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Fiscal Policy

Steering Through Turbulence

The Shadow Federal Budget for 2008

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with Robin Banerjee,
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The Backgrounder in Brief

Near-term turbulence should not distract Ottawa budget-makers from critical long-term tasks. This 2008 shadow federal budget will move Canada a key step forward by providing improved incentives and rewards for Canadians' work and saving, and a more congenial environment for investment and innovation.

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Federal fiscal policy in the past decade has replaced deficits with surpluses, and Ottawa has begun to reduce its claim on the national economy by reducing tax rates. These developments were badly needed: Canada's ability to generate high and rising living standards in a competitive world, and against the headwinds of demographic changes, cannot be taken for granted. Recent worries about weaker economic growth, particularly in the United States, demonstrate afresh the advantages of fiscal prudence and a vibrant private sector — key factors that should help Canada through near-term turbulence and prepare Canadians to face the long-term future with confidence.

The key challenge for 2008, therefore, is to ensure that transient economic concerns do not distract government from critical long-term tasks. The decades ahead will feature scarcer labour and potentially scarcer saving as well. The federal government's core economic policy goals must therefore be to encourage work, smart investment, and productivity growth to sustain public programs and living standards. The opportunity before us is to make Canada the world's preferred location for work, investment and innovation.

This 2008 shadow federal budget will move Canada a key step forward by carefully managing spending and offering tax relief to Canadians who work and invest. A reinvigorated personal and business tax relief program will improve incentives and rewards for Canadians' work and saving, and create a more congenial environment for investment, and for innovation.

Economic and Fiscal Outlook and Challenges

Economic Backdrop

Canada entered the second half of 2007 with considerable momentum. Over the past year, strong demand for natural resources and robust income growth supported growing production and employment. Agricultural and commodity prices showed large increases over the calendar year, driving expectations of tighter margins between international supply and demand for these products in years to come. The resource boom spurred growth in Canada's energy sector and beyond, and strengthened the Canadian dollar, which lowered the price of imports and boosted real incomes across the nation. The outlook for growth overseas, while less buoyant than a year ago, is still positive. And there are several additional reasons to be optimistic that Canada's economy will come through this uncertain period with continued growth, notwithstanding that since last summer, the repercussions of the sub-prime mortgage crisis in the United States have spread, both within the United States and abroad.

First, central banks — and the Bank of Canada in particular — can move quickly and powerfully to add liquidity to the financial system and ensure that problems in specific markets, such as that for asset-backed commercial paper, do not unjustifiably affect borrowing, spending and production elsewhere in the economy. Short-term interest rates are falling,[1] which — combined with a stable

1 In January 2008, the C.D. Howe Institute's Monetary Policy Council recommended further easing in the target overnight lending rate.

Table 1: *Key Economic Indicators*

	2006	2007	2008	2009	2010-12 (average)
			percent		
Real GDP Growth	2.7	2.6	1.9	2.6	2.7
GDP Inflation	2.2	2.7	1.8	1.9	1.9
Nominal GDP Growth	4.9	5.4	3.8	4.5	4.6
3-Month Treasury Bill Yield	4.1	4.1	3.9	4.0	4.0
Long Government Bond Yield	4.7	4.3	4.3	4.5	4.5

Sources: Statistics Canada, CANSIM; Canada (2007); authors' calculations.

outlook for longer-term interest rates — suggests lower borrowing costs for the private sector and for governments. Second, movements in commodity prices strongly affect the Canadian dollar (Banerjee 2007). Should a weakening world economy lower the price of key exports, a lower Canadian dollar would cushion the blow on the natural-resource sector, and speed the transition to faster growth in manufacturing and services. Third, balance sheets in Canada's public and private sectors are strong, which will increase the resilience of businesses and households in the face of temporary weakness and uncertainty.

In sum, despite near-term challenges, the outlook is for continued modest growth through 2008 and an acceleration in 2009 and beyond. Accordingly, this budget is framed around an outlook of continued real GDP growth and controlled inflation (Table 1).

