

PROTECTING CANADA'S **FUTURE**

ECONOMIC AND FISCAL STATEMENT, NOVEMBER 27, 2008

The Honourable James M. Flaherty, P.C., M.P.  
Minister of Finance



Department of Finance  
Canada

Ministère des Finances  
Canada

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## *Check Against Delivery*

Mr. Speaker, I am pleased today to present the Government's *Economic and Fiscal Statement*, and to set out our key short-term and long-term objectives as we prepare for the next federal budget.

I present this Statement at a time of unprecedented deterioration in economic and financial systems around the world. Without a doubt, here in Canada and around the world, these are difficult times that will require difficult choices.

It is important to recognize just how quickly things have changed, Mr. Speaker, and how dramatically. The cascading effects of the international credit crisis were sudden and devastating.

An unexpected credit crunch in the summer of 2007, and a U.S. recession sparked by a plunge in the American housing market, have spread throughout the world.

Today, the International Monetary Fund expects global growth to be the weakest since 1993.

The speed at which this crisis has intensified, and the damage it has brought to countries around the world, have been extraordinary.

All countries are struggling to cope with this crisis.

The Euro area is in recession for the first time since its creation in 1999.

It has been joined by Japan.

There are signs of a prolonged downturn in the U.S., with a sharp decline in U.S. consumer spending and almost 1.2 million jobs lost since the beginning of the year.

A lengthy list of American financial institutions have either collapsed or required a bailout or takeover—Citigroup, Fannie Mae, Freddie Mac, Bear Stearns, Lehman Brothers, Washington Mutual, AIG, Wachovia—all in a matter of months.



Financial rescue efforts are underway in the U.S., and similar ones are happening in countries throughout Europe.

The crisis has laid bare some serious flaws in many aspects of the international financial system:

- Non-bank institutions that were not properly regulated and were relying on borrowed money;
- Financial institutions lacking enough capital to withstand the financial market turmoil; and
- A dangerously short-sighted tendency to underestimate risk in good times.

The mistakes of some are today being felt by all.

We have not been immune to the resulting global economic slowdown. Forecasters around the world did not predict, and could not have predicted, the full force of this economic crisis.

## **Forecasts**

The volatility we are seeing in the world economy is truly historic. It is affecting Canada, driving down our economic growth expectations. Canada has not faced such severe economic tests in a generation.

Economic projections are now much lower than at the time of our last budget. Private sector forecasters expect real GDP growth of just 0.6 per cent this year and 0.3 per cent next.

The same private sector forecasters are now widely expecting a technical recession, with negative growth in the fourth quarter of 2008 and the first quarter of 2009.

No government at any level can guarantee the future. In fact, given so much uncertainty, no one could unconditionally guarantee the fiscal projections contained in today's Statement.

We will be faced with tough choices as we prepare our next budget, in the face of the deteriorating international economy. Those choices must be part of a clear plan to protect our future.



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Last week's Speech from the Throne laid out a five-pronged plan to protect Canada's economic security—a plan that will define the choices we make.

- Along with our international partners, we will reform global finance;
- Here at home, we will ensure sound budgeting;
- We will secure jobs for families and communities;
- We will expand investment and trade; and
- We will make government more effective.

### **What We've Done to Prepare—Early Action and Stimulus**

We were fully aware that difficult times were ahead when I presented our *Economic Statement* last fall.

We planned for it. We made choices to help put Canada in a stronger economic position. In fact, since 2006:

- We have reduced the federal debt by \$37 billion;
- We have reduced taxes by almost \$200 billion over 2007–08 and the following five years;
- We will have reduced the tax rate on new business investment, leading to the lowest level in the G7 by 2010;
- We have made historic investments in job-creating infrastructure; and
- We have invested in science and technology, education and training.

Our Government, from last year to next, will have doubled the level of federal funding for provincial, territorial and municipal infrastructure projects.

Canadians and Canadian businesses will pay nearly \$31 billion less in taxes in the next fiscal year, thanks to the tax reduction measures introduced since 2006.

That's equivalent to nearly 2 per cent of Canadian GDP.

This is a substantial fiscal stimulus—stimulus with staying power.



Unlike other countries, Canada is providing tax relief that is sustainable and permanent—tax relief that is helping Canadian families every single day.

We took action when it was necessary. Our performance has shown that it was worthwhile.

However, our actions did not insulate us completely from the rest of the world. Global conditions have deteriorated as 2008 has unfolded.

We had to take further extraordinary steps in the financial sector to respond to a global credit crunch we did not spark, yet which threatened to engulf us if we failed to act.

Once again, we had a head start over other nations. Our financial system is considered to be the world's soundest by the World Economic Forum.

