Intelligence MEMOS

From: Alexandre Laurin  
To: The Hon. Bill Morneau, Minister of Finance  
Date: March 25, 2019  

Even though Budget 2019 contains no sizeable flagship initiative, its orientation is clear: to appeal to as many as possible by multiplying targeted measures aimed mostly at seniors and millennials, while continuing to embrace red ink. Nonetheless, some targeted measures are good and rightly aimed at enhancing Canada’s long-term future. Let’s start with some applause.

The Good: A Few Positive Targeted Measures

Proposed rules to allow private insurers to offer pure stand-alone longevity insurance – called advanced life deferred annuities – went largely unnoticed, yet it promises to improve retirees’ standard of living for many years to come. Canadians increasingly rely on registered retirement savings in capital accumulation plans to fund their retirement, and need help planning the decumulation years. Longevity insurance enables to plan one’s retirement savings up to a specific old age after which the insurance kicks in, thus reducing longevity uncertainty.

The average retirement age is increasing, and more and more seniors wish to supplement their public pensions (OAS/GIS/CPP) with part-time work. Employment income above a $3,500 threshold, however, triggers the clawback of GIS at an implicit tax rate of 50 percent or more. The budget would increase this threshold to $5,000, and reduce the implicit tax rate by half on the next $10,000 of income, thus helping low-income seniors keep more if their earned income. Seniors who wish to stay active longer will be encouraged to do so, at the same time benefiting both the economy and retirement affordability.

Finally, small businesses are eligible to a 35-percent refundable enhanced tax credit for SR&ED expenditures, but many small businesses bunch up at the taxable income threshold ($500,000) upon which the credit starts to be reduced. The budget would eliminate the taxable income threshold (keeping the asset threshold in place), effectively removing a financial disincentive for businesses to grow.

The Bad: Continued Lack of Fiscal Discipline

Revenues this year came in about $10 billion higher than projected in Budget 2018. The government spent this entire bonus, just as it did in last year’s budget. Without a hard budget constraint, the federal fiscal fortune is at the mercy of the business cycle in the short run, and rising interest rates in the long run.

The government inherited a sizeable primary budgetary surplus – which excludes debt-servicing costs – of more than 8 percent of revenues in 2015. In 2017 and 2018, this primary surplus almost disappeared at less than 1 percent of revenues, and is projected to reach only about 2.5 percent of revenues in 2019. With debt charges around 8 percent of revenues, interest on the debt is financed with more debt. As long as the economy grows faster than the interest rate, a stable debt-to-GDP ratio ensues. But this equilibrium is fragile. Population aging is pressing down on projected economic growth, and should interest rates climb above long-run growth, Canadians would be forced to accept painful structural reforms with a large debt to pay down. Spending new revenues as they come in is not a prudent approach to managing the budget.

The Bottom Line

This is a budget that does not achieve much, and that will likely be met with relative indifference. It ignores the threat posed by Canada’s recent tax competitiveness setback. With business investment trailing behind the US and many OECD countries, one would have hoped for investment-friendly tax measures. A comprehensive review of the tax system with an eye at improving the investment climate would have been welcome by the business community and international investors. In the meantime, lower corporate income tax rates would have helped make Canada a more desirable location for capital investment.

Alexandre Laurin is Director of Research at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.

Essential Policy Intelligence / Conseils indispensables sur les politiques