

## Federal Budget 2004 Analysis

### Introduction

Finance Minister Ralph Goodale has delivered the first budget of Paul Martin's tenure as Prime Minister. With the possibility of a federal election in the near future, an overarching theme of this budget is the soundness and prudence of the government's financial management. The budget offers relatively little in the way of new initiatives compared to its predecessors, in keeping with the lowered expectations crafted by the government in recent weeks. At the same time, the expenditure review process announced when Mr. Martin became Prime Minister is expected to generate at least \$3 billion in annual savings within four years. Nonetheless, higher education and university research emerge clearly as priorities for the federal government. In the context of limited initiatives and ongoing expenditure review, the amount of new federal funding devoted to higher education and university research is significant.

The breadth of university issues addressed in the budget is considerable but not complete. However, AUC has consistently taken a longer term approach to some of these concerns, such as teaching capacity to meet increased enrolment pressures, reimbursement of the indirect costs of research at a higher, more realistic level; and the provision of greater opportunities for realizing the international dimensions of the university's mission. To some extent there are markers in the budget for future government initiatives, but AUC will continue to press for measures omitted in the current budget.

### Fiscal outlook

The budget notes a more challenging economic environment for Canada, with real GDP growth for 2003 of only 1.7 percent, down from last year's forecast of 3.2 percent; growth in 2004 of 2.7 percent; and growth of 3.3 percent in 2005. The main economic risks faced by Canada are uncertainty related to the rapid rise in value of the Canadian dollar and the sustainability of the U.S. economic recovery.

It is in this context that the government presents its seventh consecutive balanced budget, which makes Canada unique among its G-7 nation peers. The government reports a notional "status quo" budgetary surplus of \$5.5 billion for 2003-04; \$4.2 billion for 2004-05; and \$6.6 billion for 2005-06. A significant portion of these surpluses will be devoted to the contingency reserve and the economic prudence reserve. For 2004-05, only \$200 million remains after these allowances, and it is the one-off sale of the federal government's remaining share of Petro-Canada that makes possible new spending initiatives, including those affecting university education and research, without going into deficit. While there is slightly more fiscal room the following year, the government is clearly signaling that additional major initiatives are not on the agenda in the near term.

<i>\$ Billion</i>	2003-04	2004-05	2005-06
“Status quo” surplus	5.5	4.2	6.6
Budget 2004 measures	(3.6)	(2.2)	(2.5)
Petro-Canada sale		2.0	
Contingency reserve	(1.9)	(3.0)	(3.0)
Economic Prudence		(1.0)	(1.0)
Balance	0.0	0.0	0.0

The government has organized its new spending initiatives into a number of themes: agricultural assistance; health; learning; communities; knowledge and commercialization; Canada’s relationship to the world; and equalization. Measures affecting universities fall chiefly under the themes of learning, knowledge and commercialization, and Canada’s relationship to the world.

With respect to knowledge and commercialization in particular, it is worth noting that the Finance Minister chose to highlight a quote from Peter MacKinnon in his capacity as Chair of AUCC, who said that the federal focus on knowledge and innovation can “be in the 21<sup>st</sup> century what the construction of the transcontinental railway was in the 19<sup>th</sup> century. It can be a new National Dream.”

### **Granting councils**

The budget provides an increase of \$90 million in the base budgets of the three research granting councils, with both NSERC and CIHR being increased by \$39 million each, while SSHRC receives a \$12 million increase. On a total base budget of \$1.41 billion, this amounts to an average increase of about 6.4 percent over 2003-04.

The councils are expected to use a portion of their increase for commercialization of university research. (Please see item on commercialization for more details.) In line with the budget’s emphasis on enhancing accountability, the councils are also expected to “develop a more comprehensive system to track, evaluate and report on the outputs of the research they fund”. AUCC will want to work closely with the councils to ensure that their work in this area complements AUCC’s periodic public report, which will be demonstrating the ways in which the Canadian public is benefiting from the federal government’s investments in university research and innovation.

