

Canadian Federal Government Details Wage Subsidy Program

- Today Finance Minister Morneau provided much-awaited details on the 75% wage subsidy program announced last week.
- Companies of all sizes, as well as non-profit organisations, that suffer revenue declines of at least 30% (relative to the same month last year) will be eligible for the new *Canada Emergency Wage Subsidy (CEWS)*.
- The government anticipates the program will cost \$71 bn, while it is expected to reduce pressures on the new *Canada Emergency Response Benefit (CERB)* by \$16 bn as more Canadians retain their jobs.
- This brings total direct support to an estimated \$111 bn (or 5.3% of GDP), of which of \$95 bn directly targets the labour force through the CEWS and CERB.
- These measures are well-targeted to the hardest hit channels, while attempting to pave the way to a faster recovery. Still, the uptake, duration, and eventual withdrawal of this support remain the biggest question marks that only time will answer.
- Today's measures could bring deficit spending to about \$170 bn (or 7.6% of GDP) for FY21, though a budgetary balance in the order of \$200 bn (or approaching 10% of GDP) would not be unreasonable in face of this unprecedented shock.

THE COST OF LABOUR ATTACHMENT

Finance Minister Morneau provided more details on the earlier-announced wage subsidy program today. Unlike its earlier 10% wage subsidy that was to target small businesses, the new measure applies to any business (and non-profit organisations) that can demonstrate revenues losses of 30% or more relative to the same month last year. This would be retroactive to March 15th and would last through end-May, according to Minister Morneau.

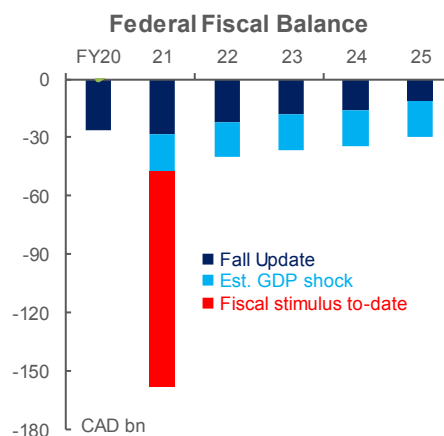
The wage subsidies comes with a price tag of \$71 bn. There was no doubt a lot of guesswork in costing this item as uptake remains unclear. Canadian wage and salaries were running at an annualized pace of about \$1 tn in late 2019. A ten-week subsidy of \$71 bn would cover about a third of Canadian payroll at this rate. The government had earlier indicated it expected about 5 million Canadians to apply for employment benefits, or about a quarter of the Canadian workforce. At the end of day, incentives are more likely to attract more, not fewer, applicants as few are immune to the present shock.

For some Canadian businesses, though, this will not be enough. Many can expect near-100% revenue shocks in the coming months. A 75% wage subsidy will help offset this loss temporarily, particularly for labour-intensive sectors, but other expenditures will persist. With some industries less likely to capture significant rebound business (think haircuts, meals, movies, etc.), they may be hesitant to take on debt—even if on highly favourable terms—for an undefined period of time. They may face few other options than to let go of their workforces and possibly even wind-up their business if the shock persists.

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Chart 1



Sources: Scotiabank Economics, Finance Canada.

Overall, there is likely more upside than downside to the \$71 bn price tag. The ten-week duration is likely optimistic. Health officials are signalling July as a 'reasonable' assumption for flattening the curve (and only the first wave). And even if the outbreak is behind us, the economic recovery will still be nascent and there would be risks to a sudden withdrawal to this extraordinary support.

It appears the program may operate on the "honour" system. Currently, there is no harmonized federal reporting structure for monthly corporate revenues. The CRA is therefore more likely to administer a self-attestation process, similar to what it will do for the CERB, to accelerate its payment. The Minister indicated businesses could receive transfers within 4 to 6 weeks, while repeatedly referencing harsh penalties for those that abuse the program.

KEEPING YOUR JOB PAYS (FOR EVERYONE)

The government emphasizes the goal of minimizing workforce reduction through this painful, but temporary shutdown. Rightly so, as the eventual recovery will be slower if businesses have to restart the hiring process afresh. Recall, one of the biggest constraints reported by Canadian businesses barely a month ago was finding talent. Minister Morneau today also reduced the size of the new employment benefit by \$16 bn with the anticipation that fewer Canadians would need to tap into this support as the wage subsidies comes on line.

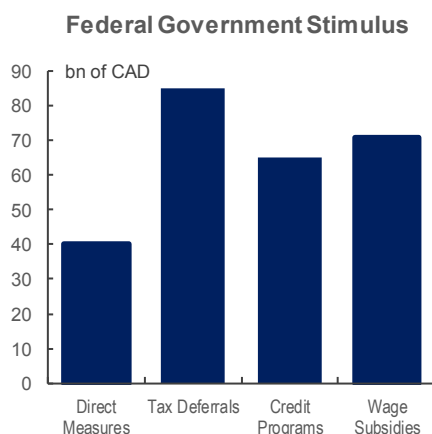
Though not driving the design, there is some potential fiscal upside for the government. Personal income tax revenues were in the order of \$160 bn last year and comprised more than half of all federal government revenues. The near-term costs of keeping Canadians employed will be offset to a degree in next year's tax filing. There may also be tax-related offsets for larger corporations that can afford to run larger losses in the near-term with the expectation of higher tax write-offs later. Corporate tax receipts represent only about 15% of federal government revenues.

