



January 27, 2009 Federal Budget *Fiscal Stimulus and Then Some*

Introduction

In one of the most anticipated budgets in memory, the federal government unleashed a raft of new measures in an effort to help stimulate the economy, limit the impact of the recession, and speed recovery. Much of the contents of the budget document had been leaked and, therefore, there were few surprises. It featured something to appeal to almost everyone.

While there are elements that we would have designed differently, the government has consulted extensively, and has answered our request to show how it thinks we can get our economy moving again. It adopted many of the Canadian Chamber's proposals, including accelerating infrastructure spending; reducing the tax burden facing low- and modest-income Canadians; providing incentives for new business investment in machinery and equipment; continuing the previously-announced corporate tax reductions; and ensuring access to credit for Canadian businesses and consumers.

The fiscal stimulus package will result in deficits higher than otherwise. The government projects a deficit of \$1.1 billion in fiscal 2008-09, \$33.7 billion in fiscal 2009-10; \$29.8 billion in 2010-11, \$13 billion in 2011-12, and \$7.3 billion in 2012-13. The government is projecting a small surplus in 2013-14. Overall, the government projects a cumulative deficit of \$85 billion over five years.

Budget 2009 projects federal debt to reach \$542.4 billion in fiscal 2012-13 – \$90 billion higher than forecast in the November *Economic Update*.

Highlights of Key Measures Announced

Measures to improve access to financing

- Commits an additional \$50 billion in the first half of 2009-10 to the Insured Mortgage Purchase Program to provide lenders with additional flexibility and capacity to lend to consumers and businesses.
- Enhances the flexibility and capacities of financial Crown Corporations by increasing the authorized capital limits of EDC and BDC by \$1.5 billion each, and increasing their associated borrowing limits as necessary.
- Increases the maximum eligible loan amount a small business can access under the Canada Small Business Financing Program from \$250,000 to \$350,000 and to \$500,000.
- Allocates up to \$12 billion to a new Canadian Secured Credit Facility to purchase term asset-backed securities backed by loans and leases on vehicles and equipment. This new facility will help consumers and businesses access financing for these products.

- Establishes a new Canadian Life Insurers Assurance Facility to guarantee wholesale term borrowings for life insurers, modeled on the Canadian Lenders Assurance Facility.
- Provides the Canada Deposit Insurance Corporation (CDIC) with greater flexibility to enhance its ability to safeguard financial stability in Canada. It proposes to increase CDIC's borrowing limit from \$6 billion to \$15 billion.
- Commits to working with willing partners to establish a Canadian securities regulator.
- Will consult on the legislative and regulatory framework for federally regulated pension plans.

Provides for increased support for laid off workers, and workforce training

- Increases for two years all regular Employment Insurance (EI) benefit entitlements by five extra weeks and increases the maximum benefit duration to 50 weeks from 45 weeks.
- Provides \$500 million over two years to extend EI income benefits for Canadians participating in longer-term training.
- Extends work-sharing agreements by 14 weeks, to a maximum of 52 weeks, so more Canadians can continue working.
- Extends the Wage Earner Protection Program to cover severance and termination pay owed to eligible workers impacted by employers' bankruptcy.
- Will consult with Canadians to develop options to provide self-employed Canadians with access to EI maternity and parental benefits.
- Increases funding for training delivered through the EI program by \$1 billion over two years.
- Invests \$500 million over two years in a Strategic Training and Transition Fund to support the needs of individuals who do not qualify for EI.
- Freezes EI premium rates for both 2009 and 2010. The Canada Employment Insurance Financing Board will be mandated not to recover any EI deficits as a result of the two-year \$2.9 billion of enhanced EI benefits and training announced in Budget 2009.

Provides tax relief to stimulate spending

- Personal income tax measures include increasing in 2009 the basic personal amount to \$10,320 from \$9,600, and the top of the two lowest personal income tax brackets¹; increasing the level at which the National Child Benefit supplement for low-income families and the Canada Child Tax Benefit are phased out; doubling tax relief provided by the Working Income Tax Benefit; and increasing the Age Credit amount by \$1,000 to provide further tax relief to seniors. These are permanent measures.
- Corporate income tax measures include a temporary 100 percent capital cost allowance rate for computers acquired after January 27, 2009 and before February 1, 2011; extending the temporary 50 percent straight-line accelerated CCA rate to investment in manufacturing or processing machinery and equipment undertaken in 2010 and 2011; repealing the interest deductibility constraints in section 18.2 of the *Income Tax Act*; permanently eliminating tariffs on a range of machinery and equipment; and extending for one year the temporary 15 percent mineral exploration tax credit to help companies raise capital for mining exploration.

¹ The upper limit of the first personal income tax bracket (15 percent income tax rate) will increase to \$40,726 in 2009 from \$37,885 in 2008; and the upper limit of the second personal income tax bracket (22 percent income tax rate) will increase to \$81,452 in 2009 from \$75,769 in 2008.

- For Canada's small business sector, Budget 2009 increases the amount of small business income eligible for the reduced federal tax rate of 11 percent to \$500,000 from the current limit of \$400,000 as of January 1, 2009.

Takes action to stimulate housing construction

- Implements a temporary Home Renovation Tax Credit to provide an incentive for Canadians to undertake new renovation projects. The 15 percent tax credit will apply on the portion of eligible expenditures exceeding \$1,000, but not more than \$10,000.
- Provides additional funding over two years to the ecoEnergy Retrofit program. This program provides home and property owners with grants of up to \$5,000 to offset the costs of making energy-efficiency improvements.
- Allows individuals to withdraw up to \$25,000 (up from \$20,000 at present) from their RRSPs to purchase or build a home without having to pay tax on the withdrawal made after January 27, 2009.
- Provides first-time home buyers a \$5,000 non-refundable income tax credit on a qualifying home acquired after January 27, 2009. This will provide up to \$750 in tax relief.
- Invests in social housing by providing \$1 billion over two years for renovations and energy retrofits; and \$400 million over two years for the construction of social housing units for low-income seniors. Support is also provided for social housing in the North and on First Nations reserves.
- Makes available up to \$2 billion over two years in direct, low-cost loans to municipalities to finance improvements to housing-related infrastructure.

