an examination of further opportunities to speed up collection of tax liabilities has been undertaken. As a result of that examination, the government is proposing additional measures that will complement the initiative to accelerate payroll source deductions for large employers announced in the February 1987 budget. These measures will not represent an increase in tax liabilities but only an acceleration in the time at which liabilities already owed to the government are remitted. They include an acceleration of federal sales and excise tax payments, a further acceleration of the remittance of personal payroll source deductions made by large employers, and an acceleration of quarterly personal income tax instalments.

As indicated in Panel B of Table 4.1, the acceleration of the sales and excise tax payments will result in a one-time revenue increase of $1.6 billion in 1988-89, while the acceleration of source deductions and quarterly instalments will result in a one-time revenue increase of $1.1 billion in 1989-90. These management initiatives will also yield ongoing savings in the form of reduced public debt servicing costs.

The cumulative impact of the measures outlined in Table 4.1 on the deficit and net debt over the 1988-89 to 1991-92 period is negligible.

Re-balancing Federal Tax Revenue Shares

Table 4.2 traces the shares of the three main federal revenue sources since the early 1970s. A number of trends stand out. The relative importance of personal income taxes has increased markedly, while the shares of both the corporate income tax and sales tax have declined significantly. This shift in the balance of federal tax revenues reflected a combination of policy actions undertaken in the 1970s and early 1980s, and the uneven impact of economic conditions in the late 1970s and early 1980s on the composition and size of the underlying tax bases.

The share of sales tax revenues declined substantially in the mid-1970s due largely to reductions in sales tax rates and a narrowing of the sales tax base by the extension of exemptions. The decline in the corporate tax share in the second half of the 1970s largely reflected policy changes, both increasing use of preferences and rate reductions. The increase in the personal income tax share reflects movements in the other shares as well as the rising trend in personal income as a proportion of national income through the 1970s.

In addition to the ongoing impacts on tax shares from policy changes in the 1970s, the very disparate impacts of the 1981-1982 recession on the underlying tax bases further altered the balance of federal tax revenues in the 1980s. In particular, corporate profits were severely depressed by the recession, and corporate tax revenues fell correspondingly. Furthermore, the losses built up during the recession, combined with the loss-carryover provisions of the corporate tax system, continued to dampen the growth in corporate tax revenues during the recovery. As a result, the share of corporate taxes declined from 24.3 per cent of total personal, corporate and sales tax revenues in 1980-81 to 17.9 per cent by 1985-86. The recession also restrained the growth in consumer expenditures, thereby dampening the sales tax share. In contrast, growth in personal income tax revenues was also negatively affected by shifts in both the size and composition of the personal income base in the first half of the 1980s, but the impact was smaller than that on the other tax sources. As a result, the personal income tax share increased further.

Since 1984-85, strengthening growth in personal income and domestic sales subject to the federal sales tax, in conjunction with fiscal policy measures relating to personal income and federal sales tax rates, have increased the shares of these tax revenue sources. With the exception of 1984-85, the share of corporate income tax revenues continued to decline, so that for 1987-88 corporate income tax is estimated to represent only 15.6 per cent of total personal, corporate and sales tax revenues, the lowest share in more than two decades. This further decline has resulted primarily from the impact of low commodity prices and increasingly aggressive tax avoidance activities.

In the absence of tax reform, increasing reliance on personal income taxes would have continued. The tax measures in the first stage of tax reform will lower the share of personal income taxes and increase the shares of both corporate income and sales taxes. The corporate tax share will increase from a low of 15.6 per cent in 1987-88 to 17.2 per cent by 1991-92. The second stage of tax reform will bring about further re-balancing of the shares of the main tax revenues as the federal sales tax is replaced by a broad-based multi-stage sales tax, and there are additional personal income tax reductions and the removal of the personal and corporate surtaxes.

Table 4.2

Structure of Main Federal Tax Revenues

Fiscal periods	Personal income tax	Corporate income tax	Federal sales tax	Total of personal, corporate and sales taxes
		(per cent)		
Historical				
1971-72 to 1975-76	57.6	22.9	19.5	100.0
1976-77 to 1980-81	59.4	23.3	17.3	100.0
1981-82 to 1985-86	64.6	19.0	16.4	100.0
Current Year Projection				
1987-88	65.1	15.6	19.4	100.0
Projection for Stage One of Tax Reform				
1991-92	62.9	17.2	19.9	100.0

Note: Details may not add due to rounding.

5. The Fiscal Principles

Introduction

This chapter reviews the outlook for expenditures, revenues and the deficit in the context of the four principles of responsible fiscal management that were set out in the Speech from the Throne in October 1986. The revenue track presented in this chapter embodies the impacts of the first stage of tax reform as discussed in Chapter 4. The expenditure track reflects the ongoing programs of the Government of Canada, updated for changes to the economic outlook as well as for the automatic impacts on federal expenditures of the first stage of tax reform.

