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The *Federal Accountability Act* mandates the Parliamentary Budget Officer (PBO) to provide independent analysis to the Senate and House of Commons on the state of the nation's finances, government estimates and trends in the national economy.

In meeting the commitments of this mandate, this short note presents an updated economic outlook and assesses its fiscal implications. The note also summarizes the broader international policy context and provides some key questions for Parliamentarians to consider.

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* The authors thank Mostafa Askari and Kevin Page for helpful comments.

On January 27, 2009, after extensive consultations, the Government of Canada will present its highly-anticipated budget. This short note attempts to provide some background information for Parliamentarians for Budget 2009 deliberations. The note: updates the Parliamentary Budget Officer's (PBO) survey of private sector forecasters and its fiscal implications; summarizes the broader international policy context; and highlights some important policy considerations.

1. Key Points

- Since PBO's November 2008 *Economic and Fiscal Assessment* (EFA)[1] the near-term outlook for the Canadian economy has weakened further and is projected to remain below its potential capacity over 2008-2013. Based on PBO's updated economic survey:
    - For 2009, 10 out of 11 forecasters now expect a decline in real (inflation-adjusted) gross domestic product (GDP). The average forecast shows a decline of 0.8%. Nominal GDP — the broadest measure of the tax base — is now, on average, expected to fall by 2% this year, the first decline in decades.
    - The output gap (real GDP relative to potential GDP) is projected to trough at roughly -5% in 2009 and persist through 2013, despite a rebound in growth beginning in 2010.
    - This gap represents approximately $260 billion or $20,000 per household in foregone income over 2008 to 2013.
    - Based on the low forecasts in the January survey, real GDP is expected to decline by 1.5 % in 2009 and nominal GDP is forecast to decline by 4.8%.

- Before accounting for any new fiscal measures to be introduced in Budget 2009, this more sluggish economic outlook suggests a further deterioration in the budget balance relative to PBO's November EFA.
    - The updated economic outlook based on the PBO survey average results in a status quo budgetary deficit reaching $13 billion in 2009-10, equivalent to 0.8% of GDP.
    - On a cumulative basis, status quo budget deficits amount to $46 billion over 2009-10 to 2013-14.
    - PBO currently judges that the balance of risks to its fiscal outlook is tilted to the downside, reflecting the possibility of weaker-than-expected economic performance and relatively optimistic assumptions about corporate profits.
    - The January survey's low forecasts are used to illustrate potential downside economic risks and imply significantly larger deficits on a status quo basis, averaging $21 billion annually over the next five fiscal years.

[1] Available at: http://www2.parl.gc.ca/sites/pbo-dpb/documents/Ecomomic%20and%20Fiscal%20Assessment%20-%20November%202008.pdf.

- After providing near-term fiscal stimulus, if the Government were to aim for a surplus position within the next five years, it would likely require contractionary measures in the outer years, while the economy is still expected to be below its potential capacity.

- Governments across the world are being called on to provide economic stimulus measures to counteract the on-going global recession. However, it is important to keep in mind that:
    - Relative to many other countries, Canada is expected to experience a milder recession. As a result of its healthier fiscal position going into the recession, Canada's status quo budget deficits, relative to the size of its economy, are projected to be much smaller than those in many other industrialized countries.
    - Further, rough estimates indicate that the Government has a structural surplus of about $6 billion — though more work needs to be undertaken in this area. Thus, any permanent fiscal actions (e.g., permanent tax cuts or permanent spending increases) exceeding $6 billion annually would likely result in structural deficits, limiting the Government's ability to manage future cost pressures due to, for example, population ageing.

2. Updated Status Quo Economic Outlook

In the PBO *Economic and Fiscal Assessment* presented in November, our judgement was that there was downside risk to the private sector economic outlook at that time. Since then, the down-grading of near-term forecasts for the Canadian economy has continued due to weak incoming data in Canada, and particularly in the U.S., as well as a further deterioration in consumer and business sentiment.

