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Promoting Recovery: Supporting the Economy and Public Finances During the Pandemic

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Recommendations

Recommendation 1
Focus more on providing economic support for Canadians during the pandemic and the recovery period by revising either program eligibility criteria or the programs themselves. For example:

1.1 Modelling access to EI on access to the CERB;
1.2 Targeting the CEWS to the hardest-hit sectors; and
1.3 Considering specific measures, such as permission to make tax-free withdrawals from RRSPs.

Recommendation 2
Consider increasing health assistance to the provinces, e.g., by increasing the CHT.

Recommendation 3
Maintain as much federal fiscal room as possible.

Introduction: guiding principles

When the COVID-19 pandemic hit, the Government of Canada chose to provide widespread, rapid support on a massive scale to the economic actors immediately affected. All available analysis shows that the objectives of these actions were largely met. In our opinion, subsequent phases of government action should seek to promote and cement economic recovery, while specifically targeting those who are still seriously affected by the ongoing situation, and to maintain a certain level of fiscal room for potential future shocks, which appear likely. Our recommendations in these areas are briefly explained below.

Targeted economic support

Reviewing the CERB and EI

The Canada Emergency Response Benefit (CERB) was the most used and most costly of the Government of Canada's support programs. While it was essential for a vast number of households, in a period of economic recovery it could become a disincentive to work.[1] Therefore, it was necessary to revise programs like the CERB, which the government began by announcing recently that the program would come to an end and be replaced by Employment Insurance (EI). Various researchers, including our teams, were advocating for this approach. However, the federal government has not announced any details at this time, especially as regards self-employed workers and the many other Canadians who are not eligible for regular EI benefits, other than to say that a new program would be created for them. Nor has it indicated what it intends to do if a second widespread lockdown occurs, or if its plan to transfer CERB recipients to regular EI and to the new program would still happen in that case.

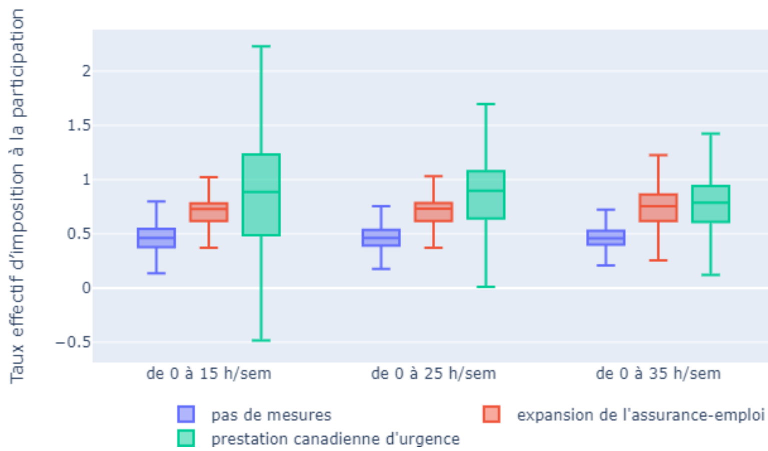
The analyses we have published since May provide an overview of the possible effects of one particularly simple scenario: make the criteria to access EI the same as for the CERB, but maintain all other existing EI parameters. According to our calculations for Quebec,[2] using the disposable income calculator (SRD) developed by the CREEi chair, if EI is expanded in this manner it would reduce the effective participation tax rate (TEPI) on entering the labour force. Figure 1, taken from one of our recently published research notes,[3] illustrates that the CERB is more of a disincentive to work than an expanded EI program, particularly for part-time workers, but that the difference between the CERB and EI is most apparent as regards the TEPI.