The Fiscal Strategy

The government's medium-term fiscal strategy is guided by four principles:

- to reduce the growth of the public debt to no more than that of the economy over the medium term: that is, to stabilize the debt-to-GDP ratio;
- to achieve continuing, sizeable year-over-year reductions in the deficit;
- to achieve substantial year-over-year reductions in the government's financial requirements; and,
- to ensure that the greater part of the fiscal progress is achieved through effective expenditure restraint and good management.

These principles have been pursued aggressively since the fall of 1984. While much progress has been made, there have also been unforeseen developments, primarily originating from adverse international events, that have slowed fiscal progress from what had been planned. In particular, the dramatic fall in oil and grain prices in 1986 and the likelihood that these commodity prices will not recover to earlier levels over the remainder of the decade has meant a substantial loss in income for the Canadian economy relative to what was expected at the time of the February 1986 budget. This in turn has put upward pressure on the medium-term deficit track through the impacts of lower oil prices on corporate income tax revenues and of lower grain prices on certain statutory expenditures.

While actions were taken in 1986 to dampen the impacts of these developments on the 1986-87 deficit, attempts to offset fully the ongoing influences of lower oil and grain prices over the remainder of the decade, through either further large expenditure cuts or large revenue increases, were judged likely to be more

Table 5.1

The Medium-Term Outlook for the Deficit, Financial Requirements, and Net Public Debt

	1986-87[a]	1987-88[b]	1988-89[b]	1989-90[b]	1990-91[b]	1991-92[b]
Budgetary deficit						
$ Billions	31.0	29.3	28.9	28.6	26.1	23.5
Percentage of GDP	6.1	5.4	5.0	4.7	4.0	3.4
Financial requirements						
$ Billions	21.6	21.3	22.3	19.7	16.0	12.7
Percentage of GDP	4.3	4.0	3.9	3.2	2.5	1.8
Net public debt						
$ Billions	264.5	293.8	322.8	351.4	377.5	401.0
Percentage of GDP	52.4	54.6	56.2	57.3	58.2	58.2

[a] Estimate

[b] Projection

disruptive to the economy than a somewhat slower pace of deficit reduction. Nevertheless, this choice was made in a way that ensures continuing progress with respect to all four fiscal principles.

Notwithstanding the impacts of lower oil and grain prices in 1986, the deficit for fiscal year 1986-87 is now estimated at $31.0 billion, $1.0 billion below the February 1987 budget projection, and $3.4 billion below the 1985-86 deficit of $34.4 billion. Program spending for fiscal year 1986-87 is estimated to be $89.4 billion, the target set out in the February 1986 budget and reconfirmed in the February 1987 budget. Revenues will be somewhat stronger than expected in the February 1987 budget, largely reflecting stronger corporate income tax collections in the first quarter of 1987 than anticipated. Financial requirements, excluding exchange fund transactions, in 1986-87 are estimated at $21.6 billion, $2.4 billion less than forecast at the time of the February 1987 budget, resulting from both the improvement in the deficit and increases in the net source of funds from non-budgetary transactions.

For 1987-88, the deficit forecast is unchanged from the February 1987 budget, although underlying the $29.3 billion deficit estimate is higher-than-anticipated statutory program spending, particularly in the areas of farm income support programs, unemployment insurance benefits, and public debt charges. These spending increases are offset by higher-than-anticipated revenue collections. Expected financial requirements for 1987-88 remain unchanged from the February 1987 budget forecast of $21.3 billion.

As indicated in Table 5.1, the pace of deficit decline is expected to slow temporarily in fiscal years 1988-89 and 1989-90. This reflects the ongoing impacts of lower oil and grain prices in 1987-88 and beyond, and the transition to the reformed corporate and personal income tax systems.

Looking ahead to the 1990s, the deficit and financial requirements are projected to show substantial declines. By 1991-92, the federal deficit is projected to decline a further 20 per cent from the estimated 1987-88 level, and financial requirements will be down 40 per cent from the estimated level for 1987-88. The debt-to-GDP ratio is expected to stabilize by 1991-92, constituting a key milestone in the government's medium-term fiscal strategy. Underlying these improvements, as shown in Table 5.2, are steadily declining expenditures as a percentage of GDP and a relatively stable ratio of revenues to GDP.

The remainder of this chapter examines the medium-term fiscal outlook in the context of the four fiscal principles.

Table 5.2

Key Fiscal Indicators Over the Medium Term

	1986-87[a]	1987-88[b]	1988-89[b]	1991-92[b]
Program expenditures				
$ Billions	89.4	95.7	99.1	108.2
Percentage of GDP	17.7	17.8	17.3	15.7
Statutory programs				
$ Billions	52.2	56.6	59.0	63.6
Percentage of GDP	10.3	10.5	10.3	9.2
Non-statutory programs				
$ Billions	37.3	39.1	40.1	44.7
Percentage of GDP	7.4	7.3	7.0	6.5
Public debt charges				
$ Billions	27.1	28.5	30.1	34.3
Percentage of GDP	5.4	5.3	5.2	5.0
Budgetary expenditures				
$ Billions	116.5	124.2	129.1	142.6
Percentage of GDP	23.1	23.1	22.5	20.7
Budgetary revenues				
$ Billions	85.6	94.9	100.2	119.1
Percentage of GDP	16.9	17.6	17.5	17.3
Gross domestic product				
$ Billions	505.2	537.8	573.9	688.4