Fiscal Prospects

The fiscal year that ends March 31, 2008, has been solid. A robust economy has supported federal revenues, helping the surplus reach $9.3 billion by mid-year, consistent with the current full-year estimate of $10.9 billion. Given the government's commitment to earmark the interest savings from debt paydown to reduce personal income taxes, this healthy bottom line will help finance further tax relief in the future. Interest savings in the last fiscal year were about $1.4 billion, and a further debt reduction of $10 billion in 2007/08 could bring the level of savings to around $2 billion for the next fiscal year, an approximate savings of $100 per tax filer.[2]

Discouraging results on the spending side, however, stand in the way of further debt paydown and tax relief. Expenditures now look likely to be at least $1.5 billion higher than forecast in the 2007 Budget. The baseline outlook for the federal government's fiscal situation is illustrated in Table 2.

2 The level of interest savings resulting from debt reduction is calculated as the annual reduction in federal debt multiplied by the average effective interest rate on the government's unmatured debt, currently 5.1 percent.

Table 2: *Summary Statement of Transactions: Outlook with Unchanged Policy*

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
				$ billions			
Taxes and Fees	230.7	233.9	235.4	244.6	253.3	264.0	274.7
Investment Income	9.2	9.4	9.6	9.8	10.0	10.2	10.4
Total Revenue	*240.0*	*243.3*	*245.0*	*254.4*	*263.3*	*274.2*	*285.1*
Program Spending	188.3	198.4	207.6	217.0	225.1	233.7	242.9
Gross Debt Charges	33.9	34.0	33.7	33.0	32.9	32.1	31.9
Total Expenditure	*222.2*	*232.4*	*241.3*	*250.0*	*258.0*	*265.8*	*274.8*
Primary Balance	42.4	35.5	27.8	27.6	28.2	30.3	31.8
Net Debt Charges	-24.7	-24.6	-24.1	-23.3	-22.9	-21.9	-21.6
Total Balance	*17.8*	*10.9*	*3.7*	*4.4*	*5.3*	*8.4*	*10.3*
Planned Debt Reduction		3.0	3.0	3.0	3.0	3.0	3.0
Total Balance After Planned Debt Reduction		*7.9*	*0.7*	*1.4*	*2.3*	*5.4*	*7.3*

Note: Calculation of gross debt charges assumes debt paydown equal to each year's planned debt reduction only.

Sources : Receiver General for Canada (2007); Canada (2007); authors' calculations.

Making Room for New Measures

Recent efforts at federal cost control have not been successful (see Table 3), with program spending growth running at about 6 percent annually over the past decade.

Robust growth, an unemployment rate lower than at any time since the 1970s, and recent upward pressure on interest rates and inflation highlight another problem of rapid spending growth: competition with the private sector for resources. Employment in Canada increased by about 2.2 percent in 2007, mainly due to a 6.5 percent increase in workers hired in the public sector, as opposed to a 0.4 percent increase in the private sector.[3] With the economy operating at — or close to — capacity, the hiring of one worker by Ottawa requires that other sectors let go of the resources simultaneously, resulting in a one-for-one tradeoff. And with total federal employment approaching the highs of the late 1980s and early 1990s, preventing further large increases in the government payroll will help control spending.

The federal government's fall economic statement projected expenditures to grow at 4.1 percent annually over the forecast period. The fiscal plan laid out in this budget will instead hold non-defence program spending to a growth rate that matches economy-wide inflation.

