

ANALYSIS

Federal Government Fall Economic Statement

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FEDERAL GOVERNMENT FALL ECONOMIC STATEMENT 2018: BOOSTING CANADIAN COMPETITIVENESS

Finance Minister Bill Morneau today released the federal government's Fall Economic Statement (FES) in the House of Commons. Titled Investing in Middle Class Jobs, the plan is designed to shore up Canadian economic confidence in the face of a strained trade relationship with the United States and a gradual shift from a resource-based economy to one based on the Liberal government's clean-growth model of innovation, technology and services. It also continues the Government's focus on growing the middle class.

One year out from the next federal election, the FES provides a good indication of how the Liberals will frame economic issues during the campaign ahead. How the opposition parties respond over the next few days and weeks will similarly reveal their game-plans.

WHAT IT IS

Released in the late fall of each year, the FES sets up the spring budget by providing a snapshot of Canada's fiscal position. It shows the strength of the economy, government revenues vs. expenditures and the degree to which spending programs are being rolled out in line with commitments.

Since its launch in 1994 by then-Prime Minister Paul Martin, the FES has increasingly included new spending commitments. It has come to be seen as an annual mini-budget ahead of the full budget released each year in late February. This year the FES followed this trend-line with new spending commitments in a number of key areas.

COMPETITIVENESS

The word of 2018 in Ottawa has been 'competitiveness'. It is the theme of the ongoing consultations that will shape Budget 2019 and has recently been the focus of countless federal roundtables and consultative processes. Minister Morneau gave voice to competitiveness issues during his 2018 budget speech but the budget itself remained largely silent on the issue. Instead, Minister Morneau asked for

time to weigh the options and develop a comprehensive competitiveness strategy. He said that competitiveness will be “Job number 1 on the centre of [his] desk for the next six months.”

There are three broad issues driving competitiveness concerns. The first is Canada’s relative position to the United States, our largest trading partner. Industries and citizens across Canada have voiced concern that U.S. efforts to lower tax rates, reduce regulatory burden, open up new areas for resource development, and pursue a protectionist agenda will erode our national competitiveness. The successful conclusion of the United-States-Mexico-Canada-Agreement (USMCA) negotiations has alleviated some pressure here but doesn’t do anything to mitigate the U.S. advantage of lower corporate tax rates. Also, punishing tariffs on Canadian steel and aluminum remain in place. Foreign direct investment in Canada in 2017 was down 55% from where it was in 2013, although some economists have pointed to a rebound in 2018.

The second issue is the concern shared by many industrial sectors across Canada that the regulatory burden in Canada is becoming dangerously heavy. The federal government continues to develop new climate regulations and is reforming impact assessments. It is introducing changes to the Fisheries Act and has had difficulty moving forward pipeline projects deemed to be in the national interest. While these are policy rather than fiscal issues, and therefore are better managed in legislation rather than budget documents, the cumulative impact of the regulatory burden has amplified calls for a systematic approach to competitiveness.

The third driver of the competitiveness narrative is regional economic issues that are symptomatic of the first two drivers but that are specific to an industry’s or a region’s competitiveness and therefore requires targeted action. An example here is the record-low price of Canadian bitumen, now under \$20 per barrel.

This FES is the vehicle by which the Minister is communicating the Government’s competitiveness strategy. Indeed, competitiveness is front-and-centre. As the Minister said during his speech introducing the FES, his Government “has made an absolute commitment to maintaining [Canada’s] competitive advantage in a volatile world.”

ELECTION 2019

While competitiveness drives the theme of this FES, Election 2019 drives the strategy. Today marks 11 months until the next Federal Election, scheduled to take place on October 21, 2019. Each federal party is focused on developing the profile, policies, strategies, and war chests that will carry them through a year-long campaign to election day. Through the FES the Liberal Government has signaled some elements of what it will stand for in the year ahead.

There is a common perception that the first three years of the Liberal mandate have been more focussed on investing in the future and ensuring equitable outcomes than on economic competitiveness and growth. They have driven up the deficit to fund infrastructure and innovation, brought in progressive legislation and focussed on fairness and inclusion type issues. There has been a strong focus on families, the middle class and emerging technologies but large incumbent industries have often felt taken for granted.

With this FES the Liberals have tried to strike the right balance by making its case that a Liberal-led Canada is open for business and that Canadians should feel confident that the Canadian economy can be both strong and fair.

WHAT'S IN IT – AND WHAT'S NOT

Tax Breaks vs. Capital Depreciation

As was widely expected, Minister Morneau's approach to competitiveness stays away from broad-brush corporate tax cuts and instead focusses on accelerated capital cost depreciation.

