

Stand Pat, Stand Strong, Stand Ready

In tabling his third federal budget in the House of Commons today, Finance Minister Jim Flaherty had three distinct objectives to accomplish:

- 1) Maintain (if not bolster) Canadian and international confidence in the Government of Canada's management of its own finances and its broader economic stewardship of the Canadian economy;
- 2) Position the Conservative government to fight an election – if need be – with this budget forming a crucial piece of the government's broader economic record; and
- 3) Announce further measures which buttress all regions of Canada to weather the brewing economic storm south of the border and international credit issues which will impact Canada – most notably vote-rich central Canada – to varying degrees of adversity.

By most measures, Budget 2008 represents a successful realization of these objectives.

Entitled **Responsible Leadership**, the Budget, as was widely expected, was thin on any major new initiatives – with the exception of a new Tax Free Savings Account (perhaps the big budget surprise). It focused on increased funding commitments to current competitiveness initiatives under the *Advantage Canada* banner – which was reaffirmed as the government's core economic policy blueprint – and a targeted approach to policy areas which coincide with either key voter demographics where support must be solidified or key regional electoral battlegrounds crucial to future Conservative prospects.

Given the precipitous drop in the real GDP growth projection for 2008 from 2.4% in October to 1.7% now (a 30% decline in the space of four months), the government has focused on further debt reduction and restrained program spending growth in 2008-09 to 3.43%. This is down markedly from the previous torrid two-year pace of over 14% since the government took office in January 2006. Continued projections of balanced budgets into the future will no doubt please national and international economists.

As for the threat of an election, the government continues its cheque-book federalism approach to the middle-class with the introduction of the Tax Free Savings Account (up to \$5,000 annually with carry over provisions) which is akin to an RRSP for more immediate needs as opposed to retirement planning. This measure costs the federal treasury little in the short-term while maximizing political impact amongst voters.

In addition, targeted spending on infrastructure in cities, a permanent extension of the gas tax transfer, support for the automotive sector, carbon capture and clean energy environmental initiatives, changes to the Employment Insurance (EI) rate-setting process, post-secondary funding announcements along with front-line policing and defence budget increases appeal both to core Conservative voters and are designed to bolster their electoral chances in major metropolitan centres, especially in Ontario and Quebec.

The remainder of this Commentary will:

- provide a drop-list synopsis of the key budget measures;
- analyze these measures against an electoral backdrop and opposition responses;
- compare these measures to the Finance Committee's budget recommendations, and
- addresses the transition of Conservatives in power to a Conservative government.

Budget 2008 – The Highlights

Economic Management:

- A debt reduction payment of \$10.2 billion in 2007-08. However, projected debt repayment for 2008-09 is \$2.3 billion and for 2009-10 is \$1.3 billion, well below historic contingency planning of \$3 billion.
- Establishment of a new crown corporation in 2009, the Employment Insurance Financing Board to implement EI rates and maintain a \$2 billion cash reserve.
- A new Tax Free Savings Account with annual contributions up to \$5,000 allowing tax free accumulation of investment income and capital gains within the account with the flexibility of tax free withdrawals.
- Three-year extension of the accelerated Capital Cost Allowance (CCA) treatment for machinery and equipment with 50% straight-line accelerated CCA for one additional year then on a declining basis over a two-year period.

Community / Industrial Initiatives:

- Solidifying the Gas Tax Fund as a permanent transfer to municipalities.
- Setting aside \$500 million in support of public transit infrastructure including projects in Vancouver, the GTA and Montreal.
- \$110 million for mental health and homelessness demonstration projects in Vancouver, Winnipeg, Toronto, Montreal and Moncton.
- \$250 million for an Automotive Innovation Fund.
- \$440 million over three years to bolster the Science and Technology (S&T) Strategy (announced in 2007) which includes \$80 million annually for university research in the automotive, manufacturing, forestry, fishing and health sectors.
- Changes to the Scientific Research and Experiment Development (SR&ED) investment tax credit regime for small and medium sized businesses (including expenditure and phase out limits) as well as allowing deductions for certain SR&ED salaries and wages incurred outside of Canada.