Under the federal government’s commitments to support the social economy, SSHRC will receive a further \$3 million annually over five years for its Community-University Research Alliances (CURA)

program which links researchers with communities and not-for-profit organizations to work on social and community economic development issues.

### **Indirect costs**

The budget provides an additional \$20 million for the indirect costs program -- an increase of nine percent on the existing base of \$225 million. (In last year's budget, the permanent indirect costs program was established at a level of \$225 million, straightlined across the following three years.) This year's increase will have the effect of maintaining the reimbursement rate at close to 27 percent, as the direct cost base will continue to rise with the increases to the granting council budgets also announced today. (The direct cost base is calculated as a rolling three-year average, lagged by one year.)

The budget notes that "it is also expected that institutions will use the additional funding to enhance the commercialization of research discoveries". This is consistent with the general emphasis on commercialization as a key theme in the budget. It should be noted that intellectual property management is already one of the five categories of eligible expenditures under the indirect costs program.

The indirect costs program is scheduled to be reviewed in its third year (by October 2005), with the results of the review to be fed into the decision-making process for the 2006 federal budget. The fact that the program has been increased at this early date sends an important signal at a time when the government is embarking on an expenditure review process with the goal of realizing \$3 billion in annual cost savings within four years.

AUCC has called upon the government to increase the indirect costs program on an annual basis, and thereby to keep up the momentum in enhancing the effectiveness of university research in the face of international competition. The language used in the budget is consistent with this approach, mentioning that "the rise in direct federal support for research has led to an increase in the indirect costs associated with world-class research facilities", and noting that the 2003 budget established a permanent program "to enable institutions to address these pressures on a stable and predictable basis".

### **Commercialization**

AUCC's January 2004 commercialization proposal argued that any new federal initiatives to enhance commercialization of university research should build upon current federal granting council programs supporting commercialization and also build commercialization capacity in university technology transfer offices. It would appear that the government has heeded this advice.

The budget provides universities with further funding to develop commercialization capacity through the establishment of a \$50 million pilot competitive fund to be managed by Industry Canada. Designed to improve the capacity for commercialization in Canada's higher education sector, this fund will accept competitive proposals from the granting councils and from consortia of universities and research hospitals. Given the government's concern that the "success of these

initiatives will depend on their responsiveness to the needs of the private sector”, an advisory committee will be established by Industry Canada to provide guidance in designing and implementing the competitive process, including setting objectives and criteria for evaluating proposals.

The budget outlines an imperative that, “to help accelerate the commercialization of university-based research”, the granting councils are expected to triple their annual investments in programs directly supporting commercialization over the next three years. The programs referenced are the tri-council *Intellectual Property Management* program, NSERC’s *Idea to Innovation* program, and CIHR’s *Proof of Principle* and *Proof of Principle Partnered* programs. AUCC understands that the granting councils are expected to finance this collective \$30 million target from their current “A base” budgets, and to triple their budgets for these programs from current levels of \$10 million collectively to \$30 million by end of fiscal 2006-07.

While the budget allocates \$250 million to the Business Development Bank for investment in Venture Capital (see separate item), it would also appear that the government has listened to our warning not to establish a central office for commercialization or technology transfer or to make massive investments in commercialization without fully assessing the current environment. “The Prime Minister has tasked the Minister of Industry and the Minister responsible for the Economic Development Agency of Canada for the Region of Quebec, the Parliamentary Secretary to the Prime Minister with special emphasis on Science and Small Business and the new National Science Advisor with studying how the commercialization environment could be improved, and how in the long term Canada can be at the leading edge of commercializing its intellectual property assets”, the budget notes.

