

# FEDERAL BUDGET 2018 ANALYSIS



Business Council of  
British Columbia  
Est. 1966

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## BUDGET 2018: MORE SPENDING WITH LITTLE TO ADDRESS COMPETITIVENESS CHALLENGES

### HIGHLIGHTS

- Budget 2018 outlines additional support for Canada's "middle class".
- New spending is sprinkled across many different areas, but the government focused on improving gender equality and providing additional support for Indigenous People.
- Enriched parental EI claims and more generous income top ups for low income workers should encourage increased labour market participation.
- Research and innovation feature prominently in Budget 2018.
- There is some additional funding to support developing new international markets for Canada's exporters.
- Unfortunately, the Budget is largely silent on any measures to bolster Canada's eroding competitive position.

### INTRODUCTION

In an environment of heightened uncertainty about NAFTA and steep tax cuts south of the border that have made the United States a more attractive place to invest capital, Finance Minister Bill Morneau's 2018 Budget focuses on expanding social supports, addressing gender issues, improving life for Indigenous Peoples, and dialing up innovation. At a high level, these priorities make sense. But the Budget is lacking in significant measures to strengthen Canada's competitiveness or stimulate business investment. From our perspective, Tuesday's Budget 2018 – titled *Equality and Growth: A Strong Middle Class* – is heavy on the equality part and alarmingly thin on ideas to accelerate growth. Apart from some additional funding to support international trade

and spur both basic research and innovation, we are hard-pressed to find much in Budget 2018 that will cause companies or investors to choose Canada. As Business Council of Canada President and Chief Executive Officer, the Honourable John Manley, stated: "[n]owhere in the Budget's 367 pages is there even a passing acknowledgement of the fact that Canada faces an intense fight internationally for investment, jobs and talent."

### REVISED FISCAL PLAN

Budget 2018 is a mid-term budget with modest spending increases. To some extent new spending announcements are back-end loaded, and there is plenty of recycling of previous announcements and commitments. Those expecting

or hoping for "big bang" spending increases will probably have to wait until next year's pre-election budget.

Despite the broadly favourable economic backdrop, Budget 2018 reports another deficit of around \$19 billion for 2017-18. Slightly smaller operating shortfalls are expected through 2022-23, leading to a steady rise in the accumulated federal debt from \$652 billion currently to \$704 billion in 2020-21 and then \$730 billion by the end of the five-year fiscal plan. The good news is that the deficits remain very modest relative to GDP (less than 1%), while the debt/GDP ratio declines marginally over the forecast horizon. The bad news is that Ottawa's failure to move to a balanced budget when the economy is performing well sets the stage for a potential sharp deterioration in the government's

TABLE 1: **BUDGET 2018 ECONOMIC ASSUMPTIONS AND FORECASTS**

	2017	FORECAST		
		2018	2019	2020
Canada Real GDP growth (% change)	3.0	2.2	1.6	1.7
Nominal GDP growth (% change)	5.2	4.0	3.5	3.8
Unemployment rate (%)	6.4	6.0	6.0	6.1
CPI Inflation (%)	1.6	1.9	2.0	1.9
Cdn 3-month T-bill (annual average %)	0.7	1.4	2.0	2.3
Cdn 10-year gov't bond (annual average %)	1.8	2.3	2.8	3.1
Exchange rate (US cents/Cdn\$)	77.2	79.0	79.6	80.3
Real US GDP growth (chained \$2009)	2.3	2.4	1.9	1.9
WTI Crude oil price (US\$ per barrel)	51	56	57	57

Source: 2018 Federal Budget.

financial well-being when the next economic downturn arrives.

Federal program spending rises to \$312.2 billion in 2018-19, up from \$304.6 billion the previous year. This represents a 2.5% increase, which is notably smaller than last year's 6.1% surge. The Budget pencils in similar-sized spending increases, in the range of \$10-12 billion annually, over the next few years. Assuming the Budget is right in forecasting that the economy will continue to grow at a reasonable pace, program spending as a share of GDP edges down from 14.2% this year to 13.6% by 2022-23.

Budgetary revenues are projected to grow a bit faster than expenditures. As a result, Ottawa's deficit shrinks modestly over time. The planned deficits are manageable when evaluated relative to the size of Canada's economy. But it is concerning that the government seemingly sees no need ever to

return to budget balance. With the economy operating at full tilt, we don't believe there is a compelling case for the string of operating deficits outlined in the Budget.

## NEW MEASURES

New spending measures are sprinkled across five different sections in the Budget: Growth, Progress, Reconciliation, Advancement, and Equality. As organizing themes, they are confusing, as many measures fit under multiple headings. Indeed, the same measures are often repeated in different chapters, adding significantly to the length (but not the usefulness) of the document.

Looking to areas where new funding is directed, the key areas of focus are gender equality, improving life for First Nations, advancing research and innovation, and increased support for low and middle-income families.

