

# CANADA'S "NEW" GOVERNMENT BRINGS DOWN A BUDGET – THE HUNT FOR THE POLITICAL CENTRE



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Proving that everything old is new again, Canada's Conservative Government proved itself as politically savvy and crafty as any previous government and tabled a Budget designed to ensure its survival on its own terms. The Conservatives are aiming for the political centre - turf the Liberals occupied for so many years. The question is: Have the Conservatives found the centre and what will be the Liberal response?

Below, our partisan pundits panel\* pontificates (try to say that a few times) and then we get serious. First some Budget highlights.

\* The Campbell Strategies/Media Profile Pundits Panel is comprised of a former MP and Liberal apologist, a shameless 'Trudeauite,' and a former Tory Ministerial staffer and Conservative 'true believer'.

## Budget Highlights

- **New budget measures are expected to cost \$19.7 billion in this fiscal year and over the next two years.**
  - \$9.2 billion surplus from fiscal 2006 to be used to pay down the federal debt.
  - Government program spending increases by \$10 billion in fiscal 2007 to \$199.6 billion.
- **\$39 billion over seven years to address the fiscal imbalance.** The provinces and territories to get nearly \$4 billion in new funding for fiscal 2007 for equalization, health and social transfers.
- \$16 billion over seven years in **new infrastructure funding**, including \$8.8 billion for national highways, urban transit and water treatment facilities. And, a new fund for innovative public-private partnerships.
- \$4.5 billion dollars in **new environmental spending**, including:
  - Extending the gas tax fund to municipalities to encourage mass transit.
  - \$1.5 billion to combat carbon emissions.
  - Phasing out of a tax incentive for the oil sands.
  - \$2 billion over seven years for renewable fuels, with ethanol companies the focus.
  - A new Green Levy of up to \$4000 on new inefficient vehicles.
- Overall federal spending on **health care** rises \$1.2 billion this year, to \$21.3 billion
  - \$900 million in the **Canada Health Infoway**, and providing the provinces with \$300 million for cervical-cancer immunization.
  - \$600 million over two years for **science and technology**, research and development and centres of excellence.
- Adjustments to increase the annual allowable **Capital Cost Allowance** for: buildings used for manufacturing or processing (from 4% to 10% per year); non-residential buildings (from 4% to 6%) computer equipment (from 45% to 55%); natural gas distribution lines (from 4% to 6%); and liquefied natural gas facilities (from 4% to 8%).
- A **Tax Back Guarantee** to be implemented calling for \$1 billion dollars in debt interest savings to be used for income tax cuts.
- Other initiatives for **working families, seniors and farmers.**

Budget documents are available online at: [www.fin.gc.ca](http://www.fin.gc.ca)

## FOR THE CONSERVATIVES...

### Sir John A's Conservative Party Built for the 21st Century: The 'Sub-Con' Majority

The clique that fancies itself as the protector of the Canadian consensus has been so captured by their own banalities that they've been fighting a Prime Minister and political party that doesn't exist. In the meantime, Prime Minister Harper has taken Sir John A's legacy and built a new national conservative majority that reflects a uniquely Canadian 'suburban conservatism'. The Americans have neo-cons we have sub-cons. With the new 'sub-con' ethos underlying Finance Minister Flaherty's 2007 Budget, the Liberals discovered their fight was with a very different Prime Minister and Conservative Party than they had been expecting.

**"The Dynamic Duo"** - On March 19<sup>th</sup> the 'Dynamic Duo' of Stephen Harper and Jim Flaherty delivered multiple body blows to the Liberal opposition. As Minister Flaherty, clad in his trade-mark Irish green tie, delivered his budget you could see the Liberal opposition slowly collapse in their seats almost hiding from the relentless assault. A green levy on gas guzzlers, incentives for hybrid vehicles --- BAM! Funding a national program for cervical cancer vaccines, creating a Registered Disability Savings Plan, and extending RRSPs to age 71 ---POW! Money for infrastructure, private/public partnerships, and environmental initiatives --- BOFF! And the biggest blow, the plan for resolving the fiscal balance --- KAPOW! By the time the Liberals knew what hit them all three provincial parties in Québec had endorsed the budget and one Liberal MP had jumped ship.

**Reaching Out** - While the Budget was crafted and delivered with the political realities of a minority Parliament in mind, it represents a lot more. In the same way that the Prime Minister reached over the entrenched foreign policy cabal in Ottawa to fashion a principled foreign policy, Prime Minister Harper and Minister Flaherty have fashioned a fiscal policy that reaches over the head of all the entrenched advocacy groups and media commentators to deliver results directly to individual Canadians. You don't need to be a tax accountant to understand this budget.

