2019 Budget: Much Investing, Very Middle Class

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Overview

The federal government would very much like you to know that its 2019-2020 budget (entitled Investing In The Middle Class) invests in the middle class. To be sure you don't somehow miss the point, the word "invest" is used 350 times in the budget, while "middle class" makes 100 appearances. What makes this thematic consistency particularly impressive is that it's essentially the same theme as the last budget. And the two before that. In fact, "invest in the middle class" is what the Liberals have been saying with metronomic regularity since the campaign of 2015.

With this rhetorical record, and an election coming in October, it is not surprising that the new budget contains no major change in direction or emphasis, with a focus on social policy, not economics. The words "drug" and "pharma" appear a combined 108 times in the budget; "housing" is used 161 times; "student" appears 177 times. The total number of mentions of "productivity" is five.

There is almost $23 billion of new spending, but it's divided among well over one hundred measures. ($300 million for the Housing Supply Challenge; $20 million for the Canada Music Fund; $327.5 million for the Post-Secondary Student Support Program; … etc.) More importantly, it's spread across five fiscal years – which means that while much of that spending may appear in government ledgers it will be written in pencil.

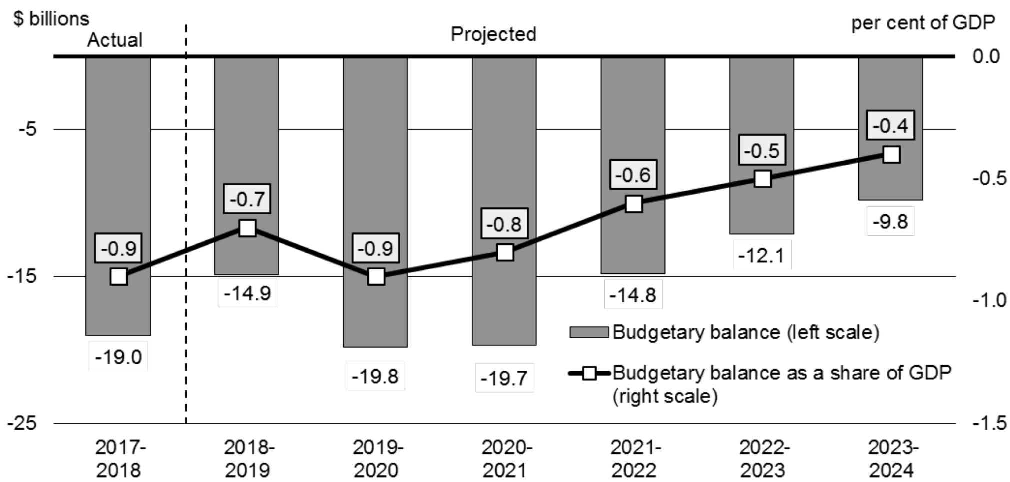
The headline policy announcements are also underdeveloped and will require a great deal of engagement with the provinces, municipalities, and other stakeholders before they can take shape and be implemented. Think of them as plans to make plans. One thing all this spending and policy-making has in common is that it is in line with the Liberal brand. Expect to see it on campaign brochures in the fall.

As for the government's overall fiscal picture, there are two ways of looking at it. Justin Trudeau favours one; Andrew Scheer is fond of the other. We'll deliver it Mr. Scheer's way first.

In the campaign of 2015 – as the Conservatives will no doubt remind Canadians later this year – Justin Trudeau's Liberals promised in the last election that they would not run a deficit higher than $10 billion a year and they would steadily reduce the deficit until the budget balanced. That glorious moment would arrive in 2019.

That glorious moment did not arrive in 2019. The budget estimates the deficit for 2018-2019 to be $14.9 billion and the government expects to run a deficit of $19.8 billion in 2019-2020. Gradual decline is projected in the following years, with the deficit reaching $9.8 billion in 2023-2024. There is no expectation of ever getting to a balanced budget. That's bad news.

