Federal

2013-2014 Budget Preview

As a think tank dedicated to improving the long-term prosperity of western Canada, the Canada West Foundation is paying close attention to the signals being sent by the region's provincial governments and the federal government in their 2013/14 budgets.

Western Canada is facing a number of challenges that governments must address including sluggish productivity growth, looming labour shortages, gaining access to new markets and enhancing the performance of the public sector. We need to be investing in the future, not just spending in the present.

Initiatives set out in the federal budget contain an additional layer of complexity for western Canada. As the four provinces vary considerably, new initiatives announced in the federal budget are bound to have differing effects across the West. For this reason, the focus of the Canada West Foundation's federal budget analysis is less on specific measures and more on the broad principles that we hope govern the policy choices made in the budget.

The federal government will release its 2013/14 fiscal plan on March 21. With the above challenges in mind, there are four areas we hope to see addressed in Thursday's budget:

1) Long-term strategic investments in public infrastructure
2) Meaningful action on labour shortages and skills training
3) Progress towards building social licence for pipeline and resource projects
4) Removal of barriers to trade and investment in Canada

Our post-budget analysis – available on March 22 – will assess the degree to which the budget addresses these issues.

1

Building for the Future: Long-term strategic investments in public infrastructure

Recent research by the Canada West Foundation has determined that sustained and strategic investment in public infrastructure is essential to Canada's long-term economic growth and to improving the quality of life enjoyed by Canadians. Inadequate infrastructure erodes economic competitiveness, which translates into fewer job opportunities and lower incomes. Conversely, strategic public infrastructure investments – in transportation systems and core services – boost economic productivity and fuel long-term income gains.

Over the years, the federal government has taken a number of important steps to re-invest in Canada's aging infrastructure. The watershed moment came in the 2007 budget, which brought together all federal infrastructure support into a broader program called the Building Canada plan that extended from 2007 to 2014. The total investment package at the time was valued at $37.1 billion. It included existing tax-sharing arrangements with municipalities, money for trade-related infrastructure, a new public-private partnership fund (the P3 Canada Fund) and an $8.8-billion Building Canada Fund. Stimulus spending under the original 2009 "Economic Action Plan" added another $5.5 billion in infrastructure investments.

Federal stimulus spending has wound down and the Building Canada Fund – the centrepiece of federal infrastructure spending – is set to expire next year. In last year's budget, the federal government confirmed its intention to develop a long-term plan for public infrastructure that would extend beyond the Building Canada plan.

A new infrastructure investment plan needs to build on the strengths of the program it replaces by committing to stable funding over a relatively long time horizon. It also needs to be strategic: prioritizing infrastructure that is likely to improve productivity in the private and/or public sectors; and infrastructure that supports domestic or foreign trade.

To replace the Building Canada plan, the 2013 federal budget should contain a long-term plan to invest in strategic public infrastructure. The focus of those investments should be on core infrastructure and projects that deliver the largest economic impact.

2

Addressing Labour Shortages: Acting now to meet current and future workforce needs

A combination of economic growth in resource-based industries, weakness in manufacturing and demographic changes are pointing to a growing skills mismatch across Canada. Some sectors and provinces are experiencing chronic labour shortages, limiting the country's economic growth potential. Others have surplus labour or skills in low demand.

The Canada West Foundation has highlighted the need to address labour shortages and skills training in each of the provincial budgets in western Canada. However, this is an area where the federal government has an important role to play as well.

Indeed, pre-budget leaks suggest that labour shortages and job training will be a major focus of this year's budget. The federal government has hinted that it may finance this agenda in part by rescinding $2 billion in Employment Insurance (EI) transfers to the provinces – money being used by the provinces to fund their own skills-training initiatives. If true, this would represent a dramatic reversal in government policy; it was only in 2007 that the federal government began providing those EI funds to support provincial job-training programs.

There are many ways to address labour shortages and to improve the existing scope and delivery of skills training programs across Canada. Because there is an important role to play at both the federal and provincial levels, the Canada West Foundation hopes that the budget avoids triggering unproductive debates between governments about money and control of programs, and that it focuses instead on meeting core objectives – addressing the existing and looming labour and skills shortages across Canada (and which are particularly acute in the West).

There are four overarching principles that should guide federal policies related to labour shortages and skills development. These are:

- **Improving labour mobility across Canada**. A well-functioning labour market is one where workers are able to access job opportunities across the country. Improving mobility also means greater access to training for job opportunities that may exist outside someone's province of residence.
- **Ensuring a match between job needs and training opportunities**. Skills training programs need to reflect current and future labour needs. This calls for close federal-provincial cooperation since provinces are usually in the best position to recognize their own labour needs. However, it may be more efficient to aggregate strategy and needs assessment at the regional level.
- **Increasing immigration**. Immigration is a critical part of the solution to addressing long-term skills, labour and demographic challenges across the country. Initiatives like the Provincial Nominee Programs (PNPs) have been enormously successful in western Canada and could be expanded.
- **Investing in Aboriginal education and training**. Aboriginal Canadians represent the youngest, fastest-growing and most under-engaged segment of the labour force, especially in the West. Steps to improve the on-reserve education system and training opportunities for First Nations would be tremendously beneficial.