[a] Estimate

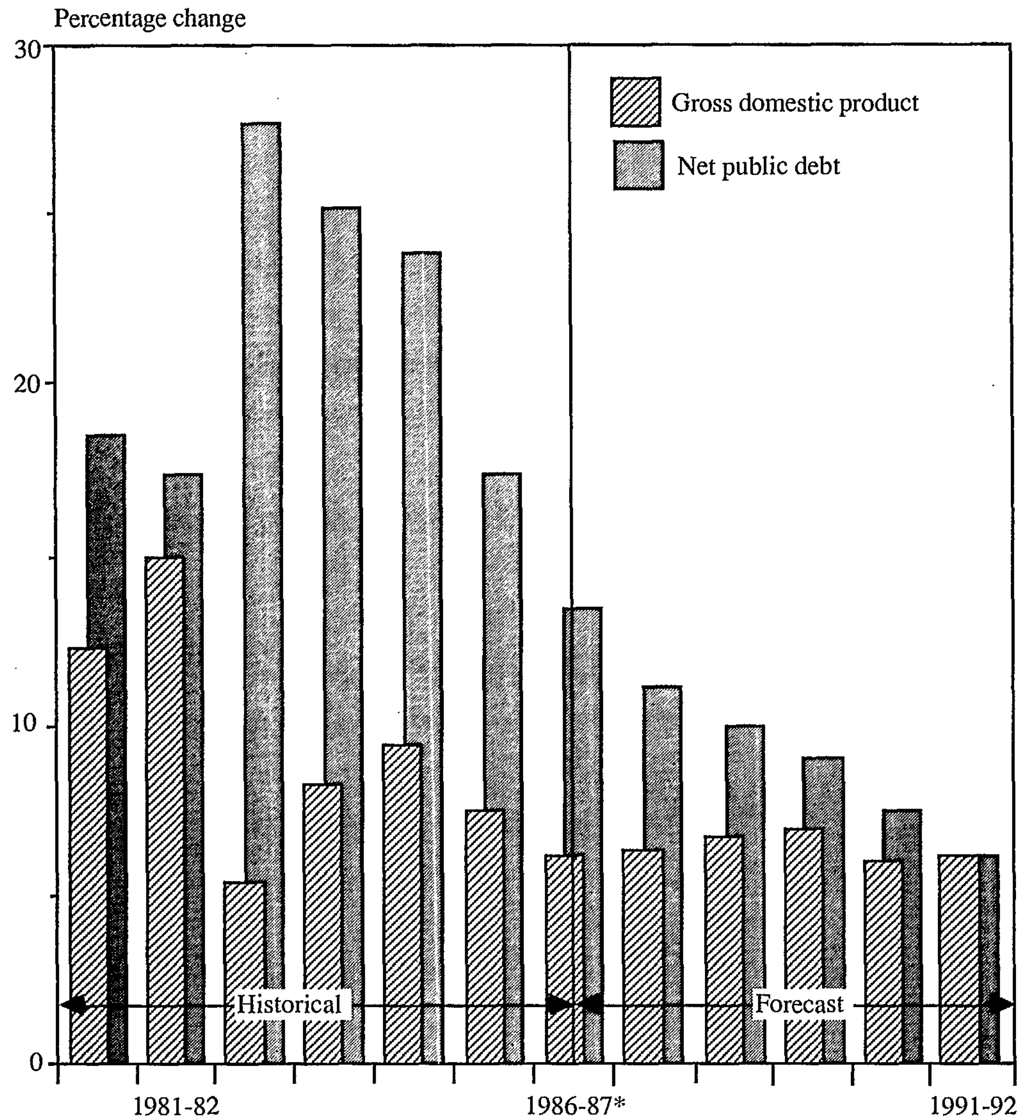
[b] Projection

Note: Details may not add due to rounding.

Chart 5.1

The Fiscal Planning Principles

Gross Domestic Product and Net Public Debt



*The estimate for 1986-87 is based on published monthly Statements of Financial Operations. Final data will be published in late summer.

Fiscal Principles in Perspective

Principle: To Reduce the Growth of the Public Debt to No More Than the Growth of the Economy (Chart 5.1)