People Initiatives:

- A consolidated Canada Student Grant program starting in 2009-10 with base funding of \$350 million rising to \$430 million by 2012-13 as the Millennium Scholarship Program is wound up.
- Increasing the Guaranteed Income Supplement exemption to \$3,500 from \$500 which responds to the fact that more seniors are working longer.
- Creation of the \$100 million Vanier doctoral scholarships program over five years starting in 2008-09.
- \$21 million to establish Canada Global Excellence Research Chairs in the S&T Strategy priority areas of the environment, natural resources and energy, health, and information & communication technologies.
- \$70 million over two years to establish a new framework for Aboriginal economic development and \$70 million for tripartite agreements to support First Nations education.
- \$22 million over two years to support immigration initiatives that better align the immigration system with labour market needs.

Environmental Initiatives:

- \$250 million for carbon capture and storage projects.
- \$66 million over two years to facilitate market development of carbon trading in Canada.
- \$21 million over two years for better enforcement of environmental laws.
- \$13 million over two years to renewable fuels initiatives.

Other Initiatives:

- Increase in the Department of Defence annual funding escalator from 1.5% to 2.0% starting in 2011-12.
- \$400 million over five years to provinces and territories to hire an additional 2,500 police officers.

To vote or not to vote: Is no longer the question

As noted earlier, the federal budget is tabled amidst the backdrop of election speculation. With the Afghanistan issue headed for a bi-partisan compromise between the governing Conservatives and opposition Liberals, defeat of the budget by all three opposition parties (Liberal, Bloc and NDP) is the most immediate trigger for a spring election. An election will **not** be triggered by this budget.

The Liberals responded immediately with a statement that, while criticizing the government for stealing measures championed by the Liberals, stated, "there is nothing in this budget that warrants an election that Canadians do not want." Indeed, it could be argued that Budget 2008, in many instances, reflects previous Chrétien/Martin era budgets with a main theme/initiative as a centerpiece coupled with various smaller funding announcements.

While the budget will not lead to an election, four days must nevertheless be set aside for budget debate in the House of Commons. On February 28th, the BQ will force the first confidence vote on the Budget with their budget amendment motion. The Liberals are slated to table their own budget amendment on March 4th, again triggering another confidence vote. Canadian media will be disappointed that neither amendment will lead to an election.

What Canadians recommended

In early February, the House of Commons Finance Committee tabled its 265-page report on 2008 pre-budget consultations entitled ***Taxing to Prosper: Canada's System of Taxes, Fees and Other Charges***.

In essence, this report reflects the priorities of Canadians drawn from all regions, industries and political perspectives as expressed in their submissions to and testimony before the Finance Committee. Excluding the various supplementary reports submitted by each party, the Finance Committee arrived at 19 unanimous budget recommendations and 18 other policy measures with budget impacts.

The following chart illustrates that the government listened to the Canadians as expressed through Parliamentarians. Equally valid, opposition MPs can assert that their constructive suggestions through the work of the Finance Committee significantly influenced and shaped government policy as evidenced in Budget 2008.

Finance Committee Recommendations	
Recommendation	Result
The federal government amend the <i>Income Tax Act</i> in order to increase the income thresholds in respect of personal income taxation.	Not done.
The federal government, in respect of the Lifelong Learning Plan, amend the <i>Income Tax Act</i> in order to enhance the ability of registered retirement savings plan holders to withdraw funds to support lifelong learning.	Not done. Some changes made to RESPs.
The federal government amend the <i>Income Tax Act</i> in order to make the Disability Tax Credit refundable.	Not done.
The federal government develop and implement a non-refundable training tax credit for employers.	Not done; earlier changes to Apprenticeship tax credit introduced in Budget 2006.
The federal government amend the <i>Income Tax Act</i> in order to enhance the Working Income Tax Benefit.	Not done.