### **Student assistance**

The Minister of Finance announced many of the items that we had expected in the area of student assistance, with the exception of enhancements to part-time student loans. However, existing measures in support of part-time students under the Canada Student Loans Program will be reviewed over the coming year with an aim to increasing the number of students with low incomes who take advantage of opportunities for part-time studies. Budget 2004 includes a variety of measures effective in 2004-05 and others that are planned for 2005-06. The costs quoted in the first five measures outlined below are the costs to the federal government, including an estimate of providing Quebec and the territories with compensation under their alternative arrangements for opting out of the CSLP.

#### Increases in student loan limits

The weekly loan ceiling for the CSLP will be increased from \$165 to \$210 starting in 2005-06 to take into account increasing costs and the growing need for study tools, such as computers. It is estimated that this measure will result in a \$74 million increase in student loan costs for the government in the first year, rising thereafter. This measure will provide 185,000 students with more support.

The ceiling will be reviewed periodically in light of the rising cost of education to ensure that postsecondary students in financial need continue to have the financial support required to pursue their studies. However, federal officials confirm that there are no plans to have regular annual reviews or any type of cost adjustment index.

#### Reductions in parental contributions from moderate to middle-income families

This measure will provide more access to student loans for an estimated 40,000 students from families with incomes in the \$60,000 to \$100,000 range, half of which were not able to access student loans prior to this change. The changes will increase the loan limits by a maximum of \$2,550 per eligible student. It is estimated that this will increase the government's costs by \$10 million in 2005-06, with further increases in following years.

#### Interest relief and debt reduction

The budget increases each of the income thresholds used for determining eligibility for interest relief by five percent, which in many cases creates a much more significant reduction in monthly loan payments for eligible students. A second part of the program change is being introduced for borrowers who remain in financial difficulty after exhausting interest relief. For these students, the maximum amount of debt reduction will also be increased to \$26,000 from the current maximum of \$20,000 to ensure that the increase in the weekly loan ceiling does not result in greater financial hardship for borrowers experiencing long-term difficulty in repaying their loans.

The cost to the federal government of these two measures is estimated to be \$8 million in 2005-06. Current debt management measures will be reviewed in consultation with the participating provinces and territories, with the aim of simplifying and improving them to ensure that they accurately reflect the capacity of borrowers to repay their student debt.

#### First-year up-front grants for students from low income families

To encourage entry into postsecondary studies, the government will provide first-year postsecondary students from low-income families with a new up-front grant. The grant will be computed as the *lesser* of one-half of the cost of tuition, up to a maximum of \$3,000 *or* the student's assessed federal need.

It is estimated that 20,000 dependent students will receive the new grant each year, at a cost of \$30 million starting in 2005-06. For students in subsequent years of study, bursaries will continue to be available to some of these same students from the Canada Millennium Scholarship Foundation.

#### Upfront grants for students with disabilities

A new up-front grant of up to \$2,000 a year will be introduced for students with disabilities. The grant will cover the *lesser* of \$2,000 *or* the student's assessed federal need, thereby reducing barriers to access associated with the high costs faced by students with disabilities. The new grant will replace the existing grant for students with disabilities which is paid only to those who have financial needs in excess of the weekly loan ceiling. The Canada Study Grants for students with

disabilities, which covers the cost of education-related services and equipment (up to \$8,000 a year) will still be available.

More than 6,000 students are expected to receive the new grant each year – a significant number of whom would not have qualified for the previous grant for students with disabilities – at a cost of \$15 million starting in 2005-06.

#### Education tax credit

In order to help more students undertake lifelong learning connected to their current employment, the government will allow students to claim the education tax credit for education related to current employment, when the costs are not reimbursed by employers, beginning January 1, 2004. For example, an employed accountant currently taking a university accounting course to upgrade his or her skills would not be eligible for the credit while the same accountant taking a course in an unrelated discipline would be eligible. The change announced in the budget will give Canadians who are upgrading their skills in their field of work access to the same tax benefit that is available to other postsecondary students, at a cost of \$5 million in 2004-05 and about \$10 million per year thereafter.

