MACLEAN'S

YOUR GUIDE TO THE

2013 BUDGET

WHO'LL WIN, WHO'LL LOSE, AND WHAT TO WATCH FOR ON BUDGET DAY.

CANADIAN BUSINESS

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Time to choose

From tax reforms to infrastructure spending, here are the five key areas to watch on budget day. By **John Geddes**

Defence

Increasing spending on the Canadian Armed Forces has probably been the most expensive element in the core policy strategy that Prime Minister Stephen Harper has pursued to give his Conservative government its particular personality.

True, cutting the GST was expensive, but most of the niche tax breaks that followed were relatively cheap. And, yes, building prisons might eventually be expensive, but the up-front cost associated with ordering judges to impose mandatory minimum penalties—the spine of the Tory tough-on-crime agenda—is very low. Streamlining environmental assessments and other regulatory requirements for energy and other resource developments generally saves Ottawa money.

But bolstering the military hasn't come cheap. Department of National Defence spending climbed to $22.8 billion for 2011-12, up from $15 billion when Harper took office in fiscal 2005-06. Last year's fiscal plan called for more than $1 billion a year to be cut from the defence department's overall budget of more than $20 billion by 2014-15. This week's budget will almost certainly continue that trend. But close watchers of defence spending are less fixated on the amounts than the conditions that surround any cuts. They will be listening for signals from Flaherty and his officials on how any reductions must be accomplished.

SOURCE: Fiscal Reference Tables (Department of Finance Website); GlobalSecurity.org

David Perry, an analyst at Carleton University in Ottawa and with the Conference of Defence Associations Institute, has low expectations for how much clarity Finance Minister Jim Flaherty will bring to the notoriously complex questions of defence spending. "A lot of the times, the budget language is so amorphous that it can mean essentially whatever you want it to," he says.

Still, Perry says he will be listening closely for any hint of whether the government might ease off on insisting the force's troop strength be maintained at 68,000 in uniform, or allowing for some scaling back of the ambitious plans for buying new military hardware—planes, ships, helicopters and more—first mapped out in 2008.

If those two major conditions—no shrinking the forces and no cutting back on procurement—remain, then something else has to give. Perry says there are only two other major ways to save: reduce the training and readiness of troops, or take a serious look at reforming the defence department's administration. The latter option was proposed in Lt. Gen. Andrew Leslie's controversial 2011 "transformation" report, a detailed blueprint for major savings in the department's sprawling head office operations in Ottawa.

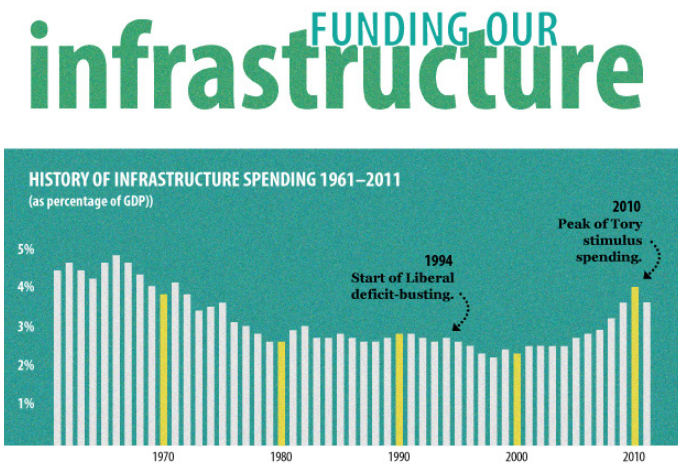
Leslie has since retired, but has spoken out recently to criticize the government for allowing the defence department's use of outside consultants and private contractors to grow in the past few years. And that's only one indication that his report isn't being implemented.

Perry says if Leslie's recommendations aren't revived, allowing major administrative cuts, the military will have to find the savings Flaherty is demanding in their front-line operations. And that could mean Canada will end up with "hollow" forces—troops who are being paid to remain in uniform, but not trained or kept ready to a degree that makes them usefully available to be deployed.

Flaherty can't be expected to give a detailed plan for military cost savings in this week's budget. But with defence spending under increasingly close scrutiny—and the Tories' reputation as staunchly pro-military hanging in the balance—any signal he sends on how cuts are meant to be accomplished would be a key budget-day story.

Infrastructure

Is it possible for a potential budget measure to be too obvious, the consensus behind it too broad? When it comes to the pressure to spend heavily on infrastructure, Flaherty might just be faced with this unlikely problem. The difficulty he faces is that so many groups have urged him to invest in infrastructure that almost anything he delivers on that front risks being judged inadequate.



SOURCE: Federation of Canadian Municipalities

Indeed, Flaherty recently tried to remind enthusiasts that no matter how compelling the case for infrastructure spending, the dollar amounts will be tempered by his continuing emphasis on shrinking the deficit. When it comes to infrastructure, Flaherty told the Economic Club of Canada, "Any decision will be made in the context of our current fiscal situation."

While many economists and lobby groups have issued recommendations on infrastructure spending, arguably the dominant voice is the Federation of Canadian Municipalities (FCM), which speaks for the cities and towns responsible for the lion's share of spending on public works—from routine sidewalk paving to erecting conference centres and building mass-transit systems.

The FCM's pre-budget position is that the federal government should ramp up its funding to municipalities for infrastructure to $5.75 billion a year, about $2.5 billion more than Ottawa currently contributes, and to lock in that funding for up to two decades to allow for long-term planning. It's a big ask, but the Conservatives have, partly out of necessity, developed a strong working relationship with city politicians over the past five years.

The turning point was Flaherty's emergency budget in 2009, a massive gush of deficit spending designed to blunt the impact of that year's recession. A major part of the plan was the swift implementation of a multi-billion-dollar infrastructure plan, much of it needing co-operation from municipal governments. The Tories deemed the plan a huge success, especially since they were able to exploit it to political advantage with a massive advertising campaign and distinctive blue and green signs on construction sites.