Assisting middle and lower income households is a clear objective. The Canada Child Benefit program is significantly enriched. A family with a net income of \$35,000 will receive an additional \$3,535 annually. Families with a net income of \$70,000 are in line for \$2,670 more. The Benefit will be eliminated for higher income households.

Other Budget measures that will help families and support increased labour market participation include enriched and extended parental EI benefits and enrichment of the Working Income Tax Benefit (now renamed the Canada Workers Benefit). The latter program targets low income workers, particularly those transitioning into the workforce.

The Business Council welcomes the new initiatives to strengthen trade and bolster Canada's connections with international markets and supply chains. In total, the Budget outlines an additional \$2.4 billion in new measures to support trade over five years. However, most of this actually reflects foregone tariff revenue related to Canada's participation in the Comprehensive and Progressive Agreement for

**Research and innovation is a prominent feature of Budget 2018. Building on the federal government's previous support for innovation and the super cluster initiative, Budget 2018 provides new funding of nearly \$4 billion to boost Canada's capacity in basic and fundamental research.**

TABLE 2: **FEDERAL GOVERNMENT FISCAL PLAN**  
(BILLIONS OF DOLLARS UNLESS OTHERWISE INDICATED)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Revenues	309.6	323.4	335.5	348.0	362.1	373.9
% change	5.5	4.5	3.7	3.7	4.1	3.3
Program Expenses	304.6	312.2	321.5	331.5	340.7	350.1
% change	6.1	2.5	3.0	3.1	2.8	2.8
Public Debt Charges	24.4	26.3	28.6	30.3	32.2	33.1
% change	1.2	7.8	8.7	5.9	6.3	2.8
Total Expenses	329	338.5	350	361.9	372.9	383.2
% change	5.7	2.9	3.4	3.4	3.0	2.8
Adjustment for risk	-	-3.0	-3.0	-3.0	-3.0	-3.0
Budgetary Balance	-19.4	-18.1	-17.5	-16.9	-13.8	-12.3
Federal Debt	651.5	669.6	687.1	704	717.8	730.1
Per cent of GDP						
Budgetary BALANCE	-0.9	-0.8	-0.8	-0.7	-0.6	-0.5
Federal Debt	30.4	30.1	29.8	29.4	28.9	28.4

Source: 2018 Federal Budget

Trans-Pacific Partnership, with just \$75 million aimed at pursuing new markets for Canadian exporters and modernizing and re-tooling the Trade Commissioner Service (TCS).

Research and innovation is a prominent feature of Budget 2018. Building on the federal government's previous support for innovation and the super cluster initiative, Budget 2018 provides new funding of nearly \$4 billion to boost Canada's capacity in basic and fundamental research. In addition, \$2.6 billion is being channeled to drive business innovation, and the government will overhaul and streamline the dozens of innovation programs that are now administered by a myriad of federal ministries and agencies. The innovation-related measures in Budget 2018 include the following:

- University and health research granting councils - \$925 million more over five years.
- Investing in equipment and facilities to support research -

\$763 million more is allocated to the Canada Foundation for Innovation over five years.

- Harnessing big data - \$572 million over five years.
- Industrial Research Assistance Program - \$700 million over five years.

The Industrial Research Assistance Program (IRAP) is designed to help Canadian entrepreneurs and small businesses develop innovative technologies and products and commercialize them. IRAP is an effective resource for assisting growing Canadian companies. The Business Council is pleased to see additional funding for this program, as well as for basic research.

To help modernize Canada's regulatory framework, Budget 2018 provides \$11.5 million over three years, starting in 2018-19, to advance a regulatory reform agenda focused on supporting innovation and spurring business

investment. The goal is to make the Canadian regulatory system more agile, transparent and responsive, so that businesses across the country can explore and act on new opportunities. To date, the current government has exhibited a marked inclination to add to and complicate the regulatory burden facing Canadian business, notably in the natural resource, infrastructure and manufacturing sectors that drive the country's exports. There is little in the statements emanating from key federal ministers to signal a genuine interest in regulatory streamlining or efficiency.

In total, Budget 2018 proposes spending measures amounting to almost \$5 billion for items related to reconciliation and/or to improving the lives of Indigenous People. The Business Council supports the government's stepped-up commitment to reconciliation.

As noted above, gender equality receives extensive mention in the

Budget. Here, the most substantial new funding, in dollar terms, is for the “Feminist International Assistance Policy,” which is part of Canada’s overall foreign aid policy and programming. But the government also intends to dedicate new resources to support women entrepreneurs and to help more women enter occupations and professions where they are now underrepresented. In addition, pay equity legislation will be strengthened for organizations and workers that fall under federal jurisdiction.

