

REPORT CARD

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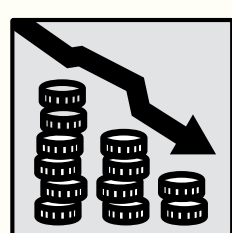
JIM FLAHERTY

GRADE AVERAGE:

B-

SUBJECT/
GRADE

COMMENTS



HANDLING OF THE FINANCIAL CRISIS

By Stephen Gordon

B+

The defining episode of Jim Flaherty's tenure as minister of finance was the financial crisis and recession of 2008-09. Although Flaherty was only one actor among many—the Bank of Canada was another key player—the government's handling of the crisis holds up well to ex post scrutiny.

After the collapse of Lehman Brothers in September 2008, the government and the Bank of Canada moved swiftly and effectively to supply liquidity in order to keep financial markets functioning. The Department of Finance's [Insured Mortgage Purchase Program](#)—which allowed banks to use their mortgage holdings as collateral for the short-term loans that they needed to function normally—was one of the cleverest measures implemented during the crisis. The federal government's stimulus program was also taken from the textbook play-book: An explicitly temporary increase in spending that was wound down when employment and output reached pre-crisis levels.

Of course, this positive evaluation of what the government did do has to be set against what the government wanted to do. The Conservatives' initial reaction—as documented in the [November 2008 fiscal update](#)—was to cut spending in order to avoid a deficit. The stimulus package that was implemented might have had more to do with the politics of the prorogation crisis than with a change in Jim Flaherty's views of how best to respond to the crisis.



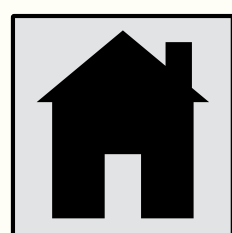
FEDERAL DEFICIT

By Stephen Gordon

D

This is the standard measure by which all finance ministers are judged: What happened to the government's budget balance under Flaherty's watch? The raw numbers are not kind: The federal government was running a \$13 billion surplus when Flaherty arrived, and it is currently running a \$25 billion deficit. To be sure, most of this deterioration was due to the recession: Tax revenues fell as economic activity slowed. But a significant part of the damage to the government's finances was self-inflicted. The reduction of the GST by two percentage points lowered revenues by about \$10-12 billion. In 2010, this shortfall was—not coincidentally—roughly equal to [estimates for the "structural" deficit](#), red ink that was not tied to the economic downturn and would not go away when the economy recovered.

The government does have a credible plan for balancing the budget. Direct program spending has been held constant for three years now, and sticking to this strategy should be enough to eliminate the deficit within the next few years. But if the GST had not been cut, the deficit would have been eliminated much earlier, possibly even in the current fiscal year.



HOUSING MARKET

By Kevin Milligan

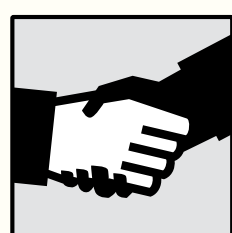
B

(interim)

The housing market became an increasingly important part of Canada's economic environment during Jim Flaherty's term as finance minister. Most of the finance minister's influence on housing comes through the tax-payer backed [Canada Mortgage and Housing Corporation](#)—which provides mortgage insurance as well as packages together mortgages into guaranteed bonds for investors. CMHC [grew](#) tremendously during the Flaherty era. Measured in terms of the amount of mortgage insurance covered, CMHC more than doubled in size between 2005 and 2012, growing to \$566 billion from \$274 billion.

Between 2006 and 2008, Finance [progressively loosened](#) the standards for CMHC insurance, at one point allowing for taxpayer-backed insurance on 40-year mortgages with zero downpayment. However, [in mid-2008](#) Ottawa reversed course. It has since tightened housing policy considerably, through [mortgage insurance](#) caps, regulatory [changes](#) at the Office of the Superintendent of Financial Institutions, the federal financial industry watchdog, and wholesale board and management [changes](#) at CMHC.