Three major questions loom over Flaherty's budget measures on infrastructure:

- Will the spending be committed over a long enough period to satisfy the demands of mayors for predictability? The FCM wants a 20-year plan. Anything less than 10 years might expose Flaherty to criticism.
- How close will Flaherty get to that $5.75- billion-a-year a target set by the FCM? He wants to balance the books by 2015, the likely year of the next federal election, so it's possible he'll spend less in the next two or three years, but will set course for more spending later on.
- How much of any new infrastructure money will be earmarked for basic stuff—unglamorous paving and digging and fixing-up—and how much for splashy projects—sparkling new facilities that let politicians bask in the favourable local publicity?

Those are the sorts of questions infrastructure experts will be asking on budget day. Flaherty, though, might well be demanding that they keep something else in mind. Although the attention is likely to be focused on new cash transfers, he's expected to require credit for the government's move to make permanent a $3 billion annual transfer of gas tax revenue to the municipalities. That's exactly the sort of predictable, substantial funding municipal governments plead for—but also the sort that federal politicians can't easily plant a sign on to claim their share of the credit.

For a video with more on Ottawa's infrastructure plans, follow this link: ***http://bit.ly/ZNRgJW***

Growth

Looking back on the economic policy of the early months of the Harper government in 2006, the mood now seems almost charmingly naive. Rather than worrying about deficits and tepid growth and European market anxieties, Flaherty released an upbeat plan called Advantage Canada, a blueprint for lower taxes, less debt and long-term investments in skills, competitiveness and infrastructure.

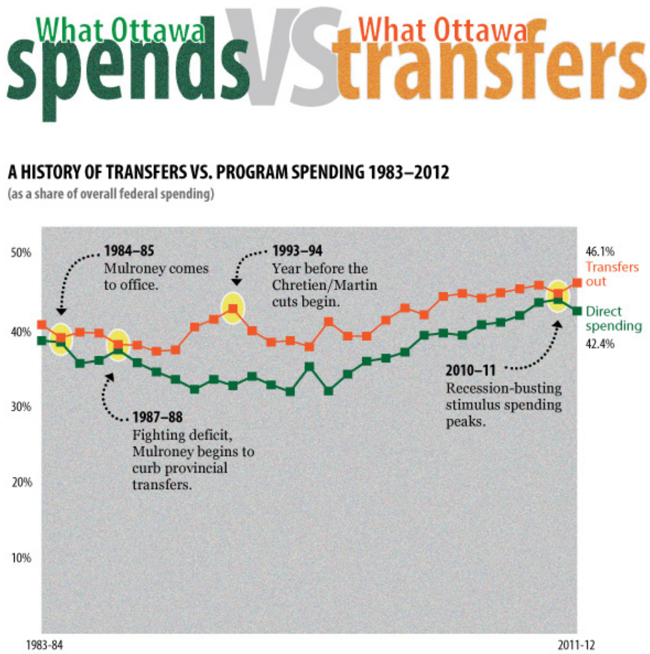
Few think back on Advantage Canada these days. After the market meltdown of 2008 and the recession that followed, Flaherty shifted to emergency stimulus spending, ramping up the deficit. Infrastructure spending was less about future prosperity and more about immediately staving off a prolonged slump. In the provinces, which have the main direct responsibility for training, pressing worries pushed aside thinking beyond the next quarter—or the next election.

But with Budget 2013 set to be delivered on March 21, Flaherty might again be thinking about what some call a growth agenda. Although private-sector economists have recently turned more pessimistic about 2013's outlook, revising projections for the uptick in Canada's gross domestic product to below two per cent, Flaherty denies stagnation is a "long-term concern" for Canada.

If he is truly confident that the economy isn't in dire need of immediate support, Flaherty might turn his attention to generational issues. Prime among them, he has signalled, is training. Already in its immigration and Employment Insurance reforms over the past year, the Harper government has moved to try to connect workers with jobs—and now Flaherty seems eager to make sure provinces are on the same wavelength.

"What we will do is focus on our top priority, jobs and economic growth, by helping more Canadians find jobs and participate fully in the workforce," he said early this month. "Several studies suggest that changing demographics and evolving economic conditions mean that we need to make sure that people have the right training and skills for jobs today."

His aim seems to be to make provinces more accountable to Ottawa for how they spend the more than $2 billion the federal government sends them every year for training. One strong possibility is that he will insist on renegotiating labour-market development agreements, which mainly cover training programs paid for under the Employment Insurance program.



SOURCE: Fiscal Reference Tables (Department of Finance Website)

While provinces might rankle against any new demands, few independent economists are likely to quibble with a federal push to make sure training connects Canadians with actual jobs. But some will view a skills-based growth strategy as insufficient to spur economic activity right now.

David Macdonald, senior economist at the left-leaning Canadian Centre for Policy Alternatives (CCPA), argues that tepid growth means poor prospects for nearly 1.4 million unemployed Canadians. Macdonald urges immediate stimulus measures, starting with infrastructure spending, which he says would result in the fastest immediate job creation. For instance, the CCPA's annual "alternative federal budget" proposes $1.35 billion a year for public transit alone, along with a raft of other infrastructure ideas.

While Macdonald emphasizes measures that would take effect right away, other economists stress the need for thinking about changes that would take longer to shift Canada onto a stronger growth path. Glen Hodgson, chief economist of the Conference Board of Canada, favours infrastructure spending, too, but also urges "a fundamental review of our tax system, making sure our system is geared toward supporting growth."

Whatever growth message Flaherty aims to send in Budget 2013 on themes like skills, infrastructure and taxes will be tested against how he calibrates program spending. With the economy only barely expanding, mainstream private-sector economists, who often like the sound of restraint, are actually worried this year about any further squeezing of departmental spending.