Finance Committee Recommendations	
Recommendation	Result
The federal government amend the <i>Employment Insurance Act</i> in order to: a) enable the creation of an independent Employment Insurance fund; and b) enhance the Employment Insurance program.	Independent Fund created through Crown corporation. No overt EI enhancements.
The federal government amend the <i>Income Tax Act</i> in order to increase, to a proportion to be determined in relation to going concern liabilities, the maximum tax-deductible surplus in respect of defined benefit pension plans before plan sponsor contributions must be suspended.	Not done.
The federal government amend the <i>Old Age Security Act</i> in order to increase the income thresholds at which the amount of Guaranteed Income Supplement (GIS) benefits begins to be reduced or “clawed back.”	Done.
The federal government amend the <i>Income Tax Act</i> in order to extend, for a five-year period, the accelerated capital cost allowance for manufacturing and processing machinery and equipment.	Done; extended from present two years to five years.
The federal government amend the <i>Income Tax Act</i> in order to increase the capital cost allowance rate applied to rail rolling stock. The rate should be comparable to that in the United States and should reflect the useful life of the rolling stock.	Partly done for locomotives only and comparable to the United States.
The federal government, in respect of the Scientific Research and Experimental Development (SR&ED) tax credit, amend the <i>Income Tax Act</i> in order to: - increase the annual expenditure limit; - increase the taxable capital threshold; - remove the Canadian-controlled private corporation restriction; and - make the credit partially refundable for all claimants.	Partly done; changes to SR&ED partly capture spirit of committee recommendations.
The federal government develop and implement a non-refundable tax credit to encourage small and medium-sized businesses to undertake activities related to pandemic preparedness.	Not done.
The federal government develop a concrete policy to assist the manufacturing and forestry sectors. This policy should include implementation of the fiscal recommendations contained in the February 2007 report of the House of Commons Standing Committee on Industry, Science and Technology.	Partly done with Automotive Innovation Fund and Community Development Trust.

Finance Committee Recommendations	
Recommendation	Result
The federal government clarify the income trust guidelines issued by the Department of Finance on 15 December 2006.	Not done.
The federal government amend the <i>Excise Tax Act</i> in order to permit arrivals duty-free purchases at Canadian airports.	Not done; small changes apply to tobacco.
The federal government make permanent the existing program for the sharing of a portion of the federal gasoline excise tax revenues with municipalities. Moreover, in the next budget, the portion to be shared should be 5 cents per litre.	Done.
The federal government, in respect of the Home Buyers' Plan, amend the <i>Income Tax Act</i> in order to increase the amount that can be withdrawn from a registered retirement savings plan to purchase or build a qualifying home for the holder of the plan or for a related person with a disability.	Not done.
The federal government develop and implement tax incentives to encourage truck owners and operators to reduce greenhouse gas emissions. In particular, incentives should be developed to encourage the purchase of vehicles that are less harmful to the environment.	Not done; other measures to promote renewable fuels.
The federal government amend the <i>Income Tax Act</i> in order to enhance incentives for charitable giving.	Partly done for donations of medicines and exchangeable securities.
The federal government encourage provinces/territories to remove internal barriers to trade. In so doing, priority should be given to reaching agreement about a common securities regulator.	Expert review panel on securities regulation announced in advance of budget.
The federal government continue to provide need- and merit-based support to students enrolled in post-secondary institutions.	Done.
The federal government create a specialized fund for medical research for children's health. In this regard, priority should be given to the establishment of a partnership with the Juvenile Diabetes Research Foundation Canada.	Not done.
The federal government continue to support students enrolled in post-secondary education at a level commensurate with the funding allocated to the Canada Millennium Scholarship Foundation.	Done and enhanced through larger base funding.

Finance Committee Recommendations	
Recommendation	Result
The federal government increase the income support available to older workers in the manufacturing sector who face employment disruption.	Not done; Community Development Trust is a part measure.
The federal government develop and implement a policy to combat poverty. This policy should include: <ul style="list-style-type: none"> - full retroactivity of Guaranteed Income Supplement benefits for those who have not received the benefits to which they are entitled; - the payment of full Guaranteed Income Supplement benefits to the surviving spouse or common-law partner for six months following the death of the recipient; and - an income support program for older workers. 	Not done; did extend transition for older workers support program by three years.
The federal government create loan and loan guarantee programs for employers in the manufacturing and forestry sectors, as well as for other industrial investments.	Not done.
The federal government allocate \$1 billion to the forestry sector.	Not done.
The federal government allocate \$1.5 billion for reimbursable contributions for businesses wishing to modernize their equipment.	Partly addressed through extension of accelerated CCA.
The federal government amend the <i>Copyright Act</i> in order to improve and modernize the legislation.	Not done.
The federal government develop and implement a program designed to ensure the removal of E. coli from the Canadian food chain.	Partly done through Food Safety measures in budget.
The federal government develop and implement a program to encourage the provinces having a sales tax to adopt a value-added tax system. This program should be available to those provinces that desire harmonization.	Not done.
The federal government encourage the Canada Mortgage and Housing Corporation to use its retained earnings to leverage private-sector development in an effort to increase the stock of affordable housing. Any legislative or other changes needed by the Corporation to attain this objective should be provided.	Not done.
The federal government allocate \$30 million annually for five years to finance the Canadian Olympic Committee's Road to Excellence Program.	Partly done.

