

BUDGET

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November 14, 2005

Federal's Economic and Fiscal Update

- Tax measures
- Economic Viewpoint

INFORMATION BULLETIN



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Federal's Economic and Fiscal Update

November 14, 2005

TAX MEASURES

Federal Minister of Finance Ralph Goodale tabled an economic and financial update this afternoon. This update mainly anticipates tax cuts for individuals as early as 2005 and an accelerated elimination of the capital tax for large corporations. However, given the current political context, we will have to wait and see if such measures will be implemented.

MEASURES AFFECTING DESJARDINS - BUSINESSES

Accelerated phase-out of capital tax for large corporations (Part 1.3 tax)

Budget 2003 proposed to eliminate the capital tax for large corporations by 2008. The current update rather proposes to phase it out by 2006. Accordingly, the applicable rate in 2005, i.e., 0.175%, would be brought back to 0 by 2006.

Extending carry-forward periods for non-capital losses and investment tax credits

The current rules allow businesses to carry non-capital losses forward 10 years. This update proposes extending the carry-forward period to 20 years for losses incurred and credits earned during the taxations years ending after 2005.

Confirming the abolition of the corporate surtax in 2008 and the gradual corporate income tax rate reduction

The February 2005 budget proposed the elimination of the 1.12% corporate surtax for the taxation years ending after December 31, 2007.

As well, this budget proposed that the general corporate income tax rate be brought back to 20.5% on January 1, 2008, then to 20% on January 1, 2009 and to 19% on January 1, 2010.

These measures remain. Accordingly, the corporate income tax rate will be as follows:

	Current rates	Proposed rates		
		2008	2009	2010
Reduced rate	13.12	12	12	12
Basic rate	22.12	20.5	20	19

MEASURES AFFECTING INDIVIDUALS

Additional increase of basic personal amounts

According to the February 2005 budget, the basic personal amount of \$8,148 in 2005 (that all taxpayers can claim in their tax return) should gradually increase by:

- \$100 in 2006
- \$100 in 2007
- \$400 in 2008
- \$600 in 2009

The current update rather proposes the following successive increases:

- \$500 in 2005
- \$200 in 2006
- \$100 in 2007
- \$100 in 2008
- \$300 in 2009

The total remains the same, at \$1,200, but the pace of the increase is significantly accelerated.

These amounts are in addition to the annual indexation. The basic personal amount for 2009 will be at least \$10,000.

As well, the amount for a dependent spouse will be increased by the following amounts:

- \$425 in 2005
- \$170 in 2006
- \$85 in 2007
- \$85 in 2008
- \$255 in 2009

In 2005, this change translates into an annual tax cut of \$63 for a Quebec resident and of \$116 for a Quebec resident with a dependent spouse.

Reduction of the income tax rate

The current update proposes to reduce personal income tax rates, in 2005 for the minimum rate and in 2010 for other rates.

So, in 2005, the applicable rate for the first \$35,595 of income will go from 16% to 15%. However, the applicable rate for non refundable credits will also go from 16% to 15%.

For Quebec residents earning over \$35,595 and taking into account the income tax abatement for Quebec residents, this change translates into a \$225 tax cut in 2005.

Starting in 2010, the rates of 22%, 26% and 29% applicable to other income brackets will also be cut by 1%.

Lastly, a measure similar to the Work Premium in Quebec will be introduced in 2008.

Fiscal measures for persons with disabilities

The last budget proposed that the maximum child disability benefit, as a supplement of the Canada child tax benefit, be increased from \$1,681 to \$2,000 as of July 1, 2005. The current update increases the amount to \$2,300 by July 2006.

As well, the last budget proposed that the maximum refundable medical expense supplement be increased from \$571 to \$750. The update now proposes to increase this supplement to \$1,000 in 2006.

Federal's Economic and Fiscal Update



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With a pre-election statement, the Martin government manages to announce yet again a range of new expenditures and fiscal initiatives

Today, Minister of Finance Ralph Goodale tabled an economic and fiscal update of the federal government's budget situation. In addition, the Martin government presented a multiyear plan (*Plan for Growth and Prosperity*) that focuses essentially on four goals: offering Canadians opportunities to develop work skills, advancing an innovative economy, positioning the country at the centre of global commerce and networks and building the right investment environment.

To do so, the liberal government proposes several new expenditures and fiscal initiatives to be included in its next budget, if the occasion arises. This budget should normally be tabled in winter 2006. However,

because it seems more and more likely that the current minority government will be brought down in the coming weeks, this budget may never come to be. As a result, the range of new announcements issued today as well as most of the promises made since the budget of February 23, 2005, especially as a result of the spring agreement with the New Democratic Party (NDP), are likely to become promises that will not be fulfilled.