"It probably would be unwise for the federal government to step on the brake further than it already has," BMO Capital Markets chief economist Doug Porter said after a recent meeting with Flaherty.

For a video with more on the stimulus question, follow this link: ***http://bit.ly/YCFP7f***

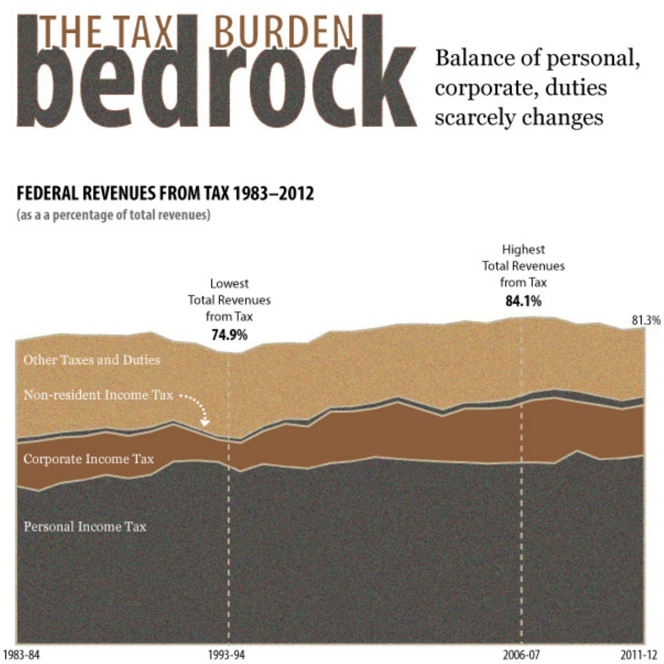
Taxation

As the longest-serving minister in Harper's cabinet, and the longest-serving finance minister in the G7, Jim Flaherty gets a lot of respect these days. After all, Flaherty has weathered extraordinarily tough economic times, and Canada has, as he never tires of mentioning, fared better than most countries. Still, when it comes to tax policy, he doesn't always get much respect.

Adjectives commonly attached to the tax measures adopted by the Harper government include "boutique," "niche," and "gimmicky." It started with the two points the Tories shaved off the GST in their early years—popular with voters but derided by economists who think consumption taxes are best. Then came all the tweaking—credits for children's fitness courses and public transit, deductions for tools and textbooks.

From a finance minister who likes to talk about fundamentals, all these looked more like frills. But is the time right for a major shift toward big thinking rather than tactical tinkering? There are signs pointing in that direction. Late last year, the House of Commons finance committee, which is dominated by Conservative MPs and chaired by respected Alberta Tory MP James Rajotte, called for the government to set up a royal commission to conduct a sweeping review of the Income Tax Act. Rajotte said Flaherty was open to the concept.

Many lobby groups join the MPs' call for comprehensive efforts to simplify the tax code. The Canadian Chamber of Commerce, for example, bemoans "ad hoc changes to tax legislation by successive governments." The group counts some 260 exemptions, deductions, credits and rebates offered now, and argues that a rational tax sys-



SOURCE: Fiscal Reference Tables (Department of Finance Website) tem would eliminate many of them and instead lean toward as low a tax rate as is possible spread over a broad, uncomplicated base.

The Conference Board's Hodgson calls for "reinventing" the tax system. He expects only incremental changes in Budget 2013, but suggests the moment might be right for the start of a more ambitious review. One possible outcome sketched in a recent Conference Board report: keep the same three-bracket system for personal income taxes as there are now, but with lower rates in exchange for far fewer loopholes and exceptions.

Is Flaherty really game for a major review? In a recent speech to the Economic Club of Canada, he was hardly apologetic about his record on tax policy to date. Flaherty boasted he's given Canada the lowest tax rate on business investment in the G7, helped Canadians who most need a tax break with the Registered Disability Savings Plan, allowed seniors to split their incomes for tax purposes and—"most important"—introduced tax-free savings accounts.

All that sounded like a robust defence of what critics might call a piecemeal tendency on taxation but Flaherty, evidently, considers it a strategic approach. For those hankering for a clear change in direction, the finance minister might have been sending a very different signal.

And even if Flaherty decides not to embark on any fundamental rethink of Tory taxation policy, at least one significant move in Budget 2013 is all but certain—more funding for the Canada Revenue Agency to hunt down cheaters who stash money in foreign tax havens. "People shouldn't be hiding money from the government of Canada. Some people do that offshore," Flaherty said recently. "And sometimes it makes sense to invest more resources, for example, in the Canada Revenue Agency so that we are better at policing the minority of Canadians who do not pay their fair share."

For a video with more on reforming Canada's tax system, follow this link: ***http://bit.ly/YN3SU1***

Deficit

Running massive deficits wasn't supposed to have been in the cards when Harper made Flaherty his finance minister back in February 2006. A global credit crisis and the world recession it ushered in reshuffled the economic deck. Restoring the federal books to balance must now rank among Flaherty's main goals.

But is the drive to erase the deficit by the Tories' target of 2015—not coincidentally, the likely year of the next federal election—more motivated by economic fundamentals or political symbolism? Economists asked by *Maclean's* were divided.

Macdonald at the Canadian Centre for Policy Alternatives sees deficit-slaying as a distraction from the more pressing task at hand: promoting job-creating growth. "From an economic perspective, the deficit is so small that the debt-to-GDP ratio is falling," Macdonald says. "It's entirely political."

The Conference Board's Hodgson argues that eliminating the deficit is a key goal beyond any political symbolism attached to it, if only because more debt means more interest payments, reducing the government's capacity to spend on other priorities.

But Hodgson says Flaherty's ability to hit that 2015 target will be made difficult by slow growth and the resulting lower tax revenues. "It's a very turbulent time. The growth forecasts are going to be tepid," he says. "So it's going to be very tight."