Finance Committee Recommendations	
Recommendation	Result
The federal government apply the principles of the Leadership in Engineering and Environmental Design (LEED) Green Building program to federal public buildings.	Partly addressed in previous Federal Buildings Initiative.
The federal government establish a timetable in order to reach an allocation of 0.7% of Canada's Gross National Product to assist developing countries.	Previous commitment to double assistance by 2011-12 but falls short of 0.7% target.
The federal government develop and implement a cap-and-trade system in respect of carbon emissions.	Enabling funding in Budget 2008.

Canada's "New Government" is no more

Conservative strategists have deployed branding and reputation management techniques to varying degrees of success as the Conservative Party attempts to fashion a winning majority government when Canadians next head to the polls.

From this perspective, Budget 2008 marks a subtle but noticeable shift and evolution from a Conservative government whose immediate post-election mission was to implement a change agenda to a government that has become comfortable and confident as managers of the Canadian economy and broader policy agenda. Gone from this year's budget is the tag line of *Canada's New Government*. In addition, there is a noticeable shift in tonality in this third budget.

In the 2006 Budget, the budget was entitled ***Focusing on Priorities: Turning a New Leaf***. This was an expression of their new mandate and desire to be seen as change agents. The 2007 Budget was ambitiously titled ***Aspire To a Stronger, Safer, Better Canada***. As late as last October's Economic Statement, the government themed their tax relief measures under the banner of ***Strong Leadership: A Better Canada***. All of these themes denoted action, purpose and movement.

Meanwhile, this year's Budget is, simply and cautiously titled ***Responsible Leadership***. This theme not only overtly reflects the uncertain international economic circumstances, it also signals a government that will focus more and more on managing the change it has implemented and a clear desire to run on its record when it goes back to Canadians to seek another mandate in October 2009 or earlier should the opposition parties decide to trigger a trip to the polls on another issue.

Conclusion

Budget 2008 is a stand pat budget for the Government. In a sense, Finance Minister Jim Flaherty has borrowed "liberally" from former Finance Minister Paul Martin.

The centerpiece of this budget is the Tax Free Savings Account which provides maximum political credit with minimum cost to the federal treasury over the short-term. Bookending this initiative, which is clearly targeted at the middle class, are a swath of measures aimed at seniors, students, industry, and cities amongst other identifiable groups.

The Budget has been crafted to allow the Conservatives to continue to govern while at the same time, positioning the Government to wage an election on its record and this budget, should the opposition parties decide to defeat the government on another issue or in a supply day motion later this spring.

While the IMF has noted that Canada's financial position is very strong within the OECD and amongst its G-7 peers, the opposition Liberals make a valid point in noting that the federal cupboard has become quite bare and the government has little room to maneuver should a full blown U.S recession take hold or other international economic events overtake the global economy.

The prospects for an election based on this budget are non-existent. However, it is clear that if an election were to occur some time in 2008, the Canadian economy, and the government's handling of its own finances, will be a key issue on which the election is fought.

Links to Budget 2008:

<http://www.fin.gc.ca/budtoce/2008/budget08e.html>

Government release:

<http://www.budget.gc.ca/2008/news-nouvelles/news-nouvelles-eng.htm>

Liberal Party response:

http://www.liberal.ca/story_13624_e.aspx

Bloc Quebecois response:

http://www.blocquebecois.org/fr/manchette_detail.asp?id=9925977

NDP response:

<http://www.ndp.ca/page/6216>

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