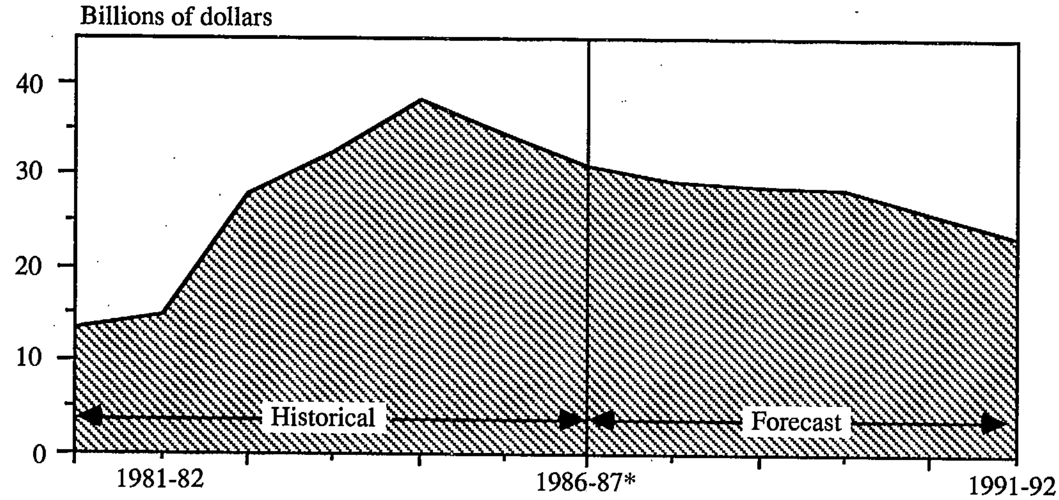
The problems of a continuously rising debt-to-GDP ratio can be put very simply. Unchecked growth in the debt-to-GDP ratio puts upward pressure on interest rates and threatens the economy's long-term growth prospects. It also means that interest payments on the government's debt consume a growing proportion of government expenditures and revenues. This leaves the government's fiscal position highly exposed to events beyond its control and severely restricts the government's capacity to manage the economy effectively.

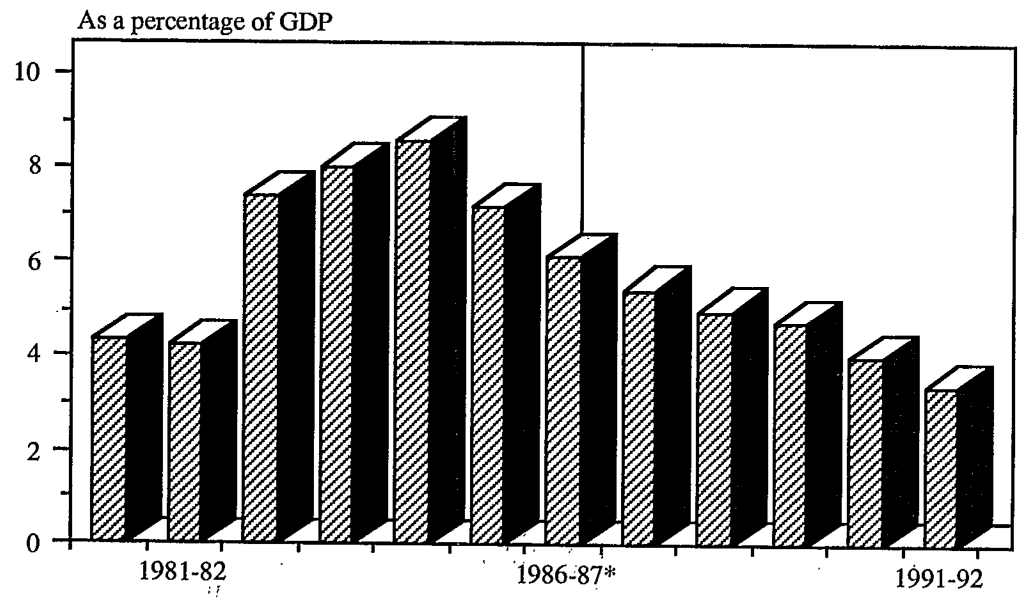
In the four years ending in 1984-85, the fiscal situation was out of control. Debt rose by 23.5 per cent per year during this period, as interest rates remained well in excess of the growth of the economy. The restraint program introduced in the fall of 1984, and continued in successive budgets, has dramatically reduced this growth to an estimated 11.1 per cent in fiscal year 1987-88. This cut in the growth of the debt has not yet been sufficient to halt the increase in the debt-to-GDP ratio. With the policy framework now in place, and with the projected moderate but steady economic expansion, the growth of the debt-to-GDP ratio will slow continuously over the medium term and stabilize by 1991-92.

Chart 5.2

The Fiscal Planning Principles

The Deficit





* The estimate for 1986-87 is based on published monthly Statements of Financial Operations. Final data will be published in late summer.

Principle: To Achieve Continuing, Sizeable Year-Over-Year Reductions in the Budgetary Deficit (Chart 5.2)

Continuous reductions in the deficit are the key to stabilizing the debt-to-GDP ratio. The government began correcting the deficit problem in the fall of 1984 and the progress is clearly demonstrated in Chart 5.2. Since the deficit peaked in 1984-85 at $38.3 billion, strong deficit reduction action has contributed to a projected reduction in the federal deficit of over $9 billion by fiscal year 1987-88. Relative to the size of the economy this represents a cut of 37.2 per cent in the federal deficit over three years.

With the broad restructuring of revenues and expenditures that has taken place since the fall of 1984, the deficit is projected to continue to decline over the medium term, reaching $23.5 billion, or 3.4 per cent of GDP, by 1991-92. Relative to the size of the economy, this would be the lowest deficit level realized since the mid-1970s.