Table 1 below compares the latest PBO economic survey completed January 12, 2009, to the EFA numbers based on forecasts as of November 10, 2008. The results show that the near-term outlook has weakened significantly during the past two months. Last November only 2 of 11 forecasters expected real gross domestic product (GDP) to decline in 2009; just two months later all but one forecaster is expecting a decline. However, the updated survey now points to a strong rebound beginning in 2010, bringing the economy back to the level of real GDP projected in the EFA by 2013.[2]

For 2009, private sector forecasts of GDP, both real and nominal, and consumer prices are weaker, interest rates are expected to be substantially lower, and unemployment is expected to rise. Nominal GDP — the broadest measure of the tax base — is expected to decline by 2%, which would be the first annual decline in Canada in several decades. Indeed, relative to expectations in November, the level of nominal GDP is projected to be about $40 billion lower on average over 2009-2011. Interest rates at both the short and long end remain about a percentage

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[2] The impacts of any anticipated fiscal stimulus factored into the economic forecasts should be removed. Our review of the underlying forecasts suggests that anticipated fiscal measures (for the few forecasters that have incorporated expected measures) are not significantly impacting their economic outlooks. As a result, the economic outlook based on our updated survey can essentially be regarded as a 'status quo' i.e., before any economic impacts of new fiscal stimulus measures have been included.

point lower for a few years, and the impacts of a weaker labour market are also expected to persist, with the unemployment rate rising to 7.7% in 2010.

Table 1: Average Private Sector Forecasts

	2008	2009	2010	2011	2012	2013
Real GDP growth (%)						
November 2008 EFA Average	0.6	0.5	3.1	3.0	2.8	2.7
January 2009 PBO Survey	0.7	-0.8	2.6	3.8	3.5	3.1
GDP inflation (%)						
November 2008 EFA Average	3.8	0.2	1.2	2.0	2.0	1.9
January 2009 PBO Survey	3.9	-1.2	1.5	2.1	2.1	1.9
Nominal GDP growth (%)						
November 2008 EFA Average	4.4	0.6	4.4	5.1	4.8	4.7
January 2009 PBO Survey	4.6	-2.0	4.1	6.0	5.6	5.1
Nominal GDP level ($ billions)						
November 2008 EFA Average	1,603	1,613	1,684	1,769	1,855	1,941
January 2009 PBO Survey	1,607	1,574	1,639	1,737	1,835	1,928
3-month treasury bill rate (%)						
November 2008 EFA Average	2.4	2.0	3.0	3.5	4.0	4.3
January 2009 PBO Survey	2.4	0.9	1.9	3.2	3.8	4.3
10-year government bond rate (%)						
November 2008 EFA Average	3.7	3.8	4.3	5.0	5.2	5.3
January 2009 PBO Survey	3.6	2.9	3.4	4.2	4.9	5.6
Unemployment rate (%)						
November 2008 EFA Average	6.1	6.9	6.8	6.5	6.4	6.3
January 2009 PBO Survey	6.1	7.4	7.7	6.9	6.5	6.4
Total CPI inflation (%)						
November 2008 EFA Average	2.6	1.6	1.7	1.9	2.0	2.0
January 2009 PBO Survey	2.4	0.8	1.7	1.9	2.0	2.0

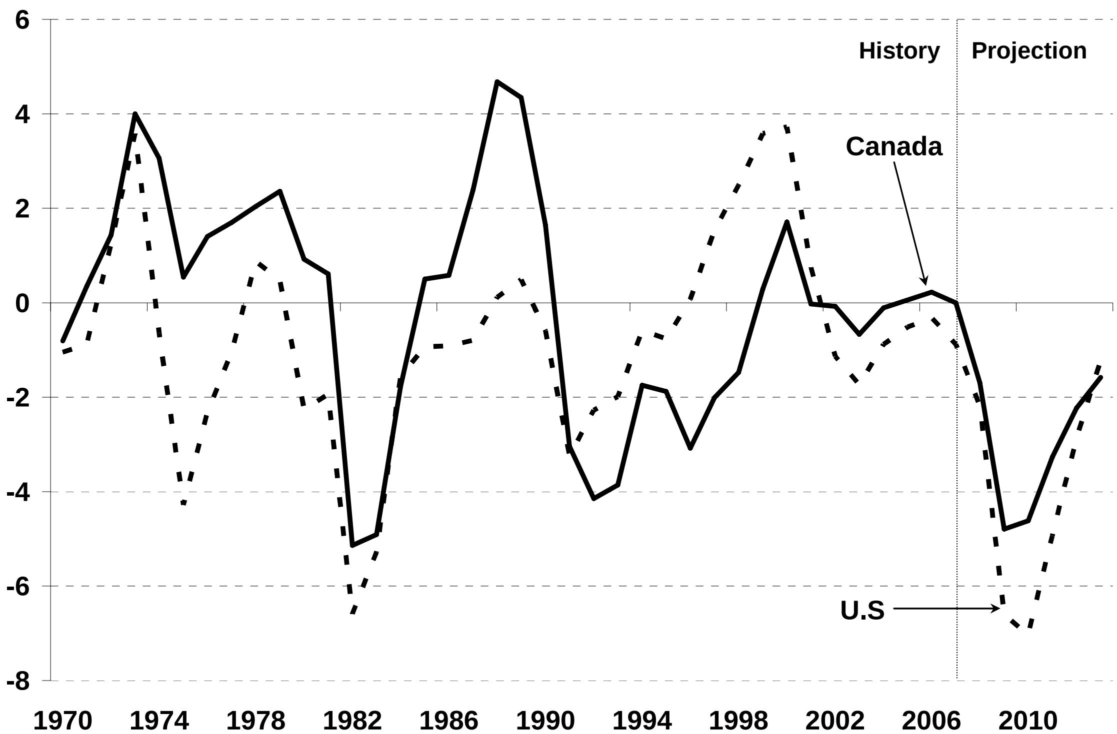
Recent analysis[3] at the PBO highlights the usefulness of 'output gaps' to inform discussion about the magnitude and nature of fiscal actions needed to stabilise the economy. The output gap is the percentage difference between real GDP and potential GDP, which is the level of output produced when labour is at its potential, capital is fully utilized and technology is at its trend value. Figure 1 shows the output gaps for Canada and the U.S over 1970-2013.[4] While these estimates, both historical and forward-looking, are subject to a high degree of uncertainty, it is clear that output in