The Canada West Foundation is looking for the federal government to present a skills agenda that makes progress in the following areas: improving labour mobility across Canada; ensuring Canadians have the skills they need to work anywhere in the country; increasing immigration; and improving education and training within First Nations communities.

3

Improving Public Confidence: A plan to address concerns about pipeline and resource projects

The oil and gas industry is a major driver of national economic activity. However, the long-term economic future of the industry is threatened by inadequate pipeline infrastructure. Capacity on existing lines is quickly running out and the West's inability to reach markets outside the US Midwest is a major factor behind the wide price differentials between western Canadian heavy crude and North American benchmark blends. Those differentials are not only hurting governments' bottom lines in Alberta and Saskatchewan but, if allowed to persist, could undercut the business case for future exploration and development. The economic implications would be felt across the country.

Public resistance is the main obstacle to pipeline expansion and development. This resistance has two components: concerns that expanding pipeline capacity will increase oil sands output and thus lead to higher greenhouse gas emissions and other environmental damage; and the risk of a spill, whether on land or at sea.

These concerns need to be addressed. In other words, steps must be taken to acquire or maintain the social licence to build and operate the pipelines that western Canada needs. There is a range of policy actions that the federal government could take that would improve public acceptance of resource and pipeline development. These could include improvements to the quality of regulation and oversight of resource industries, improved pipeline and marine safety standards, or measures to reduce the environmental impact of oil sands production. On March 18, the federal government announced changes designed to improve marine safety.

The Canada West Foundation is looking to the federal budget to contain meaningful steps to improve public confidence in resource development and pipeline transportation projects across Canada.

4

Accessing New Opportunities: Removing barriers to trade and investment

The Government of Canada has made trade and investment a clear policy priority. Recent budgets have included several trade- and investment-related initiatives and the federal government has been actively pursuing agreements with countries around the world. The 2012 budget also committed to updating Canada's Global Commerce Strategy (GCS) – a 2007 document intended to position Canada to benefit from a rapidly-changing global economy. Consultations on the updated GCS have taken place, but a revised strategy has yet been released.

In spite of recent efforts, there remain a number of barriers to a properly-functioning trade and investment system in Canada. Progress in any of the following areas would be welcome:

- A more coherent approach to foreign investment rules in Canada;
- Taking steps to dismantle Canada's system of supply management, a proven obstacle to completing trade deals and market access gains for western Canada;
- Financing the trade-related transportation infrastructure needed to ensure that exporters are able to access overseas markets;
- Providing better support to small- and medium-sized enterprises that are active exporters; increasing the competitive intensity within Canada; and
- Ensuring that the West's strategic priorities are reflected in federal policy and overseas market development efforts.

The Canada West Foundation believes that international trade and investment is a critical determinant of long-term economic prosperity in the West and across Canada. We are looking for the 2013 budget to contain specific plans and objectives to remove existing barriers to a properly-functioning trade and investment system.

2012 Budget Review

The 2012 federal budget – rebranded the "Economic Action Plan" since 2009 – set the federal government on a path to balance the budget by 2015/16. It projected a $21.1 billion deficit in 2012/13, a modest improvement in the bottom line from an estimated $24.9 billion deficit the previous year.

As set out in the budget, the government's long-term plan was to gradually eliminate the deficit by focusing heavily on the expenditure side of the equation. There were only a small number of modest changes on the revenue side: Employment Insurance (EI) premiums were increased, certain tax credits and preferences were phased out and some tax "loopholes" were closed. In total, the federal government projected revenues of $255 billion for 2012/13 – an increase of 2.8% over estimates for the previous year. Personal income taxes – the single largest source of federal revenue – were budgeted to increase by 3.7%.

For their part, program spending was budgeted at $245.3 billion for the fiscal year, an increase of 1.4% over 2011/12. In a real sense, the federal government cut program spending – that 1.4% growth rate was well below inflation and population growth. Federal transfers to the provinces were untouched in the budget. Most cost savings were expected to come from cuts to the public service. In total, the federal government announced the elimination of 19,200 government jobs, to be phased in over a 3-year period. The other major factor was a decision to defer $3.5 billion in spending on new equipment for the Canadian Forces.

2012/13 Fiscal Update

In November 2012, the federal government released its fiscal update for the 2012/13 budget year. That update saw the bottom line deteriorate across the projection period. The projected deficit for 2012/13 was revised from $21.1 billion to $26.0 billion, and the government pushed back its expectation for when it will eliminate the deficit. According to November projections, the budget will not be balanced until 2016/17.

As with most provincial budgets so far this year, the federal fiscal shortfall is largely the result of slower-than-expected economic growth undercutting revenues in 2012. As of November, the government expected total revenue for 2012/13 to come in $6.3 billion lower than initially forecast. For its part, program spending was projected to be slightly higher than laid out in the budget.

The one positive note to come out of the fiscal update was that the cost of servicing the public debt will be less than expected. Low interest rates produced $1.3 billion in savings on debt financing in 2012/13. These savings help offset some of the revenue shortfall.

This budget preview was prepared by Canada West Foundation Senior Economist Michael Holden. The opinions expressed in this report are those of the author and are not necessarily those of the Canada West Foundation's Board of Directors, funders or advisors.

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