

Budget ideas for a better Canada

THE BUDGET CONTEXT

In 2009, the US economy is facing its challenges with a new president. Hope is high. The major countries around the world (G20) have agreed to stimulate their economies by at least 2 percent of GDP. They have also indicated that protectionist policies will not be pursued at this time. This approach ensures that leakages from one member of the G20 to others will help all of the G20. It also means that there is every reason to not play protectionist games as stimulus is rolled out.

What did Canada do in its federal budget of January 27? It promised to deliver fiscal stimulus amounting to almost 2 percent in 2009 and somewhat less (1.4 percent) in 2010. This includes assumed provincial and municipal spending on infrastructure and additional spending by groups receiving focused lending (for example, the auto sector and some cities). If it emerges that not enough has been done, then the next budget or economic statement can add further stimulus. It will be important to watch the delivery to ensure that the actions are also completed.

There is general agreement that the United States went into recession in the latter part of 2007, Europe and Japan followed, and Asia has recently joined the recession fray. Canada entered the recession starting in the latter part of 2008. The lag in Canada should have provided the opportunity to rebuild the automatic stabilizers after tearing them down from the early 1990s on. We did not.

Provincial governments now face the full brunt of welfare load increases without federal participation. Increases on equalization have recently been limited. The temptation for the provinces will be to move toward restraint as the federal government stimulates, offsetting many of the positive impacts. This would be unfortunate, but not unexpected. The lack of trust between governments in Canada is leading to a dysfunctional system.

BY MIKE McCracken

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THE STARTING POINT

Starting in 2007, subprime mortgages became a problem for some financial institutions in the United States, with people walking away from their mortgages or banks foreclosing on mortgages for properties in arrears. After several years of a housing bubble, it burst with a sharp drop in new housing starts and growing concerns about the industry. It became apparent that many of these “toxic” mortgages were packaged and securitized around the world.

Subprime mortgages were not the only problem in the United States. Higher oil prices eroded consumer income as effectively as a major tax increase. The only difference was that the proceeds went mainly abroad—to OPEC, Mexico, and Canada. Other high commodity prices also hit consumers and some businesses, although others prospered. A depreciating US dollar increased US consumer prices, while helping some exporters and import-competing industries.

In the latter part of 2008, some of these adverse forces reversed. Oil prices declined, the US dollar appreciated against some currencies (for example, the Canadian dollar and the euro), and

many commodity prices fell. Consumer Price Index (CPI) measures dropped significantly in December 2008, leaving little inflation over the last year.

Restoration of liquidity to financial markets with some restoration of trust among the participants must be the goal—progress is slow, with new revelations of fraud adding additional difficulties. Measuring the impact of economic stimulus on the level of trust seems beyond our current capacities. Ominous signs of new problems with consumer credit and corporate debt are appearing as well.

The US economy is still moving into a deep recession. Unemployment has exceeded 7 percent on its way to 8 percent or more. Declining output is expected for 2009 (–1.8 percent on an annual basis with the stimulus package) and a modest recovery in 2010. The new administration is expected to move vigorously, with stimulus of about 2 percent of GDP each year, or about \$400 billion per year for at least two years. Additional stimulus may be needed beyond 2010, particularly if the financial system continues with its problems. Their economic objectives will include: a reduction in the unemployment rate to below 6 percent as soon as possible, through job creation (about four million jobs by the end of 2010); improvements in real incomes of Americans; enhanced infrastructure; and progress on developing a “green” industry.

CANADA'S ECONOMY

Some institutions in Canada held subprime mortgage investments in US securitizations. More recently, we have found out that some of the same companies were invited into Canada in 2006 to sell their products here. According to the *Globe and Mail* (December 13, 2008), associated losses have not been identified so far.

In Canada, asset-backed commercial paper fell into disrepute in 2007, with

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people who thought they had a very secure asset for holding short-term funds discovering that these “bank-backed” instruments were not liquid and not backed. This market remains illiquid, with some resolution tantalizingly close in January 2009. Similar difficulties plague other financial instruments that had evolved over the past few years in many countries.

