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Addressing fundamental small business priorities in the 2017-18 Nova Scotia budget

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In advance of the 2017-18 provincial budget, the Canadian Federation of Independent Business (CFIB) is putting forward pre-budget recommendations addressing the fundamental priorities of Nova Scotia's small- and medium-sized enterprises (SMEs). Small business owners across Nova Scotia are asking government to focus on creating a foundation for small business success so they can focus on what they do best— creating jobs, growing the economy, innovating, and contributing to local communities throughout the province.

Introduction

On behalf of CFIB and our 5,200 members across Nova Scotia, we appreciate the opportunity to present our pre-budget recommendations for the 2017-18 provincial budget.

CFIB is a non-partisan, non-profit, political action organization with a membership comprised of over 109,000 small- and medium-sized enterprises (SMEs) across Canada. Our members regularly provide feedback on their current business priorities and perspectives through CFIB surveys. In addition to this feedback, virtually all of our members meet with a CFIB representative at least once a year, providing additional insight into the needs and concerns of Nova Scotia's small business sector.

In order to provide the government of Nova Scotia with our members' top priorities for the upcoming budget, we conducted the *Nova Scotia 2017 Pre-budget Survey* between October 6 and October 20, 2016. The results were clear. Small business owners across our province want the government to do its part in creating a foundation for small business success. This involves getting back to the basics of what's needed for a small business-friendly environment including: reducing the total tax burden, cutting red tape, addressing government spending, and supporting small business innovation. Leadership is needed in these areas to encourage existing small businesses to grow and to entice new entrepreneurs to start-up in Nova Scotia.

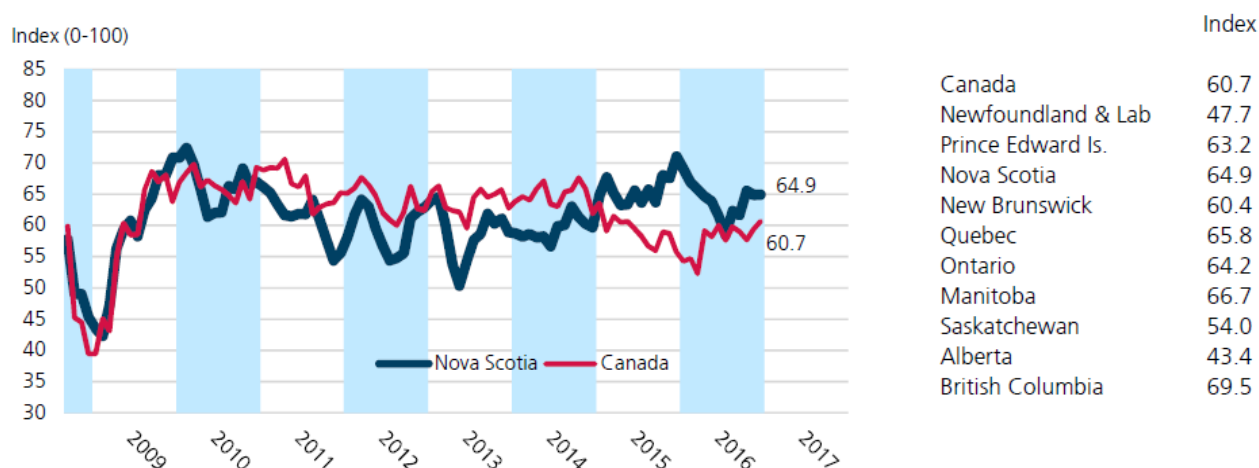
Small Business Confidence in Nova Scotia

CFIB Business Barometer®

CFIB's monthly Business Barometer is an accurate indicator of economic growth used regularly by a number of financial institutions and media outlets in Canada, including Bloomberg, the Bank of Canada and Scotiabank. Tracked against GDP, the Business Barometer Index closely reflects current economic conditions and confidence levels within the small business sector. Measured on a scale between 0 and 100, an index level above 50 means owners expecting their business' performance to be stronger in the next year outnumber those expecting weaker performance. Index levels range between 65 and 75 when the economy is growing at its potential.

