TD Bank Financial Group

TD Economics

Special Report

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THE FEDERAL GOVERNMENT HAS SCOPE FOR BROAD-BASED TAX RELIEF

The federal government will soon be releasing the 2007 Economic & Fiscal Update. This comes in the wake of recent reports of a $13.8 billion surplus for 2006-07, compared to a budget estimate of $9.2 billion, and an $8.7 billion surplus for the first 5 months of 2007-08, $1.5 billion ahead of the surplus for the corresponding period the previous year. The large surpluses, together with intentions announced in the Speech from the Throne, have lead to speculation there may be broad-based tax relief in the Update. TD Economics has taken its economic forecast and updated the status quo fiscal outlook to provide an assessment of the fiscal capacity to cut taxes. The projections in the Update will differ because Finance uses the average of private sector economic forecasts (TD Economics is a bit more pessimistic on economic prospects than the average) and does its own fiscal projection. Nevertheless, the numbers provided here should be indicative of what will appear in the Update.

The TD Economics fiscal projection incorporates all policy actions announced through the 2007 Budget. It does not include in this "status quo" the promised second point cut to the GST rate. The 2007-08 surplus is estimated at $14.5 billion. The surplus grows every year thereafter. For 2008-09 it is projected to be $16 billion. The Government has committed to paying down $3.0 billion a year against the debt. That leaves $13.0 billion that could be allocated to new initiatives. For 2009-10 the surplus is projected to be $16.5 billion, leaving $13.5 billion after the debt payment.

Beyond 2009-10 the surpluses grow quickly as revenues rise faster than program spending and interest payments on the public debt are flat. By 2012-13, for example, the surplus is projected to be $27.5 billion, leaving $24.5 billion for fiscal action after the debt payment. By 2012-13, the federal debt-to-GDP ratio could be down to 17.9 per cent if no additional fiscal action is taken. If only the $3.0 bil-

FISCAL PROJECTION

	(billions of dollars)						
Fiscal year	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
Budgetary transactions							
Revenues	236.0	248.0	256.5	265.5	277.5	288.5	300.0
Expenses	-188.3	-199.5	-206.5	-215.0	-222.5	-230.5	-238.5
Public debt charges	-33.9	-34.0	-34.0	-34.0	-34.0	-34.0	-34.0
Total expenses	-222.2	-233.5	-240.5	-249.0	-256.5	-264.5	-272.5
Underlying surplus	13.8	14.5	16.0	16.5	21.0	24.0	27.5
Planned debt reduction	0.0	3.0	3.0	3.0	3.0	3.0	3.0
Planning surplus	13.8	11.5	13.0	13.5	18.0	21.0	24.5
Federal debt	467.3	452.8	436.8	420.3	399.3	375.3	347.8
% of GDP	32.3	29.5	27.1	24.9	22.5	20.2	17.9

Source: Department of Finance, TD Economics

ECONOMIC & FINANCIAL ASSUMPTIONS							
Calendar year	2006	2007	2008	2009	2010	2011	2012
Real GDP, Y/Y % chg.	2.8	2.6	2.3	2.4	2.8	2.6	2.6
Implicit GDP deflator, Y/Y % chg.	2.4	3.6	2.6	2.2	2.5	2.1	1.8
Nominal GDP, Y/Y % chg.	5.2	6.2	4.9	4.6	5.3	4.7	4.4
Nominal GDP, C$ billions	1,446.3	1,536.0	1,611.2	1,685.4	1,774.7	1,858.1	1,939.8
3-month T-bill rate	4.0	4.2	4.8	4.9	4.9	4.9	4.9
10-yr GoC bond yield	4.2	4.4	4.9	5.1	5.1	5.1	5.1
Source: Statistics Canada / Haver Analytics; Forecast by TD Economics as at Oct. 2007							

lion annual payments are made the ratio would be 23 per cent. In either case the Government's target of a 25 per cent debt-to-GDP ratio would be met.

The TD Economics fiscal projection suggests the federal government has ample room to deliver broad-based tax relief. The focal point will be 2008-09 and 2009-10 where the planning surpluses (capacity available for fiscal action after making $3 billion annual debt payments) are $13.0 and 13.5 billion respectively. The second point cut in the GST rate could be made effective immediately as it lops around $5.5 billion off revenues annually. Hopefully that will not be a priority as it does nothing to address the competitiveness needs of the economy. Further, it should only be offered in the context of provinces still with retail sales taxes agreeing to harmonize with the GST. Instead, the priority should be personal and corporate income tax cuts. The Government has spoken in favour of extending income-splitting beyond pensions to include all forms of income but has balked at the cost. But at around $5 billion per annum, it could clearly be financed under these projections. As a rule-of-thumb, each percentage point knocked off the marginal personal income tax rates costs around $5.5 billion per year. Alternatively the marginal personal income tax rates for low-to-middle income class taxpayers could be reduced by cutting the tax back rates on various social payments such as the Canada Child Tax Benefit, the low-income GST credit or Guaranteed Income Supplement payments. A one point cut to the general corporate income tax rate costs around $1 billion per year. The opportunity is there for a bold move to deliver substantial personal and corporate income tax relief that, if structured appropriately, would raise the economy's productive capacity limit.

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