[3] http://www2.parl.gc.ca/Sites/PBO-DPB/documents/CABB%20-%20E.pdf

[4] For Canada, this updates the December 2008 PBO analysis to include January's PBO survey average forecasts of real GDP growth. Potential output is assumed to grow at 2.4% annually, see http://www2.parl.gc.ca/Sites/PBO-DPB/documents/CABB%20-%20E.pdf. The U.S. fiscal projections are from the Congressional Budget Office, January 2009. These data are available at: http://www.cbo.gov/budget/econproj.shtml.

both economies is expected to be significantly below its potential capacity for several years to come. In Canada, the output gap is projected to trough at -4.8% in 2009, a similar magnitude to that experienced during the 1980s recession but with a gap persisting for a longer period. To put this gap into perspective, it represents approximately $260 billion, or $20,000 per household, in foregone output/income over the period 2008-2013. The situation is worse still in the U.S. with the output gap projected to reach -7% in 2010. Neither gap is projected to be fully closed by 2013.

Figure 1: Estimated Output Gap, Canada and the U.S. 1970-2013 (per cent of potential GDP)



Sources: Department of Finance Canada, Office of the Parliamentary Budget Officer (PBO) and the Congressional Budget Office (CBO).

3. Implications for the Budgetary Balance

The updated economic survey results in a markedly worse status quo fiscal projection for the Government compared to the previous PBO survey average scenario, but still within the lower range of the projections over 2009-10 to 2012-13 presented in PBO's November EFA.

To update our fiscal projections, in addition to the new economic outlook, we have refined some of our underlying assumptions regarding income tax collections. As well, we have adopted the underlying updated direct program spending track presented in the Government's November Economic and Fiscal Statement (EFS); however, we have not included the projected results of the proposed asset sales or reviews that were announced and recorded in the Government's

November EFS.[5] The PBO is unable to assess the feasibility of realizing the revenues or savings associated with the proposed initiatives as no supporting documentation has been provided. This update also excludes other actions proposed in the Government's EFS, due to uncertainty regarding their implementation.

Table 2 provides an estimate of the implications of the weaker economic outlook relative to the average scenario presented in PBO's EFA this past November. The updated PBO survey average scenario shows that, prior to any fiscal stimulus measures proposed in Budget 2009, the Government is projected to run a deficit of $13 billion in 2009-10, improving to a deficit of $5.3 billion in 2013-14. Box 1 below provides a discussion of the fiscal results for 2008-09. Relative to the size of the economy, the $13 billion deficit projected for 2009-10 amounts to 0.8% of GDP (see Figure 2 below).

Table 2: Fiscal Implications of Revisions to the Average Private Sector Economic Outlook

$ billions	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
(1) Starting Budget Balance (PBO EFA survey average scenario)	**4.0**	**-3.9**	**-1.4**	**1.6**	**3.0**	n/a
(2) Net Fiscal Impact of January Avg. Scenario	**-4.0**	**-10.2**	**-10.9**	**-10.6**	**-10.7**	n/a
a) Budgetary Revenues	-4.9	-11.3	-11.5	-10.6	-8.8	n/a
b) Program Expenses	0.6	-0.3	-0.5	-0.4	0.1	n/a
c) Public Debt Charges	0.3	1.4	1.1	0.4	-2.0	n/a
(3) = (1) + (2) New Underlying Budget Balance	**0.0**	**-14.1**	**-12.3**	**-9.0**	**-7.7**	**-5.6**
(4) Insured Mortgage Purchase Plan	0.2	1.1	0.7	0.4	0.3	0.3
(5) = (3) + (4) Status Quo Budget Balance	**0.2**	**-13.0**	**-11.6**	**-8.6**	**-7.4**	**-5.3**
Share of GDP (%)	0.0	-0.8	-0.7	-0.5	-0.4	-0.3