The International Monetary Fund concluded Canada's financial system is mature, sophisticated, well managed and able to withstand sizeable shocks.

We have acted to keep it that way. We have protected its stability, so that Canadian businesses and families would continue to have access to credit.

Businesses need credit to invest or to meet their payrolls. Families need it to take out mortgages and loans.

These are basic and vital components of the Canadian economy.

We took steps to maintain the availability of longer-term credit with the purchase of mortgage pools through the Canada Mortgage and Housing Corporation.

This innovative measure is allowing Canadian financial institutions to continue lending to consumers, homebuyers and businesses at an affordable cost.

Our Government also created the Canadian Lenders Assurance Facility. The Facility offers insurance on a temporary basis on wholesale term borrowing by Canadian financial institutions.

This backstop ensures that our financial institutions are not at a competitive disadvantage internationally.

We increased the borrowing authority of Export Development Canada and the Business Development Bank of Canada.



The combined boost of nearly \$4 billion that we introduced will mean more lending choices for Canadian businesses.

We announced new rules for government-guaranteed mortgages this summer to prevent a U.S.-style housing bubble, rules that are in place today.

Our sensible Canadian approach is paying off.

Our country will come out of this economic crisis in a strong position, because we are going into it in a strong position.

Faced with threats outside our borders, we answered with leadership from within. The result is a fiscal position that is the best of all G7 countries.

The next fiscal year will be difficult. But Canadians can be fully confident that we will overcome whatever hardships may lie ahead in 2009, and beyond.

## **Fiscal Position**

Mr. Speaker, like governments, families face economic challenges beyond their control every day.

When they face challenges like those, families must adjust their priorities. Just like governments, they must make tough choices—tough, but pragmatic. They make choices that give them flexibility to weather the storm.

Their choices are made with the future in mind. To protect the future they want, they make sacrifices today.

Our Government will take the same approach. We will protect the future by maintaining strong fiscal and financial management.

We take no pleasure in saying that despite our best efforts, this may not be enough to keep a small surplus on the books.

But in situations like this, it would be misguided to simply engineer a surplus, just to be able to say we have one.

Today's Statement lays out a plan that keeps our budget balanced for now.



However, in the weeks ahead, we will determine the extent to which we will inject additional stimulus to our economy, joining the efforts of our international partners.

Any additional actions to support the economy will have an impact on the bottom-line numbers in our next budget. These actions, or a further deterioration in global economic conditions, could result in a deficit.

We do not take the potential of a deficit lightly. The thought of a long-term structural deficit would be even more serious—one that the Government is unable to climb out of, even when the economy improves.

The days (and years, and decades) of those chronic deficits are behind us. No matter what 2009 brings, they must never return.

Our goal must be to ensure the strength of the economy—to protect jobs, to encourage investment, and to help business grow.

We must do that while protecting the long-term fiscal position of the Government, so that when the economy improves, we return quickly to balanced budgets.

Today, our Government is announcing a series of measures designed to strengthen Canada's fiscal position in an uncertain time.

These measures will enable us to plan on a balanced budget framework, while recognizing potential downside risks.

## **The Road Ahead—New Actions**

### **Fiscal**

We cannot ask Canadians to tighten their belts during tougher times without looking in the mirror.

Canadians have a right to look to government as an example. We have a responsibility to show restraint and respect for their money.

Canadian tax dollars are precious. They must not be spent frivolously or without regard to where they came from.



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Canadians pay taxes so governments can provide essential services. They trust the people they elect to serve society with that money, not serve themselves.

The truth is, tax dollars have been supporting political parties for a long time.

For example, we take advantage of reimbursements on our election spending. Canadians also receive a tax credit on their donations to political parties.

This is a generous allotment of tax dollars to politicians. It ought to be sufficient for all of us. But we ask for much more, in the form of a \$1.95 subsidy for every vote we receive in an election.

Canadians pay their own bills, and for some Canadians that is getting harder to do. Political parties should pay their own bills too, and not with excessive tax dollars.

Even during the best of economic times, parties should count primarily on the financial support of their own members and their own donors.

Today, our Government is eliminating the \$1.95-per-vote taxpayer subsidy for politicians and their parties, effective April 1, 2009.

There will be no free ride for political parties. There never was. The freight was being paid by the taxpayer. This is the last stop on the route.

There will be no free ride for anyone else in government either.

We are directing government ministers and deputy ministers from every single department and agency of the Government to rein in their spending on travel, hospitality, conferences, exchanges and professional services.

This includes polling, consultants and external legal services.

In the broader fiscal picture, we will expand the actions under the new Expenditure Management System we put in place in 2007. We will use this systemic approach to help keep spending growth on a sustainable track.