Like the monthly child care benefit from last year, Canadians will see the benefits directly in the form

## FOR THE LIBERALS...

### The World is Upside-down: A Tory Spendthrift Budget

As ironies would have it, the Federal Conservatives delivered a Budget that activist Liberals could only dream about. It's full of goodies for provinces, seniors, corporations, cities, and the environment. The Budget re-announces and enhances a veritable orgy of Tory spending, breathless in scope and unprecedented for that Party. A comparative effort by a Liberal Prime Minister would have been met with howls of outrage about profligate, 'tax and spend' Liberals recklessly squandering fiscal discipline. Like Nixon to China, it took Liberals to tame the deficit and a Conservative Prime Minister to open the floodgates to old-fashioned big government spending!

Liberals are aghast for several reasons. First, most of the announcements could have been made by the previous Liberal government. Indeed many had been "booked" by the Liberals for future years or were very much in the works. Secondly, the Conservative election Budget is fuelled by the successful Liberal assault on the deficit. Those brave Martin Budgets paved the way for the Tory spending spree. And who can blame Harper for so shamelessly spending – after all there is no danger of a new deficit... or is there?

**Paying Off the Provinces... Chasing a Dream** - Particularly notable are the lavish transfers to the provinces. In this, Harper has earned the sobriquet "headwaiter to the Provinces" – a role for Prime Ministers which Chrétien so often derided. We are witnessing "cheque book Federalism" on a massive scale. So certain was Quebec about the good news Federal Budget that Premier Charest in Québec headed into a Provincial Election counting (no pun intended) on the Federal Budget to put him over the finish line.

But Harper will learn that you can't buy off the provinces – there is no bottom to that slippery slope. Witness the Quebec Election Debate where an edgy Jean Charest after listing how much he "got" for Quebec out of the Federal Government, was pinned to the mat by Mario Dumont and Opposition Leader André Boisclair shouting: "And what are your next demands?" By promising to pass through the Federal largesse as

of cheques, credits, new savings plans, taxes or rebates on cars, and even vaccines to protect their daughters. Canadians will be bumping into the benefits of this Budget at almost every turn in their daily lives.

On the arcane issue of fiscal balance, Minister Flaherty has proposed a sensible and fair solution that allocates money on a per capita basis with a base and a cap to ensure equity. Finally, provinces with large and growing populations will have funding certainty to pay for social services. Provincial 'war lords' aided and abetted by local media seeking to sell newspapers will have a lot tougher time holding the federal treasury hostage. Provincial ranting has been replaced with the fairness of per capita allocations.

The Budget also reflects the Conservative preference for letting the Provinces deliver and manage social programs while the federal government focuses on its more traditional responsibilities. While it didn't get much media attention this government's commitment to reduce inter-provincial trade barriers and rationalize fragmented capital markets seems very real.

When Minister Flaherty abandoned the tradition of buying new shoes and instead chose to buy new skates for his son, there was no better picture of the new 'sub-con' ethos that underlies the Harper Conservatives. The 2007 Budget is but another step in defining the new Conservative Party and its leader.

*Paul Brown*

*See following page for analysis of Budget's proposals for Canadian capital markets (Leadership on Global Capital Markets).*

a tax cut, Premier Charest simply perpetuated the need for more Federal transfers in the future to offset the ongoing gap between Québec's tax revenues and Canadian standard social services.

These Liberals predict that Canadians will soon sit back and ask: "What kind of Federal Government is this? What sort of Canada is being shaped? Is there anyone in the Conservative camp prepared to say "No" to the provinces, or is Ottawa just one big ATM machine?"

The activist Harper government's big tent strategy leaves little room for the Liberals. The Tories hope the Liberals get crowded out of the middle of the political spectrum.

**Where Does the 'Broad Middle' Live ... And Who Knows them Best?** - There is an opening for the Liberals. Left out of the Tory tent are Canada's major cities, whose call for more funding was ignored by the Tories and the Tories don't seem to care. They did not elect a single MP in Toronto, Montreal or Vancouver. Effectively, the Tories told the big city Mayors get your own fiscal house in order before coming to us. The Conservatives are playing to their suburban and rural base who believe the big cities are run by bike-riding, spendaholic, left-wing hippies. This rift between urban and suburban/rural voters is a major factor in the current Québec provincial election where there is a strong anti-Montreal sentiment pushing the ADQ to new heights.

But Liberals know better. As the recent census points out, Canada has become an urban and suburban nation. The Tories are betting that the new suburban majority shares the outlook of rural Canada – the Tories' base. We think they are wrong. In our view, suburban Canada is becoming more like its big cities: multi-cultural, progressive and, as the last election showed, it's the Liberals who are best able to represent this growing urban culture. This new political centre is defined not by rural Canadian values leaching into the suburbs, but rather by urban Canadians and new immigrants moving there and bringing their values and concerns with them. Liberals will continue to speak their language best.

The question remains: who will bring down this government and why? At this point it looks like no one except the Prime Minister himself.