Table 2 shows the larger projected deficit is mainly a result of lower income tax revenues due largely to lower nominal personal and corporate income. Program expenses are largely unchanged as lower Old Age Security (OAS) payments and direct program expenses offset higher Employment Insurance benefits resulting from higher projected unemployment. The lower direct program expenses result from the adoption of the Government's EFS forecast.

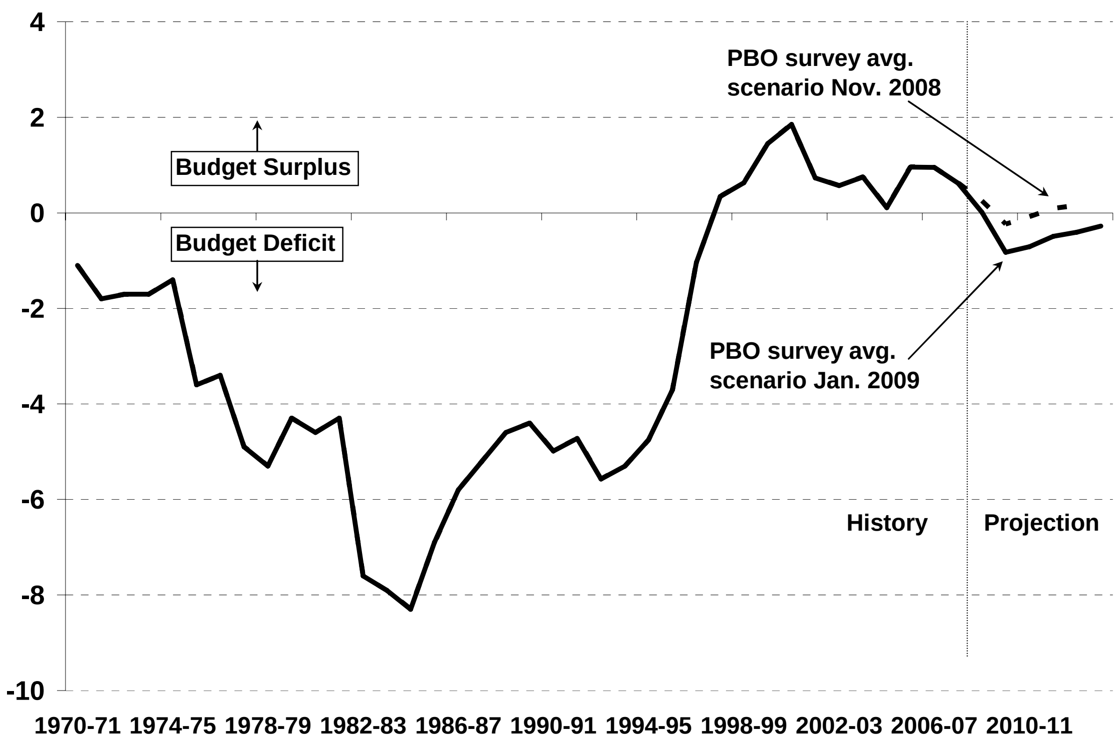
As a result, on a status quo basis, the Government is projected to run a cumulative deficit of approximately $46 billion over the next five fiscal years. However, we currently judge that the balance of risks to the status quo fiscal outlook is tilted to the downside. This judgement reflects the possibility that the economic outlook could be even weaker than private sector forecasters' current expectations — i.e., the downturn could be deeper and/or longer than that reflected in the

[5] We have also not included the full reduction in direct program spending (relative to Budget 2008) in 2008-09 attributable to continued lower-than-expected departmental program spending (DPS), based on the strong year-to-date growth in 2008-09 (9.7%) shown in the Fiscal Monitor. Underlying direct program expenses were projected to be $1.3 billion lower than expected in 2008-09 and about $0.4 billion in 2009-10 and 2010-11 than in Budget 2008, before the impacts of the various reviews announced in the EFS were taken into account.

PBO survey.[6] Also, past recessions suggest that corporate income tax revenues will likely be weak for some time and this revenue loss may not be fully offset by higher revenues elsewhere.