\$54,500,000,000 more than expected!

GDP, inflation and interest-rate growth assumptions are consistent with our expectations and very realistic. However, the budget surplus is where the shoe pinches.

Table 1

Summary of Transactions

In billions of \$	2004-2005	2005f-2006f	2006f-2007f	2007f-2008f	2008f-2009f	2009f-2010f	2010f-2011f
Budgetary transactions							
. Budgetary revenues	198.4	202.3	212.3	222.0	229.9	239.3	247.8
- Variation (%)	6.6	2.0	4.9	4.6	3.6	4.1	3.6
. Total expenses							
. Program expenses	-162.7	-163.7	-170.7	-178.8	-187.2	-195.8	-203.6
- Variation (%)	15.1	0.6	4.3	4.7	4.7	4.6	4.0
. Public debt charges	-34.1	-34.0	-34.4	-34.8	-34.6	-34.5	-34.4
- Variation (%)	-4.6	-0.3	1.2	1.2	-0.6	-0.3	-0.3
. Total expenses	-196.8	-197.7	-205.1	-213.6	-221.8	-230.4	-238.0
Budgetary surplus	1.6	4.6	7.2	8.4	8.1	8.9	9.8
Prudence							
. Contingency Reserve	---	3.0	3.0	3.0	3.0	3.0	3.0
. Economic prudence	---	---	1.0	2.0	3.0	3.5	4.0
Total	---	3.0	4.0	5.0	6.0	6.5	7.0
Remaining surplus	---	1.6	3.2	3.4	2.1	2.4	2.8
Federal debt							
. Assuming balanced budget	499.9	499.9	499.9	499.9	499.9	499.9	499.9
. Assuming Contingency Reserve is applied to debt reduction	---	496.9	493.9	490.9	487.9	484.9	481.9
Per cent of GDP							
. Budgetary revenues	15.4	14.9	14.9	14.8	14.7	14.6	14.4
. Program expenses	12.6	12.1	11.9	12.0	12.0	12.0	11.9
. Public debt charges	2.6	2.5	2.4	2.3	2.2	2.1	2.0
. Total expenses	15.3	14.6	14.4	14.3	14.2	14.1	13.9
. Planning surplus	0.1	0.1	0.2	0.2	0.1	0.1	0.2
. Federal debt							
. Assuming balanced budget	38.7	36.8	35.0	33.4	32.0	30.5	29.1
. Assuming Contingency Reserve is applied to debt reduction	---	36.6	34.6	32.8	31.2	29.6	28.1

Source: Department of Finance of Canada, November 2005

f: forecasts

Table 2
Fiscal Outlook Including November 2005 Update Measures

In billions of \$	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	Total
Status quo underlying surplus	13.4	15.0	16.4	15.7	16.5	19.8	96.8
. Initiatives proposed before the November 2005 Economic and Fiscal Update	2.3	1.8	1.8	1.9	1.6	1.5	10.8
. Allocation for prudence							
. Contingency Reserve	3.0	3.0	3.0	3.0	3.0	3.0	18.0
. Economic prudence	---	1.0	2.0	3.0	3.5	4.0	13.5
. Total	3.0	4.0	5.0	6.0	6.5	7.0	31.5
Status quo planning surplus	8.2	9.2	9.5	7.9	8.4	11.3	54.5
Total proposed tax and spending initiatives in the fall update	6.6	6.0	6.1	5.8	6.0	8.5	39.0
Remaining planning surplus	1.6	3.2	3.4	2.1	2.4	2.8	15.5

Source: Department of Finance of Canada, November 2005

Once again, the liberal government clearly underestimated the budget surpluses for the upcoming years, including the current one. Taking into account the measures proposed before today's update, the surplus should reach \$8.2B this year, increasing gradually and exceeding \$11B in five years. The total is an impressive \$54.5B on a cumulative basis during the period. Serious questions need to be raised on the current government's planning ability. In only nine months, i.e., since the 2005-2006 budget was tabled, the surpluses have literally exploded. This lack of thoroughness needs to be denounced.

According to the document presented today, the surpluses for planning purposes will total over \$50B by the 2010-2011 budget year. Where does this money come from?

New money

As for budget expenses, the improvement in the labour market should bring down employment insurance benefits between \$1.1B and \$1.8B per year by 2009-2010 in comparison with the initial estimates in the February 2005 budget. This new addition will however be offset in part by a reduction in employment insurance premiums. Lower-than-expected interest rates also led to a reduction in the public debt expenditures. Accordingly, by 2009-2010, the federal government hopes to save between \$1.1B and \$1.7B per year in interest charges on the debt. Yet a large share of the new leeway comes from the federal government's increased budget revenues. In addition, corporate income tax should increase by \$4.6B to \$10.7B per year, due to the impact of the recent increase in energy prices on corporate income and higher-than-expected earnings.