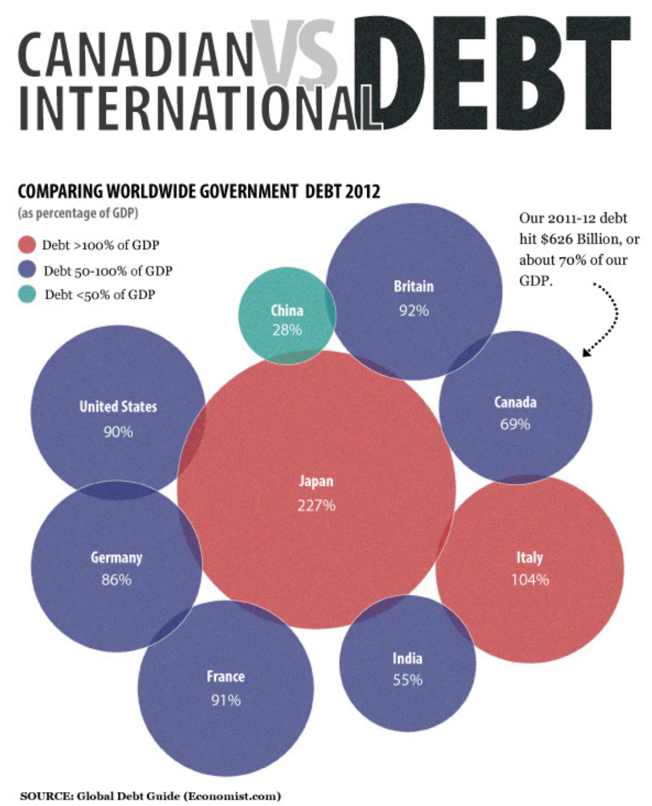
As well, Flaherty allows himself very little flexibility to restrain spending, essentially limiting himself to cutting programs Ottawa delivers itself, rather than curbing the money it gives to Canadians and their provincial governments. "We are not going to reduce transfers to individuals, including seniors and children. In fact, we continue to increase them," he said in a key speech last month. "The next big pool of spending is transfers to the provinces and territories. The previous government reduced that spending in order to balance the budget. That creates hardship in education, social services and health care, so we will not do that. We will not reduce the transfers to the provinces."

That leaves federal programs. In last year's budget, Flaherty slashed $5.2 billion out of $75.3 billion that federal departments spend on their own programs. The cuts ranged from a low of 1.1 per cent out of Veterans Affairs and 2.7 per cent from Aboriginal Affairs, to deeper reductions, such as the 10.7 per cent cut at Transport Canada and 9.7 per cent taken from international assistance. How much Budget 2013 cuts, and where the axe is aimed, is a major question as Flaherty tables his new fiscal plan this week.

Even though Canada's federal deficit looks manageable by international standards, the numbers still look daunting. In his fiscal update last fall, Flaherty predicted a 2012-13 deficit of $26 billion. For 2013-14, the deficit is expected to be about $10 billion less than that. Shrinking it to zero by 2015 looks doable—but troubling variables cloud the outlook. For instance, Flaherty has admitted that the heavily discounted price being applied to Canadian crude oil—a serious fiscal problem for Alberta—is also hurting Ottawa's revenues.

Here's one last thing to consider as Flaherty prepares to unveil his budget: the federal tax haul last December (the latest figure available) was up 2.8 per cent over the same month a year earlier—but still below the 3.8 per cent rise in federal spending. And the main driver of that increased spending? Those very same transfer payments Flaherty vows never to squeeze.

For a video with more what should be done about Canada's debt, follow this link: ***http://bit.ly/ZNRhxL***



A few billion off the top

Almost imperceptibly, the federal government is shrinking from Canadian life

PAUL WELLS

ONE THING STEPHEN Harper learned soon after he became Prime Minister was that Canadians have little intuitive grasp of decimal places. A government does not get 1,000 times more credit for spending $1 billion on something than it does for spending $1 million. In fact it does not get twice as much credit. As long as the government notices a problem and nods at it, it wins approval from voters who care about that problem. So not long after his man Jim Flaherty started delivering budgets, a Harper era of small and essentially symbolic investment began.

Similarly, the ability to tell the difference between a little belt-tightening and a wholesale cut to a government service or department is not a widespread skill. So as long as the government offers only the vaguest information about its spending cuts, few Canadians will go searching for details.

This general numerical dyslexia will come in handy this year more than most, as Jim Flaherty tries to meet a zero-deficit target that is suddenly rather close—2015, give or take—while dealing with a lousy economy.

For the longest time, the Finance Department simply hoped Canada's 15-year lucky streak, lately AWOL, would kick back into gear. Thursday's budget has been a very long time coming. A comparison is handy. Stephen Harper delayed the 2011 budget for weeks, until near the end of March, for precisely one reason: to open up a great big hole in the winter and fill it with an unprecedented television and radio advertising barrage against the Liberal leader of the day, Michael Ignatieff. The budget that year came on March 22. The budget this year comes only a day earlier. And this time there is no electoral reason for the timing, only the hope, now extinguished, that the economy would pick up on its own.

The sun having failed to come out, expect Flaherty to describe a lot of million-dollar spending items in loving detail, while offering only vague mentions of billion-dollar spending cuts. The newspapers and the dinner-time news shows will play right along, listing the spending items without noting the modest allocations that go along with them. The tiny cadre of Ottawa reporters who try to learn details of the cuts will find it's pretty near impossible. On the same day Flaherty delivers the budget, Parliamentary Budget Officer Kevin Page will be in court trying to get details of cuts from two budgets ago.