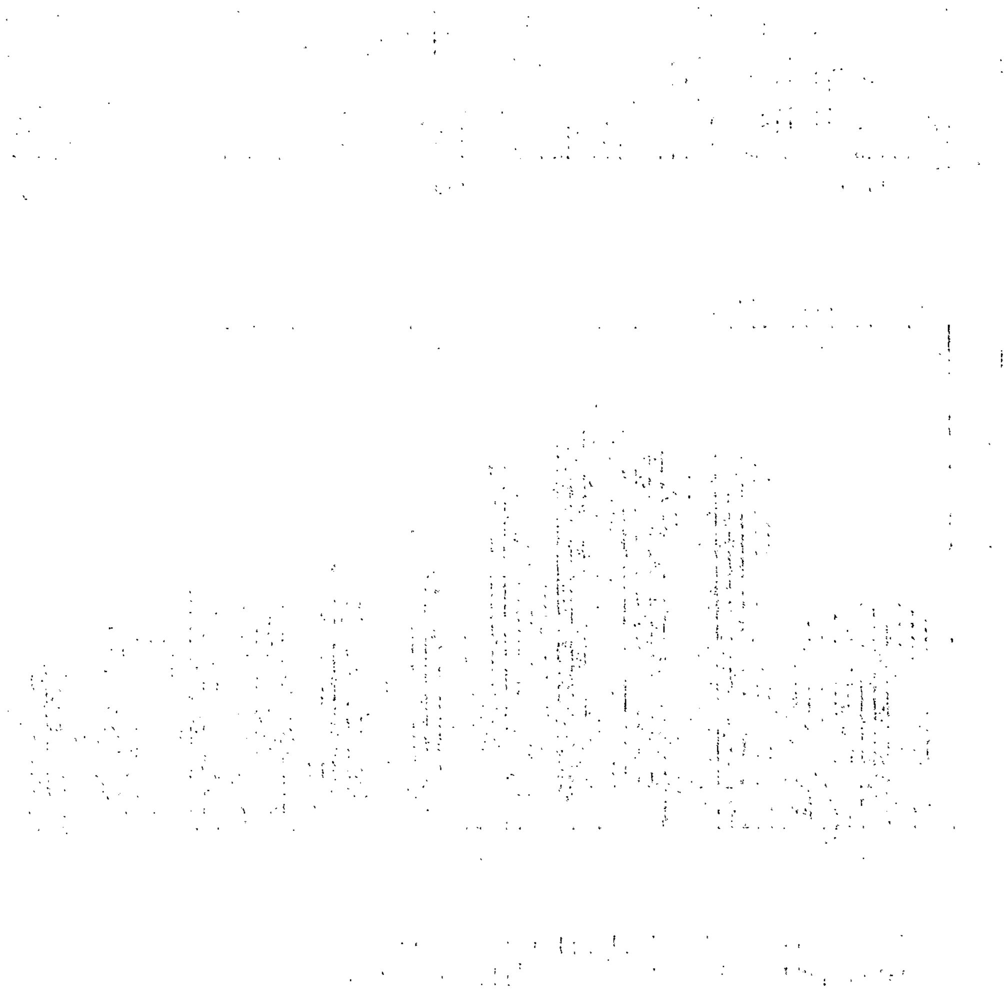
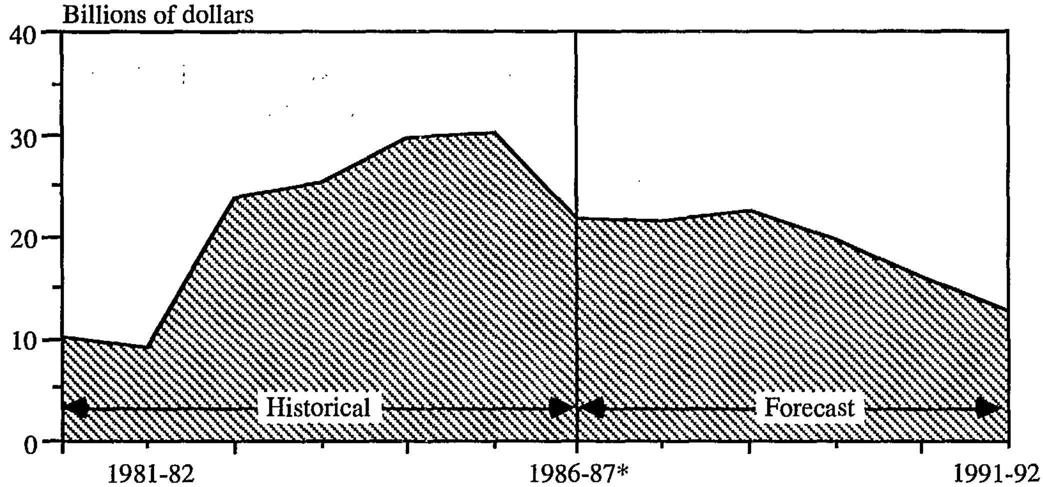
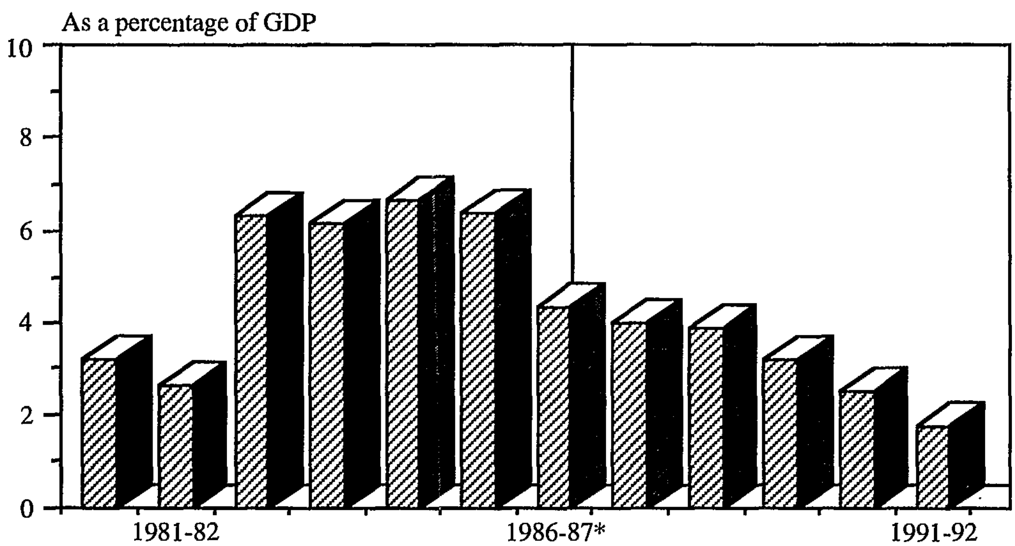