*Barry Campbell & Patrick Gossage*

## AND NOW FOR SOMETHING NON-POLITICAL...

### LEADERSHIP ON GLOBAL CAPITAL MARKETS

The Budget included a separate document called “Creating a Canadian Advantage in Global Capital Markets” that lays out a plan to improve and make more competitive Canadian capital markets. Previous governments have also made statements, including in budgets, about the need for efficient capital markets and national regulation, so it is legitimate to ask, what is different this time?

There are a number of answers to this. First, while previous references took a few paragraphs, or a small section, this is the first time that the Federal Government has put forward a reasonably comprehensive multi-faceted proposal with several elements. The plan includes a number of small and big measures, many of which need the full cooperation of provincial and foreign governments to be operational. To that extent, it reflects a “wish list” of future direction.

The most significant proposal is the call for a common securities regulator. While this has occurred in several previous budgets, this time there is more detail of what it would be based on – a principles based approach with ongoing participation of provincial governments. In addition, there is a very strong endorsement of the conclusions of the Ontario Crawford Report and the Allen Task Force work for the Investment Industry Association. This provides more clarity of the desire and expectations of the Federal Government for a common regulator. The next step is for the Minister of Finance to meet with provincial Ministers responsible for securities to see if there is a meeting of minds. This is obviously where “the rubber hits the road” and where things have bogged-down in the past. In a minority government environment, the push for real progress on a common regulator will be clearly difficult.

Another previously discussed proposal is enhanced enforcement of securities rules in Canada. But what is interesting and different here is the apparent recognition that the Integrated Market Enforcement Teams (IMETs) have not been working, a view held by many observers outside government. A “senior expert advisor” will be appointed to make recommendations and the government is committing

to funding the recommendations as necessary. While little details are provided, it seems that the federal government is getting serious about making the IMETs into the vehicle for fighting financial crime that was promised when they were established in 2003.

There are also measures that have not been noted before that could have some impact on capital markets.

First is a strong commitment to create “free trade” in securities trading. This is unfinished business going back to the NAFTA. At that time, no deal was struck on securities because of the unwillingness of the U.S. SEC to show flexibility in allowing access to the lucrative U.S. market. The document notes the expectation that the U.S., and indeed the G-7, can use mutual recognition to create opportunities to reduce or eliminate barriers to entry and therefore more efficient capital markets. This would be an enormous step for companies and investors alike, but we will need to see the willingness of Canada’s G-7 partners to see if this liberalization can come to fruition.

A second interesting new initiative is the intention to consolidate the borrowings of a number of Crown Corporations into the general borrowings of the government that will increase liquidity for benchmark bonds and lower overall financing costs. This is an area where the Federal Government can proceed, even without the co-operation of other governments. Other such federal-only initiatives referred to in the document are the withholding tax changes, improved investor education, and enhanced disclosure by banks for principal protected notes.

This document is important in suggesting that the Federal Government is going to get serious about the efficiency of our capital markets. The question remains as to whether, outside of some minor moves, the Minister of Finance can get the co-operation of the provinces and international governments to make changes that will have an impact on the average Canadian investor. In a minority government with a short term horizon, the document may be more a statement of future direction and intent than a real plan for action. Nevertheless, it can be a framework for real progress by a majority government in the future.

*Frank Swedlove*

## THE CAMPBELL STRATEGIES / MEDIA PROFILE TEAM

**Campbell Strategies** provides a broad range of government relations services covering all levels of government. Our unique experience enables us to effectively bridge the gap between the public and private sectors and assist our clients to communicate effectively in the political environment.

**Barry Campbell** served as a Member of the Parliament in the Liberal Government from 1993 to 1997. He served as Parliamentary Secretary to the former Minister of Finance, the Rt. Hon. Paul Martin. [barry@campbellstrategies.com](mailto:barry@campbellstrategies.com)

**Paul Brown** served in the Conservative Government of Canada from 1984 to 1988 as Policy Advisor to the Industry Minister, Executive Assistant to the President of the Treasury Board, and Chief of Staff to the Minister of Labour. [paulb@campbellstrategies.com](mailto:paulb@campbellstrategies.com)

**Frank Swedlove**, until April 2006, as Assistant Deputy Minister of the Financial Sector Policy Branch, Department of Finance, was responsible for policy development concerning the financial sector, management of the government's assets and liabilities, and Canada's anti-money laundering and anti-terrorism financing regime; as well as coordination with government agencies including the Financial Transactions Reports Analysis Centre of Canada (FINTRAC). Previously, Frank led the effort to revise Canada's financial sector legislation. [swedlove@sympatico.ca](mailto:swedlove@sympatico.ca)

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**Patrick Gossage** is one of Canada's most highly respected communications practitioners. He served as Prime Minister Trudeau's press secretary from 1976 to 1982 and Minister of Information at the Canadian Embassy in Washington.

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[www.campbellstrategies.com](http://www.campbellstrategies.com)  
416-368-7353

*and*

[www.mediaprofile.com](http://www.mediaprofile.com)  
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