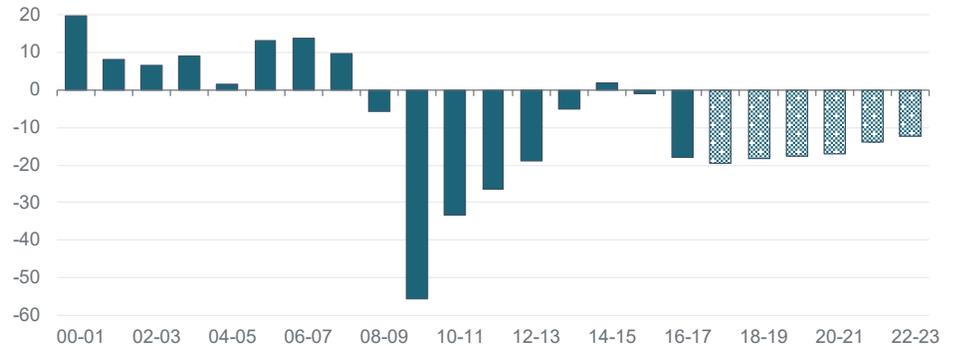
The Budget also earmarks \$3.2 billion over five years to enhance protection for air travel, to increase the protection afforded to temporary foreign workers, enhance border security, support the court system, and accelerate efforts to address gender-based violence and harassment, among various other items to improve security and well-being.

A number of smaller scale funding measures are also worth noting:

- funding to renew and modernize Statistics Canada (\$56 million over five years);
- support for women and girls in sport (\$30 million over five years);
- funding for Canadians impacted by Autism Spectrum Disorder (\$20 million over five years);
- \$206 million to improve client services at the Canada Revenue Agency.

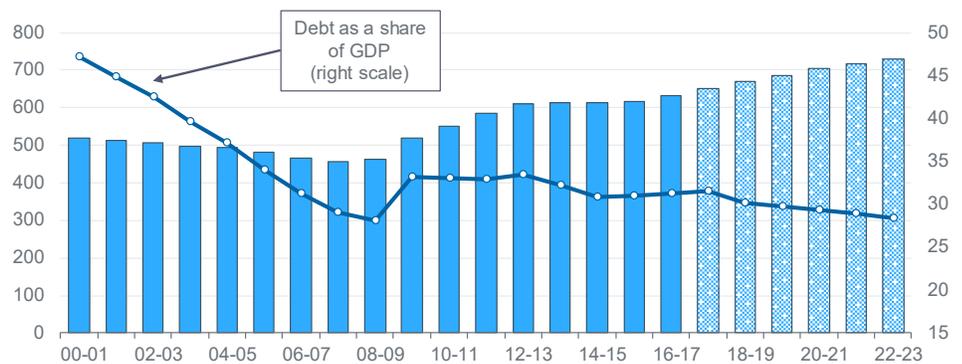
Finally, Budget 2018, introduces the final details of the government’s changes to the overall tax regime for small business (a process that has proven difficult for this government).

FIGURE 1: FEDERAL DEFICIT, BILLIONS \$



Sources: Fiscal Reference Tables and 2018 Federal Budget for projections.

FIGURE 2: FEDERAL DEBT (ACCUMULATED DEFICITS), BILLIONS \$



Sources: Fiscal Reference Tables and 2018 Federal Budget for projections.

Under intense pressure from business associations and small business owners, the Finance Minister’s Fall 2017 Economic Statement scaled back the government’s initial plans to eliminate income sprinkling and modify the rules governing passive investment income earned by small corporations. Budget 2018 provides further details. A limit of \$50,000 per year of passive income (meant to match a 5% rate of return on a million dollars of savings) will be enforced. Corporations with significant passive

savings will lose access to the lower small business tax rate, with access phased out on a straight-line basis. The \$500,000 small business rate limit will be gradually reduced until investment income reaches \$150,000. After that, a corporation will no longer qualify for the reduced tax rate. Most of the small business tax proposals advanced by the Department of Finance last summer have been abandoned.

## CONCLUDING THOUGHTS

This Budget is aimed at Canada's "middle class" (a term that is not defined in the document) and at providing additional resources to advance gender equity and reconciliation with Canada's Indigenous Peoples. These are important high-level priorities that we also share.

The Business Council is pleased to see measures that will foster greater participation in the workforce and more training and career opportunities for women and First Nations. Getting more people engaged in the labour market is one way to build prosperity, expand the "supply capacity" of the economy, and enhance family well-being.

Additional funding for basic research and business innovation is also welcome, particularly because we believe BC's academic and applied research institutions and the local technology sector are well-positioned to spearhead the development of new innovative products and services over the medium term.

All of that said, Budget 2018 also leaves us disappointed in some respects. The lack of any commitment to return to a balanced budget is troubling given the inevitability of an economic downturn within a few years' time. More immediately, we are concerned that government is doing little to tackle Canada's competitiveness challenges in a world where the competition for capital and talent is intensifying and our dominant trading partner is moving aggressively to attract investment and repatriate business activity. The Budget is largely silent on the topics of business investment and Canadian competitiveness. That does not leave us feeling particularly hopeful about what lies ahead.

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