Accelerates and expands investment in infrastructure

- Provides, in total, almost \$12 billion in new infrastructure stimulus over two years.
- \$4 billion over two years to establish an Infrastructure Stimulus Fund that will provide funding to provincial, territorial and municipal infrastructure rehabilitation projects. The federal government will project plans, and will cover up to 50 per cent of eligible project costs.
- \$1 billion over five years for the Green Infrastructure Fund to support projects such as sustainable energy.
- \$1 billion over two years to expedite ready-to-go infrastructure projects.
- \$500 million over two years for infrastructure projects in small communities.
- \$2 billion to repair, retrofit and expand facilities at post-secondary institutions.
- \$750 million for infrastructure through the Canada Foundation for Innovation.
- \$225 million over three years to Industry Canada to develop and implement a strategy on extending broadband coverage to unserved communities.
- \$407 million for VIA Rail Canada.
- \$14.5 million for two bridges at two of the busiest U.S.–Canada border crossings: the Blue Water Bridge in Sarnia and the Peace Bridge in Fort Erie.

Provides support for sectors, regions and communities

- Including \$170 million over two years to Canada's forest sector; \$500 million to Canada's agriculture sector; and \$175 million for the procurement of 98 new Coast Guard vessels.

- Offers short-term repayable loans to the automotive sector, in collaboration with the Province of Ontario and the U.S. government.
- Establishes a new Clean Energy Fund that supports clean energy research development and demonstration projects, including carbon capture and storage.
- Support for regional developments includes more than \$1 billion over five years for a Southern Ontario development agency to help workers, communities and businesses in this region; and \$1 billion over two years for a Community Adjustment Fund that will help mitigate the short-term impacts of restructuring in communities. Regional support will be provided through regional development agencies, and the establishment a new regional economic development agency for the North.

Federal Budget Analysis

The government's Action Plan contained a myriad of measures. In the Canadian Chamber's view not all qualify as fiscal stimulus in the traditional sense.

The most successful stimulus measures are those that are timely in response, and well-targeted to the needs of the economy. Infrastructure spending fits the bill. It was a top priority in Budget 2009, and rightly so. Not only can it provide short-term stimulus but also tremendous long-term benefits. High quality infrastructure is critical in encouraging private sector investment, attracting foreign direct investment, and boosting international trade. It is crucial in strengthen our nation's competitiveness and productivity going forward.

Measures to reduce the tax burden on Canadians are also welcomed from a long-term competitiveness perspective. Raising the maximum Working Income Tax Benefit (WITB) will encourage more people to enter the labour force and current WITB recipients to extend hours of work. Increasing the basic personal amount and the top of the two lowest personal income tax brackets will enable Canadians to earn more income before paying federal income taxes, or before being subject to higher tax rates. While it does offer some potential to provide short-term stimulus across the board, it is lower-income individuals that are more likely to be credit constrained and more likely to be among those with the highest propensity to spend.

Incentives in Budget 2009 for new businesses investment – like the temporary accelerated CCA rate for investment in manufacturing or processing machinery and equipment, and the temporary 100 percent CCA rate for investment in computers – change the timing of when capital is acquired and, thus, can provide short-term stimulus. From a longer-term perspective, they contribute to boosting Canada's productivity through the faster adoption of newer technology and by encouraging the retooling needed by businesses. Whether Canadian businesses take advantage of these tax incentives at this time remains to be seen as many face slowing demand, deteriorating profit margins, and difficulty in obtaining corporate financing.

The Canadian Chamber is encouraged by the Government's continued efforts to provide additional support for Canadian credit markets by utilizing all tools at its disposal. It compliments the aggressive measures taken by the Bank of Canada to ensure liquidity and the affordability of credit for Canadian businesses and consumers.

The measures announced in Budget 2009 come with a high cost – large deficits for the foreseeable future. We need to be mindful that there is a price to be paid when a deficit

is incurred. Canadian will have to pay it back in the future - both principal and interest - making it harder to cover program costs, like health care and education, and meet the needs of an aging population. If deficits persist over a long period of time, Canadians and Canadian businesses will face a higher tax burden, and our competitiveness will be threatened.

The problem with running a deficit, even during recessionary periods, is that the government may lose its ability to bring spending into line when the economy recovers. The government said it will “continue to carefully manage spending” and “focus spending measures in two years”. This appears to be contingent on the government “taking action to ensure the Equalization program grows in line with the economy” and limiting growth in federal public sector compensation.

More work needs to be done on the government's plan to get us back to a surplus position. The government is hoping that budgetary revenues will rise fast enough – about 7 percent per year over the 2009-10 to 2013-14 period – to get us back into a surplus position. With nominal growth in the economy expected to average about 4-5 percent per annum, it may be difficult to accomplish.

The Canadian Chamber is disappointed the government did not state that it will adopt more prudent budgeting principles including allocating annual funds (i.e. setting aside a reserve) within the budget to cover the indebtedness when the budget returns to surplus. This approach would assure Canadians and international investors that the government is serious in getting Canada's books back in surplus position. The government plans to use budget surpluses first of all to repay the deficits expected in the upcoming four years.

Taken overall, however, the budget represents an important step forward.