Canada’s economy is slowing down, with rising unemployment evident in November and December 2008 (70,000) and with an employment decline of 105,000 (seasonally adjusted), with 64,000 in Ontario. Further weakness is expected into 2009. Announcements of cutbacks pepper the media, while public officials add further words of caution.

Strong fiscal action in the form of a discretionary increase in the budget deficit is required. A discretionary stimulus in the form of lower taxes (higher transfers) and higher expenditures on goods and services by governments in the amount of about \$33 billion for 2009

and 2010 was delivered in the January 2009 budget. (This level meets the international commitments if it is interpreted as 2 percent over two years.) Additional stimulus is possible; however, some of the tools are in provincial and municipal hands or the private sector. Much of the infrastructure is to be put in place at provincial and local levels. Sharing mechanisms are in place and project lists are ready to go, although now the other levels of government are claiming to have no money. If more is needed, then there should be ideas for further stimulus worked out; if less is needed, then some actions can be terminated or phased out.

OBJECTIVES OF THE CANADIAN FEDERAL BUDGET

The Conservative federal budget has been accepted by the Liberals, at least for the time being. In any case, some forward thinking about another budget may be useful. The economic objectives should include: job creation sufficient to

reduce the unemployment rate below 6 percent as soon as possible; improvements in real incomes of Canadians; enhanced infrastructure; reduction in regional disparities; reduction in poverty; and improvements in retirement security.

SPECIFIC FEDERAL MEASURES

There are many possible actions that the government can pursue. Some are quicker acting; others have additional virtues (for example, infrastructure, green projects). Some tools can be easily reversed if conditions warrant, while others are likely to become permanent fixtures that will require new funding sources.

Targeted tax and transfer changes

Increasing disposable income for people with low and middle incomes would increase consumer expenditure and help residential construction, including repairs. Some measures that would serve that purpose include: old age security

TABLE 1 Actions in Other Countries: Fiscal Plans of G20

| Country | Per year | % of GDP | Start | End | Features |
|--------------------------|--|-----------------------------|-------|------|---|
| <i>US</i> | \$400 billion | More than 5% over two years | 2009 | 2010 | Broad tax cuts; infrastructure |
| <i>EU</i> | €200 billion | 1.5% | 2009 | 2010 | |
| <i>UK</i> | €23 billion | | 2009 | 2010 | VAT cut; low wage tax cuts; infrastructure |
| <i>Spain</i> | €38 billion | | 2009 | 2010 | Tax cuts and public works |
| <i>France</i> | €26 billion | | 2009 | 2010 | Infrastructure speedup |
| <i>Italy</i> | €5 billion | | 2009 | 2010 | Tax breaks for poorer households; delay tax payments for firms |
| <i>Germany</i> | €62 billion | 1.3% per year | 2009 | 2010 | Tax and social levies cuts; additional spending on infrastructure |
| <i>Japan</i> | \$300 billion in 2008; \$111 billion in 2009 | 8% | 2008 | 2009 | Tax cuts; small business credits, cash to households; another \$144 billion for financial markets |
| <i>China</i> | 2.6 trillion yuan | 9% over two years | 2009 | 2010 | Infrastructure, health, and education |
| <i>Canada: Option I</i> | Restraint of \$5 billion | small | 2008 | 2009 | Reduced government expenditure; cut for political parties funding |
| <i>Canada: Option II</i> | Stimulus of \$50 billion | 3.3% of GDP over two years | 2009 | 2010 | Tax cuts; expenditure increases |

(OAS)—monthly payment for seniors of about \$6,000 per year, clawed back over a range of \$64,000 to \$104,000 (increase OAS by \$50 per month); GIS (Guaranteed Income Supplement)—seniors, income-tested monthly payment of about \$7,600 per year, with clawback at 50 percent of other income, excluding OAS (increase GIS by \$50 per month); and refundable sales tax credit—income-tested, with annual value of \$362 and clawed back at 5 percent, starting at about \$31,000.

The only specific measures in the January 2009 budget were: an increase in the National Child Benefit Supplement and Canada Child Tax Benefit to align the schedules for people with an income of \$25,000 to \$50,000; an increase in the Working Income Tax Benefit (WITB) from \$522 to \$925 for singles and from \$1,044 to \$1,680 for single parents and couples; and an increase in the Age Credit by \$1,000.

