Intelligence MEMOS

From: Glen Hodgson

To: Concerned Canadians

Date: March 20, 2019

Re: **A PRE-ELECTION BUDGET WITH LIMITED ECONOMIC CONSEQUENCES**

Yesterday's federal budget was branded with a theme, "Investing in the Middle Class," that is fully consistent with this government's stated priorities and therefore hardly surprising. This was most definitely a pre-election budget aimed at specific interests, issues and concerns of segments of Canadian society, with only limited mention of the over-arching competitive needs of the Canadian economy.

Economic and Fiscal Context

Budget 2019 comes at time of significant global churn, with the US and Chinese economies both showing the negative effects of their bilateral trade dispute and with Brexit still hovering in the wings. A US-China trade deal would offer a bit more optimism about global economic prospects.

Although recent Canadian employment growth has been surprisingly strong, the consensus outlook underpinning the budget is for the Canadian economy to grow more slowly in 2019 and 2020, at 1.9 per cent annually, in line with the economy's estimated growth potential. Combined with low and stable inflation, this translates into current and future government revenues also growing more slowly, squeezing the space for ambitious spending plans.

Budget Initiatives

The 460-page budget contains myriad new and enhanced program initiatives targeted at segments of the middle class, for many age groups, plus vulnerable groups in Canadian society. The budget material is arrayed under four broad priorities: good jobs; housing; seniors; and pharmacare, with specific commitments under each theme.

For example:

- the budget introduces a new benefit, the Canada Training Benefit, designed to help Canadians invest in their workforce skills.
- It announces a new cost-sharing program to help finance up to 10 percent of a home purchase for first-time buyers, and increases the ceiling, to $35,000, for borrowing RRSP funds for a home purchase down payment.
- It also announces plans to create the Canadian Drug Agency, with the goal of making prescription drugs more affordable for Canadians in partnership with the provinces and territories.
- The single largest new spending item is on Indigenous services, where the government plans to spend $8.1 billion over five years on improved healthcare, water quality, and land claims settlement.

However, Budget 2019 is largely silent on issues related to competitiveness and taxation. The government is evidently relying on last fall's adjustment to the tax treatment of capital cost allowances as the means to encourage business investment and address the deep cuts to US corporate income taxes. Most tax-related items included in the budget addressed aspects of improving tax compliance and tax fairness. For example, the government announced its intention to limit the use of the current employee stock option tax regime and move toward aligning the tax treatment with the United States for employees of large, long-established, mature firms.

Assessment

In most respects this is a stay-the-course budget, with a clear eye on shoring up the government's political base for the election later this year. Its focus remains indisputably on supporting the middle class. Little added attention is paid to economic competitiveness or to boosting the overall performance of the Canadian economy.

Plans to restore fiscal balance and cap the rising stock of public debt have been bumped down the road yet again. Annual deficits of almost $20 billion are projected for the next two fiscal years. As a substitute, the federal debt ratio is projected to fall below 30 percent of GDP in 2022-23 and is once again offered as evidence of sustainable fiscal management. We do welcome that projected steady drop in the planning period, although we would be even more pleased with a hard commitment to balance the federal books. We believe it remains important to solidify the federal government's capacity to address future recessions or external shocks.

In addition, the budget does not do much to acknowledge the turbulent global environment. Most importantly, a failure to resolve the US-China trade dispute satisfactorily could result in sharply slower global economic and trade growth and throw the fiscal plan off course.

Overall, the economic consequences of this budget will likely be minimal to the overall economy, with no material change to Canada's overall economic performance and growth path - although increased investment in the long-term capacity of Canada's workforce is certainly welcome. Further measures to buttress Canadian competitiveness will evidently have to wait for another day.

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