According to our calculations for Quebec,[4] also conducted using the CREEi disposable income calculator, an expanded EI program with the same eligibility criteria as the CERB would have

[1] See our work in Boisclair et al. (2020a), at https://cirano.qc.ca/en/summaries/2020PE-32.
[2] For these calculations and information about Figure 1, including the definition of the TEPI, see Boisclair et al. (2020b), https://cirano.qc.ca/en/summaries/2020PE-32.
[3] See Boisclair et al. (2020b), https://cirano.qc.ca/en/summaries/2020PE-32.
[4] Idem.

cost about $500 million (or 11%) less than the CERB for the period from April to June 2020 for those aged 25 to 64. These results show the potential savings in support offered across Canada, without any major economic impacts, as long as most households are able to make other adjustments (for example, cutting expenses, using savings, going into debt).[5]

Figure 1: Distribution of effective participation tax rates (TEPI) with different numbers of hours worked



Taux d'effectif d'imposition à la participation	Effective participation tax rate
De 0 à 15h/sem	From 0 to 15 h/week
De 0 à 25h/sem	From 0 to 25 h/week
De 0 à 35h/sem	From 0 to 35 h/week
Pas de measures	No measures
Expansion de l'assurance-emploi	Expanded Employment Insurance
Prestation canadienne d'urgence	Canada Emergency Response Benefit

Notes: Calculations made using the disposable income calculator (SRD) and the SPSD, taking into account a long list of federal and provincial fiscal measures, including the work premium. Work revenues during the pandemic were calculated using the hourly wage observed in the SPSD. The figure shows the effective tax rate (vertical axis) for someone who plans to work a certain number of hours (horizontal axis), compared to a situation where the individual does not return to the job market. A scenario without specific support measures (that is, pre-pandemic measures) and a scenario with support measures, either the CERB or an expanded EI regime, are shown. Distributions are calculated using weighted measures based on the probability of losing employment during the pandemic.

CEWS: in the medium term, targeting affected sectors

Based on our calculations for Quebec,[6] as well as data reported by various authors and media outlets, some economic sectors were harder hit by the pandemic. While some sectors were able to reopen early on or may be able to do so shortly, others will feel the effects for a long time,

[5] Our work above shows a slightly negative effect on federal finances if the CERB is replaced with an expanded EI with the same eligibility criteria, but this analysis did not take into account the dynamic of EI premiums or the possibility of somewhat limiting eligibility to benefits.
[6] See our work in Achou et al. (2020), at https://cirano.qc.ca/fr/sommaires/2020PE-24.

such as the hospitality and culture sectors. This approach suggests targeting programs such as the Canada Emergency Wage Subsidy (CEWS) over the medium term to sectors experiencing widespread difficulties due to anti-COVID-19 measures.

Allowing tax-free RRSP withdrawals

According to the survey our team conducted in Quebec in May, many people in higher working income deciles pre-pandemic were CERB beneficiaries.[7] These individuals were more likely to compensate for lost working income using means other than the CERB. Many of them also had over $8,000 in savings they could have used.

For this reason, and even though it would not work for everyone, since these savings are primarily intended for retirement, one option to consider in order to support consumption would be to allow people to withdraw a certain amount from their RRSPs tax-free. Two scenarios should be considered, and have been proposed by various researchers and analysts:

1) A withdrawal that is completely exempt from tax; or
2) A withdrawal that must be reimbursed over a certain period, similar to the Home Buyers' Plan (HBP).

In the first scenario, it is assumed that the government is permanently renouncing all the tax that could have been collected in the future on these withdrawals, which is not the case in the second scenario. While it is difficult to quantify at this point the value of tax that the government would be renouncing in the first scenario (and, potentially, additional benefits to pay out, such as for the Guaranteed Income Supplement), the point is that the cost of this measure would be felt in the future, not in the present. Table 1, based on our survey, indicates than one quarter of Quebeckers aged 25 to 64 who have an RRSP, or approximately 1 in 6 respondents, would have been willing to withdraw money from their RRSP if it were tax-free, for an average amount of $8,200 (which corresponds to approximately 16 weeks of the CERB).