In his update tabled today, Minister Goodale is proposing to use \$39B of the \$54B leeway to introduce new expenditures and fiscal initiatives. The rest, i.e., \$15.5B, should remain available for budget planning purposes. Taking into account the \$10.8B already announced since the February budget, namely for the government's response to the increase in energy costs and the Canada-Ontario agreement, the federal government's new initiatives should total \$49.8B during the next six budget years.

Economic and financial forecasts

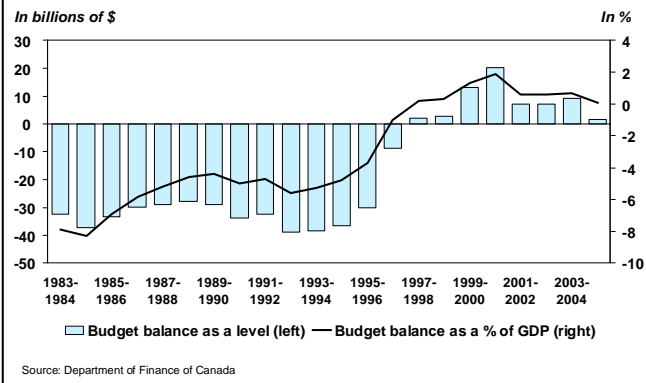
	2005		2006	
	Federal Budget*	Desjardins Group	Federal Budget *	Desjardins Group
Nominal GDP (%)	5.3	5.3	5.2	5.4
Real GDP (%)	2.8	2.9	2.9	3.2
3-month Canadian Treasury Bills (%)	2.7	2.8	3.4	3.8
10-year Canadian Bonds (%)	4.0	4.1	4.4	4.6

* Average consensus forecasts of the Canadian private sector.

Sources: Department of Finance of Canada and Desjardins, Economic Studies

The question is then justified: how will the federal government manage to fund all the new measures proposed in today's statement? Only nine months ago, the federal government tabled a balanced budget for the next five financial years, without any budget surplus except for the amounts earmarked for the contingency reserve and economic prudence.

Canada: Budget surplus after budget surplus

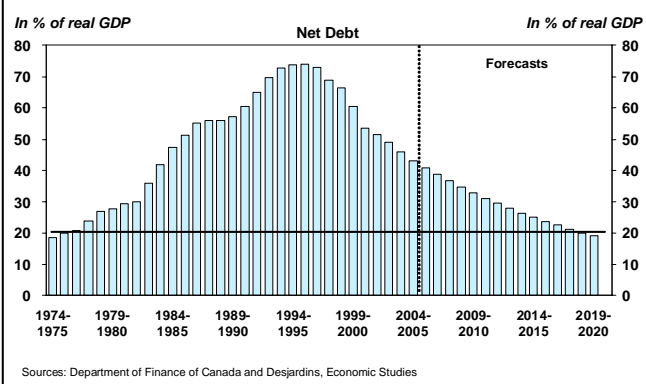


More specifically, the liberals are announcing a cumulative reduction of \$29.1B in personal income tax with a gradual reduction of the tax rates and an increase in basic personal amounts. Corporate income tax should decrease by \$1.1B by 2010-2011. The federal government also wants to invest \$9.2B on education (grants, financial support, scholarships, workplace-based training), persons with disabilities and integration for immigrants.

This listing is not complete and several other measures of lesser significance are also proposed (the details of the new initiatives are presented in tables 3 and 4 attached). Let us only draw attention to a cumulative investment of \$1.2B to improve international trade flows, including \$590M to modernize Canada's Pacific gateway, the port of Vancouver in particular.

In closing, bear in mind that the federal government aimed in its 2004 budget to reduce the debt-to-GDP ratio to 25% by 2015. Minister Goodale proposes in

Canada: A rapid reduction of the debt-to-GDP ratio



his update to bring the ratio down to under 20% within fifteen years. To do so, the \$3B contingency reserve would be used every year to pay down the debt.

Conclusion

It is obvious that this economic and fiscal update is establishing the foundations of the liberals' electoral program in view of the elections that are likely to be announced in the coming weeks. It will be interesting to see what the other parties will be proposing in the light of this rather surprising budget leeway.