But the broad outline of the government's action is not a secret, it's simply been buried in the annexes at the back of each year's budget document instead of basking in the limelight near the front. Federal transfers to individuals—things like elderly benefits, Employment Insurance and child benefits—are frozen at the rate of growth of GDP. So are Ottawa's cash payments to provinces.

That leaves everything Ottawa funds directly, whether it's environmental survey stations, the CBC, tourism promotion, food inspection, roads and bridges, what have you. Spending on that vital envelope is to be held constant in dollar terms. Which means while transfers to individuals and provinces increases slightly as the economy grows, direct federal spending declines as a fraction of GDP. "This will inevitably lead to program cuts," the economist and *Maclean's* contributor Stephen Gordon has written, "since the costs of providing a fixed level of services increases over time."

But there's another dynamic going on. Each year's budget brings a new round of cuts, offices shut down, services terminated. In 2011 there was "Strategic Review," with $2.4 billion in cuts over three years. In 2012 it was "Strategic Operating Review," worth about $5 billion a year. Last autumn Treasury Board Secretary Tony Clement was put in charge of a new cabinet subcommittee on spending restraint. A news report at the time called the new effort "strategic review on steroids."

So each year's modest cuts are followed, a year later, by further modest cuts. It's like sharpening a pencil. You shave off a curlicue of wood every few weeks and one day the pencil's gone. The annex nobody read at the end of the 2010 budget projected direct federal spending for 2014-2015 at about 6.1 per cent of GDP. That target was cut a hair in the 2011 budget, and another in 2012, until direct federal spending for 2014-2015 was now projected at 5.7 per cent of GDP. The difference between the earlier figure and the latter is about $7 billion. One presumes this year's target for direct federal spending in 2014-2015 will be another few billion lower.

With transfers to individuals and provinces growing, the total amount of all federal spending will continue to grow, and Andrew Coyne will be able to sign his annual *National Post* column complaining that we are governed by drunken sailors on shore leave. But the numbers tell another story.

The Liberal era, especially after the federal deficit was eliminated in 1997, was one of steadily increasing ambition for the federal government's role in Canadian life. Paul Martin did not announce in 1997 all the fun things he would wind up doing with your tax dollar in 2005; he simply thought of new programs, foundations, grants and accords with every passing year.

The Conservative era has been one of progressively circumscribed ambition for the federal government's role in Canadian life. Harper did not shut down everything he considered useless in his first budget, two months after he was elected in 2006. He kept nearly all of it and found new things to fund on top of them. And when the opposition coalition nearly ended his career in 2008 he opened the purse strings still further. But since 2010 he has installed a new dynamic.

The NDP advocates a return to the pre-2006 mindset in which there is always some new frontier of collective action. Peggy Nash, the Opposition finance critic, wants Flaherty to postpone his balanced budget target. This happens to be precisely the choice the PMO wants to put before Canadians: do we want a government that keeps finding ways to spend less, or one that keeps finding ways to spend more?

It is hardly a coincidence that the date Flaherty has set for the elimination of budget deficits, 2015, coincides with the year we will probably vote in the next federal election. Harper believes he has succeeded in changing the group psychology of Canadian budget politics. He believes he can win a confrontation between "more government" and "limited government," as he did in 2008 and 2011.

Don't ask me to predict a winner in that confrontation. In Thomas Mulcair and Justin Trudeau, Harper will face different and in many ways more formidable opponents than he did in those earlier confrontations. But he will also have had four more years to make his case, one cut at a time.

The good, the bad and the wishful

What will—and what should be—in the federal budget

ECONOMISTS TRY TO make a clear distinction between making positive statements (what will happen) and normative statements (what should happen). It's good to keep this distinction in mind when speculating about the budget.

Good ideas that will probably be in the budget:

• Training/education. We're hearing a lot about the mismatch between the skills employers are looking for and the skills job-seekers actually have. This is a serious problem that is amplified by demographics: there aren't that many new people entering the workforce. Happily, this is an area where the Conservatives haven't staked out a strong position, so they may base their proposals on the best advice the public service can provide. Measures should be read with an open mind.

Good ideas that most definitely will not be in the budget:

• A carbon tax. It's a measure that would allow the government to cut other taxes (or increase spending, but it's a Conservative government) and would very likely remove much of the opposition to the various pipeline projects on the table. It's also a measure that enjoys the support of environmentalists, economists and the oil companies.

• Something—anything—that will make it easier for Canadians to understand what's going on with public finances. Last year, the government decided to change its accounting rules without updating the historical data. Also, the budget numbers have nothing to do with the spending estimates, and the only agency with the mandate and the resources to try to figure it out is the Parliamentary Budget Office. Too bad the agency has been put in a plastic bag and left dangling from a thread suspended from the Alexandra Bridge.

Bad ideas that will probably be in the budget:

• More boutique tax credits—marketed as tax relief for households occupying a demographic niche that Conservative polling has identified as being in play.

• More pork for businesses concentrated in regions that Conservative polling has identified as being in play.

Bad ideas that will probably not be in the budget:

• A renewal of fiscal stimulus. We're not in a recession. And unless we want to relive the deficit-debt spiral of the 1970s, '80s and '90s, we don't want to get into the habit of implementing fiscal stimulus because we think there's a chance we might be in a recession soon.

Wishful thinking:

Getting rid of the nickel. They should have done this when they eliminated the penny. It's time to finish the job. ♣

Stephen Gordon is professor of economics at the University of Laval in Quebec City, and a regular contributor to the Econowatch blog at *Macleans.ca*

What Bay Street wants

Economists, lobbyists and industry experts weigh in with what they would like to see from Ottawa

IN THE DAYS leading up to the release of the 2013 federal budget, economic experts and business leaders across the country have voiced their ideas, hopes and recommendations. They represented a wide range of perspectives, asking for reforms to employment insurance, taxes—or little change at all.

"I would hope for a stay-the-course budget," said Craig Wright, senior vice-president and chief economist for RBC Financial Group on Friday.