Further, the federal government will commit to ending large one-time, non-equalization transfers to the provinces, with the exception of provincial incentives for sales tax reform, discussed below. Ad hoc federal transfers to fund provincial responsibilities, such as regional infrastructure, health and education, have

3 See Statistics Canada Tables 282-0089, 282-0088.

Table 3: *Federal Spending by Major Category, 1998/99 to 2007/08*

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
					$ billions					
Major Transfers to Persons	39.9	40.2	41.9	45.8	48.0	50.0	51.3	52.6	55.6	58.4
Major Transfers to Other Governments	25.5	23.2	24.7	26.6	30.6	29.4	42.0	40.8	42.5	43.5
Other Transfer Payments	17.4	18.0	21.1	18.3	20.0	23.0	25.0	24.9	26.8	27.9
Crown Corporations	5.8	5.2	5.4	6.1	6.6	6.6	8.9	7.2	7.2	7.5
Defence	9.3	10.1	9.7	10.4	11.8	12.9	14.3	15.0	15.7	17.0
Non-Defence Operations	21.6	22.8	27.2	29.7	29.0	31.9	34.4	34.7	40.4	41.5
Total Program Spending	*119.5*	*119.5*	*130.1*	*137.0*	*146.0*	*153.7*	*175.9*	*175.2*	*188.3*	*198.4*

Sources: Receiver General of Canada, Public Accounts for Canada, various issues; authors' calculations.

resulted in a confusing assortment of third-party trust funds (e.g., Public Transit Capital Trust, Post-Secondary Education Infrastructure Trust), whose existence obscures public financial reporting and usurps Parliament's role in allocating spending. Such transfers amounted to $3.4 billion in 2007/08, and will not be repeated.

New Measures

Federal spending, properly directed, can increase the nation's productive capacity, by facilitating and rewarding investment by individuals and businesses and strengthening the economic union. A federal investment in provincial tax reform would offer an opportunity to do so, notably by improving the investment environment.

Investment in People

Human capital and its renewal is a central concern to any business or economy, and the education system is vital to the process of knowledge transmission and innovation. Canada lacks a national, endowed scholarship program aimed at attracting new talent from abroad, a failure this budget proposes to fix. An internationally competitive Canadian scholarship program, along similar lines to the US Fulbright Scholarship, would see 1,000 scholars annually — selected via an independently adjudicated process — brought to pursue advanced graduate and postgraduate research in Canada. The annual cost of the program will be $45 million. Complementary policies will see immigration policy tuned to

Table 4: *Impact of Spending Measures*

	2008/09	2009/10	2010/11	2011/12	2012/13
			$ billions		
Constrained non-defence operating spending					
Crown Corporations	-0.7	-1.0	-1.2	-1.4	-1.7
Other transfer payments	-2.6	-3.1	-3.6	-4.0	-4.4
Other program expenditures	-1.8	-3.1	-4.3	-5.5	-6.9
Changes in transfers to other levels of government					
CHST	-1.1	-2.2	-3.1	-4.2	-5.2
Fiscal arrangements	0.0	-0.2	-0.4	-0.7	-1.0
Transfers to RST-reform Provinces	0.4	0.2	0.1	0.0	0.0
International graduate scholarships	0.0	0.0	0.1	0.1	0.1
Net Change in Program Spending	*-5.8*	*-9.3*	*-12.5*	*-15.7*	*-19.1*

Source: Authors' calculations.

accommodate visiting scholars who wish to remain and work, thereby permitting Canada to recoup public investment in visiting scholars' human capital.

Facilitating Provincial Sales Tax Reform

Steep reductions in the marginal effective tax rates (METRs) on capital are readily available through reform of provincial sales taxes in British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island (Chen, Mintz and Tarasov, 2007 and Smart, 2007). Retail sales taxes apply at many points in the production of finished goods, often including business investment in intermediate capital goods and services. This cascading effect is a major contributor to business METRs, and is largely eliminated through value-added tax reform in provinces that harmonize their sales taxes with the federal GST.

The non-harmonized provinces currently fear revenue loss if they harmonize at tax rates they consider politically acceptable. This budget therefore proposes carefully limited, lump-sum payments to provinces that harmonize retail sales taxes with the GST. The incentive provided by large, one-time transfers to provinces that decided to follow the federal government's lead could be done at a low fiscal cost, depending on how the details are negotiated, as Smart (2007) shows.

