FINANCIAL POST

Stimulus packages miss the mark

Governments feed the usual sacred cows

Mathieu Belanger/ReutersCanada's Prime Minister Stephen Harper (r), Quebec's Premier Jean Charest (L), Canada's Minister of Transport and Infrastructure John Baird (2nd R) and Quebec's Minister of Municipal Affairs Nathalie ...

Capital Insight

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Amid copious analyses of global government "emergency stimulus" spending packages coming in the frenzied rush to make everything better in the world, here is some of import for small to mid-sized businesses.

In the next two years, the Canadian federal government will spend roughly 3% of total gross domestic product of $1.5-trillion in its emergency stimulus packages; the U. S. federal government, about 5% of roughly $14.3-trillion in GDP.

These are staggering amounts totalling roughly $50-billion in Canada and $800-billion in the United States above and beyond regular annual spending of $225-billion and US$2-trillion, respectively. Put another way, stimulus spending represents a 20%-plus rise in government cheque-writing in Canada and an appalling 35% in the United States under bills with Orwellian names such as the American Reinvestment & Recovery Act.

Aside from what this means for the future of the economy, the crowding out of private-sector spending, tax or interest rates, more specifically, how much of this cash being flung about is going to SMBs?

You would think there would have to be a lot given the laws of physics -- a few large drops from the buckets of money being dropped from government helicopters must be landing on SMBs. Small businesses (100 employees or less) account for roughly a third of annual GDP and almost two-thirds of private-sector employment in Canada. The corresponding U. S. figures (for companies of 500 or less) are both about 50%.

President Barak Obama's first move for SMBs is to commit US$15-billion to buy Small Business Administration loans from banks. There is chatter about much larger programs to come through a massive effort to reignite securitization markets. All obscure and indirect and likely more than offset by other initiatives such as the raising of personal tax rates in the highest brackets, which directly affects SMBs by burdening their owners who file as individuals, and indirectly by burdening angel investors.

Canada has the only slightly less Orwellian and no more effective Economic Action Plan, with the requisite billions for the sacred cows: Infrastructure, retraining, incremental tax rate reductions far into the future, social spending, huge bailouts for chosen industries such as automotive, as well as various obscure enhancements and incentives for business and personal lending activity.

The only remotely direct assistance for SMBs is through initiatives with Export Development Canada and the Business Development Bank of Canada, including the injection of about $350-million of capital into each of these organizations, and another initiative involving the EDC, BDC and the banks called the Business Credit Availability Program, plus an assortment of program tweaks similar to those made in the United States.

Similarly, Ontario announced a $250-million coinvestment fund for tech firms in the province -- the only problem being there are few investors putting money in the sector for the government to co-invest with. The Ontario Venture Capital Fund announced with great fanfare last June has yet to make one investment, although there are rumours one is imminent.

Here's my suggestion: The federal government puts out a standing offer to buy 5% of the shares of any incorporated business with revenue of less than $1-million for $10,000 in cash. Those shares attach to the owner or owners of the business and have no voting or other shareholder rights -- basically, when the owner sells their shares, the government gets 5% of the proceeds in addition to any other income-and investment-related tax receipts. Any business with sales of $1-million to $10-million gets the same deal, for $50,000; and for companies with sales of $10-million to $25-million, $150,000.

There need be no government-run portfolio management of these investments, rather it would rely on the economic incentives of the owners to maximize their stakes, with the government along for the ride. Penalties for misrepresentation and fraud would be severe; the only requirements to get the money would be that the business exists legally and has filed at least one corporate tax return.

Based on rough numbers from Statistics Canada, there are 2.3 million SMBs in Canada, around 75% of these have sales of less than $1-million; of the remaining 25%, about 75% would go into the second group and 25% into the third. The rough math is as follows: - 1.725-million x $10,000 = $17.25-billion - 431,300 x $50,000 = $21.6-billion - 143,800 x $150,000 = $21.6-billion - Total maximum theoretical outlay = $60-billion.

However, many companies would consider themselves worth more than the implied value of this capital injection, or just not want the hassle-- so say 25% of companies, the most needy, might take the offer, leaving the total cost around $15-billion, well within the $50-billion total stimulus package budget. The invisible hand of the market would drive the flow of funds to where the need is greatest, and the government would have some equity upside on more than 500,000 Canadian businesses. The government would also enjoy the corporate and personal income tax flow coming out of these stronger companies.

This, or something like it, would stimulate the economy more than well-intentioned but fundamentally hollow initiatives we are seeing in Canada and the United States now.

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