Specifically, the FES proposes three immediate changes to Canada's tax system, in order to enhance business confidence in Canada:

1. Allowing businesses to immediately write off the cost of machinery and equipment used for the manufacturing or processing of goods, which the Government hopes will fuel new investments and

support adoption of advanced technology and processes by this highly mobile sector of the economy;

2. Allowing businesses to immediately write off the full cost of specified clean energy equipment to spur new investments and the adoption of advanced clean technologies in the Canadian economy; and,
3. Introducing the Accelerated Investment Incentive, an accelerated capital cost allowance (i.e., larger deduction for depreciation) for businesses of all sizes, across all sectors of the economy, that are making capital investments.
4. These measures are expected to cost the Government \$14 billion over the next five years and will reduce the average effective tax rate on new business investment from 17% to 13.8%.

Additional Competitiveness Measures

In addition to accelerating business investment in Canada, the FES focusses on three areas that the Government says will help bolster confidence within the business sector:

1. Making it easier for businesses to grow;
2. Removing barriers to trade within Canada; and,
3. Making Canada the most globally connected economy.

Making It Easier For Businesses To Grow

The FES proposes several new steps in the Government's efforts to reform and modernize federal regulations, while continuing to protect Canadians' health and safety and the environment. Specifically, the FES commits the Government to:

- Exploring making competitiveness a permanent part of regulatory mandates;

- Introducing an annual modernization bill to keep regulations up-to-date;
- Establishing a dedicated External Advisory Committee on Regulatory Competitiveness;
- Launching a Centre for Regulatory Innovation;
- Enhancing Government's capacity to develop and implement effective regulations; and,
- Taking immediate action in response to business recommendations.

Removing Barriers To Trade Within Canada

The FES proposes that the federal government will work with provincial and territorial partners to accelerate action to remove regulatory and other barriers in four specific areas:

- Transporting goods between provinces and territories;
- Harmonizing food regulations and inspection rules across the country;
- Aligning regulations in the construction sector, including the harmonization of building codes across Canada; and,
- Facilitating greater trade in alcohol between provinces and territories.

Making Canada The Most Globally Connected Economy

The FES sets a target of 50% export growth by 2025. To facilitate this, the Government proposes to invest \$198 million over six years to put more resources directly in the hands of Canadian businesses seeking to develop export plans, build global partnerships, or gain skills and training for global trade, including by:

- Providing funding to Canadian small and medium-sized enterprises (SMEs) to help them explore new export opportunities including by providing them with funding to support participation in trade shows and trade missions, market research, legal fees and adaptation of marketing tools;
- Connecting Canadian entrepreneurs that are looking to move into new overseas export markets with seasoned Canadian business executives who have in-market experience;
- Expanding the Canadian Trade Commissioner Service's Canadian Technology Accelerator program globally including in global technology hubs, such as Delhi, Hong Kong, and Tokyo; and,
- Making new investments in internships through the Mitacs International Incubators Internships program.

This investment is part of a larger \$1.1 billion Export Diversification Strategy previously committed to by the Government that will be rolled out over the next six years.

FEDERAL DEFICIT

During the 2015 election campaign the Liberal platform committed to running short-term deficits not exceeding \$10 billion per year in order to stimulate the economy and drive clean growth. The deficit for fiscal year 2018/2019 came in at \$19 billion, which matched the 2017/2018 deficit. The Conservatives have continually called out the Government for its lack of a roadmap to return to balanced budgets. This FES won't give them much comfort in that regard.

The FES estimates this year's deficit will be \$18.1 billion. Next year it will swell to \$19.6 billion before declining to \$11.4 billion in 2023-24. By continuing to focus on the debt-to-GDP ratio rather than the deficit, the Liberals have given themselves latitude to continue significant program spending into the future.

SUPPORT FOR NEWS MEDIA

Canada's news media has been challenged for over a decade by falling ad revenues. Revenues fell from \$5.5 billion per year in 2008 to \$3.2 billion in 2016; the number of daily papers across the country has

declined from 139 to 88. Federal officials have raised concerns that the erosion of journalism could undermine democratic institutions throughout Canada. Today the Government announced new measures to help the struggling industry.

The FES proposes three new initiatives for supporting Canadian journalism, which together will provide \$595 million to the sector through investments and tax breaks:

- allowing non-profit news organizations to receive charitable donations and issue official donation receipts,
- introducing a new refundable tax credit to support original news content creation, including local news; and,
- introducing a new temporary non-refundable tax credit to support subscriptions to Canadian digital news media.

DAIRY COMPENSATION

Canada's dairy farmers have given up significant market share under a succession of international trade deals: first with the European Union, then with the Trans-Pacific region and then with the U.S. and Mexico. Each deal came with concessions for foreign access to domestic dairy markets. Canadian farmers have been promised compensation for this loss of market share. However, details of this compensation were not laid out in the FES. Instead the FES notes that:

The Government of Canada has initiated discussions with Canada's dairy, poultry and egg sectors regarding the impacts of recently signed trade agreements with Asia-Pacific countries and the United States. The Government is firmly committed to working in partnership with these sectors to develop and implement appropriate supports for affected Canadian farmers.