#### Canada Learning Bond

Starting in calendar 2004, a \$500 Canada Learning Bond will be provided at birth for children in families that are entitled to the National Child Benefit supplement — generally families with incomes under \$35,000.

These children will also qualify for \$100 instalments in each year to age 15 that their family is entitled to the National Child Benefit supplement.

Children born after 2003 who are not eligible for the learning bond at birth but become entitled to the National Child Benefit supplement in a subsequent year will qualify at that time for a \$500 bond. Thereafter, they will qualify for annual \$100 instalments, in each year in which their family is entitled to the child benefit supplement.

The learning bond will be paid into a registered education savings plan established by the family for the child's postsecondary education. An additional \$25 will be paid in conjunction with the initial \$500 bond in recognition of the cost of establishing an RESP.

A child in a low-income family could receive CLB payments totalling up to \$2,000, which — with a 3.5 per cent real rate of return — could be worth up to \$3,000 by age 18. This is effectively an up-front grant for students from low income families.

It is estimated that in 2004 the learning bond will benefit more than 120,000 newborns, at a cost of \$85 million.

### Canada Education Savings Grant

Currently, for every \$100 contributed to an RESP, the government provides a \$20 grant called the Canada Education Savings Grant. The maximum annual federal CESG is \$400 a year for each child with an RESP.

Beginning in 2005, this 20 percent matching rate will be doubled to 40 percent for families with incomes up to \$35,000. The budget also increases the rate to 30 percent for families with incomes between \$35,000 and \$70,000. These enhanced CESG rates will apply to the first \$500 contributed in a year to a child's RESP.

The enhanced CESG will be available to the families of more than 4.5 million children. It is expected to cost \$80 million annually.

### **Teaching capacity and transfers to the provinces**

As expected, there is no direct reference in the budget to increased federal transfers to support capacity enhancement under the Canada Social Transfer, nor are there any signals indicating a longer term federal commitment to work with the provinces on an increased transfer to target capacity issues. Similarly, there is no mention of the "teaching chairs" that were rumoured to be under consideration to provide a federal focus on the importance of teaching to higher education. However, the budget speech does highlight the priority that the government accords to learning by stating that, with regard to the expenditure review process, "within a period of four years, we expect to identify at least \$3 billion for new investments in the ever-evolving priorities of Canadians – in health care, learning and innovation, communities, Aboriginals, people with disabilities."

### **Aboriginal education**

This budget renews the Aboriginal Human Resources Development Strategy, introduced as a five-year \$1.6 billion strategy in 1999 to help Aboriginal people develop their skills and find jobs. The budget commits \$25 million a year to the strategy for another five years. Similarly, the Urban Aboriginal Strategy, which provides funds for projects addressing a variety of challenges that Aboriginal peoples face in urban settings, has been renewed to 2006-07. While no new initiatives were funded specifically for Aboriginal education, the federal government reiterated its commitment to work with First Nations and Inuit people to better understand their educational needs and aspirations, to reduce drop-out rates and to improve access to postsecondary education for Aboriginal Canadians. In particular, the government will undertake to make a special effort to inform Aboriginal students of the various access programs that are available to eligible individuals from low-income families.

### **GST Rebate**

In the Speech from the Throne, the government committed to raising the GST rebate for municipalities from 57.14 percent to 100 percent. The budget confirms this commitment. Effective February 1, 2004, municipalities will receive a full 100 percent rebate which will provide them with

an estimated \$7 billion in additional revenue over the next 10 years. After the Speech from the Throne, AUCC urged the Finance Minister to extend this measure to the postsecondary sector as a “downpayment” on a future federal initiative on teaching capacity and as a complement to the announcement regarding the municipal rebate. The budget gives no indication of any possible future steps to broaden the measure to PSE institutions, school boards or hospitals.