KEEPING AN EYE ON THE MONEY

It can be difficult to track the overall support package with so many moving pieces and revamped programs. Earlier in the month, the Minister had announced two new employment insurance benefits totalling \$15 bn; following a shocking 1 mn Canadians applying for EI the following week, these plans were quickly revised to blend them into one new program—the CERB—with \$40 bn in funding. This was scaled back to \$24 bn today.

We estimate direct measures announced to-date total \$111 bn or 5.3% of GDP (chart 2, table 1). Of this amount, \$95 bn is directly targeting the employment shock through CEWS (\$71 bn) and CERB (\$24bn). The remainder more modestly targets vulnerable segments of the population through existing transfers mechanisms. Overall, this reflects a well-targeted package with the onus now on getting money out quickly.

Chart 2



Sources: Scotiabank Economics, Government of Canada.

Table 1

Direct Measures (\$bn)	Prior to Apr. 1 2020-21*	As of Apr. 1 2020-21
Canada Emergency Response Benefit	40.0	24.0
Enhanced GST Credit		5.5
Enhanced Canada Child Benefit		1.9
Canada Student Loan Payments		0.2
Support for Indigenous Communities		0.3
Support for the homeless		0.2
Support for women shelters		0.1
Lower RRIF Minimum Withdrawal		0.5
Provincial and medical support		1
Canada Emergency Business Account (25% forgiveness)		6.25
Canada Emergency Wage Subsidy	3.9	71
Total Direct Support To-Date		111
Other Non-Budgetary Measures (\$bn)		
Tax deferrals		85
Canada Emergency Business Account (75%)		19
Additional lending capacity through BDC/EDC		40
Total Other Non-Budgetary Measures		144
Total New Measures Announced (Budgetary and Non-Budgetary)		255

* Only changed items listed

Sources: Scotiabank Economics, Government of Canada.

There is likely still more to come. The Prime Minister and various Cabinet Ministers have suggested targeted support for the oil sector, while more support for the airline industry will likely also be needed. There has yet to be significant transfers to provinces. Many may become eligible down the line under the Fiscal Stabilization Transfer that takes into account large revenue shocks, but its backward-looking design would be too late so the federal government could be expected to address this gap.

The government has also announced various loan and payment deferral measures amounting to another \$144 bn (or 7% of GDP). Deferrals provide some immediate cash-flow relief, but eventually have to be repaid. Loans, even highly concessional, can be challenging for some businesses, particularly the longer the shutdown endures as it becomes a question of solvency, not liquidity. These measures are not likely to add to deficit spending but would most likely add to federal debt accumulation as assets would have to be held against these non-budgetary items for accounting and provisioning purposes.

Today's stimulus measures can be expected to bring the deficit in the range of \$170 bn in FY21 (or 7.6% of GDP). This includes \$111 bn in stimulatory measures, along with earlier-planned deficit spending, and an expected impact on the fiscal balance from significantly lower GDP (chart 1, pg. 1). This is of course subject to uncertainty with few details on the current health of federal finances in light of the shock.

BOTTOM LINE

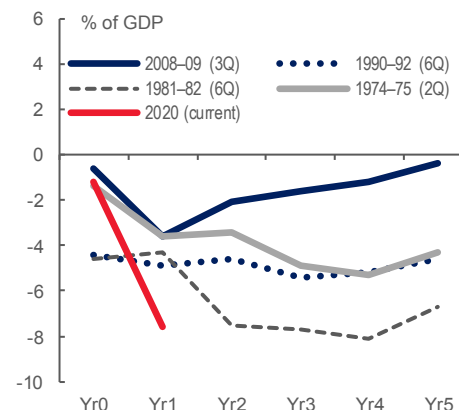
Deficit spending above \$200 bn can reasonably be expected once additional measures are announced and final price tags come in. This would dwarf spending in past recessions (chart 3), but given the magnitude of the shock Canada is facing, this would be warranted. The risk of responding too slowly or too cheaply would come at the cost of a more protracted recession that would take a much bigger toll on the economy and the government's finances.

The federal government has headed into the shock in a relatively enviable position. Canada's net debt (federal and general government) as a share of the economy is the lowest among peers by far for the most part (chart 4). A sizable federal government response is shifting the burden that, absent government intervention, would fall squarely on households and businesses—or possibly provinces—all of which are far more leveraged than the federal government at present.

It does raise uncertainties with respect to debt issuance in the near-term. The federal government will need to issue substantial securities, likely shorter-term, in the coming weeks and months at a moment when the Bank of Canada is aggressively trying to calm short-term funding markets. Needless to say, markets will anxiously await details on the government borrowing plan.

Chart 3

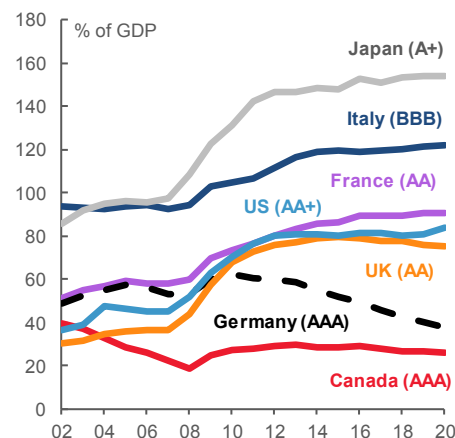
Deficit Spending in Past Recessions



Sources: Scotiabank Economics, Statistics Canada, Department of Finance, CD Howe

Chart 4

G7 General Government Net Debt



Sources: Scotiabank Economics, IMF, S&P.

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