Chart 3
Federal Budgetary Balance



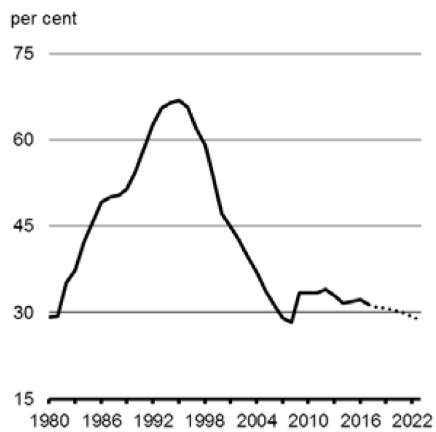
Note: 2017-18 has been restated to reflect historical revisions to Canadian GDP series.
Sources: *Fiscal Reference Tables*; Department of Finance Canada calculations.

Source: Investing in the Middle Class Budget

Using these data and a complex proprietary algorithm, TACTIX can confidently forecast that the Conservative leader will say "It's red ink as far as the eye can see!" at least a dozen times in 2019.

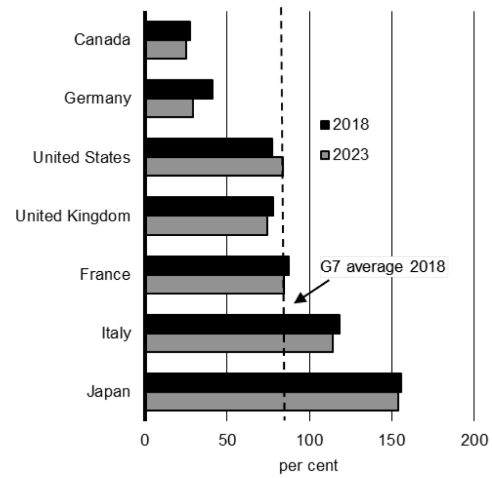
Mr. Trudeau is more sanguine about the federal government's fiscal situation. What truly matters, the government now insists, is not deficits and debt, but the debt-to-GDP ratio. The Liberals promise it will not significantly worsen on their watch. And so far, it hasn't. Canada's debt-to-GDP ratio – that is, the federal, provincial, and municipal debts combined – is the lowest in the G7. This year's budget foresees it declining modestly and gradually, reaching 28.6% in 2023-2024. That's excellent news.

Chart 4
Federal Debt-to-GDP Ratio



Note: Figures have been restated to reflect historical revisions to Canadian GDP series.
Sources: *Fiscal Reference Tables*; Department of Finance Canada calculations.

Canada's Forecasted Net Debt-to-GDP Ratio Lowest in G7



Note: The general government net debt-to-GDP ratio is the ratio of total liabilities, net of financial assets of the central, state and local levels of government, as well as those in social security funds. For Canada, this includes the federal, provincial/territorial and local government sectors, as well as the Canada Pension Plan and the Quebec Pension Plan.
Source: International Monetary Fund, October 2018 *Fiscal Monitor*.

Source: Investing in the Middle Class Budget

Nonetheless, the Liberals face two big challenges. One involves communication, the other policy.

The communication challenge is explaining what the debt-to-GDP ratio is and why people should care. Economists have always favoured putting the focus on the debt-to-GDP ratio but politicians have always balked because they know that to the average voter any discussion of debt-to-GDP ratios sounds like when the adults speak in a Peanuts cartoon ("waa waa WAAA waa…"). But now the Liberals have no choice but to speak High Wonkish with Canadians.

But the policy challenge is much bigger. The problem is Pharmacare.

While this budget provides seed money for certain elements of Pharmacare, it's clear the Liberals intend to make universal, national Pharmacare the centrepiece of their fall campaign. Polls suggest it will be a popular pitch. But a truly universal, national program will cost tens of billions of dollars. How can the government keep the budget anchored to the debt-to-GDP ratio while implementing an enormous increase in spending? Logically, there are only three possibilities: greatly scale back the program, raise taxes substantially, or cut the chain to the fiscal anchor.

But these are problems for the distant future of later this year.