Under this new system, the Government has been reviewing all departmental program spending. The Government already examined department spending of \$13.6 billion in 2007, and is examining \$25 billion in program spending this year.



For the first time in nearly 15 years, the Government is also expanding this businesslike and multi-year review to include corporate assets: Crown corporations, real property and other holdings.

The review will take a careful approach to the sale of any asset, considering market conditions and ensuring fair value can be realized for the benefit of taxpayers.

Our Government expects to save over \$15 billion over the next five fiscal years under the new Expenditure Management System. This system will be an invaluable tool to help us maintain balanced budgets, along with the other steps announced today.

As indicated in last week's Speech from the Throne, the Government is also introducing legislation to ensure predictability in federal public sector compensation.

Our Government values the contribution and hard work of our public servants. They must be fairly compensated for their work on behalf of Canadians.

We must bear in mind that their work is also paid for by Canadians.

We will introduce legislation to ensure that the pay for the public sector grows only in line with what taxpayers can afford as the economy slows.

This legislation will put in place annual public service wage increases of 2.3 per cent for 2007–08, and 1.5 per cent for the following three years.

This restraint will also apply to MPs, Senators, Cabinet Ministers and senior public servants.

The legislation would also temporarily suspend the right to strike through 2010–11.

Another issue we intend to address is the litigious, adversarial, and complaints-based approach to pay equity. Since the mid-1980s, Canadian taxpayers have paid out over \$4 billion in pay equity settlements.

These settlements were the result of pay equity complaints to the Canadian Human Rights Commission. These complaints were filed after agreements on public sector wages had already been reached through collective bargaining.



New complaints continue to be filed, sometimes for the same groups that have already received past pay equity settlements. These represent large potential future costs to taxpayers.

This costly and litigious regime of “double pay equity” has been in place for too long. We are introducing legislation to make pay equity an integral part of collective bargaining.

We are also bringing certainty to the growth of Equalization. We have put its growth on a sustainable path.

A new, three-year moving average that puts growth in Equalization in line with nominal GDP growth will bring fairness and stability to both the provinces and the federal government, while reflecting changes in the Canadian economy.

We are ensuring that Equalization will continue to grow, because it is a key federal program for providing support to provinces.

We are also protecting the Canada Health Transfer and the Canada Social Transfer. Provinces must be able to plan accurately, especially when it comes to some of the largest expenditure items in their budgets: health care and social services.

These transfer payments will continue their built-in growth of 6 per cent for the Canada Health Transfer and 3 per cent for the Canada Social Transfer.

We will ensure any new measures to support the economy are carefully chosen and targeted for maximum benefit.

In preparing for the 2009 budget, we will ensure spending is as effective as possible, and aligned with Canadian priorities.

Infrastructure is an example of such worthwhile spending. Investment in infrastructure creates jobs for today and for the future. It creates essential links between communities and regions.

Next year’s increase in infrastructure spending will be our largest, and will push the total amount to over \$6 billion in stimulus to the economy.

Our Government is committed to expediting our historic, \$33-billion Building Canada plan to get projects moving as quickly as possible, in particular for the upcoming construction season.



We will work with provinces and territories to identify a limited number of key infrastructure projects across Canada by January 2009.

These investments will help keep Canada moving forward as the world economy slows.

## **Pensions, Credit and the Financial Sector**

Quickly deteriorating circumstances in the financial sectors in other countries have contributed to this slowdown.

Here at home we must have the flexibility to respond quickly and decisively, and protect our financial system from global risks.

Our Government is proposing that the Minister of Finance be granted additional flexibility to support financial institutions and the financial system in extraordinary circumstances.

This is consistent with the additional powers we provided the Bank of Canada earlier this year. It is also in keeping with the action plans we agreed to with our international counterparts at the G7 and G20 meetings.

These proposed measures include authority for:

- Funding in the unlikely event there is a draw on the Canadian Lenders Assurance Facility;
- Canada Deposit Insurance Corporation to establish a bridge bank to help preserve critical banking functions;
- An increase in the borrowing limit of CDIC to \$15 billion to reflect the growth of insured deposits, the first increase since 1992;
- The power to direct CDIC to undertake key resolution measures to ensure financial stability when necessary; and
- The legal ability to inject capital into a federally regulated financial institution to support financial stability, on terms that would protect taxpayers.

These are additional tools in our tool box. I hope we never have to use them.

But the lessons of the past couple of months have shown us that we have to be ready to deal with every kind of risk, even the unlikeliest ones.

With these measures, we will be ready.

We are taking steps to help Canadian seniors. Our seniors built this country and deserve to live with dignity and respect.

Many seniors are understandably concerned about the impact of the sharp decline in the markets on their retirement savings.

Registered Retirement Income Funds, or RRIFs, and their associated withdrawal requirements are of particular concern.