SUPPORT FOR ALBERTA'S OIL PRODUCERS

While the tax breaks on new investment will benefit the oil sector, there is nothing in the FES that specifically addresses the low price of oil currently wreaking economic havoc in Alberta. Minister

Morneau did acknowledge the issue in his remarks, noting “the challenges facing the oil and gas sector in Alberta, which is contending today with very low crude oil market prices compared to international benchmarks.” However, there is nothing in the FES to directly support the sector, as some had hoped there would be.

STRATEGIC INNOVATION FUND RECAPITALIZATION

The Strategic Innovation Fund (SIF) allocates repayable and non-repayable contributions to firms of all sizes across all of Canada's industrial and technology sectors. The program has a budget of \$1.26 billion over five years and is managed by Innovation, Science and Economic Development Minister Navdeep Bains.

To accelerate support for business innovation in Canada, the Government is proposing to provide a further \$800 million over five years to the SIF - including \$100 million earmarked for the forestry sector - which will continue to be available to support innovative investments across the country and in all economic sectors.

NATIONAL TRADE CORRIDORS FUND

The FES notes that investments in marine ports and along the busiest rail and highway corridors will help address transportation capacity constraints—providing new opportunities for Canadian businesses to get their products to international markets. To expedite projects over the next five years, the Government will establish a continuous call for proposals for the National Trade Corridors Fund. Backed by an accelerated investment of \$773.9 million over five years, the Fund will prioritize projects that provide the best economic benefits, drawing on better transportation data and reviews of key challenges in businesses supply chains.

SOCIAL FINANCE FUND

To help charitable, non-profit and other social purpose organizations access new financing, and to help connect them with private investors looking to invest in projects that will drive positive social change, the Government proposes to make available up to \$755 million on a cash basis over the next 10 years to establish a Social Finance Fund. Details of the fund's governance and parameters will be released in

2019, but the purpose is to help close the capital financing gap faced by organizations that deliver positive social outcomes, and to help accelerate the growth of the existing social finance market in Canada.

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The FES will be judged on the extent to which it is seen to show that the Liberal government is serious about economic growth and the competitiveness of Canadian industry.

The Sussex team believes that the document is designed to protect the Liberal flanks during the coming election campaign. It acknowledges and addresses competitiveness concerns in Canada's traditional resource-based sectors, which will allow the Liberals to focus Budget 2019 on the issues that led to their success in 2015: sustainability, innovation and inclusion. They want to be progressive and optimistic. Heading off competitiveness pessimism now gives them cover to play to their strengths as the election nears.

Will it work? That depends on a number of factors over the next year – most notably the strength of the Canadian economy. If Canadian stock prices hold up well against US stocks, as we have seen in recent weeks, and oil prices rebound, that will help the Liberal narrative that sustainability and economic growth do indeed go hand-in-hand and that Canada is well positioned for the future. Large capital investment announcements like the \$40 billion LNG Canada project in B.C. also help. Conversely, if markets weaken and the Government cannot get corporate Canada onside it will open the door for Conservative Leader Andrew Sheer to present himself as the more pragmatic choice in 2019.

An early test of the vision laid out in the FES will be the by-election scheduled for December 3rd in the riding of Leeds-Grenville-Thousand Islands and Rideau Lakes. The riding is being contested following the tragic passing of Conservative MP Gordon Brown. The front runners in the race are Conservative Michael Barrett and Liberal Mary Jean McFall. While by-elections are typically more focussed on local rather than national issues, political Ottawa will use the outcome as a barometer of party momentum. This analysis will continue through three other by-elections that will take place in the spring.

WHAT IT MEANS GOING FORWARD

The implementation of the competitiveness strategy will require input from affected Canadian companies. The Government will want to hear how they can make these measures most impactful as they develop the resulting legislation and regulations. Moreover, the Liberals will want to be able to show prior to the 2019 election that the new funding initiatives announced in the FES have gained traction with industry and are moving forward on schedule. In both cases, meetings with officials in Ottawa in December or early in the new year will be critical to properly positioning corporate interests.

Beyond reacting to the fall economic statement, there are two areas of note for proactive engagement over the coming months. The first is to be well-positioned for the spring budget, which will likely be released in late February or early March. The pre-election budget is typically full of popular, politically-attractive spending commitments. Time is running short to put new ideas forward to the Government - pre-budget consultations began in August - but the window has not closed.

The second proactive opportunity is all-party advocacy. Each political party will spend the first part of 2019 crafting its election platform. They will be looking for good innovative ideas or for problems in need of a fix. While it is important to engage with all parties equally to avoid perceptions of favoritism, there is an opportunity to help shape the platforms that will inform the policy and spending priorities following the next election.

The markers set out in the FES provide a good opportunity to align advocacy with Government priorities. Government officials – both elected and departmental – will be looking for ideas and advice on implementation in the weeks and months ahead.

CONTACT US

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