Budget Impact on Canada's Business Community

TACTIX keeps a close watch on political developments and public policy issues of interest and importance to our clients. To that end, in the Annex we examine the contents of Budget 2019 as they relate to nine key sectors of the Canadian economy:

1. Skills Development
2. Digital Economy
3. Technology and Innovation
4. Energy
5. Defence, Security and Procurement
6. Infrastructure
7. Financial Services
8. Manufacturing and Automotive
9. Agriculture and Agri-Food

In Closing

All budgets are plans built on forecasts, and are therefore subject to the vicissitudes of life. That's particularly true of budgets delivered shortly before elections. And all the more true of this particular pre-election budget.

It has been a decade since the brief and mild recession of 2008 and a quarter century since the serious downturn of the early 1990s. If business cycles still exist, we're due. And remember the wider context. Slowing global growth. Worsening international trade wars. The precarious state of NAFTA 2.0. The bull in the Oval Office china shop. Clearly, a vast array of the possible futures we now face include an economic downturn which would make a hash of all the government's projections and plans.

As Robbie Burns once wrote to a mouse whose nest he accidentally dug up and destroyed while ploughing:

But Mousie, thou are no thy-lane,

In proving foresight may be vain:

The best laid schemes o' Mice an' Men Gang aft agley,

An' lea'e us nought but grief an' pain,

For promis'd joy!

~ The TACTIX Team

Budget 2019 Annex

Skills Development

Among several new initiatives in Budget 2019, the Canada Training Benefit will see $1.7 billion invested over 5 years in those Canadians seeking to renew or refresh their skills. Whether brushing up on new skills to keep your existing job or learning something to aid a career change, this is a portable personal benefit with two components. One is a new non-taxable Training Credit to help with the costs of training programs, and the second is an Employment Insurance (EI) Training Support benefit for income support while training. Accrued at $250 per year, workers age 25 to 64 will have the ability to spend $1,000 and four weeks every four years for skills training, with the security of knowing they'll have a job to come back to when their training is done.

Beginning in 2020, small business owners who pay EI premiums will be eligible for a rebate to offset premiums resulting from the new EI Training Support benefit.

Digital Economy

Building on the government's ongoing commitment to improving connectivity, Budget 2019 takes a step forward with the launching of the Universal Broadband Fund to increase access to high-speed internet at minimum speeds of 50/10 Mbps. Up to $1.7 billion will support universal high-speed internet in rural, remote and northern communities, with investments helping to address backbone infrastructure to underserved communities, support low-latency satellite capacity, and survey Canadians to measure household access and use of the internet and online businesses.

In support of much-needed digital skills development, Budget 2019 provides $60 million over two years, starting in 2019–20, to support CanCode's ongoing work and help one million more young Canadians gain new digital skills.

On the regulatory front, the increasing importance of wireless communications is being recognized by $117M over 5 years to support 5G, the next-generation wireless network. The money will support equipment modernization and the development of innovative tools and systems to minimize network interference and verify compliance with health and safety standards.

Technology and Innovation

Budget 2019 delivers more targeted activities building on the Superclusters and Strategic Innovation Fund platforms it created in earlier budgets.

This time around, Canada's forest sector will receive up to $251.3 million over three years, starting in 2020–21, to support pre-commercial research and development, industrial commercialization, and adoption of innovative technologies and processes. Funding to increase and diversify market opportunities for Canadian forest products in offshore markets, and expand wood use in non-residential and mid-rise construction, as well as support to the Indigenous Forestry Initiative are included.

In order to reduce the regulatory burden and accelerate the development of innovative technologies, funding and legislative revisions were also announced that will permit regulatory departments and agencies to move forward on Regulatory Roadmaps, including providing the Canadian Food Inspection Agency, Health Canada and Transport Canada with up to $219.1 million over five years, and $3.1 million per year on an ongoing basis.

There will be additional funding in support of numerous organizations, including the Stem Cell Network (to support work and foster Canada's leadership in stem cell research); the Brain Canada Foundation (help the medical community better understand the brain and brain health); the Terry Fox Research Institute (help establish a national Marathon of Hope Cancer Centres Network); Ovarian Cancer Canada (help address existing gaps in knowledge about effective prevention, screening, and treatment options for ovarian cancer); Genome Canada (enable Genome Canada to launch new large-scale research competitions and projects, in collaboration with external partners, ensuring that Canada's research community continues to have access to the resources needed to make transformative scientific breakthroughs and translate these discoveries into real-world applications); and Let's Talk Science (to support STEM activities and learning programs).

