



THE SOUND OF TWO SHOES DROPPING

Canadians were treated to a Parliamentary two-step this week. The Speech from the Throne marked the opening of the Third Session of the 40th Parliament on March 3rd, followed the next day by the tabling of the 2010-11 Budget. Basking in the warm afterglow of the record-setting Olympic gold medal performances of Canada's finest winter sports athletes, the Harper government declared Parliament open for business once again. A touch bloodied but unbowed by the controversial prorogation of Parliament last December, Prime Minister Harper put his stamp firmly on the shape of the nation's business over the coming year. In our January 19, 2010 Commentary, your TACTIX correspondents foreshadowed some of the key themes we expected to see in the Throne Speech and in the Budget. We invite you to read on and see whether our crystal ball was clear or cloudy that day.

SPEECH FROM THE THRONE: JOBS, JOBS, JOBS

Despite the subject header, the key theme of the Speech from the Throne (SFT) was not about the IT savant who introduced the world to the iPod. Reminiscent of the 1993 federal election campaign when Canada was emerging from recession, the key focus of the SFT was on creating jobs. This time, jobs of the future. Hundreds of thousands of Canadians lost their jobs during the global recession of 2008-09. The federal government's overriding imperative, both economic and political, is to put Canadians back to work, building Canada's competitive, innovative economy of the future.

Job number two is to achieve this goal while eliminating the deficit and returning Canada's books to fiscal balance. The SFT makes it clear that this will not be accomplished by raising taxes, cutting pensions, or reducing transfers to the provinces for health care and education. The government's two-pronged approach is to wind down the two-year stimulus spending announced in Budget 2009 and to restrain federal program spending. One important SFT measure not to be overlooked is the freezing of departmental operating budgets, including the costs of salaries, administration and overhead. While planned salary increases will be honoured and employee benefits and pensions will not be touched, the overall effect of such a freeze will be to reduce the size of the public service. This outcome aligns with the Harper government's vision of a smaller, less intrusive federal government.

Bearing a small "c" conservative stamp, the SFT also featured calls for increased foreign investment in some heretofore protected sectors, including the telecommunications and satellite industries, a reduction in regulatory red-tape faced by small and medium-sized businesses, and a strong "tough on crime" message. Not surprisingly, given the fiscal challenges facing the Government of Canada, these measures come at essentially no cost to the government. Indeed, with the exception of carrying out Year II of its stimulus spending promised in Budget 2009, most of the Throne Speech commitments are no-cost or low-cost items.

BUDGET 2010: TRANSITIONING TO THE FUTURE

The tabling of yesterday's Budget – *Leading the Way on Jobs and Growth* – completes the two-step of Parliament's return by providing Canadians with a more detailed explanation and costing of the broad agenda laid out in the SFT. Budget 2010 is a transitional document, laying out the path from economic stimulus measures necessitated by the global economic meltdown toward a federal austerity program.

Budget 2010 lays out – for Canadians and international investors alike – the government's plan to:

- Wind down its extraordinary two-year economic stimulus actions unveiled in Budget 2009 under the brand of *Canada's Economic Action Plan*;
- Return the country to fiscal balance over the medium term from our present and historic fiscal deficit position of \$53.8 billion; and,
- Serve as a financial blueprint for how the vast machinery of the federal government can enable and aspirationally protect and accelerate an admittedly fragile economic recovery to help in – as noted in the SFT – “building the jobs and industries of the future.”

With a tepid global economic recovery underway, Finance Minister Jim Flaherty's Budget speech reinforced the government's mantra since Budget 2009: compared to our global peers in the G8 and G20, Canada was best positioned going into the recent recession, best positioned during the depths of this recession, and is now best positioned to recover from it.

For the record, since assuming power in 2006 the Conservatives repaid almost \$40 billion of national debt while cutting the GST by two percentage points, as well as reducing personal and corporate income taxes. However, they inherited an enviable fiscal position from the Chrétien-Martin administrations which racked up a decade of balanced budgets. Moreover, the small-c conservative nature of our domestic financial sector bolstered by a solid regulatory framework insulated Canada's banks from the collapse and calamity that occurred in many other nations which triggered the global economic crisis.

