Steps Ottawa can take to restore fiscal stability

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The upcoming federal budget will be the first in more than two years. Last year, it was postponed to give the government scope and flexibility to limit the spiralling economic damage stemming from business lockdowns and mandated social distancing brought on by the pandemic. Instead of a budget, last November, Canadians got a peek at the impact of the pandemic on the economy and Canada's finances in the fall economic statement.

The statement confirmed the magnitude for fiscal support, with the budget deficit projected at $381.6-billion for fiscal 2020-21. The federal debt was forecasted to reach almost $1.4-trillion by fiscal 2025-26, or roughly 50 per cent of GDP.

Canadians will be looking to this new budget for a strategy to restart the economy as it recovers from the COVID-19 pandemic and provide a fiscal anchor for future years to manage soaring debt levels. The statement introduced the concept of "fiscal guardrails" or data-driven triggers (employment rate, unemployment rate, and total hours worked) that would guide when stimulus will be wound down. Yet the government has not provided any specific targets for its guardrails, or how they would be calibrated. It is important the government provide greater transparency and accountability around its fiscal plan, bolstering business and investor confidence and assuring markets and credit agencies.

Restoring fiscal stability is a daunting challenge. The federal government has said it is not contemplating raising taxes on Canadians. We agree there should be no increases to personal and corporate taxes, especially in the current economic environment. This does not mean that taxation cannot play a role in stabilizing public finances. Instead of increasing tax rates, the focus should be on improving the efficiency of the tax system.

Tax bases should be as broad and comprehensive as possible. This can be done by simplifying the GST system to generate additional revenue, and by undertaking a review of tax expenditures (exemptions, deductions, credits, and rebates), with a view of eliminating or scaling back those that are not meeting intended policy goals or delivering value for money.

Importantly, the budget should introduce timely measures to promote a post-pandemic recovery. First, the federal budget should address the anemic low levels of business investment, particularly for small business.

The government should introduce a tax incentive, such as a personal tax credit, to encourage Canadians to invest in the equity shares of qualified small- and medium-sized businesses, structured along similar lines to the successful U.K. Enterprise Investment Scheme, to stimulate small-business expansion and spending. A Canadian version of the EIS would be an effective vehicle to rebuild small businesses in Canada decimated by the pandemic. A discussed increase in the effective tax rate for capital gains by increasing the inclusion rate above the 50 per cent threshold should not happen in precarious business conditions, deflating investment intentions, notably for riskier small business investments. The capital gains tax should be kept as is.

Second, emphasis should be placed on strong upskilling and reskilling programs to ensure Canadians remain connected to the labour force, especially displaced workers in sectors facing dismal post-pandemic recovery prospects. Third, it is critical that the government provide increased scope for Canadians to accumulate savings in tax-assisted retirement programs. These increased savings are not just to meet the retirement needs of aging Canadians living longer lives, but for the inevitable and expensive long-term care. Without sufficient private-sourced resources, the funding problem will ultimately fall to the state. Increasing the allowable annual contribution to RRSPs and extending the deductibility of payroll taxes for contributions to group RRSPs would assist younger Canadians to save for retirement.

Self-employed Canadians, on the other hand, would benefit from a larger annual RRSP contribution amount. The government should also increase the eligible age to make RRSP contributions beyond age 71, enabling older Canadians who work past retirement age, and other seniors, to supplement their private retirement savings.

There are good reasons to introduce a budget now—the most important are to build the policy foundations for sustained economic growth and the framework for solid public finances.

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