Between 1997 and 2000, Newfoundland, New Brunswick and Nova Scotia received $961 million in compensation for reducing their tax rates when they harmonized with the GST. Following a similar formula, Saskatchewan could receive up to $280 million over the next four years, while Manitoba could receive up to $480 million. British Columbia, Ontario and Prince Edward Island would see their revenues increase should they levy a VAT at their current rate of PST. Summary of spending measures appear in Table 4.

Business Tax Measures

High business tax rates distort decision-making with regard to business structure, financial flows and investment allocation, leading to lower levels of investment and slower economic growth. The current tax design also discourages businesses from growing beyond the threshold at which small business concessions cease, or new taxes — such as capital taxes — take effect (Hendricks et al., 1997). Rather than offering piecemeal tax credits, the goal of tax policy should be to reduce the marginal effective tax rate on new capital investment.

Recent troubles in the manufacturing sector reinforce the need for Canadian business to improve productivity in order to compete in a high dollar environment. One way to improve productivity performance and help Canadian workers raise their incomes is to add to capital stock, or plant and equipment. Unfortunately, a comparison of international trends indicates that Canada is falling behind.

A decade ago, the average Canadian worker was backstopped by about the same investment in new private-sector plant and equipment annually as his or her counterpart elsewhere in the OECD (Banerjee and Robson 2007). Last year, however, for every dollar of new plant and equipment enjoyed by the average OECD worker, the average Canadian worker got about 94 cents. Comparing Canada with the US, for every dollar of new plant and equipment enjoyed by the average US worker a decade ago, his or her Canadian counterpart got 89 cents. More recently, the figure was 82 cents.

These trends mask even greater underperformance at the provincial level. While Albertan workers received an average $2.06 per employee of new capital investment relative to $1 invested in their US counterparts, workers in the rest of the country received significantly less, with B.C., Ontario, and Quebec workers receiving less that 61 percent of the US investment. This consistent underperformance in capital investment reduces Canadian businesses competitiveness and will make it more difficult to support the kind of income growth Canadian workers will need in the future.

Accelerated Reductions in Corporate Income Taxes

The 2007 economic statement brought some welcome relief in the federal corporate statutory rate. The general corporate income tax rate is scheduled to fall from 19.5 percent in 2008 to 15 percent in 2012. These recommendations follow the 2007 C.D. Howe Institute shadow budget, but represent only a modest change in the effective tax burden that capital investment faces. As Chen (2007) notes, even with these changes Canada will still have extremely wide disparities in tax rates across industries, which leads to an inefficient allocation of investment. Canada will still have one of the 10-highest effective marginal tax burdens on capital amongst OECD countries.

This budget proposes that the federal government go further still by reducing the general corporate income tax to 12 percent by 2013, accelerating the current pace and improving upon the established goal for 2012. This would further reduce marginal effective tax rates to approximately 23.1 percent, placing Canada's effective rate below that of Norway. In fact, there is growing evidence that a reduction in corporate taxes may not decrease federal revenue on a dollar-for-dollar basis (Mintz, 2007). Capital tax relief has a respectable record of producing partly offsetting revenue gains through increased economic activity (Mankiw and

Weinzierl, 2006). Although research suggests (Trabant and Uhlig, 2006, for example) that up to 80 percent of a corporate income tax rate reduction can be self-financing, estimates below do not assume significant dynamic offsets.

LIFO Accounting

Rising energy and commodity prices in recent years have confronted businesses with challenging cost pressures. Inventory accounting for Canadian tax purposes, however, requires first-in, first-out costing, which tends to make profits calculated for tax purposes higher than actual economic profits. This budget therefore proposes transition measures that would lead to last-in, first-out cost accounting for inventories. This change will lower METRs on business investment, which is especially important to those businesses with significant inventories and volatile input prices.