A hot housing market limited the blow to the Canadian economy in the years following the financial crisis. On the other hand, of course, allowing ever more lending and borrowing for housing might have taken Canada on a path to its own housing-led finance crisis, so Flaherty was wise to pull the reins. Timing is the key question here, and we won't know if Flaherty's course reversal was well-timed or too late until a few more years have passed. If housing corrections in the various local markets turn out to be gentle and Canadians manage to work off their debt overhang gradually over time, then Flaherty's housing moves will deserve accolades. If housing markets tumble and cause grief to indebted households, blame will rightly fall on the man who encouraged the market (and accompanying household debt) to new heights.



TRADE POLICY

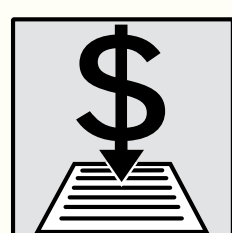
By Mike Moffatt

A-

Attributing trade policy to a single minister is difficult, since it involves everyone from the trade minister to the agriculture minister to the minister of public safety (who is responsible for the Canada Border Services Agency, or CBSA). Overall, what we can ascribe to Minister Flaherty over his tenure is quite positive.

The good: Flaherty's 2009 budget was particularly strong, with the elimination of a number of tariffs on machinery and equipment, along with border improvements at Sarnia and Fort Erie, Ont. The [elimination of tariffs](#) on baby clothes and sporting equipment in the latest budget, while a relatively small measure, helps Canadian families and is a test case for future tariff reductions. While I am not a fan of how the General Preferential Tariff (GPT), which imposes lower-than-normal tariffs on imports from developing countries, was [modernized](#), there is no question that the system was woefully out of date and needed to be addressed.

The bad: Canada's ability to sign only minor trade deals under Flaherty's tenure has little to nothing do with Finance, so the minister gets a pass for that. Less clear is Finance's involvement (if any) in a number of puzzling moves by the CBSA, all of which would have led to an increase in government revenue if they had been successful. These include, but are not limited to, their about-face on [end use certificates](#), the [dispute with Frito-Lay](#) and the treatment of the [apparel duty remissions](#). More directly attributable to Finance is the manner in which GPT was modernized, which will lead to higher tariffs for Canadian businesses and increased cross-border shopping. Overall, though, the pluses outweigh the minuses, since most of the minuses cannot be directly attributed to the minister.



TAX POLICY

By Kevin Milligan

B

Flaherty mostly avoided root-and-branch reform to Canada's tax system, preferring incremental change in most areas. He began with a sales tax cut—[lowering](#) the GST by two percentage points, down to five per cent from seven per cent, in the first two years of his tenure. The GST wouldn't be the tax cut of choice for most economists. The move [substantially](#) lower federal revenues, by about \$12 billion a year. In later years, Flaherty pushed further on harmonization of federal and provincial sales taxes, finding success in [Ontario](#) and [P.E.I.](#), and ultimately failure in [B.C.](#)

Another early [move](#) was to raise taxes on [income trusts](#) in order to bring them in line with those on traditional corporations. It rarely makes sense to have big gaps in the taxation of profits coming out of different types of legal corporate structures. Flaherty correctly pushed the system in the direction of comparable tax treatment across corporate forms, incurring some political [heat](#) in doing so.

On income taxes, Flaherty steered clear of big, structural changes. High earners did not see tax cuts like those enacted by [President George W. Bush](#) in the U.S. On the other hand, they did not see the increases demanded by [some](#) as a response to growing income inequality either. The minister, however, oversaw the introduction and expansion of several "boutique" tax credits—for things like children's fitness and volunteer firefighters. There is little [evidence](#) that these ad-hoc tax credits achieved their stated policy goal—such as promoting children's fitness—and whatever their political appeal, they are a poor addition to the tax system.

Other notable developments on the minister's watch include the introduction of income splitting for [seniors](#), and new [tax-free savings accounts](#), as well as the continued lowering of the [corporate](#) tax rate. Evaluation of these moves varies quite a bit across economists.

On the other hand, it's hard to see much success in the attempt to set up an independent mechanism to determine employment insurance [rates](#). Continued [interference](#) by Flaherty eradicated any sense of independence in EI rate-setting.