"The economic outlook continues to be challenging and uncertain, suggesting limited appetite for any dramatic change of the fiscal course. I assume the budget will continue to be based on conservative economic assumptions alongside the maintenance of a large allowance for risk. The net effect will be that what is tabled will be the worst-case outlook with the actual outcome continuing to be one of smaller deficits and a quicker return to balance that forecast."

'I would hope for a stay-the-course budget,' says one economist. 'The economic outlook continues to be challenging and uncertain.'

John Manley, president of the Canadian Council of Chief Executives, said he hoped the government's efforts to improve the tax system would continue.

"Maintaining focus on Canada's international competitiveness to ensure the private sector can drive growth and jobs is essential," he said. "I would also encourage the federal government to continue its work on jobs and skills. Recent EI and immigration reforms are a good start, and further reforms to encourage mobility are needed. We should also be working harder to develop and train workers from disadvantaged groups, including Aboriginal communities, and to attract international students and researchers to Canada."

Corinne Pohlmann, vice-president of national affairs for the Canadian Federation of Independent Business, had several things on her wish list, including no increases in CPP or QPP premiums and extending the Employment Insurance hiring credit. "This credit has been helpful to offset the increases in EI premiums, which can be a deterrent to hiring among small businesses," she said. "However, the credit has not been extended beyond 2012 yet; EI premiums will continue to go up for a few more years."

Pohlmann also hoped for a sign the government would lower taxes on small businesses. "The general corporate rate has come down quite a bit over the last several years, from as much as 28 per cent in 2001 to just 15 per cent today. During that same period, the small business rate has decreased from 12 per cent to (just) 11 per cent."

The C.D. Howe Institute is looking for a more aggressive approach to fiscal responsibility, which would balance Canada's books far earlier than even the Conservative government plans to. In its shadow budget, the think tank has proposed setting limits on Ottawa's operating costs, reducing the numbers of federal staff and trimming subsidies to Crown corporations.

In this way, Canada would return to a surplus by fiscal 2014-15, a year ahead of schedule.

Finally, the oil and gas industry is looking for a few treats from the budget that could help producers through a slow-growth business environment. The Canadian Association of Petroleum Producers is asking the government to ensure non-discriminatory policies in other jurisdictions toward Canada's oil and gas exports, and to support its initiative to diversify export markets, in particular access to Asia-Pacific markets from Canada's West Coast.

The energy industry is also looking for a tax break. It wants liquefied natural gas (LNG) facilities to be reclassified as manufacturing and processing assets so they can be included in a more favourable tax class. This will bring the assets in line with the way tax authorities treat LNG processing facilities in the U.S. and Australia. SARAH BARMAK

Invested interest

There hasn't been much to wow investors in recent budgets, but here are a few ideas that would appeal

OVER THE YEARS, the Conservative government has thrown investors the occasional bone—the biggest being the introduction of the tax-free savings account in the 2008 budget—but since then it's done little more than tinker when it comes to helping the plight of Canadian savers. And in the lead-up to the 2013 budget, Ian Russell, president and CEO of the Investment Industry Association of Canada, doesn't expect the government to suddenly shift course. "They've brought down seven budgets so far and they've been very careful and cautious in terms of new proposals," he says. "Everything has been quite modest, so I wouldn't expect a lot."

There are always rumours of some grand gesture to investors, such as increasing the TFSA limit to $10,000 (it's currently $5,500), raising RSP contribution room or lowering capital gains taxes, but with the government still trying to wrestle its deficit under control, Russell says not to expect any measure that threatens its tax haul.

Still, there are some more minor changes investors could at least hope to see. In the 2011 budget, the government introduced the Pooled Registered Pension Plan (PRPP), which was supposed give small-business employees access to a low-cost pension plan. Two years later, and the PRPP hasn't gotten off the ground. Like many in the industry, Russell doesn't know when the program will get regulatory approval, but in the meantime he'd like the government to give business owners a tax deduction on EI and CPP for contributions they make to a group RSP. Under the proposed PRPP, owners would get a tax deduction if they match contributions to those types of savings plans, but they don't get it with a group RSP plan. A deduction would encourage owners to match contributions and therefore boost employee savings.

'They've brought down seven budgets so far and they've been very careful and cautious,' says Russell. 'I wouldn't expect a lot.'

He'd also like to see the government either reduce capital-gains taxes or offer other incentives to invest in small-cap companies outside the resource sector. This part of the market, typically made up of small technology and biotech companies, often struggles to attract investors because people prefer the safety of owning shares in larger companies. Russell proposes what's called a rollover plan, which would allow investors to sell existing investments and avoid paying taxes on any gains, so long as the proceeds are reinvested in specific small-cap-heavy sectors. Doing that would help grow smaller industries and, as a result, diversify the market beyond sectors like financial services and resources, which dominate the Canadian stock landscape. Russell has pitched this idea to the government before, and so far nothing has happened.

While the government may not do anything specific for investors, Russell does say that its commitment to lowering business tax rates and creating a more business-friendly climate helps companies grow earnings, which should then, theoretically, boost stock prices.

Ultimately, people shouldn't get too hopeful for any major budget announcements, at least until the government's balance sheet improves.

BRYAN BORZYKOWSKI

Left holding the bag

Even as Ottawa boasts of its relatively sound finances, the provinces are spiralling toward a debt crisis

FINANCE MINISTER JIM FLAHERTY likes to draw up comparisons with other advanced economies. Even when announcing in November that the federal deficit would come in at $26 billion, $5 billion higher than predicted in the 2012 budget, the minister couldn't resist gloating: "Unlike many of Canada's counterparts in the G7, we remain on track to return to balanced budgets over the medium term."

But with provincial deficits swelling from coast to coast this year, and rising health care costs expected to ravage provincial coffers in the coming decades, federal figures are starting to paint an increasingly misleading portrait of Canada's government debt situation.

