National Post

Two fine fixes; 1. Make EI benefits easier to get nationally 2. Expand the investment tax credit

Friday, December 19, 2008
Page: FP11
Section: FP Comment
Byline: Finn Poschmann
Source: Financial Post
Illustrations: Black & White Photo: Brendan Smialowski, AFP, Getty Images /

The conventional wisdom on "stimulus packages" says they should be "timely, targeted and temporary." That they should be timely, there is no doubt. But some elements of a potential "stimulus package" ought not to be targeted and temporary, or undertaken at all.

Take the first and most important element of a government's economic toolkit: monetary policy. In the wake of a credit crunch, where financial institutions collectively become reluctant to lend and households and businesses become reluctant to borrow, dramatic addition of liquidity to the system is one good step. And slackening demand, relative to the economy's ability to supply it, calls for cheaper and more abundant money.

Timely action on these fronts is exactly what Canada's central bank, like others around the world, has been undertaking. The United States this week has taken cheap money to its extreme, with the U. S. Federal Reserve setting its overnight rate target at zero to 0.25%. That is almost as low as it can go, barring a tax on bank deposits. With an overnight rate now down at 1.5%, Canada has a little more room for interest rate easing if we need it, and the Bank of Canada has plenty of additional capacity for buying up the risky securities that gum up businesses' balance sheets and make them reluctant lenders or borrowers.

These actions are timely but they are not targeted, and they are only as temporary as market conditions warrant.

Government is at its best when it pursues broad-based measures that treat different industries equivalently and fairly, and is even handed in how it treats different regions. Government is also at its best when the broad measures it pursues lay the framework for a promising investment environment: the foundation for building jobs, growth and innovation.

Consider the rusty Employment Insurance program, which offers regionally differentiated benefits that depend on the local unemployment rate. The distortionary result is that someone who earned $500 per week and has 630 qualifying work hours in Bathurst, N. B., where the unemployment rate recently has been 14.8%, could, if laid off, qualify for 31 weeks of benefits at roughly $275 per week. However, if the same worker lived in the Toronto area, where the unemployment rate has been 7%, he typically would not qualify for benefits at all.

Why not make EI benefits easier to get, and for more weeks, by treating claimants in areas where the unemployment rate is below 10% in the same manner as the unemployed living in areas where it is 10%?

Such a move would be timely, general in its application, help equalize a program that has regional unfairness built into it and reduce the distortions the program otherwise induces by offering more generous to benefits to people who live where jobs are not. There is no reason, however, to make such an improvement temporary --if withdrawal of this stimulus became appropriate over time, further EI improvements could make the system fairer yet.

Consider next the federal investment tax credit. This credit is available only in the Atlantic region, including the Gaspe, and applies to investment spending on buildings, machinery and equipment, in the farming, fishing, logging, mining, oil and gas, and manufacturing and processing business. The credit is partially refundable for Canadian private corporations, typically small businesses.

Why only those regions, those investments, those activities and only some businesses? Not for any significant economic policy reason, other than afford-ability on the part of government.

Expanding the investment tax credit to make it available to all businesses -- even potentially making it partially refundable for all -- irrespective of activity or location, would improve the tax system's fairness. Making the credit's expansion temporary would encourage businesses to shift planned investments from the future to the present, or to avoid postponing them, and that is what fiscal "stimulus packages" are meant to do. The case for keeping the credit temporary, however, is not rock solid--a permanent lowering of the effective tax rate on new business investment could improve Canada's long-run growth trajectory. Alternatively, the credit could be phased out as the federal and provincial governments lower their corporation income tax rates.

But what's best about a general investment tax credit is that it avoids picking winners or continuously subsidizing losers. Businesses will only pursue qualifying investments if they see a market that warrants investment in plants, products, processes and people. A nonrefundable credit would tend only to reward them if their plans eventually proved profitable.

In stark contrast, some popular "stimulus package" elements should fall very low on Canadian governments' to-do list.

Take proposals to offer more loan guarantees to businesses, or to purchases of preferred equity shares; politicians, understandably, tend to tie such support to specific outcomes. But politically preferred employment outcomes, for example, may not be best for businesses' or employees' long-term prosperity. And if governments guarantee loans and put themselves, in return, above secured creditors at recovery time, they may effectively rewrite bankruptcy law and scare off future lenders.

Similarly with equity stakes. While current shareholders may forgive earnings dilution if that is the price of needed capital, the prospect of more government purchases of corporate equity, and further capital dilution, can only make potential future investors wary, thus prolonging rather than shortening a market slump.

Sometime in 2009, governments and businesses will return to governing and doing business. Just possibly, better and fairer fiscal policy will accompany the return.

-Finn Poschmann is vice president, Research, at the C. D. Howe Institute.