Scenario 1 would be more beneficial for experienced workers who lost their jobs or for semi-retired workers, if their investments were not overly affected by the pandemic, and would be even more beneficial if making this withdrawal would allow them to receive higher benefits from Old Age Security programs after the age of 65. The table also shows that older individuals were more likely both to have an RRSP and to withdraw an amount; in our survey, 15% of respondents aged 55 to 64 said they had already made a withdrawal from their RRSP.

[7] Idem.

Table 1: Intent to withdraw from RRSP if it were tax exempt in 2020 (up to $10,000)

Age group	% With an RRSP	% who would make a withdrawal if it were tax exempt (of those with an RRSP)	Average amount of withdrawal
25-39 years	53.7	18.9	$7,249
40-54 years	60.6	24.9	$8,328
55-64 years	68.4	35.1	$8,893
Total (25-64 years)	59.2	24.7	$8,187

Source: Online survey by IRE-CREEi-CIRANO conducted from May 8 to 20 through the *Qu'en pensez-vous?* panel N=3009; in order to make the survey representative of the Quebec population aged 25 to 64, statistical weight was applied based on the 2016 Census.

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1.4 Modelling access to EI on access to the CERB;
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Provincial health care needs

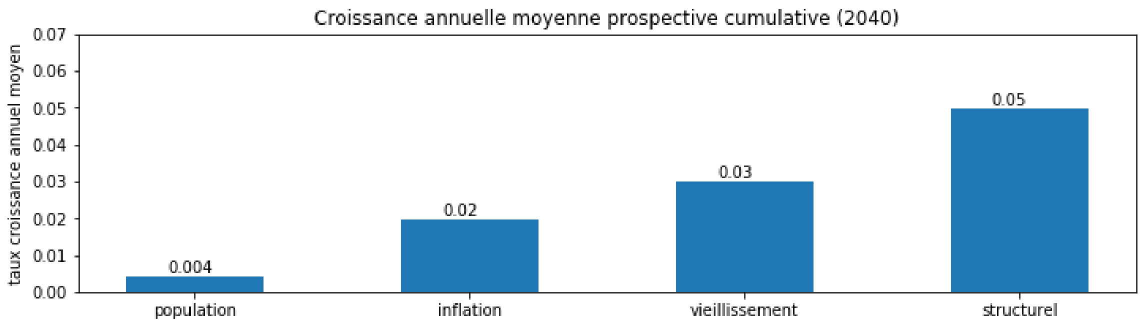
Figure 2 shows our **pre-pandemic** projection for Quebec, leading up to 2040: significant upward trends that were already present before the pandemic will not disappear any time soon. With a second wave of COVID-19 in the wings, and looking ahead to a post-pandemic period, many people anticipate an increase in health care expenses in the provinces, especially in light of how the pandemic affected long-term care homes.

One way to support these expenses while taking into account the major differences between provinces (for example, how long-term care services are organized or delivered), could be to increase the Canada Health Transfer (CHT). A note to be published on CIRANO suggests that the CHT be increased by 5% per year, instead of at the rate of the GDP, in order to maintain a consistent federal funding rate of 14.9% for health care in Quebec. An alternative could be to transfer fiscal room to the provinces, but if this room does not grow at a faster rate than the GDP, it may have to be readjusted over time.

The corresponding amounts could also lead to increased employment and services in related areas, which would support provincial economies in years to come. Of course, it would also help the provinces address what could be a massive shift that seems to be coming for long-term care

and home care. Some work is underway to quantify the scope of unmet needs. The July 2020 agreement for $19 billion in additional transfers to the provinces will ensure that certain pressing needs can be met, for example, as regards COVID-19 tests or municipal insolvency, but nothing more. The agreed-upon amount is a one-time payment, representing approximately $500 per person.[8]

Figure 2: Average annual growth rate in health care expenses in Quebec, 2020–2040



Source: Projections using data from the ISQ for demographic forecasts and historic calculations from CIHI, 2000-2018.