Lower-than-expected revenues have dug a $4-billion hole in Alberta's finances and inflated Newfoundland's deficit to over $700 million (almost triple what was initially projected), adding resource-rich provinces, along with long-time offenders such as Ontario and Quebec, to the list of fiscally challenged jurisdictions.

The long-term forecast looks scarier still. Even assuming, as the Parliamentary Budget Office does, that Ottawa's debt will steadily shrink and disappear around 2040, provincial, territorial and local governments are on track to swell Canada's total public debt to the equivalent of 100 per cent of GDP by 2070.

You wouldn't know by looking at government statistics. Ottawa doesn't publish any of its long-term analyses that show how federal and provincial fiscal trends add up, a practice common among several industrialized countries and recommended by the Organization for Economic Development and Co-operation and the International Monetary Fund.

When Auditor General Michael Ferguson prodded Finance Canada last fall to make such comprehensive forecasts available to the public, the department politely declined, noting that "the federal government is not accountable for the fiscal situation of the provinces and territories."

It's easy to sympathize with that view. After all, provincial governments absorbed very little of the deficit-slashing lesson of Liberal prime minister Jean Chrétien. While Ottawa's share of public sector debt shrunk from 62 per cent in 1991 to 33 per cent in 2011, the provinces and territories' grew from 34 to 47 per cent, according to Statistics Canada. (The balance is made up of debt owed by local governments and the Canada and Quebec pension plans.)

Yet one might feel more lenient toward Canada's provinces after considering that they shoulder the brunt of what is expected to become one of the heaviest burdens on government balance sheets across the industrialized world: health care costs. It's the ever-higher medical bills of a rapidly aging population that are setting provinces on a path to fiscal ruin, according to the Parliamentary Budget Office.

The ever-higher medical bills of an aging population are setting the provinces on a path to fiscal ruin, warns Canada' budget watchdog

Conversely, one of the reasons why the federal government's fiscal trajectory looks so promising is that Ottawa "cleverly insulated itself" from such a long-term threat by capping health transfers to the provinces, according to economist Don Drummond. In December 2011, Ottawa moved away from six per cent annual increases in such transfers, pegging them instead to growth in non-inflation adjusted GDP beyond 2016. Those cost risks, though, might boomerang should a province's debt become unsustainable and require a federal bailout, Drummond and others have warned.

That would be every taxpayer's problem, and that's why Canadians deserve to have a full picture of government debt—wherever it might be hidden. ERICA ALINI

Loopy tax expenditures

Outdated tax credits and other loopholes are easy to complain about, but hard to fix. Is the government about to try?

FINANCE MINISTER JIM Flaherty has dropped hints to the effect that the March 21 budget will include efforts to revisit the system of tax expenditures: the deductions, exemptions and credits for various activities, firms and people. Eliminating tax loopholes always sounds like a good idea, but it's not always obvious what the distinction is between a loophole and an integral part of a well-designed tax system.

The largest single item in the 2012 edition of the Department of Finance's report on tax expenditures is the basic personal amount deduction: more than $30 billion in foregone tax revenues. There is no way the government will remove this tax deduction, nor should it: public finance theory recommends a deduction covering the minimal income required to sustain a basic existence. Other big-ticket items include the system of RRSPs ($15 billion) and exemption of groceries from the GST ($3.9 billion). You can see why the business of eliminating loopholes is not simply a matter of wiping the slate clean. There are a lot of babies in that bathwater.

This is not to say the current system is perfect; far from it. The most pressing problem is transparency. After a tax expenditure has been implemented, it pretty much disappears from view—they don't show up in the budget items, and they are not subject to any formal process of review. Some of those measures are probably designed to solve problems that no longer exist.

Many tax expenditures are spending in all but name: the working-income tax benefit is best thought of as a transfer to low-income households, but up until last year it was classified as a tax expenditure. There are many, many other tax expenditures indistinguishable from regular spending measures—think of the children's art tax credit and other boutique tax credits that have become a trademark of Conservative budgets. But since these programs are classified as tax expenditures, they can be marketed as "tax relief" and not "increased spending."

After a tax expenditure has been implemented, it disappears from view. Some were designed to solve problems that no longer exist.

Perhaps the best way to proceed is to pick up on a suggestion of John Lester in a paper published by the University of Calgary's School of Public Policy: integrate tax expenditures into departmental budgets and treat them in the same way they treat regular expenditures. For example, the various business tax credits would be included in the budget of Industry Canada and the tax expenditures for video and film production would be part of Heritage Canada's budget. It would then be up to the various departments to decide if the expenditures were in fact the most efficient way of achieving their policy goals.

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Omnibus signs

The government's reliance on sprawling budget bills poses a serious threat to parliamentary democracy

ON JAN. 26, 1971, Speaker of the House Lucien Lamoureux presented two existential questions to the House of Commons. "Where do we stop?" he asked. "Where is the point of no return?" Lamoureux was responding to a point of order raised about Bill C-207, the Government Organization Act. The complaint concerned the omnibus nature of the bill—that the legislation in question contained several distinct and unique measures that would be better dealt with separately. While the speaker was sympathetic to the arguments presented, he ultimately ruled that the bill was in order—but not without a caveat that should ring in the ears of every current member of Parliament. "I would have to rule—if I must rule—that the government has followed the practice that has been accepted in the past, rightly or wrongly," he said, "but that we may have reached the point where we are gong too far and that omnibus bills seek to take in too much."

In 1994, Harper complained that the Liberal government was bringing in omnibus budget bills 'that we might call the kitchen-sink approach'

Forty-two years later, Lamoureux's questions remain unanswered, at least officially. And it is in the absence of answers that our parliamentary democracy has come to be tested each spring with the presentation of a new budget.