Last year, our Government raised the age limit for converting a Registered Retirement Savings Plan to a RRIF from 69 to 71.

I have heard from seniors about two issues they are dealing with today:

- The impression among some that assets in RRIFs must be sold in order to meet withdrawal requirements; and
- The recent steep drop in market value of some of those assets.

There is no requirement under the tax rules to sell these assets to meet the RRIF minimum withdrawal requirements, and seniors should not be left with the impression that there is. Assets may be kept intact, so that they can grow in the future.

To help deal with this issue, last week I wrote to all federally regulated financial institutions. I asked these institutions to ensure that in-kind distributions are accommodated at no cost to clients, or that clients are offered another solution that achieves the same result.

Now, these are exceptional circumstances, and we are taking further action to allow RRIF holders to keep more of their savings in their RRIFs.

To help seniors cope, today I am proposing a one-time change that will allow RRIF holders to reduce their required minimum withdrawal by 25 per cent for this tax year. For example, for an individual otherwise required to withdraw \$10,000 from their RRIF in 2008, the required withdrawal will be reduced to \$7,500.

If the individual has already withdrawn more than \$7,500, they will be permitted to re-contribute the excess up to \$2,500, and claim an offsetting deduction for the 2008 taxation year.



We are also addressing the immediate consequences this financial distress has dealt to Canadian workers who contribute to federally regulated pension plans.

Based on what has happened so far, and under current rules, the decline in value of these plan assets would trigger substantial payments at the worst possible time for struggling companies.

The money these companies would need to use for pension top-ups could otherwise be used for further investment and growth.

The Government is proposing to allow plans under federal jurisdiction to double the length of time required for solvency payments from 5 to 10 years.

Companies that pursue this option must meet one of two conditions:

- The agreement of pension plan members and retirees by the end of 2009; or
- The securing of a letter of credit to cover the 5-year difference to protect pensioners.

Today's announcement will give these companies one more option they can use to cope with these extraordinary circumstances.

To deal with longer-term pension concerns, we will soon be launching consultations on issues facing defined benefit and defined contribution pension plans, with a view to making permanent changes next year.

Since pension plans are regulated either federally or provincially, our Government will coordinate our efforts with our provincial and territorial counterparts to create a pension system able to withstand whatever future challenges come its way.

This subject will be high on the agenda when I meet with my provincial and territorial colleagues next month.



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While helping Canadian workers save, we will also help the businesses that employ them, in particular with their ability to borrow.

We will increase the supply of credit available to export-oriented manufacturers, including the auto sector, as well as small and medium-sized businesses.

On top of a recent \$2-billion increase to the borrowing authority of Export Development Canada, today I am announcing a \$350-million equity injection that will support up to approximately \$1.5 billion in increased credit for Canada's export businesses.

The export sector has been hit hard by the financial crisis. EDC will now be able to add to the nearly \$80 billion in exports and investment it helps make possible for Canadian enterprises, including \$4 billion for the auto sector alone.

The Government will also inject \$350 million in equity to the Business Development Bank of Canada to assist small and medium-sized companies. This new injection will increase BDC's lending ability by about \$1.5 billion, and comes on top of a \$1.8-billion borrowing increase announced earlier this year.

We will also move forward quickly on the securities regulation front. Our cumbersome and unwieldy system of 13 securities regulators is a glaring flaw in Canada's world-leading approach to promoting financial stability.

The Government will soon receive the report of the Expert Panel on Securities Regulation. The report is expected to outline the best way forward to improve the content, structure and enforcement of securities regulation in Canada.

We will act on it quickly. We invite all participants to join us in improving our regulatory system.



## **Conclusion**

Mr. Speaker, this Government came to office looking years down the road. Our country is better off today thanks to exactly such an approach. Short-term problems will not distract us from continuing to focus on the horizon.

At the same time, we are far from finished confronting unheard-of global economic and financial threats. There are warning signs ahead that we must heed if we are to remain a global role model in an uncertain time.

We will address our immediate, external challenges the same way we will reach our longer-term goals: by continuing to manage tax dollars wisely, investing strictly in the essentials and focusing on what ultimately matters—the longer-term prosperity of all Canadians.

These are not easy times. But we must not forget that our country has been through plenty of hard times before, and we'll get through these ones the same way.

Our Government will respond to the challenges of the upcoming year the same way we are seeing this year to a close, through the values Canadians themselves hold dear: prudence and restraint, combined with hard work and a focus on the future.

The greatest histories are always written in the toughest times. I believe that we're in the midst of writing some bold new chapters in our country's long-running success story—an unfolding account of new accomplishments by a country that is compelled to grapple with global hard times, and that will emerge even stronger because of them.

Thank you, Mr. Speaker.