GST reduction by 2 percentage points

This could be implemented as a temporary measure for the period from the budget date to some time in the future. A review could determine whether an extension is needed. Otherwise it would be returned to at least 5 percent as of January 1, 2010. The direct fiscal cost of this measure is expected to be about \$10 billion per year. The GST sales tax credit will not be adjusted downward for this change, nor will it be adjusted upward when the rate is returned to its previous level.

Why this measure? It can be implemented quickly and immediately begins providing a benefit to everyone buying taxable goods and services. It will lower the CPI temporarily, easing the concerns of those worrying about inflation. The target is consumption and residential investment. It is universal, affecting everyone who spends on taxable goods. This is a plus factor for coverage and political support. However, it means the leakage into saving may be higher than some programs targeted on low-income families.

Delivery of any measure has administrative costs. Businesses will need to alter their computer programs and cash registers to accommodate the change, although they have had two recent requirements to lower the GST by 1 percentage point. Concerns are that people are not spending and this will help little. However, it is subsidizing spending, not saving. Others are concerned it will not be reversed, although it is an easy parameter in the tax system to change. (Recall that the rate was reduced from 7 percent to 6 percent and then to 5 percent.) In some parts of Atlantic Canada, the GST rate was increased to 13 percent for the harmonized sales tax (HST). Another wrinkle in implementation is to announce that the rate would be lowered and then increased back to a higher level, say, 7 percent, at a certain date, further encouraging people to speed up their spending now.

Personal income tax changes

The fundamental issue is the degree to which the changes should focus on the income distribution or on the total of disposable income of all Canadians. Potential items for discussion include: the definition of income—should capital gains receive special treatment, how should housing gains be treated, and what are the individual versus family concepts?—and donations to charities—should they be eliminated or increased?

For this budget, it is probably important to have a consistent message—namely, the desire to stimulate the economy through increased spending by Canadians. Note that in the United States, the closing of estate tax loopholes and other high-income improvements under Bush are going to be allowed to “run out” rather than closed up a year earlier. Aggressive moves to tighten the tax system will be in conflict with the stimulus message. The chosen change was an increase in the minimum income to pay tax and a widening of the brackets for the first two income classes. This provides a tax cut for everyone with income over \$10,000 with the maximum

absolute amount for those above about \$80,000.

Most budget measures were one time or limited to two years. This personal income tax change is described as “permanent” and defined for five years. This is consistent with the Conservative ideology of seeking permanent tax cuts whenever possible.

Improve the employment insurance program

Freezing contribution rates at current levels for the next two years—this will avoid the problem of increasing taxes at the time of a recession, and raising the price of hiring labour when the objective is to increase labour hiring. After the recession is over, there should be a review of the financing of the EI system as well as the benefits side. The budget froze the contribution rate at \$1.73 per \$100 for 2010, continuing the rate from 2009. From 2011, a new rate-setting mechanism is to be put in place.

Lengthening the benefit period—currently, the benefit period is a maximum of 45 weeks and is dependent on the unemployment rate of one’s location at the time of application for benefits. There is a matrix, as detailed in Schedule I of the *Employment Insurance Act*, that shows the maximum benefit period, by hours worked in the qualifying period and the unemployment rate of the claimant’s region. The budget took the modest step of raising the benefit period by five weeks.

Increasing coverage by reducing the number of hours to qualify—the EI “reforms” moved from the number of weeks worked to the number of hours. This decreased the number of eligible people, particularly those in the ranks of part time. Reducing the number of hours from 910 hours per year to 500 hours would remove some of the sting from the current program. No action was taken here in the 1989 budget.

Increasing coverage by including those who voluntarily quit a job—in the early 1990s, those who voluntarily quit employment were no longer able to

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access the EI program. This decision should be reversed, although some disincentive such as not receiving payment for the first four weeks of unemployment may be necessary for public acceptance. This measure is not about those who are actually unemployed by their actions alone. Rather, it also increases the power or choices available to someone working in an environment that is not a good workplace. No action was taken here in the 1989 budget.

