Canada Budget Offers Tax Cuts, Spending Ahead of Vote (Update5)

By Theophilos Argitis

March 19 (Bloomberg) -- Canadian Prime Minister Stephen Harper released a C$233.4 billion ($198 billion) budget that offers tax cuts for families and seniors and pledges more money for Quebec ahead of an election that may be held this year.

The spending plan announced today in Ottawa forecasts a budget surplus of C$3.3 billion for the fiscal year ending next March. That's down almost two-thirds from the current year, as Harper increases spending in Ontario and Quebec, where his minority government failed to garner enough support in last year's vote.

``There is a natural tendency for all minority governments to want to spend money because their objective is to want to be a majority,'' said Nikita Nanos, president of SES Research. ``One piece of luck for this government is that it happens to be a minority government at a very good time from the point of view of tax collection.''

The world's eighth-biggest economy has benefited from rising commodities prices and record corporate profits, allowing Finance Minister Jim Flaherty to offer tax breaks for everyone from low-income workers, seniors, truck drivers, public transit riders and manufacturers. There's even C$1.5 million to promote Canadian three-down football and lacrosse.

The 477-page plan calls for an 11th straight budget surplus and an increase in spending of 4.6 percent from the current fiscal year. A series of spending announcements over the past two months, including new money for the environment and public transit, will drive up program spending 7.9 percent for the current fiscal year, the third-fastest increase in two decades.

Opposition Parties

Harper's Conservative Party government is 29 seats short of a majority and needs support from at least one of Parliament's three opposition parties to pass legislation. The separatist Bloc Quebecois plans to back the budget, likely ensuring its approval. New Democratic Party Leader Jack Layton, which heads the smallest party in Parliament, said his caucus won't be supporting the budget. Liberal Party Leader Stephane Dion said his party will vote against the plan.

Minority governments in Canada average 18 months, and a budget defeat in the House of Commons would force the country's third election since 2004.

Harper's Conservatives made new provincial funding a key promise during last year's election campaign after Quebec and other provinces argued the previous Liberal Party government didn't share enough of its rising tax revenue.

``It will be very well received by the provinces,'' Clement Gignac, chief economist with National Bank Financial, said in an interview.

The federal government will boost transfers to provincial governments by C$6.1 billion this year, accounting for about two-thirds of the increase in spending. About one-third of that stems from new announcements in the budget.

Quebec Funding

The increase in direct transfers for Quebec, where Harper won just 10 of 75 seats, totals more than a third of the C$6.1 billion, while Ontario will receive a C$1.11 billion increase.

Spending increases for provinces left Harper with less room to reduce taxes. Harper didn't have enough money to meet a campaign pledge to abolish the capital gains tax for people who reinvest profits from selling assets such as stocks. Flaherty said he plans to take more action on capital gains in the future.

``We are going to do more there,'' Flaherty said in an interview with Bloomberg Television from Parliament.

The government also opted for a scaled-back version of income splitting for families, giving a tax break of as much as $209 for workers whose spouses make little or no money.

Flaherty also said legislation implementing a tax on income trusts will be included in the budget implementation bill.

Growth Forecast

The government cut its estimate for economic growth this year to 2.3 percent, citing economists' forecasts, down from a projection of 2.7 percent in November. The government attributed the slowdown to declining oil prices and a higher dollar that hurt manufacturers. The economy expanded 2.7 percent last year.

To be sure, Canada remains the sole country in the Group of Seven forum of nations with a balanced budget. The surplus for the year ending March 31 will be C$9.2 billion, all of which will go to pay debt, and adds to more than C$80 billion in surpluses over the past decade. The surplus would have been C$10.6 billion this year without the new spending and tax measures.

Flaherty reiterated his call today for the country to become the first Group of Seven nation to bring debt levels in line with assets by 2021, a plan that could effectively make Canada's public sector a creditor. This target takes into account the assets of the Canada Pension Plan.

The government plans to pay down C$3 billion in debt this year, and expects to reduce its debt to 30 percent of gross domestic product by March 2009, and to 25 percent of GDP by 2013.

Tax Breaks

The government also announced about C$2.4 billion worth of new tax cuts in the coming year, including a child tax credit of C$310 per child up to age 18, tax credits for low-income individuals re-entering the workforce and a temporary two-year increase in the amount of new investments manufacturers are allowed to write off.

The government increased the age limit for investing in tax-sheltered pension plans to 71, from 69. And the grant for investments in university savings plans was increased to C$500 a year from C$400, while the limit on these investments was removed.

The budget measures boost consumer and business spending by about C$4.9 billion this year and C$7.4 billion next year, adding fuel to an economy that is already growing at full capacity, according to budget projections. That may prompt the central bank to put off interest rate cuts.

``Because the fiscal policy is so stimulative, we are even more likely to see the Bank of Canada remain on the sidelines rather than cutting interest rates to make sure we don't overheat the economy and run an inflation risk,'' Sherry Cooper, chief economist at BMO Capital Markets in Toronto, said in an interview.

The Bank of Canada has kept its overnight lending rate at 4.25 percent since last May.

To contact the reporter on this story: Theophilos Argitis in Ottawa at targitis@bloomberg.net .

Last Updated: March 19, 2007 20:25 EDT