Chart 5.3

The Fiscal Planning Principles

Financial Requirements





* The estimate for 1986-87 is based on published monthly Statements of Financial Operations. Final data will be published in late summer.

Principle: To Ensure Substantial Year-Over-Year Reductions in Financial Requirements (Chart 5.3)

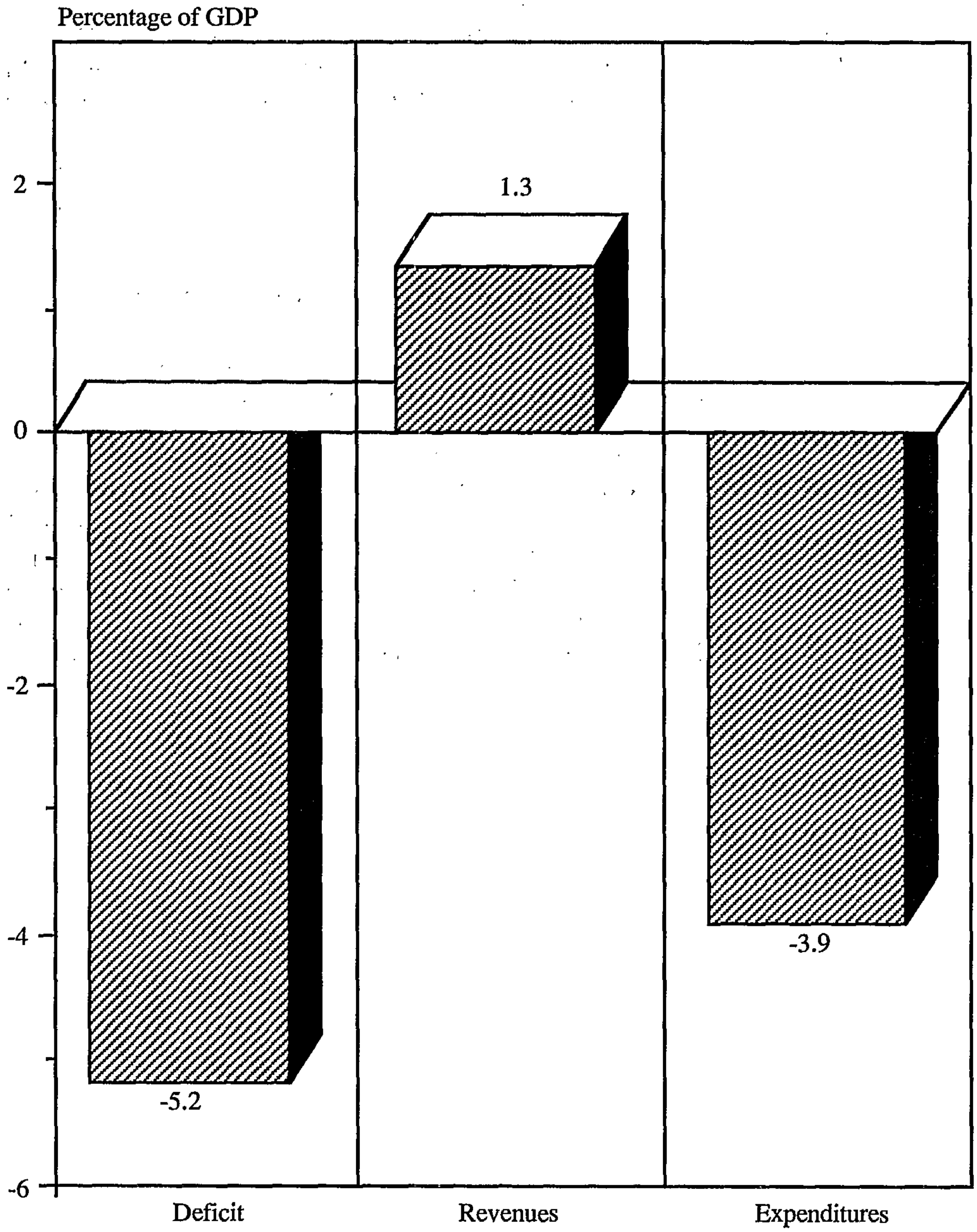
Financial requirements are the most comprehensive measure of the net borrowing demands the government puts directly on private capital markets. The lower these demands are, the more room there is for other borrowers to raise the capital they need. After reaching $29.8 billion in 1984-85, financial requirements, excluding foreign exchange requirements, are projected to drop to $21.3 billion in 1987-88. Relative to GDP this represents a decline of almost 40 per cent over three years.