### **Canada Corps**

As anticipated, the budget announced new money to support the Canada Corps initiative, with \$5 million in 2004-05 and \$10 million in 2005-06. The goal of this new program is to provide enhanced opportunities for students and recent graduates to participate in governance initiatives in developing countries undertaken by a variety of governmental, non-governmental and private sector organizations across Canada, so that young Canadians can learn about the world as they contribute to it.

In discussions with officials, AUCC learned that CIDA will lead an interdepartmental process aimed at developing an approach to implementing the program by the fall. It is expected that there will be a broader consultation with non-government groups in which AUCC will be involved. It is not clear at this time whether Canada Corps will ultimately reside within one department or be a virtual network bringing together the range of government and non-government players in the governance field as a focal point for engaging youth.

### **Genome Canada**

To date, the federal government has invested \$375 million in Genome Canada “to strengthen genomic research in Canada and position Canadian researchers for global leadership”. Budget 2004 builds on these efforts by providing Genome Canada with additional funding of \$60 million in 2004-05. The budget plan also states that, given the conclusion of Genome Canada’s five-year mandate in 2005, “over the next year the Government will review the foundations for world-leading genomics research enabled by Genome Canada’s investments, and develop a long-term strategy for excellence in this important field.”

### **Networks of Centres of Excellence**

In 2003, the Canadian cattle industry faced unprecedented challenges with the discovery of a case of bovine spongiform encephalopathy (BSE). This resulted in a number of research projects on BSE and other transmissible spongiform encephalopathies (TSEs) at universities and health facilities across Canada. In this budget, the government has announced that “an additional \$5 million a year will be provided to support the creation of a new NCE network for research on BSE and other TSEs, to further support Canadians in their research leadership roles and position Canada as a world leader in TSE/BSE science”.

### **National Research Council of Canada**

NRC, a significant funder and performer of research across Canada, received two injections of funding in this budget. First, the council's Industrial Research Assistance Program (IRAP) program, from which some university technology transfer offices have benefited, receives "an additional \$5 million per year ...to strengthen its support for the regional innovation and commercialization strategies". Second, NRC will be involved in a "pilot program to encourage the commercialization of research conducted in non-regulatory federal laboratories, similar to the approach being taken for university-based research. Through this initiative, \$25 million will be made available over the next five years, on a competitive basis, to support proposals by federal science-based departments and agencies aimed at improving their research commercialization activities", the budget notes. It adds that "an advisory committee will be established by Industry Canada, in coordination with science-based departments and agencies, to provide guidance in designing and implementing this competitive process, including setting objectives and the criteria for evaluating proposals".

### **Venture capital fund**

Canadian universities may find assistance for start-up ventures or other commercialization initiatives through \$250 million set aside in the budget for investment in venture capital by the Business Development Bank of Canada. The BDC has been asked to submit a "detailed plan for the implementation of specific seed-stage and venture capital initiatives", with funding to be provided upon approval of the plan by the government. AUCC will argue that concerned stakeholders, including universities, should be consulted as this plan is developed. The \$250 million dollar fund will be broken down into \$100 million for pre-seed and seed investment to nurture the development of embryonic technologies; \$100 million to support the creation of specialized venture capital funds that will lever additional private equity investment in leading-edge technologies; and \$50 million to invest directly in innovative start-up and early-stage companies.

### **Environmental technology**

The budget confirms that the federal government intends to sell its Petro-Canada shares and use the proceeds to increase its investments in support of new environmental technologies by \$1 billion. These investments include a further \$200 million to Sustainable Development Technology Canada, an arm's-length foundation that supports the development and commercialization of new technologies that address climate change and air quality issues. This amount is in addition to the initial funding of \$100 million provided to SDTC in the 2000-01 budget and the \$250 million provided in the 2003-04 budget. The mandate of the SDTC will also be broadened to include support for clean water and soil technologies. Universities and their affiliated institutions have participated in consortia that have received SDTC funding. The federal government has also earmarked an additional \$800 million over five years in support of environmental technologies, as new opportunities emerge and priorities are identified.