As we see it, the range of federal initiatives in health and education, which are provincial jurisdictions, is causing administrative overlap that leads greater inefficiency and ineffectiveness between the country's various governmental bodies. The federal government should rather be setting its sights on reducing the fiscal burden of individuals more intensively, which would give the provinces a chance to increase their fiscal revenues, and resolving in the short term the fiscal imbalance between it and the provinces. This could help the provinces not only maintain a balanced budget, but also eventually bring down the debt level.

Table 3
Initiatives Proposed Since the February 2005 Budget

In million of \$	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	Total
A Plan for Growth and Prosperity							
<i>. Creating Opportunities for All Canadians</i>							
. Enhancing Canada's World-Class Workforce	1,077	623	1,197	1,568	1,579	1,579	7,622
. Meeting the Demographic Challenge	34	161	246	316	397	397	1,551
. Improving Labour Mobility and Labour Market Efficiency	---	10	10	15	15	15	65
. Total	1,112	794	1,453	1,899	1,991	1,991	9,238
<i>. Advancing an Innovative Economy</i>							
. Leadership in University-Based Research	500	275	335	335	335	335	2,115
. Strengthening International Research Networks	30	---	---	---	---	---	30
. Accelerating the Commercialization of New Technologies	---	24	47	49	50	30	199
. Total	530	299	382	384	385	365	2,344
<i>. At the Centre of Global Commerce and Networks</i>							
. Positioning Canada in Global Business Networks	---	49	94	108	114	120	485
. Creating World-Class Gateways	---	93	158	160	151	129	690
. Total	---	142	251	268	265	249	1,175
<i>. Building the Right Investment Environment</i>							
. Tax Reductions to Support Prosperity	5,335	5,050	4,695	4,095	4,290	6,800	30,265
. Promoting Regulatory Efficiency	50	18	18	18	18	18	140
. Promoting Energy Efficiency	---	2	3	5	10	30	50
. Total	5,385	5,070	4,716	4,118	4,318	6,848	30,455
Total	7,027	6,305	6,802	6,669	6,959	9,452	43,213
Government's Response to Higher Energy Costs	1,041	566	238	238	150	150	2,383
Canada-Ontario Agreement	160	230	450	350	200	100	1,490
(excluding amounts included in the Plan for Growth and Prosperity, as well as the Government's responsible to higher energy costs)							
Other Announced Initiatives	599	708	435	360	302	298	2,702
Total	8,827	7,808	7,925	7,617	7,610	10,000	49,788
Of which:							
Initiatives Proposed Before the November 2005 Economic and Fiscal Update (see table 4)	2,258	1,775	1,833	1,851	1,611	1,507	10,835
Initiatives Proposed in the November 2005 Economic and Fiscal Update	6,569	6,034	6,092	5,786	6,000	8,493	38,953

Source: Department of Finance of Canada, November 2005

Table 4**Initiatives Proposed Before the November 2005 Economic and Fiscal Update**

In million of \$	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	Total
Government's Response to Higher Energy Costs	1,041	566	238	238	150	150	2,383
Canada-Ontario Agreement							
. Higher education	400	---	350	400	400	400	1,950
. Housing and infrastructure	150	150	100	100	100	---	600
. Cities	149	149	---	---	---	---	298
. Labour market development and immigration	80	300	400	560	634	634	2,608
. Climate change	---	40	140	158	200	200	738
. Corporation tax collection and meat inspection	10	80	350	250	100	100	890
. Total	789	719	1,340	1,468	1,434	1,334	7,084
Less :							
. Funding included in Budget 2005 and the response to higher energy costs	171	218	180	215	275	275	1,334
. Net cost	618	501	1,160	1,253	1,159	1,059	5,750
Other Announced Post-Budget Funding Decisions							
. Airport rents reduction	---	48	72	97	132	176	525
. Wage Earner Protection Program	4	32	32	32	32	32	164
. Canadian Museum for Human Rights	10	10	10	20	20	---	70
. Prince Rupert Port upgrade	10	20	---	---	---	---	30
. Global Centre for Pluralism	30	---	---	---	---	---	30
. International Fishing Governance	6	7	7	---	---	---	20
. Quebec City's 400th anniversary celebrations	11	34	45	19	---	---	110
. Measures to aid Darfur	120	78	---	---	---	---	198
. Afghanistan (extended mission deployment)	286	286	50	---	---	---	622
. Pakistan	57	---	---	---	---	---	57
. Immigration measures	68	93	9	9	11	11	201
. Other announced initiatives	165	205	265	248	182	171	1,236
. Total	767	814	491	425	377	390	3,263
Less :							
. Funding included in Budget 2005	168	106	55	65	75	92	560
. Net cost	599	708	435	360	302	298	2,702
. Total net cost	2,258	1,175	1,833	1,851	1,611	1,507	10,835

Source: Department of Finance of Canada, November 2005