> Box 1: **Fiscal Results for 2008-09**
>
> The November EFA projected a budgetary surplus of $4.0 billion in 2008-09 under the PBO survey average scenario but cautioned that a deficit was a ‘distinct possibility’ for the year. We have adjusted our projection to show a balanced budget in 2008-09, though a deficit remains a ‘distinct possibility’. As of October, the Government’s year-to-date surplus for the first seven months of the fiscal year was $0.2 billion. However, the most significant period for tax revenues is the last four months of the year, in particular for corporate income taxes. This is because corporations, who to date have been remitting monthly tax instalment payments based on estimates made earlier in the year, make their final settlement payments based on actual taxes owing in this period. These final settlement payments could be much lower than in previous years given the economic situation that materialized in the latter half of 2008. In addition, capital losses due to the declines in financial markets will likely mean personal income tax revenues will be adversely affected when Canadians file their 2008 taxes.

Figure 2: Budget Balance as a Percentage of Nominal GDP, 1970-71 to 2013-14



Source: Department of Finance Canada and Office of the Parliamentary Budget Officer.

[6] Recent research by the IMF Clasesens et al, *What Happens During Recession, Crunches and Busts?* (2008, WP/08/274) and academic economists Reinhart and Rogoff, *The Aftermath of Financial Crisis (2008)* both analyze the cross-country evidence and find evidence that financial, credit and housing related recessions tend to be longer and more severe.

Thus, the average scenario may represent an optimistic view in terms of the size of budgetary deficits on a status quo basis. To help assess the potential fiscal impacts of downside economic risks to this outlook, the January survey's low growth, inflation and interest rate forecasts, along with the high unemployment rate forecasts, are used for illustrative purposes (see Annex 1). This updated PBO survey low scenario implies significantly larger deficits on a status quo basis, averaging $21 billion annually over the five-year projection period (Table 3).

The higher deficit forecast in the low scenario is a result of lower tax revenues due to significantly weaker income projections. This reduction is dampened marginally by reduced program expenses due to the impact of lower projected prices on inflation-sensitive programs such as OAS.

Table 3: Fiscal Implications of PBO January Low Scenario

$ billions	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
(1) January Average Scenario Budget Balance	**0.2**	**-13.0**	**-11.6**	**-8.6**	**-7.4**	**-5.3**
(2) Net Fiscal Impact of January Low Scenario	**-1.8**	**-6.2**	**-10.7**	**-12.2**	**-13.8**	**-15.1**
a) Budgetary Revenues	-1.9	-7.2	-12.0	-13.6	-15.2	-16.1
b) Program Expenses	-0.1	0.0	0.5	1.4	1.7	2.0
c) Public Debt Charges	0.2	1.0	0.8	0.0	-0.3	-1.0
(3) = (1) + (2) Status Quo Budget Balance in January Low Scenario	**-1.6**	**-19.2**	**-22.2**	**-20.7**	**-21.1**	**-20.4**
Share of GDP (%)	-0.1	-1.3	-1.4	-1.3	-1.2	-1.1

Status Quo Structural and Cyclical Budgetary Balances

Table 4 below presents updated estimates of status quo structural and cyclical budgetary balances based on the updated PBO average economic scenario. Although the status quo budget balance is projected to remain in deficit over the entire projection period this is not necessarily indicative of a structural deficit. That is, the persistent deficit reflects that the economy is projected to remain below its potential capacity over the period. Therefore, although a fiscal stimulus of 1% of GDP (roughly $15 billion) in 2009-10 would reduce the cyclical balance further by about $15 billion and result in a budget deficit of about $28 billion, *as long as the fiscal stimulus measures remain temporary and do not become permanent* – a crucial assumption – a projected structural surplus of about $6 billion would remain in tact. Furthermore, in order for the Government to return to a surplus position over the next five years, discretionary measures would have to be taken, which would further dampen the effectiveness of any cushion or 'automatic fiscal stabilizer' (represented by the cyclical budgetary balance) while the economy remains well below its potential capacity.

Table 4: Structural and Cyclical Budget Balances

($ billions)	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Status quo budgetary balance (PBO January average scenario)	+9.6	+0.2	-13.0	-11.6	-8.6	-7.4
Structural budgetary balance	+9.6	+4.7	+3.3	+5.0	+5.9	+5.9
Cyclical budgetary balance	0.0	-4.5	-16.3	-16.5	-14.4	-13.3

4. Macroeconomic Stabilization Policy

The previous section illustrates that the Government's budget balance can be expected to deteriorate when the economy weakens. This demonstrates the role of automatic fiscal stabilizers, which are one of two broad types of fiscal stabilization policy. *Automatic stabilizers* are changes in tax collections and government spending programs that adjust automatically in response to changing economic conditions. For instance, tax collections slow as income growth slows and unemployment benefit payments increase as unemployment rises. These are, in some sense, 'passive' policy because they require no new government initiatives and are determined by the inherited statutory structures of the fiscal system, such as the progressivity of the tax system and the generosity of unemployment benefits.