Capital Cost Allowance Rate Increases

Recent analysis (Patry 2007) suggests that economic depreciation rates, for some classes of assets, run well ahead of allowed capital cost allowances (CCA). While Budget 2007 increased CCA rates for certain building types, some natural gas facilities and computers, that was only a start. Economic depreciation rates in numerous industries have risen since 1995, more so than have CCA rates. Continued review and realignment of existing CCA rates is in order.

Unblocking Foreign Investment

A number of Canadian tax policies inhibit useful foreign investment, while yielding revenues for Canadian governments that are small or nil. Canadian and US venture-backed companies compete directly with each other in the North American markets, yet Canadian companies enjoy a smaller capital base and are less productive than they might otherwise be.

This budget proposes changes in a number of areas that would make the border less of an impediment to people with the funds and ideas that could help Canada grow:

- To make Canadian venture firm investments more attractive to nonresidents, this budget proposes to streamline the clearance process for obtaining tax treaty benefits for foreign investors who file notice of claim for treaty benefits (Hurwitz and Marett, 2007).

- While Canadian individual investors benefit from a basic personal exemption that shields income below $9,600 from taxation, individual foreign investors receive no such benefit. Other countries such as the United States and the United Kingdom do exempt income below a low threshold from taxation, which makes partnership and other ventures for international investors more attractive, and spares a good deal of administrative expense. This budget proposes to extend the basic personal amount to all individual investors.

Tariffs on Intermediate Goods

Canadian businesses are increasingly competing in a world where products are no longer produced in one place, but rather are produced in a series of steps along "value chains" leading from raw materials to finished products (Sydor 2007). While import tariffs may once have been an administratively convenient way for governments to raise revenue, the harm they cause consumers and the distortions they create in the economy make them increasingly unattractive. In a world of cross-border value chains, moreover, their perverse effects are more evident — Canadian producers of goods and services as diverse as clothing and shipping compete in unprotected markets while paying tariff-inflated prices for their inputs.

This budget therefore proposes to reduce remaining tariffs on intermediate goods. Relief from these damaging taxes will enhance the ability of Canadian producers to compete in general, and will provide welcome help for those producers faced with temporarily weak markets or the competitive pressures of a higher Canadian dollar. The federal government collected approximately $3.6 billion in customs revenue in 2007, about 1.5 per cent of total revenues. It is time to eliminate these fiscally minor but economically significant barriers to innovation and trade.

Promoting Saving

Canadians are handcuffed by limits on contributions to pension plans and Registered Retirement Savings Plans (RRSPs), double-taxation of retirement saving, and distorting taxes on reinvested capital gains. These and other tax policy failings are addressed below.

Improving RRSP and RPP Room

Policies that permit only limited tax relief on contributions to pension plans impede saving. Limits on RRSP contributions and formulas restricting the size of defined-benefit pensions prevent many individuals from providing adequately for retirement. And the prohibition on contributions to defined-benefit pension plans that have assets equal to more than 110 percent of their liabilities stops plan sponsors from preparing during good times for the deficits that will normally occur when times are harder.

A long-standing benchmark has it that individuals should aim to replace 70 percent of their pre-retirement income. Based on current annuity rates and a 5 percent nominal growth rate of earned income over 35 years, RRSP and pension plan contribution limits would need be about 35 percent of annual income, or about twice the current limit of 18 percent of earned income, to achieve this objective.[4] Individuals who withdraw funds from their RRSPs, moreover, do not get their contribution room back, which puts people with fluctuating incomes and large temporary needs such as home purchases at an additional disadvantage.

4 Some estimates (for example, see Office of the Chief Actuary, 2006, p.59) indicate that the terms of the federal public service pension plan enable contributors to set aside the equivalent of 30 percent of salary.

