Intelligence MEMOS

From: Alex Laurin and Bill Robson

To: Concerned Canadians

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Re: **BUDGET 2017 - HIGH DEFICIT, HIGH DEBT, AND A MISSED OPPORTUNITY**

Notwithstanding talk about an innovative future, the 2017 federal budget is very much about the present. New spending sprinkled all over, bigger deficits, and for longer. While we wait for US tax reforms and trade talks to commence, Ottawa missed the opportunity to prepare the table for a more competitive tax system to attract top talents, encourage private investment, and more work.

The budget does not put on the brakes on deficit spending. Overall program spending this year is about the same as was projected in last year's budget, but spending in each of the next two years is higher by more than $5 billion. Thanks to lower projected debt charges – a windfall from lower interest rates – absorbing the drop in projected revenues, deficits in 2018 and in 2019 will be higher than anticipated in last year's budget by about $5 billion, and by $7 billion in 2020.

Deficits mean higher taxes in the future. Today's middle class – and those struggling to join it – may or may not benefit from this fiscal path. Tomorrow's middle class – and those struggling to join it – will suffer.

And the escalating federal debt will not make it easier for the feds to fund infrastructure commitments – there is a limit to governments' ability to borrow. Delivering on the Infrastructure Bank would help, and although the budget targets the next few months for the Infrastructure Bank to become operational, it provides no new details on its planned operations.

The Bank seems mostly intended to help attract private capital by providing low-cost loans and guarantees. The problem with this reasoning is that it would simply subsidize the returns of private institutional investors. Infrastructure projects have a risk component otherwise institutional investors would just buy government bonds. For every project, taxpayers – who are the Bank's shareholders – will thus share in the investment risks, but unless they get the same rewards as their private investing partners, they will be subsidizing private investors, and this subsidization will be essentially hidden from view. Moreover, the bank may not lever private capital to the extent hoped if investors realize their returns depend on government subsidies for decades into the future. If you have pensions to pay, do you really want that kind of risk?

The bank is a good idea only if taxpayers reap the same rewards as their private partners for the public infrastructure they will ultimately pay for through their user charges. The bank should be investing in equity on the same basis as private investors, thus ensuring taxpayers are equally compensated for the financial risks they undertake.

Moreover, new investments sprinkled on improving skills' development and an innovation strategy may yield long term economic fruits, but it does nothing to improve Canada's attractiveness for top talents, high income earners, and global head offices. In many respects this is a budget in waiting for major trade reforms and tax reductions prefigured by the Trump administration.

Increasing the size of government and poking "the rich" in the eye is perhaps understandable in the heat of an election campaign, but the context has changed. More deficit-financed spending may mean saddling high-income earners – and those struggling to get there – with higher taxes in budgets coming, and this is no way to instill business confidence, attract investments, top talents, and encourage work. The United States economy is doing well, and tax cuts may be on the way. The government needs to signal a change of course.

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