Croissance annuelle moyenne prospective cumulative (2040)	Prospective average annual growth, cumulative (2040)
Taux croissance annuel moyen	Average annual growth rate
Population	Population
Inflation	Inflation
Veillissement	Ageing
Structurel	Structural

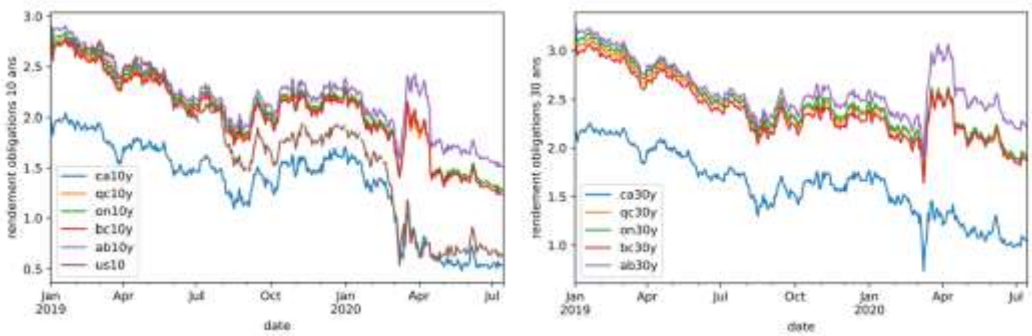
Recommendation 2
Consider increasing health assistance to the provinces, e.g., by increasing the CHT.

Canadian government debt

The Government of Canada had a good amount of fiscal room before the pandemic, and it is one of the most sought-after public lenders in the world by investors. Nevertheless, the significant amounts allocated to emergency support have put a serious strain on public federal finances, the most severe in 75 years. A credit agency even downgraded Canada’s debt rating by one point in June 2020. A lower rating could mean a higher cost of borrowing. Scientific literature and studies underway suggest that an increase in public debt will lead to an increase in the cost of borrowing for the government in question.[9]

[8] At the time this document was written, the method for dividing the amount between the provinces was unknown.
[9] Gamber and Seliski (2019, Congressional Budget Office Working Paper Series) estimated that each increase of one percentage point in federal debt as a percentage of GDP would boost interest rates by two to three basis points in the United States. Engen and Hubbard (2005, NBER Macroeconomics Annual 2004, vol. 19) in their overview of the literature and their own estimates came to a similar conclusion. Afonso et al. (2020, International Review of Law

The government's fiscal space has therefore shrunk considerably. However, the Canadian government's low borrowing rates are likely partly based on the fact that the Bank of Canada acted quickly, in March 2020, to purchase a large quantity of Canadian debt, leveraging its assets over several months. The announcement of a provincial bond buyback program was also quite well received, although the performance gap between provincial bonds and federal bonds seems to have increased since the beginning of the pandemic. Many provinces have much more restricted fiscal room than the federal government, which is a point in favour of the federal government being somewhat prudent as regards its level of debt. While no one is predicting an increase in rates in the foreseeable future for a given credit rating, a significant increase in debt makes Canadian public finances more vulnerable to new shocks, such as a second wave, a slow recovery or a W-shaped recovery.



Source: Bloomberg Data, ca = Canada, qc = Quebec, on=Ontario, bc = British Columbia, ab = Alberta and us= United States. The chart on the left shows the yield to maturity over 10 years, and the one on the right, over 30 years.

Rendement obligations 10 ans	Bond yields 10 years
Rendement obligations 30 ans	Bond yields 30 years

While the Government of Canada can use monetary mechanisms and remains less indebted than most provinces, it should seek fiscal prudence in the near future. Some of the measures described above, such as replacing the CERB or giving savers the option to make a tax-free withdrawal from their RRSPs, could help the Government of Canada stay on that track.

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and Economics vol. 63) showed that announcements of a growing debt or deficit affected bond spreads in the Euro zone. Booth et al. (2007, Canadian Journal of Economics vol. 40 no. 3) showed that the federal-provincial yield spread was affected by debt levels. Our own estimates for Quebec show that there is an increase of one to two basis points for every increase of one percentage point in the debt to GDP ratio.