This budget therefore proposes to increase the earned income limit to 25 percent immediately, and to deliver a substantial improvement to the currently scheduled increase in annual contribution limits: from $22,000 in 2010 to $32,000 by 2015, with lockstep increments in the value of defined-benefit pension plan contribution room. In addition, withdrawals from RRSPs will henceforth restore contribution room. While these changes will still leave Canada's treatment of pension plan contributions less generous than those in countries, such as the United States and the United Kingdom, they will improve the situation of skilled workers at income levels that are close to, or above, maximum pensionable earnings eligible for pension or RRSP treatment, and will therefore improve Canada's attractiveness to such workers.

As for pension-plan funding, this budget proposes, effective immediately, to revise the applicable threshold so that defined-benefit plan sponsors may make tax-deductible contributions totalling up to 125 percent of liabilities, an increase from the existing limit of 110 percent. Consultations will also commence about the advisability of removing such limits altogether.

Greater Flexibility for RRSP Holders

Preventing individuals from adding to their retirement saving accounts at age 71, forcing people to take RRSP savings into income at specified rates and at specified times, and restricting access to savings accumulated in RRSPs are all measures that inhibit older Canadians from saving and spending according to their individual needs. To provide greater flexibility in retirement saving — and to facilitate further saving by people who might refrain from it for fear of encountering regulations on how they can use their money — this budget proposes a number of changes.

The age at which RRSPs must be annuitized, or converted to Registered Retirement Income Funds (RRIFs), will rise to 73 effective immediately, and the government will launch consultations on the practicality of further increases in coming years.

The reference ages for calculating minimum withdrawals from RRIFs will rise immediately by five years — among other things, this change will mean that the age at which the minimum withdrawal rises to 20 percent will go from 94 to 99.

Employees who change jobs and leave deferred pension plans often are able, under federal or provincial legislation, to transfer the present value of their benefits to a "locked-in retirement account" or similar plan. Limits on access to benefits under these plans no longer suit the needs of workers requiring flexibility and mobility in their financial and career planning. The federal government will therefore remove legislated restrictions on withdrawals, remove requirements for creating locked-in accounts, and encourage provinces to make similar changes, so that workers face similar rules across provinces.

Improving Savings Options

Tax-Prepaid Saving Plans (Kesselman and Poschmann 2001) will help Canadians better manage their lifetime savings. TPSPs would permit individuals to earn income within the plan exempt from tax, with contributions to the plan triggering no deduction from taxable income, and distributions from the plan attracting no tax on withdrawal. As is the case with RRSPs, interest on funds borrowed to invest in TPSPs would not be deductible.

Reinvesting Capital Gains

The current capital gains tax discourages savers from reallocating assets as economic circumstances change. Letting savers defer tax when they sell investment assets and reinvest the capital would prevent this lock-in effect, which inhibits portfolio adjustments. This budget proposes a provision whereby taxpayers would calculate a year's taxable gains as they do now, but would receive a matching increase in the dollar limits to their RRSP contributions, unbound by current caps and percent-of-earned-income limits. Instead of paying capital gains tax, which applies to 50 percent of gains, individuals would be able to reinvest up to half their net capital gains in an RRSP in the first 60 days of a calendar year, as with other post-year-end contributions. Investors who took their gains into current income would be liable for the usual capital gains tax in the year the gains were recognized. Improved capital market performance, arising from unlocking accrued gains, will generate economic activity (and federal revenue), offsetting part of the cost to federal revenue that arises from postponing taxation of the capital gain.

Refundable Dividend Tax Credits for Dividends Paid to RSPs

Income trusts in Canada grew in popularity because of a key failure of integration between business and personal taxes. In principle, income earned at the business level and paid to shareholders should be taxed at the business level or the individual level, but not both. At present, the dividend tax credit provides relief for investors who hold dividend-paying shares when tax has been paid at the business level prior to dividend distribution. But no equivalent relief from double taxation exists for investors who hold shares through pension or retirement savings plans. Providing a refundable dividend tax credit to RRSPs and RPPs will resolve this issue. The fiscal plan for this budget makes provision for such payments by allocating $2 billion in tax relief in fiscal year 2009/10 and beyond.[5] In the interim, the government will launch consultations on the best way of ensuring that these payments are made only in respect of dividends paid by tax-paying corporations.