BUDGET 2010: IT TOO IS ABOUT JOBS, JOBS AND MORE JOBS

In the 23-page SFT, the most often used word to describe the government's priority, excluding titles and section headers, was “jobs” with a total of nine mentions. Yesterday's Budget speech deployed the word “jobs” 32 times across 19 pages of text. Conservative polling consistently has shown that jobs and job security remains the dominant concern of Canadians, whether currently employed or unemployed.

A focus on job protection and job-creation permeates the major sections of Budget 2010, including a \$19.2 billion conclusion of year two of the *Economic Action Plan* announced in Budget 2009. This new stimulus spending is deconstructed as follows:

- \$7.7 billion for infrastructure stimulus projects and complementary initiatives;
- \$3.2 billion in personal income tax relief measures;

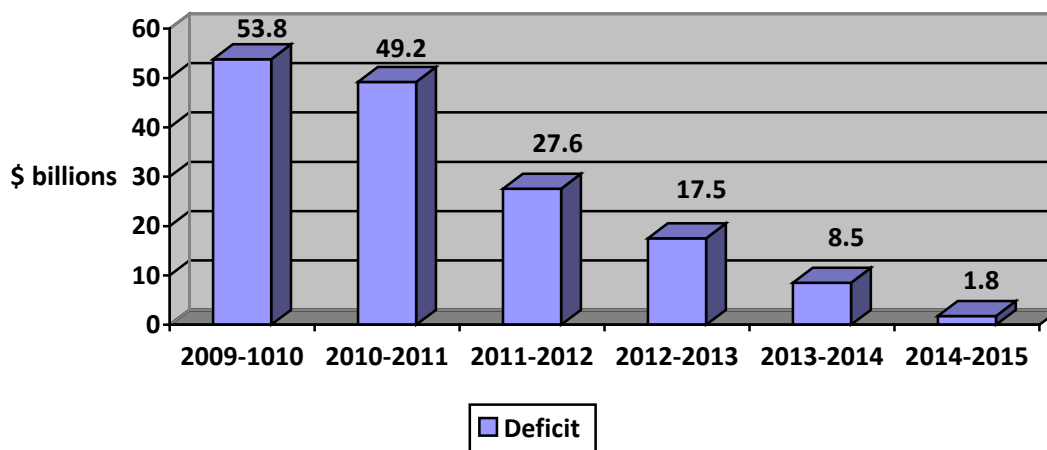
- \$2.2 billion in stimulus and adjustment support for adversely affected communities and regions;
- \$1.9 billion in post-secondary education infrastructure, innovation, research and environmental funding;
- \$1.6 billion in continuing benefits to the unemployed;
- \$1.6 billion in maintaining low Employment Insurance rates; and,
- \$1 billion for enhanced training opportunities.

The federal government projects the total impact of its two-year stimulus plan at \$62 billion dollars. This assumes follow-on provincial and territorial actions of \$8.4 billion arising out of the 2009 federal measures of \$28.1 billion and a further bump of almost \$6 billion resulting from this year's \$19.2 billion stimulus spending.

NOW ABOUT THAT DEFICIT THING

If there is a silver lining in the projected \$53.8 billion deficit number for fiscal 2009-2010, it is that the deficit is lower than the number which some analysts expected to top out at \$60 billion. Through a combination of projected tax revenue growth as a result of economic recovery and a cumulative \$17.6 billion trimming of federal spending over five years – slowing defence budget growth, capping the international assistance funding envelope, and containing the administrative cost of government – the government plans to cut the deficit in half by 2011-2012 and by a healthy two-thirds by 2012-2013. The projected reduction in the deficit is depicted below.

It bears noting that the government is not predicting that it will balance the federal books over the five years of its projection. The government did not want the lead Budget story to be about its credibility.



The challenge for the government is that as the economy improves, the opposition Liberals will amplify their focus on Canada's deficit. The wisdom of the Harper government's GST cuts, which significantly reduced government revenues, will come under opposition attack once again.