The main benefits of automatic stabilizers are that the economic stabilization they provide is timely, temporary and substantial.

Timely: these stabilizers act automatically rather than requiring lengthy deliberations and discretionary provisions because they are already built into tax and spending programs.

Temporary: automatic stabilizers are not a permanent measure and are removed automatically as the economy recovers and therefore do not contribute to persistent 'structural' deficits.

Substantial: Comparisons of actual and Department of Finance estimates of 'cyclically-adjusted' budget balances for Canada suggest that automatic stabilizers have subtracted 1.5% to 2% of GDP from the Government's budget balance during the recessions of the early 1980s and 1990s, providing an offsetting cushion to the decline in demand.[7]

[7] See Tables 45 and 46 of the Department of Finance Fiscal Reference Tables. Estimates are based on the Department of Finance Working Paper '*Fiscal Policy and the Business Cycle: A New Approach to Identifying the Interaction'* (2003), Stephen Murchison and Janine Robbins. Congressional Budget Office estimates for the U.S. economy find similar results, with automatic stabilizers subtracting between 1% and 2.5% of GDP from the government's budget balance during U.S. recessions since 1968.

Until recently, it was thought that fiscal policy could best contribute to economic recovery by simply allowing its automatic stabilizers to work, while assigning the primary economic stabilization role to monetary policy. That is, the conventional wisdom argued against the use of discretionary fiscal policy on the basis that it was too slow to react and in some cases ineffective at stimulating demand. Box 2 provides some further historical context on the debate.

Box 2: **Historical Context: Are we all Keynesians, yet again?**

The debate regarding the use of fiscal stabilization policy can be characterized by two poles along a spectrum of Keynesian and Classical schools of economic thought. Keynesian economists think the economy occasionally moves into periods of protracted disequilibrium. As a result, they see an active role for government to support economic activity during downturns. Conversely, classical economists argue that economic fluctuations are largely a response to evolving economic fundamentals. They view the market economy as reasonably well-behaved and essentially self-correcting, and as such, see a more limited role for government intervention.

Over time, economic events, policy successes and failures, and theoretical research developments have swung the pendulum back and forth between these two views. After World War II, reconstruction efforts and the large-scale expansion of government benefit programs led to a belief in the desirability of fiscal policy to stabilize the economy, best typified by U.S. President Nixon's famous remark in 1971 that "we are all Keynesians now". High-profile economic policy mistakes throughout the 1970s in response to oil price shocks,† combined with major research advances in economic theory,* largely shifted support back to the classical paradigm. Since then, the prevailing consensus among academic economists has been that monetary policy should play the primary role in stabilizing the economy, while fiscal policy can best contribute by allowing automatic stabilizers to work.

The recent global economic downturn has raised fundamental questions about the classical approaches' assumptions of rational agents operating in markets that equilibrate themselves quickly through rapid price adjustment. Indeed, governments across the world are now undertaking major discretionary fiscal stimulus packages and a Keynesian policy prescription that government spending can compensate and be a catalyst for insufficient demand in the private-sector is receiving renewed support.

† Such as perceiving increasing inflation as a positive demand shock and responding by increasing interest rates, rather than interpreting it as a negative supply shock to trend potential output, which would call for less restrictive monetary policy.

* Robert Lucas' rational expectations revolution and Finn Kydland and Ed Prescott's real business cycle theory and measurement.

The conventional wisdom is being challenged this time around, with several factors contributing to renewed support for discretionary fiscal stimulus in the current situation. The first set of factors is the nature of the recession: its global scope, as well as the expected size and duration of the downturn many economies are facing — as the output gap projections in Section 2 highlight. The second set of factors is the origins of the recession. For many economies these were largely a financial crisis and housing market correction, which suggest the scope for additional stimulus from conventional monetary policy may be limited.[8] Conventional monetary policy acts by lowering nominal interest rates, but central bank policy rates already sit at historic lows in many countries, leaving little additional room to manoeuvre. Furthermore, even when nominal rates are cut, the weakened state of financial markets will likely result in less effective monetary policy actions because lenders have become more risk averse. This situation is further complicated by abating overall price pressures, which push up real interest rates as inflation falls.

