Oil plunge restricts Harper tax-cut leeway before Canada vote

By Theophilos Argitis, Bloomberg News,
Bloomberg

NOVEMBER 13, 2014, 11:20 PM

OTTAWA, Ontario — Lower oil prices are constraining Prime Minister Stephen Harper's ability to balance his two main political priorities — eliminating the budget and lowering taxes — as he prepares for elections next year.

On Wednesday Finance Minister Joe Oliver added an additional layer of insurance to the nation's fiscal projections by curbing Canada's revenue forecast by C$2.5 billion ($2.2 billion) a year to reflect the recent plunge in crude. The move, coupled with C$27 billion in tax cuts announced last month, reduced projected surpluses by about half over the next four years.

The careful forecasting is an attempt by Harper and Oliver's ruling Conservative Party to reinforce the message they are serious about balancing the budget, even as they press ahead with cutting taxes, the two key pillars of their platform in elections four years ago that helped them win a majority.

"They just have to say 'trust us with public finances,'" said Nik Nanos, an Ottawa-based pollster at Nanos Research Group. "'We deliver tax cuts when it is prudent to do that, we will not put our finances at risk to deliver tax cuts to Canadians.'"

Canada will post cumulative surpluses of C$18.1 billion in the four years from 2015 and 2018, down from a February projection of C$32.9 billion, according to a fiscal update released on Wednesday from Ottawa. The government will post a C$1.9 billion surplus in the fiscal year starting in 2015, down from the C$6.4 billion budgeted in February. It would be the first surplus since 2007-08.

The figures include an annual C$3 billion risk cushion, set aside in the 2014 budget against global uncertainty, and an additional C$2.5 billion revenue adjustment to account for the drop in oil prices since September, when the government finalized its economic forecasts. The adjustment reflects an assumption that West Texas Intermediate will remain at current levels of about $81 a barrel, according to the document.

"What we saw was a prudent fiscal plan," said Craig Wright, chief economist at RBC Capital Markets. "Underlying that is conservative economic assumptions."

Tax cuts have been the mainstay of Harper's tenure up to now, with tax revenue in 2011 and 2012 falling to 11.5 percent of GDP, which is the lowest since at least the early 1960s, according to finance department data. That's down from 13.3 percent when Harper took power in 2006.

According to data compiled by Bloomberg from Statistics Canada historical data, the federal government's tax take may have fallen to the lowest since 1940 before edging slightly higher last year.

The cuts have prompted opposition parties to call for a reassessment of allocating projected surpluses to further tax reductions. Suggestions include investing in initiatives such as infrastructure and national daycare.

"We already know the government has committed to spending it on immediate tax credits that are designed to get people to vote Conservative," Liberal Leader Justin Trudeau said in a Nov. 4 speech in Toronto. "I humbly offer that a much better thing for the government to be focusing on is investing in infrastructure. That ought to be the priority."

Even the Parliamentary Budget Office, a non-partisan group that analyzes fiscal issues for lawmakers, has warned that existing fiscal capacity is misleading.

In an Oct. 21 report, the budget office estimated the government's fiscal room exceeds its February projections, mostly due to temporary factors such as the decision not to lower employment premiums until 2017 and the economy growing above its potential.

"Policymakers should be wary of using surpluses to implement permanent tax relief or spending initiatives if they wish to avoid returning to deficits as economic growth subsides," according to the report.

Up until now, the cuts have been financed partly by deficit financing and lower borrowing costs as interest rates remain at historically low levels. To eliminate the shortfall, Harper is pressing departments to cut operating budgets — which don't include transfers and account for just under half of all expenses — down to near the lowest levels in the past 50 years as a share of GDP.

Thomas Mulcair, leader of the main opposition New Democratic Party, on Wednesday called the projected surpluses a "mirage" predicated on "the cuts they have brought in."

Not that the Conservatives are offering any apologies. Last month Prime Minister Stephen Harper announced a slew of tax cuts for families with children, including measures that will allow couples to divide their income for tax purposes, increase the amount of child-care expenses families can deduct from taxes, and expand a direct per-child monthly payment to parents.

With a federal election scheduled for next year, Harper and Oliver are hinting more tax relief is still to come.

"We trust Canadians to save and spend their hard earned money better than all-knowing bureaucrats and social engineers," Oliver said in a speech on Wednesday in Toronto. "Granted, there are some people who do not agree but that's what elections are about."