Energy

A number of energy- related initiatives were announced alongside the government's climate change initiatives. Of notable mention includes the proposal to invest $1.01 billion in 2018–19 to increase energy efficiency in residential, commercial and multi-unit buildings - investments to be delivered by the Federation of Canadian Municipalities (FCM) through the Green Municipal Fund.

The oil and gas sector is also supported by way of the commitment to provide a further $100 million over four years to the Strategic Innovation Fund, leveraging private sector, co-investments, in order to support the activities of the Clean Resource Innovation Network.

The unique energy challenges of northern regions are addressed by more than $1.7 billion over 12 years that will support the three northern territories to develop infrastructure through bilateral agreements under the Investing in Canada Plan, including $400 million for the Arctic Energy Fund to help northern communities access more reliable and renewable energy.

To improve decision making regarding future energy investments, Budget 2019 provides $15.2 million over five years, with $3.4 million per year ongoing, to establish a virtual Canadian Centre for Energy Information.

Defence, Security, Procurement

When it comes to military and defence, Budget 2019 showed a stay-the-course approach. The previously launched Defence Policy (2016) already committed to a funding profile for the next 30 years, leaving little left to announce. A key piece for defence in Budget 2019 was the announcement of more than $1 billion for operations in the Middle East and Ukraine, easing perennial concerns that operational needs will be funded out of existing commitments. On veterans, meanwhile, the government added what it hopes is enough funding in education, training, and transition services to mitigate it becoming an election issue.

When it comes to security, “cyber” and “digital” continue to be the hot topics. Legislative changes to introduce a new critical cyber systems framework will be matched by investments of $145 million over 5 years to improve resiliency of critical infrastructure, and $80 million over 4 years promoting coordination between centres affiliated with post-secondary institutions.

The largest ticket items from a procurement point of view are going to service the government itself. With the process to find a replacement to the Phoenix pay system already underway, more than $500 million (largely in the next 3 years) is now added to the budget to ‘fix’ Phoenix on an interim basis.

In transport, the proposed decision to spin CATSA off as an independent entity was surely the largest news. Coming with a significant outlay of cash over the next couple of years, CATSA would function as a not-for-profit entity once transitioned. Other legislative changes will include amendments that would indemnify NAV Canada for any liability arising from its support of military operations.

Infrastructure

Budget 2019 includes a number of initiatives affecting the building, maintenance and protection of public infrastructure across Canada. Considerable background information is provided on the Investing in Canada Plan, the government's signature infrastructure investment plan. This includes a number of tables highlighting dollar values of investments already made, as well as identifying where those investments have been made.

Working to resolve a long-standing problem that has plagued major infrastructure investments in the past, namely the timely transfer of funds from the federal government to its provincial partners, the Budget references the government's pilot project to advance funds before projects are completed.

With regard to specific announcements, the Budget includes the following measures:

- A one-time payment of $2.2B through the Gas Tax Fund directly to municipalities. This direct relationship with municipal governments circumvents provincial governments that are constitutionally responsible for municipalities.

- The Federation of Canadian Municipalities (FCM) is being allocated $350 million through the Municipal Green Fund, which it manages on behalf of the Government of Canada, to provide municipalities and non-profit community organizations with financing and grants to retrofit and improve the energy efficiency of large community buildings. This funding will also go toward community pilot and demonstration projects in Canadian municipalities, both large and small.

- The Canada Infrastructure Bank has been allocated $5 billion for investments in green infrastructure, which could include electricity projects such as interties between provinces and territories.

- To assist with response to the increasing number of emergencies and natural disasters affecting communities across the country, the Budget proposes to:

    - Invest $151.23 million over five years, starting in 2019–20, and $9.28 million per year ongoing, to improve emergency management in Canada, including in Indigenous communities. This investment will help to assess the condition and resilience of Canada's critical infrastructure, including energy grids, water and food supplies and health services, in the aftermath of a natural disaster.

  - Support response and recovery efforts in the wake of large-scale natural disasters, the Budget proposes to provide $260 million over two years, on a cash basis, starting in 2019–20, to Public Safety Canada to support provincial and territorial disaster relief and recovery efforts through the Disaster Financial Assistance Arrangements Program.