Finally, for Canada there are concerns that policy changes enacted in the last few decades will mean that automatic stabilizers will provide less of an offset in the current recession, relative to the past. For example, fewer workers are currently covered by Employment Insurance benefits than in the past and the personal income tax system has likely become less progressive.[9] Whether automatic stabilizers are less effective is a complex issue requiring further research (see Box 3).

Box 3: Has the Effectiveness of Canada's Automatic Stabilizers Diminished?

One can get a rough sense of the possible size of automatic stabilizers in the current recession, by comparing estimates of the cyclical budget balance in Table 4 and the projected output gap (from Figure 1) to other downturns. Our rough estimates suggest that automatic stabilizers could now have a smaller impact, relative to past recessions. As noted in Section 2, the output gap is projected to trough at a similar magnitude (of about -5%) to that experienced during the 1980s recession at which time the cyclical budgetary deficit on a National Accounts basis reached 2% of potential GDP in 1982 (based on Department of Finance estimates http://www.fin.gc.ca/frt-trf/2008/frt08_8-eng.asp#46). Our estimates suggest that the cyclical budgetary deficit, which provides a measure of the size of automatic stabilizers, would be approximately 1% of potential GDP in 2009-10, well below (i.e., only 50% of) the magnitude realized in the 1980s recession.

Taken together, these considerations have led many commentators and international organizations like the IMF and OECD to call for discretionary fiscal policy measures that will not only complement traditional monetary policy, but will itself play a central role in providing economic stimulus.

5. International Policy Context

The IMF has recommended an overall global goal of fiscal stimulus worth 2% of global GDP. At the same time, however, both OECD and IMF policy documents recognize three important considerations. First, each country's economic situation, though interdependent, is unique. Second, initial budgetary situations differ across countries, leaving some countries more fiscal flexibility than others. Finally, once the economic recovery is established, tough actions will be

[8] To date, several governments have taken actions to address financial market problems, including: drastically lowering monetary policy target interest rates; purchasing troubled assets; expanding central bank credit to the private sector; and providing government guarantees for lending.

[9] A recent Statistics Canada analysis (http://www.statcan.gc.ca/pub/11f0019m/11f0019m2007298-eng.pdf) of before and after-tax and transfer family incomes indicates that governments' tax and transfer system provides less redistribution compared to previous decades.

required to ensure long-run stability of public finances, particularly given spending pressures from population ageing.

In addition, the IMF[10] advocates several principles for fiscal stimulus, including that measures are:

- timely (enacted quickly);
- large;
- diversified (using several different tools, to protect against focusing too narrowly on any specific measure, given the uncertainties of the effectiveness of any one measure);
- contingent (indicating up-front that further actions will be taken if the economy weakens more than expected; and conversely, pre-committing to unwinding measures after the recovery takes hold); and,
- fiscally sustainable (to avoid a large increase in public debt in the future).

Given the longer-than-usual period of economic weakness expected, the IMF supports spending measures, as the traditional concern of the long lags to implement spending are less of a concern this time around. Temporary tax cuts or transfers targeted to those most likely to be credit-constrained (i.e., low income families and the unemployed, who have a higher marginal propensity to spend additional income) may also provide short-term stimulus.

What other countries are doing

Two points should be emphasized at the outset. First, relative to many other countries, Canada is expected to experience a milder recession. Second, because of its healthier fiscal position going into the recession, Canada's status quo budget deficits relative to the size of its economy are projected to be smaller than those in many other advanced industrialized countries.

U.S.: President Obama's economic team is still finalizing the details of a proposed stimulus package. Currently, this package is expected to be worth roughly $775B ($950B CAD) over two years, or more than 5% of GDP. It will feature infrastructure spending, personal tax cuts, increased transfers to state and local governments and other measures to help low-income households. One of the plan's primary goals is to save or create at least 3 million jobs by the end of 2010. (These stimulus measures are distinct from the Troubled Asset Relief Program aimed at restoring financial stability through asset purchases.) Even before accounting for this latest package, the Congressional Budget Office estimates budget deficits of 8% of GDP.

Europe: In November 2008, the European Commission presented a plan for a coordinated fiscal stimulus across the European Union to be worth €200 billion ($320B CAD), or about 1.5% of GDP.

U.K.: In November 2008, a fiscal package featured new measures worth £21.5B ($38B CAD) over two years, or roughly 1.5% of GDP. More than half of this was attributable to temporarily lowering the value-added consumption tax from 17.5% to 15% until 2010. Other measures include infrastructure spending and personal and business tax measures. Government borrowing will increase dramatically and budget deficits may hit 8% of GDP.