Over the medium term, once the first stage of tax reform is fully phased in, financial requirements will show further substantial declines. By 1991-92, financial requirements are projected to decline to $12.7 billion, and relative to GDP, they will be down to levels not seen in more than a decade.

Chart 5.4

The Fiscal Planning Principles

Contributions to Deficit Reduction 1984-85 to 1991-92



Principle: To Make Expenditure Control and Good Management the Primary Focus of Fiscal Restraint (Chart 5.4)

Expenditures grew rapidly in the early 1980s, both in absolute terms and relative to the size of the economy. This growth reflected discretionary initiatives, such as increased energy-related subsidies, and non-discretionary factors such as higher unemployment insurance payments and public debt charges. The rapid rise in expenditures was evident in the unprecedented expansion of federal spending relative to the size of the economy – from 19.3 per cent of GDP in 1979-80 to 24.6 per cent in 1984-85.

The actions introduced in the fall of 1984 and in subsequent budgets have had a dramatic impact on reversing this trend. After growing by more than 14 per cent per year from the beginning of the decade through 1984-85, the rate of growth of program spending (total federal government spending excluding public debt servicing costs) has since been cut to just 3.3 per cent per year, on average, through 1987-88. This represents annual average declines in real program spending of roughly 1 per cent.

With continuing restraint in place, expenditure growth is projected to average a moderate 3.1 per cent per year over the medium term. The average inflation rate is also projected to average about 3 per cent per annum, implying little or no real growth in federal spending over the 1989-90 to 1991-92 period.

Over the 1985-86 to 1991-92 period, expenditure control accounts for the majority of deficit reduction. As is apparent from Table 5.3, the decline in the deficit from 8.6 per cent of GDP in 1984-85 to 3.4 per cent in 1991-92 arises mainly from the sharp decline in federal expenditures as a percentage of GDP. The fall in budgetary expenditures from 24.6 per cent of GDP in 1984-85 to a projected 20.7 per cent in 1991-92 accounts for a full 75 per cent of the decline in the deficit as a percentage of GDP. The increase in the revenue-to-GDP ratio of 1.3 percentage points, which occurred over the period 1985-86 to 1987-88, accounts for 25 per cent of the improvement in the deficit.

Table 5.3

The Fiscal Record, 1985-86 to 1991-92

Record: Seven-year period	1984-85	1991-92	Change	Contribution[1] to change
	(as a percentage of GDP)			(per cent)
Budgetary revenues	16.0	17.3	1.3	25
Budgetary expenditures	24.6	20.7	–3.9	75
Deficit	8.6	3.4	–5.2	100
Expenditure components				
Program expenditures	19.6	15.7	–3.9	73
Public debt charges	5.1	5.0	–0.1	2

Note: Figures may not add due to rounding.

[1] A positive sign indicates a contribution to a reduction in the deficit as a ratio to GDP.

Risks and Uncertainties in the Medium Term: The Need for Fiscal Flexibility

While much progress has been made in tackling Canada's fiscal problems, recent events have shown the vulnerability of the fiscal strategy to events that are beyond the government's control. This in turn highlights the need for continued resolve to ensure that the fiscal plan is not thrown off track.

The Canadian economy is currently in its fifth year of economic expansion, and is well positioned to continue to grow steadily over the years ahead. But Canada's medium-term economic and fiscal prospects will be affected by international economic developments, in particular the progress the major industrial economies make in resolving current trade and fiscal imbalances. With the extent of the risks and uncertainties presently in the international economy, it is all the more important that continued progress be made in improving and strengthening the underlying structure of the Canadian economy. Such progress will provide Canada with a greater degree of independence in managing its fiscal and economic affairs.