Financial Services

Finance Minister Morneau used the occasion of his 2019 Budget to announce that his Department plans to table legislation that would implement a new retail payments oversight framework. Canadians are increasingly availing themselves of purchasing goods and services, and transferring funds, via mobile and electronic devices. The pending legislation will seek to balance the government's twin objectives of encouraging innovation in financial services while at the same time protecting consumers.

The Budget also notes that the government will be introducing technical amendments to the Canadian Payments Act, seeking to modernize the governance of Payments Canada.

Of interest to financial institutions and consumers alike, the Budget makes the following additional announcements:

- The government's review of open banking continues with the work of the Advisory Committee on Open Banking announced in last year's budget. Open banking would allow consumers to share their financial transaction data with financial services providers in addition to their primary provider, with the public policy objective of injecting further competition in the marketplace.

- The government will appoint a governance council to support and help guide the work of the Financial Consumer Agency of Canada.

- In keeping with its legislative mandate to periodically update the legislation governing Canada's federally regulated financial institutions, Minister Morneau announced the government's intention to introduce amendments to these statutes, including the Bank Act and the Canada Deposit Insurance Corporation Act.

Manufacturing/Automotive

There is little in the way of new budgetary initiatives of interest to Canada's manufacturing sector writ large. The Budget does confirm the government's commitment, announced in Minister Morneau's 2018 Fall Economic Statement, to provide for an Accelerated Investment Incentive and to allow the full cost of machinery and equipment used in the manufacturing and processing of goods to be written off immediately.

Of interest to Canada's automotive manufacturing sector, however, Budget 2019 includes a number of significant measures. Several of these initiatives relate to the Government of Canada's Zero Emissions Vehicle (ZEV) policy, including:

- Providing Transport Canada with $5 million over 5 years to work with the automotive manufacturers to establish voluntary ZEV sales targets.

- An incentive of $5,000 for consumers to purchase electric and hydrogen fuel cell vehicles with an MSP of under $45,000 (thus excluding the purchases of Tesla and other high-end ZEV vehicles). A total of $300 million is being allocated over three years to Transport Canada for this purpose.

- An incentive for businesses to purchase electric, plug-in hybrid and hydrogen fuel cell vehicles.

- Giving Natural Resources Canada $139 million over 5 years to deploy recharging and refuelling stations in workplaces, public parking facilities commercial and multi-unit residential buildings and in remote locations.

One additional item of interest to Canada's automotive sector is the announcement that Transport Canada will be working with provincial and territorial governments to align road safety and transportation requirements, including for the use of autonomous and connected vehicles. Moreover, funding will be made available to stakeholders to identify road safety options, including for new technologies.

Agriculture and Agri-food

In the last two budgets, the agri-food sector has done well. There was a clear recognition of the importance the sector to the export-driven Canadian economy and to the health and prosperity of Canadians. While taking a back seat to the 100+ spending announcements targeted at micro-segments of the Canadian electorate, there are a few important announcements in Budget 2019 for the agri-food sector.

Budget 2019 builds on the announcements in 2018 that the government was serious about creating a more efficient and friendly regulatory system for Canada's farmers, food processors and the value chain that supports the sector. In a few weeks we can expect to see Regulatory Roadmaps that will group changes into three clusters: 1) User-Friendly Regulatory System; 2) Novel or Experimental Approaches; 3) Greater Cooperation and Reduced Duplication. Budget 2019 allocated $219 million over five years for this initiative.

Tucked away under the announcement for a national "Food Policy" was $100 million additional funding for the Strategy Innovation Fund to support innovation in the food processing sector. That's welcome news given the lack of investment in the sector over the past 10 years.

The other notable announcement was that the government announced that it would launch a "broad-based review of the Canada Grain Act, and of the operations of the Canadian Grain Commission, will be undertaken to address a number of issues raised by the Canadian grain industry, including redundant inspections and issues within the current grain classification process that unnecessarily restrict Canadian grain exporters." With the number of false starts over the past five years, perhaps we will see changes in 2020/21.