Promoting Productivity

The financial reward to work must always be a key motivator for labour force participation. Federal tax policy can do better for Canadian workers.

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5 Trusteed Pension Funds received over $3.5 billion in dividend payments in 2005/06. Assuming an average corporate tax rate of 20 percent on the earnings from which these dividends were paid, a credit to the pension plans concerned would have cost almost $0.9 billion. Assuming that RRSPs would be entitled to similar credits and that the cost would be proportional to the ratio of RRSP to RPP assets, which stood at 30:63 as of 2006, and assuming similar treatment to dividends received by the C/QPP yields a total cost of under $1.7 billion.

Personal Taxes/Transfers

The previous government proposed a reduction in tax rates for low and middle earners and an increase in the threshold at which upper-income earners begin to be taxed at the highest rate. A single point decrease for the middle brackets and the introduction of a new upper-middle income tax bracket would lower marginal tax rates for most Canadians.

Changing Tax Thresholds

This modest reduction to low- and middle-income tax brackets and the creation of a new tax bracket would reduce federal income tax receipts by about $2.8 billion for 2009 (Table 5).[6] This near-term relief constitutes a downpayment on a longer term rate reduction plan which, by 2012, will see Canadians again enjoying a three-tiered rate structure, with federal personal rates set at 15, 21, and 25 percent, the last rate applying to income above $100,000 in 2008 dollars.

Table 5: *Current and Proposed Federal Income Tax Brackets, 2008-2012*

2008 (Current)		2009		2010		2011		2012	
Marginal Rate %	Applied to Income at $	Marginal Rate %	Applied to Income at $	Marginal Rate %	Applied to Income at $	Marginal Rate %	Applied to Income at $	Marginal Rate %	Applied to Income at $
15	<37,885	15	<38,643	15	<39,416	15	<41,616	15	<42,448
22	<75,769	21	<77,284	21	<78,830	21	<104,040	21	<106,121
26	<123,184	25	<125,647	25	<128,161	25	<208,080	25	>106,121
29	>123,184	27	<204,000	27	<208,080	29	>208,080		
		29	>204,000	29	>208,080				

Benefits for Working Families

Federal support for families delivered through income-tax and transfer mechanisms is weakened by clawbacks that subject working families to benefit reductions that stack on top of ordinary taxes, producing very high marginal effective tax rates. This is important, because people do respond to real changes in their incomes, and increasing employment is a critical strategy in reducing poverty (Richards, 2007 and Eissa and Hoynes, 2005). An expansion of the Working Income Tax Benefit would make paid employment more financially

6 This analysis is based on Statistics Canada's Social Policy Simulation Database and Model, Release 15.0. The assumptions and calculations underlying the simulation results were prepared by the C.D. Howe Institute and the responsibility for the use and interpretation of these data is entirely that of the authors.

Table 6: *Impact of Revenue Measures*

	2008/09	2009/10	2010/11	2011/12	2012/13
			$ billions		
Staged CIT relief (12 percent by 2013)	-0.4	-1.8	-1.9	-4.0	-6.4
Phased out tariffs on intermediate goods	-0.3	-0.6	-0.9	-1.2	-1.5
Increased earned income limits, RPP/RRSP contribution room	0.0	0.0	-0.5	-1.0	-1.5
LSVCC credit phaseout	0.1	0.1	0.2	0.2	0.2
Reinvesting capital gains	-0.4	-0.6	-0.9	-1.2	-1.2
Refundable credit for pensions	0.0	-1.7	-1.8	-2.0	-2.2
PIT relief	-0.7	-2.8	-3.8	-6.7	-9.0
Enhanced WITB	-0.4	-0.4	-0.4	-0.4	-0.5
Total Revenue Measures	*-2.1*	*-7.8*	*-10.0*	*-16.4*	*-22.1*