Annex

Table A-1

Major Federal Tax Revenue Sources: Levels

Fiscal year	Personal income tax	Corporate income tax	Sales tax	Total
		(millions of dollars)		
1971-72	7,227	2,396	2,653	12,276
1972-73	8,378	2,920	3,052	14,350
1973-74	9,226	3,710	3,590	16,526
1974-75	11,710	4,836	3,866	20,412
1975-76	12,709	5,748	3,515	21,972
1976-77	14,634	5,363	3,929	23,926
1977-78	13,988	5,280	4,427	23,695
1978-79	14,656	5,654	4,729	25,039
1979-80	16,808	6,951	4,698	28,457
1980-81	19,837	8,106	5,429	33,372
1981-82	24,046	8,118	6,148	38,312
1982-83	26,330	7,139	5,842	39,311
1983-84	26,967	7,286	6,561	40,814
1984-85	29,254	9,379	7,592	46,225
1985-86	33,008	9,210	9,345	51,563
1986-87[a]	37,900	9,815	12,000	59,715
1987-88[b]	42,620[c]	10,200	12,675	65,495[c]
1988-89[b]	44,320	11,100	14,755[d]	70,175[d]
1989-90[b]	45,810[c]	12,300	15,995	74,105[c]
1990-91[b]	51,920	14,100	16,965	82,985
1991-92[b]	56,640	15,505	17,930	90,075

[a] Estimate

[b] Projection

[c] Excludes the revenue impact of the acceleration of personal income tax and quarterly remittances as the tax liability is unaffected.

[d] Excludes the revenue impact of the acceleration of sales and excise tax remittances as the tax liability is unaffected.

Table A-2

Major Federal Tax Revenue Sources: Shares

(As percentage of total personal/corporate/sales tax revenues)

Fiscal year	Personal income tax	Corporate income tax	Sales tax	Total
		(per cent)		
1971-72	58.9	19.5	21.6	100.0
1972-73	58.4	20.3	21.3	100.0
1973-74	55.8	22.4	21.7	100.0
1974-75	57.4	23.7	18.9	100.0
1975-76	57.8	26.2	16.0	100.0
1976-77	61.2	22.4	16.4	100.0
1977-78	59.0	22.3	18.7	100.0
1978-79	58.5	22.6	18.9	100.0
1979-80	59.1	24.4	16.5	100.0
1980-81	59.4	24.3	16.3	100.0
1981-82	62.8	21.2	16.0	100.0
1982-83	67.0	18.2	14.9	100.0
1983-84	66.1	17.9	16.1	100.0
1984-85	63.3	20.3	16.4	100.0
1985-86	64.0	17.9	18.1	100.0
1986-87[a]	63.5	16.4	20.1	100.0
1987-88[b]	65.1[c]	15.6	19.4	100.0
1988-89[b]	63.2	15.8	21.0[d]	100.0
1989-90[b]	61.8[c]	16.6	21.6	100.0
1990-91[b]	62.6	17.0	20.4	100.0
1991-92[b]	62.9	17.2	19.9	100.0

[a] Estimate

[b] Projection

[c] Excludes the revenue impact of the acceleration of personal income tax and quarterly remittances as the tax liability is unaffected.

[d] Excludes the revenue impact of the acceleration of sales and excise tax remittances as the tax liability is unaffected.

Note: Details may not add due to rounding.

Table A-3

Major Federal Tax Revenue Sources as Percentages of Gross Domestic Product (GDP)

Fiscal year	Personal income tax	Corporate income tax	Sales tax	Total
		(per cent)		
1971-72	7.4	2.5	2.7	12.6
1972-73	7.7	2.7	2.8	13.2
1973-74	7.2	2.9	2.8	13.0
1974-75	7.7	3.2	2.5	13.4
1975-76	7.4	3.4	2.0	12.8
1976-77	7.4	2.7	2.0	12.1
1977-78	6.4	2.4	2.0	10.9
1978-79	6.1	2.3	2.0	10.4
1979-80	6.1	2.5	1.7	10.3
1980-81	6.4	2.6	1.8	10.8
1981-82	6.8	2.3	1.7	10.8
1982-83	7.0	1.9	1.6	10.5
1983-84	6.7	1.8	1.6	10.1
1984-85	6.6	2.1	1.7	10.4
1985-86	6.9	1.9	2.0	10.8
1986-87[(a)]	7.5	1.9	2.4	11.8
1987-88[(b)]	7.9[(c)]	1.9	2.4	12.2[(c)]
1988-89[(b)]	7.7	1.9	2.6[(d)]	12.2[(d)]
1989-90[(b)]	7.5[(c)]	2.0	2.6	12.2[(c)]
1990-91[(b)]	8.0	2.2	2.6	12.8
1991-92[(b)]	8.2	2.3	2.6	13.1

(a) Estimate

(b) Projection

(c) Excludes the revenue impact of the acceleration of personal income tax and quarterly remittances as the tax liability is unaffected.

(d) Excludes the revenue impact of the acceleration of sales and excise tax remittances as the tax liability is unaffected.

Note: Details may not add due to rounding.