## **International development**

The budget announced an increase to Canada's International Assistance Envelope (which includes CIDA, IDRC and Canada's contribution to the multilateral development banks) of \$248 million, or an eight percent increase, for 2005-06. This builds upon the 8 percent increase already provided for 2004-05 in last year's budget. Half of these new resources will continue to be directed to support Africa's development.

The budget also indicates that much of the remaining increase to the International Assistance Envelope will go to the following areas:

- Expanded reconstruction and humanitarian assistance to Afghanistan of \$250 million over five years beginning in 2004-05.
- Building on debt relief provided by the Heavily Indebted Poor Countries Initiative in 2004, Canada will add Rwanda and the Democratic Republic of Congo to the list of countries benefiting from Canadian debt forgiveness, with an immediate moratorium on debt owed by these countries, for a total of \$48.8 million. Canada will also cancel Guyana's \$1.8 million debt, along with other debts owed by eligible HIPC countries.
- In addition to the existing contribution of up to \$300 million in aid to Iraq, Canada will provide debt relief on the vast majority of Iraq's debt to Canada which stands at approximately \$750 million.

Given these targeted initiatives, we cannot say definitively to what extent these new funds will mean an overall increase in CIDA's base budget of the type that could have a positive impact on funding available for projects involving Canadian universities such as the University Partnerships in Cooperation and Development Program.

## **Other international issues**

There were no specific announcements related to international students and immigration issues. However, the budget did announce specific measures related to the government's goal of better integrating new immigrants into the Canadian economy. There will be an additional investment of \$15 million a year, for a total of \$20 million in annual investment, to expand pilot projects with provinces and employers to deliver advanced labour market language training for new immigrants, labour market orientation, and assistance in finding employment. In addition, the government announced an additional \$5 million a year beginning in 2005-06 to further enhance the work of sector councils in the assessment and recognition of the credentials for internationally trained workers.

We are continuing to monitor the international research collaboration file, but there were no announcements related to enhancing Canada's international engagement in this area.

### **Changes to disbursement quotas for charities - endowments**

The budget includes several measures to improve the regulatory framework for registered charities, including a number of changes to disbursement quota rules for charities. One such change relates to the realization of capital gains from endowments. The effect of the current rules is to discourage registered charities from realizing capital gains in order to meet disbursement obligations to fund charitable programs and services. The budget proposes technical changes to the rules to resolve this issue, which will apply to taxation years that begin after March 22, 2004.

### **Tax treatment of charitable donations**

In 1997, the government established a regime of preferential treatment for donations of listed securities by providing that the capital gains inclusion rate for such donations would be half of the general capital gains rate. In subsequent budgets, both rates have been reduced so that the capital gains rate for donations of listed securities now stands at 25 percent in comparison with the general rate of 50 percent. These measures have achieved their goal of significantly increasing donations to charities, including universities.

Despite recommendations by the House of Commons Standing Committee on Finance in 2001 and 2002 that this measure be broadened in a number of ways, the budget is silent again on this matter.

### **New workplace skills strategy**

The government is developing a workplace skills strategy in cooperation with its partners among the provinces, labour unions, employers and sector councils. As a first step, the Minister of Human Resources and Skills Development will be seeking the advice of representatives of employers and workers, industry associations, skills providers, provinces and communities with a view to developing a strategic plan for workplace skills of the future and to identify practical options and priorities for action. Key issues to be considered would include literacy training and essential skills upgrading for workers; measures to encourage apprenticeships in skilled trades; and employer-based training. Some universities, such as those providing continuing education programs, may have a role to play in this context.

As an immediate measure the budget proposes to put in place a three-year Training Centre Infrastructure Fund pilot project with funding of \$15 million over the first two years. This measure will address a growing need for union training centres to replace aging equipment and simulators not up to current industry standards as well as to match employer and union investments in new machinery and equipment for selected training centres, with a particular focus on trades that have undergone significant technological change or whose scope has broadened or have new curricula.

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