The quandary of omnibus legislation returned to the fore last year with C-38 and C-45, the two budget implementation acts, tabled in the spring and fall, respectively. Each numbered more than 450 pages and contained dozens of measures. And each, in protest, was subject to hours of voting as the opposition parties sought to bring attention to both the controversial changes contained therein and the highly questionable design of the bills themselves.

Though omnibus bills that deal with related measures (the Harper government's omnibus crime bill, for instance) can be defended, the sprawling budget bills raise several concerns: they put numerous and disparate measures—everything from environmental regulations to abolishing Canada's spy watchdog—to a single vote, and severely test the ability of MPs to properly review such myriad elements.

And their use by the Harper government has only grown. To put it in perspective, between 1994 and 2005, the 12 budget implementation bills passed with the Liberals in power averaged just under 74 pages. Under the Conservatives, such bills have swollen exponentially. In 2006, the Conservatives tabled two budget bills totalling more than 300 pages. In 2007, the two bills combined for more than 500 pages. In 2009, more than 600 pages. In 2010, more than a thousand pages—including a single bill, C-9, that numbered 904 pages. While efforts were made to split up C-9, they languished. With the government in a minority position at the time, any effort to amend or defeat a budget bill could have been considered a confidence measure, and may have triggered yet another election.

With the Conservatives now holding a majority, it is impossible to block the government from ramming through massive omnibus budget bills, but the Opposition has stepped up its efforts to highlight the threat these measures pose to the principles of parliamentary democracy. The result has been the spectacle of MPs stuck in the House through the wee hours of the morning, voting over and over again on the hundreds of clauses contained in each bill. Coupled with an estimates process that is broken—impairing the ability of MPs to properly scrutinize government spending—the annual budget has become a mark of the disrepair we have allowed our House to fall into. And like prorogation before, the Conservatives have turned a possibly arcane matter of procedure into a widely acknowledged concern.

In the wake of so much controversy last year, it has been suggested that the next budget bill will be somehow smaller. But after years of such massive bills, a smaller budget bill is now relative (oh, for the days of 1994, when a single budget-implementation act of 24 pages was passed). And having registered their objections so loudly last year, the opposition parties would seem to have established a principle that compels them to fight each and every time an egregious bill is presented. Expect more such battles this year.

In 1994, 23 years after Speaker Lamoureux posed his questions, they were invoked by a young Reform Party MP. “I submit to you that it has become a standard practice with governments to bring in omnibus legislation following every budget under what we might call the kitchen-sink approach,” the MP complained. “In the interest of democracy, I ask: How can members represent their constituents on these various areas when they are forced to vote in a block on such legislation and on such concerns?”

That question, too, remains unanswered, even if that MP is now Prime Minister. But then perhaps Stephen Harper, in testing the limits these last few years, has brought us to the point at which we must figure out what kind of Parliament—what kind of democracy—we want. **AARON WHERRY**

Turning the Page

Outgoing Parliamentary Budget Officer Kevin Page on his concerns for the office after he's gone, and hopes for the future

IN THE LEAD-UP to budget day, *Maclean's* Associate Editor Aaron Wherry spoke with parliamentary budget officer Kevin Page, whose term expires on March 25. This is an edited transcript of some of what Page had to say. The full interview and a video of their conversation is available on ***Macleans.ca*** at ***http://bit.ly/XV0Myu***

On what he's accomplished:
We felt like we came in to build a true legislative budget office. We've shown people what that could look like.

On disappointments of his term:
We didn't see the policy discussions around issues, whether it's fighter planes—do we really need a stealth fighter plane?—or on the tough crime agenda: what if we didn't spend the money we're spending now to have more inmates in for longer periods of time?

On criticisms of his profile and conduct:
I don't think there'd be any profile if the quality of the work wasn't there. And I think there is a link between the business model and the quality of the work. We're a very open office. We're the antithesis of public service right now, where they can't talk to other people, they can't publish. We don't release anything until we talk to everybody that's deemed to be an expert. And we make it completely transparent and we put it up on our website. Everything we've done is actually on our website. So that I feel proud about.

On the gap between transparency and the need for information:
We went from strong economic growth and low unemployment rates to a significant recession. We went from surpluses to deficits. And we had a government and a public service that moved forward on major legislation and said, you don't need any information. So on the tough-on-crime agenda, you couldn't put together more than a couple of pages on the numbers. On fighter planes, up and until KPMG did a report for the government, there wasn't even more than one piece of paper.

On the scrutiny of spending:
We don't see members of Parliament incentivized to actually scrutinize spending, to go to standing committees and to scrutinize spending—where are we spending the money? Do we have too much overhead, not enough overhead? Looking at program evaluations for different programs, should we be fixing these things?—and then tracking them on a year-over-year basis. We have to ask ourselves: why don't they feel incentivized when this is such a constitutional responsibility?

On signals for the short term:
If this office is being unwound as we speak—the fact that the process to replace me as parliamentary budget officer is just really starting and I'm out the door in a week, the fact that the governor-in-council, the Prime Minister, has appointed on an interim basis the parliamentary librarian, a very nice person, smart lady, but who has no experience on a budget. We have people with major experience within my office who could have acted. And we have a process to replace me that is completely secretive—"can't tell you their names, trust me it's going to be fine"—and then we find out there's somebody from the Privy Council Office, which supports the executive, not Parliament, actually on the selection committee. These are all negative, negative signals for the short term.

And hopes for the future:
I think it was incumbent upon me and my office to raise the bar as high as we can, to show people that if you've got 15 people and you operate in a very open, transparent way, you could do a lot of work on tough issues with a very different business model. So then maybe the PBO comes back in a couple of years. Niebuhr said, "Nothing of real value can be done in one lifetime, so you're saved by hope." So I guess the hope is that we've raised the bar, maybe we go through a dark period, but it comes back and gets even stronger.

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