By announcing a freeze on departmental operating budgets (salaries, administration and overhead) through fiscal 2012-13, the government faces the challenge of motivating the federal public service at a time when its ranks are effectively under siege. Combining this workplace shock with the reality of increased salary costs that comes with negotiated wage settlements unaffected by this freeze, public service managers must reallocate funds from existing program budgets or make tough human resource calls to stay under the freeze line while their compensation envelope continues to grow.

While the plan to constrain federal spending is logical and laudable, it becomes all the more problematic for the Conservative government at a time when the federal public service has demonstrated its capacity to deliver across the whole of government – and deliver in spades – on key files such as the highly successful Winter Olympic Games in Vancouver/Whistler and a globe-leading response in the aftermath of the tragic earthquake that struck Haiti on January 12, 2010.

THE BEST LAID DEFICIT PLANS OF MICE AND MEN ...

Often overlooked in each Budget are the economic growth assumptions on which the budget revenue forecast is based and the analysis which highlights the revenue shortfall should an unforeseen shock or event impact the Canadian economy. Given that this “transition” budget has an inherent imperative for the government to return to a state of “fiscal balance”, the consensus private sector assumptions – from 15 of Canada’s most reputable financial institutions – of the major economic indicators which underpin the Budget framework are depicted below.

	2010	2011	2012	2013	2014
Real GDP Growth (%)	2.6	3.2	3.2	2.8	2.6
GDP inflation (%)	2.2	2.1	2.2	2.1	2.0
Unemployment (%)	8.5	7.9	7.4	6.9	6.6
CPI inflation (%)	1.7	2.2	2.1	2.1	2.1
Exchange (US c/C\$)	95.5	98.3	97.7	99.3	98.5

According to the 2010 Budget, a one percentage point decrease in Real GDP in 2010-2011 would negatively impact the total budgetary balance (decrease in taxes and EI premiums collected and an increase in higher EI benefits paid out and higher debt interest charges) by \$3.1 billion in 2010-11, \$3.4 billion in 2011-2012 and \$4.4 billion in 2013-2014.

Both the government and opposition parties will pay unprecedented attention to the quarterly economic updates going forward. The risk to the Conservatives of an economic shock caused by a potential double-dip recession in the United States, while uncontrollable, would have immediate and lasting repercussions on their future electoral fortunes. Conversely, should the Canadian economy exceed the above-noted projections, an acceleration of the government’s deficit elimination schedule could result in the government taking credit for its competent economic management, positioning it nicely for the next general election campaign.

THE TOUGHEST CALLS COME IN 2011

In closing, this week's complementary SFT and Budget lay out the government's game plan for the coming year. The year 2010 can be described as the year in which the Government of Canada tries to execute a pivot from extraordinary Keynesian prime-the-pump spending to slowly turning the pump handle towards the "off" position. The fine calibration required to successfully land the Canadian economy on the path to growth and to put more Canadians to work in jobs of the future will be a significant challenge, particularly in light of the fragility of the global economic recovery alluded to earlier.

Prime Minister Harper's government will survive the confidence votes in the House of Commons triggered by the Throne Speech and the Budget. The opposition Liberals have learned their lesson from the school of hard knocks they attended last fall when their leader was poised to trigger an election that Canadians clearly did not want. They will oppose the Budget but register their opposition "responsibly", political code for ensuring that a large number of Liberal MPs will suffer from a bad case of the sniffles, keeping them out of the House when confidence votes are taken.

The 2010 Budget is a transitional fiscal plan, shifting the government's books from a record deficit to a near-balanced budget over five years. The Harper government has positioned itself as opposed to raising taxes and cutting transfers to the provinces and individual Canadians for health care, education, and pensions as the way to balance its books. This means the Conservative's path to fiscal balance is a combination of robust economic growth and program spending reductions, again fraught with some degree of risk and uncertainty.

Budget 2010 foreshadows the day when difficult decisions must be made about which programs will be left behind. Those tough calls will come in Budget 2011. As for who will be making those calls, that is a question we expect to be asked by our clients time and time again in the months ahead. For now, all we can say is, "stay tuned".

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