Raising the benefit rate—raise the benefit rate to 70 percent of the median wage in the economy for those living in a family with children and 65 percent for everyone else. This income measure will be a positive stimulus to disposable income and should have a high marginal propensity to consume out of the incremental income. No action taken here in the 1989 Budget.

INCREASE INFRASTRUCTURE SPENDING

Projects here could include: joint ventures with provincial and municipal governments; undertakings by the federal government in its areas of responsibility (airports, ports, military facilities, buildings); and community-sponsored projects with objectives of improving the environment, livability, and job creation. This could be in the form of one-time grants of \$1 million per project, with regional boards approving the projects.

Recent problems with federal bridges in Ottawa and Montreal are obvious targets. Improvements to the Windsor-Detroit bridges are another potential federal project. New runways, enhanced port facilities, and improvements to the Trans-Canada Highway are obvious opportunities for stimulus by changing the time profile of work. This is a major area for federal actions, with about \$21 billion in activity in 2009 and 2010, including about \$9 billion by provinces and local governments. If other governments do not cooperate, then the federal share could be diverted to other activities.

INCREASE GOVERNMENT GOODS AND SERVICES

Major wish lists should be at hand in every department. Cultural undertakings, improvements in handling immigrant cases, clients of Indian and Northern Affairs, military needs, the Coast Guard, etc., should all be on the list. Provincial and municipal transfers are always welcomed, with promises to spend. In the federal budget there is an increase in spending on training, R & D, tax credits for home renovation, and some social housing spending.

PROVINCIAL BUDGET ELEMENTS


The provinces are of comparable economic size to the federal government. Provincial own-account revenue was \$263 billion in 2007; local government—\$65 billion; federal government—\$246 billion. Their debt ratios are better than that of the federal government. The provinces guard their areas of responsibility—highways, education, health care, and social assistance. These areas represent targets for stimulative fiscal action.

Provincial governments could lower

their sales taxes by 2 percentage points to stimulate consumer spending and business investment, in line with the federal government. (Efforts to harmonize the system afterward could be fruitful as well.) Increases in social assistance by 10 percent would partially offset past cuts and stimulate the incomes of a group of people with high propensities to spend.

COSTING THE PROGRAMS

Informetrica Limited has recently updated its multiplier studies, providing estimates of the additional GDP, employment, and impacts on the fiscal balances for numerous tax and expenditure actions. Similar tables of multipliers appear in the budget document (p. 240). A separate study of the economic impact of the budget is available on request from Informetrica Limited.

As a general rule, fiscal stimulus should lead to a “fiscal dividend” to governments, lessening the impact on their budgets—about 25 to 40 percent of a fiscal action return to various levels of governments. 

See more writing by Daniel Drache at www.yorku.ca/drache/wto.php



The screenshot shows a web browser window with the address bar displaying <http://www.yorku.ca/drache/wto.php>. The page title is "WTO Papers and Reports". On the left side, there is a "contents" menu with links to HOME, BIOGRAPHY, TEACHING, BOOKS WRITTEN/EDITED, WTO, N.A. INTEGRATION, ICONOGRAPHY OF DISSENT, T.O. PUBLIC CULTURE, CANADA WATCH, CONFERENCES, and CONTACT. The main content area lists several papers and reports:

- Deadlock in the Doha Round: The Long Slow Decline of Trade Multilateralism (338K)** by Daniel Drache and Marc D. Froese
- Trade, Development and the Doha Round: A Sure Bet or a Train Wreck?** by Daniel Drache
- The Global Cultural Commons after Cancun: Identity, Diversity and Citizenship (344K)** by Daniel Drache and Marc D. Froese
- Rethinking the Very Essence of Social Inclusion and Things Private (264K)** by Daniel Drache
- The Great Global Poverty Debate: Balancing Private Interests and the Public Good at the WTO (360K)** by Daniel Drache and Marc Froese
- The Imperative of the Social Bond After the Triumph of Markets (80K)** by Daniel Drache
- Poverty Eradication, Economic Integration and Citizenship: Modeling Social Inclusion After the Quebec Summit (384K)** by Daniel Drache
- The Short But Amazingly Significant Life of the ITO Free Trade and Full Employment: Friends or Foes Forever? (384K)** by Daniel Drache