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[10] See the full paper for more details: *Fiscal Policy for the Crisis*, IMF Staff Position Note, SPN/08/01, released December 29, 2008.

Germany: In January 2009, the coalition government announced a second stimulus package worth about €50B ($80B CAD) over two years, in addition to its original plan of €12B ($19B CAD) over two years. Together these packages are worth roughly 2.5% of GDP. The second package features infrastructure spending, tax cuts, environmental incentives and other measures, including a €100 ($160B CAD) government fund to insure business loans. *The Economist* magazine reports that government deficits could reach 3-to-4% of GDP.

China: In November 2008, the government announced a massive package, which included infrastructure, health and education spending. Excluding some projects which appear to cover previously-announced measures, the new money is worth about 2.6 Trillion yuan ($465B CAD) over two years, or 9% of GDP.

6. Some Key Questions for Parliamentarians to Consider

- Is there a single, or set of over-arching fiscal policy objectives that the stimulus package will aim to achieve?

  In the US, a key goal has emerged to save or create 3 million jobs by end of 2010. While this may be difficult to measure in practice, the existence of a stated objective provides a useful lens to assess the impact of proposed policies.

- To-date the Government's fiscal policy framework has been based on a combination of several stated fiscal targets over differing time horizons:
  - *Short-term*: Balanced budgets or better annually;
  - *Medium-term*: 25% federal debt-to-GDP ratio by 2011-12, and non-increasing program spending relative to nominal GDP; and,
  - *Long-term*: Eliminate net total government debt by 2021.

  As the PBO's November 2008 EFA report highlighted, and a concern that is even more acute now, the weakened global and Canadian economic outlook poses a significant challenge for the Government to achieve its stated short-term and medium-term fiscal targets. Which of these targets will be re-stated, will some be re-affirmed, or replaced with new policy targets?

- The current economic slowdown is global. As such, there are many external influences beyond the control of Canadian policymakers that will impact Canadian economic growth and fiscal finances. Further, PBO analysis suggests that for the Government to return to a surplus position over the next five years, contractionary measures (i.e., additional spending restraint and/or increased taxes) would have to be taken which would dampen the effectiveness of automatic fiscal stabilizers while the economy remains well below its potential capacity.

  Will the Government provide a transparent medium-term fiscal plan that addresses the projected weakness in the economy and supports a meaningful recovery towards the economy's potential level of activity without limiting the Government's fiscal capacity to respond to future spending pressures arising from population ageing?

Annex 1 – PBO January 2009 Economic Scenarios

	2008	2009	2010	2011	2012	2013
Real GDP growth (%)						
January 2009 PBO Average Scenario	0.7	-0.8	2.6	3.8	3.5	3.1
January 2009 PBO Low Scenario	0.5	-1.5	1.9	3.3	3.1	3.1
GDP inflation (%)						
January 2009 PBO Average Scenario	3.9	-1.2	1.5	2.1	2.1	1.9
January 2009 PBO Low Scenario	3.6	-3.3	-0.5	1.9	1.9	1.9
Nominal GDP growth (%)						
January 2009 PBO Average Scenario	4.6	-2.0	4.1	6.0	5.6	5.1
January 2009 PBO Low Scenario	4.1	-4.8	1.4	5.3	5.0	5.0
Nominal GDP level ($ billions)						
January 2009 PBO Average Scenario	1,607	1,574	1,639	1,737	1,835	1,928
January 2009 PBO Low Scenario	1,598	1,522	1,544	1,625	1,707	1,793
3-month treasury bill rate (%)						
January 2009 PBO Average Scenario	2.4	0.9	1.9	3.2	3.8	4.3
January 2009 PBO Low Scenario	2.4	0.3	1.1	2.1	2.9	4.3
10-year government bond rate (%)						
January 2009 PBO Average Scenario	3.6	2.9	3.4	4.2	4.9	5.6
January 2009 PBO Low Scenario	3.6	2.4	2.9	3.4	3.7	5.6
Unemployment rate (%)						
January 2009 PBO Average Scenario	6.1	7.4	7.7	6.9	6.5	6.4
January 2009 PBO Low Scenario	6.1	7.7	8.3	7.2	6.7	6.5
Total CPI inflation (%)						
January 2009 PBO Average Scenario	2.4	0.8	1.7	1.9	2.0	2.0
January 2009 PBO Low Scenario	2.4	0.3	1.0	1.6	1.9	2.0