Source: Authors' calculations.

rewarding for workforce entrants. This budget proposes to raise the maximum benefit amount for families from $1,000 to $1,500 and the maximum for singles from $500 to $750. An increased maximum for the working income benefit extends the income range over which the benefit is phased in, meaning better marginal incentives for more entrants to the labour force, and for existing beneficiaries who take on extended hours of work. This government will also work with the provinces to improve the design of federal and provincial income-tested cash and in-kind benefits, so that provincial working-income supplement programs do not interact with federal benefits in ways that raise the effective tax rate on incremental income to unreasonable levels.

The Federal Labour Funds Credit

Past budgets have raised doubt about the merits of the federal credit for investment in labour-sponsored venture capital corporations, intended to encourage pooling of small investors' seed money in support of numerous speculative ventures across Canada. Alternative vehicles, however, may better suit the current marketplace, and as domestic and foreign investors find effective routes for matching their investment capital to promising projects, the federal credit emerges as a hindrance to steering resources to their best uses (Cumming, 2007). This budget therefore proposes to follow Ontario's lead in phasing out the existing credit.

The combined impact of these measures is shown in Table 6.

Pulling It Together

This budget has proposed a suite of changes aimed at improving the outlook for savings, investment, and prosperity. The net impact of these proposals reflects a strong fiscal outlook (Table 7). As is evident from the bottom line, measures to improve Canada's attractiveness as a place to work, invest and innovate are possible within a prudent framework.

Table 7: *Summary Statement of Transactions: Impact of Budget Measures*

	2008/09	2009/10	2010/11	2011/12	2012/13
			$ billions		
Non-Interest Revenue					
Status Quo Projection	235.4	244.6	253.3	264.0	274.7
Impact of Revenue Measures	-2.1	-7.8	-10.0	-16.4	-22.1
Outlook after Revenue Measures	*233.3*	*236.8*	*243.3*	*247.6*	*252.7*
Program Spending					
Status Quo Projection	207.6	217.0	225.1	233.7	242.9
Impact of Restraint and Reallocation	-5.8	-9.3	-12.5	-15.7	-19.1
Outlook after Restraint and Reallocation	*201.8*	*207.7*	*212.6*	*218.0*	*223.8*
Primary Balance					
Status Quo Projection	27.8	27.6	28.2	30.3	31.8
Impact of Budget Measures	3.7	1.5	2.5	-0.7	-3.0
Outlook after Budget Measures	*31.5*	*29.1*	*30.7*	*29.7*	*28.9*
Net Debt Charges					
Status Quo Projection	-24.1	23.3	22.9	21.9	21.6
Impact of Budget Measures	0.0	0.0	0.0	0.0	0.0
Outlook after Budget Measures	*-24.1*	*23.3*	*22.9*	*21.9*	*21.6*
Total Balance					
Status Quo Projection	3.7	4.4	5.3	8.4	10.3
Impact of Budget Measures	3.7	1.5	2.5	-0.7	-3.0
Outlook after Budget Measures	*7.4*	*5.9*	*7.8*	*7.8*	*7.3*
Debt Reduction and Prudence Factors					
Planned Debt Reduction	3.0	3.0	3.0	3.0	3.0
Economic Prudence		1.0	2.0	3.0	4.0
Total Balance after Debt Reduction and Prudence	*4.4*	*1.9*	*2.8*	*1.8*	*0.3*

Note: As in baseline, calculation of gross debt charges assumes debt paydown equal to each year's planned debt reduction only.

Source: Authors' calculations.

Canada's ability to generate high and rising living standards in a competitive world, and against the headwinds of demographic changes, should not be taken for granted. Weak economic growth in the United States demonstrates the advantages of fiscal prudence and a vibrant private sector — key factors that should help Canadians through current turbulence and prepare us to face the future with confidence.

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