Figure 1:

Business Barometer Index, Nova Scotia vs. Canada



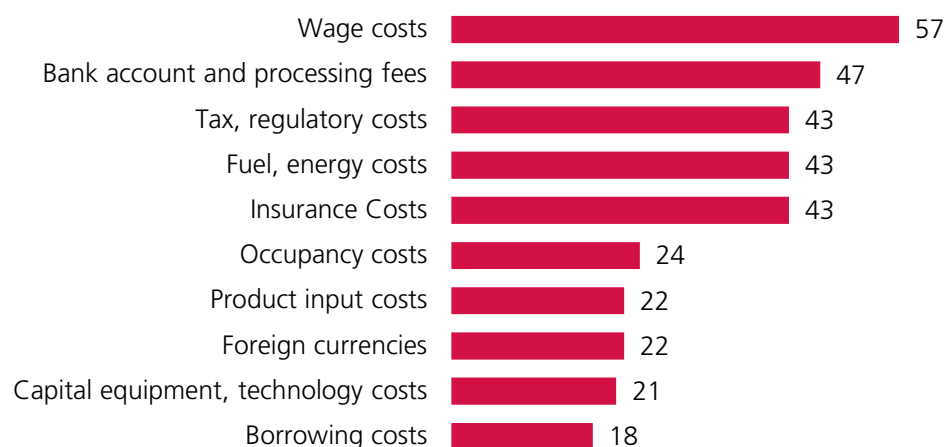
Source: CFIB, Business Barometer Index, December 2016

Nova Scotia's small business optimism led the country at the beginning of 2016 with an index level of 69 (Figure 1). However, within the first six months of the year, optimism steadily declined, shaving about 10 points off the index. Mid-year, optimism started regaining strength but, by the end of 2016, only some of the momentum was regained, ending the year with an index level of 64.9.

Business Barometer results from December revealed full-time hiring intentions were very weak with 22 per cent of members foreseeing layoffs while only 10 per cent are planning to increase employment. This level of layoffs is the highest we've seen for small businesses in Nova Scotia. Not surprisingly, the share of business owners saying their firms are in good shape also decreased in December, (33 per cent), while 11 per cent say their firms are in bad shape.

While 64.9 is a solid index level and indicates the economy in Nova Scotia is performing relatively well, there is much that can be done to increase small business confidence. By addressing fundamental small business priorities and focusing on creating small business-friendly conditions confidence levels could increase.

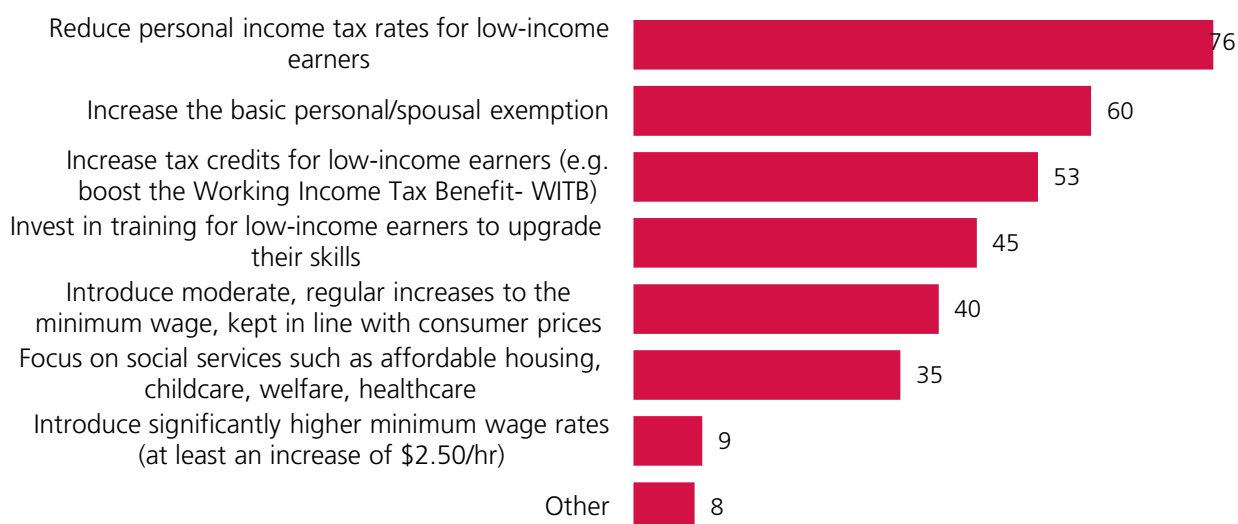
Figure 2:

Business Barometer Index, Major Cost Constraints (% response)

Source: CFIB, Business Barometer Index, Nova Scotia results, November 2016

Small businesses are impacted by increasing operating costs in a number of areas, however, it comes as no surprise that small business owners point to wage costs as the leading cost constraint to their business (Figure 2). Small businesses are very concerned by discussions surrounding increasing the minimum wage to \$15 per hour and the implications it could have to their operations. Any steep increase in wages would have a severe impact on the small business sector possibly forcing some businesses to close, putting existing jobs at risk, while also preventing small businesses from creating much needed, new jobs.

Figure 3:

What is the best ways for governments to improve the standard of living for low-income earners? (% response)

Source: CFIB, Employment and Wages Survey, December 2016

The best way for the Nova Scotia government to improve the standard of living for low-income earners is through a targeted reduction in personal income taxes rates as stated by the majority of small business owners (Figure 3). About two-thirds of business owners support increases to the basic personal/spousal exemption for low-income earners. About half of respondents support investing in upgrading skills for low-income earners and/or increasing tax credits targeted at low-income earners. Government should not consider increasing the minimum wage until it has exhausted its ability to assist low-income earners through other, more effective means.

Recommendation #1: Assist low income earners through tax relief measures and investments in skills development rather than minimum wage increases.

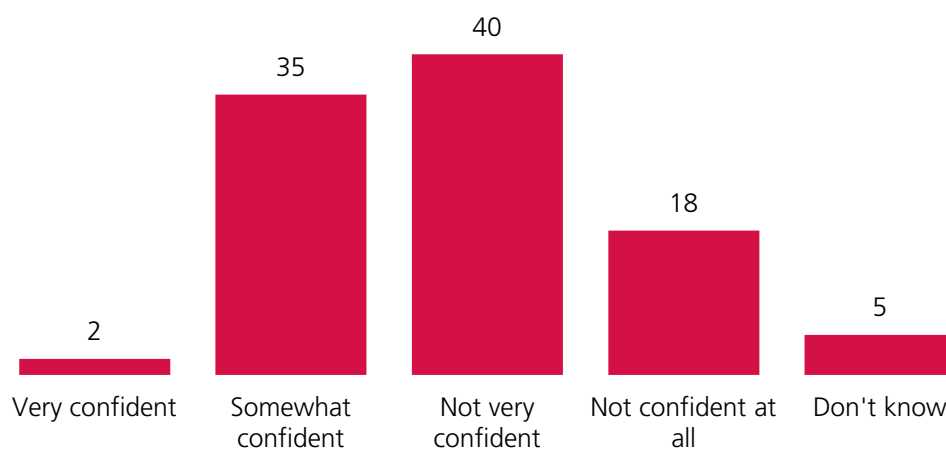
Needed: A Small Business-friendly Environment

In our pre-budget survey, we asked our members how confident they were that the provincial government is working to create a small business-friendly environment. The majority, 58 per cent, were not confident, while 37 per cent were confident (Figure 4). Low confidence indicates small businesses are frustrated by the lack of action on fundamental issues of importance.

"The overall environment is too costly (taxes, fees) and too time-consuming (reg. compliance). Reductions in both areas will enable businesses to grow."
CFIB Member, Kings - South

Figure 4:

How confident are you that the Nova Scotia government is working to create a small business-friendly environment?



Source: CFIB, Pre-Budget Survey, October 2016, n = 170

In order to address the lack of confidence and to help create a small business-friendly environment, business owners want action on their fundamental issues. CFIB members identified the following actions must be taken in order to create a small business-friendly environment including: reducing the total tax burden, cutting red tape, addressing government spending, and supporting small business innovation.

Recommendation #2: Focus on addressing fundamental small businesses issues including: reducing the total tax burden, cutting red tape, reducing government spending, and supporting small business innovation.

Addressing the Tax Burden

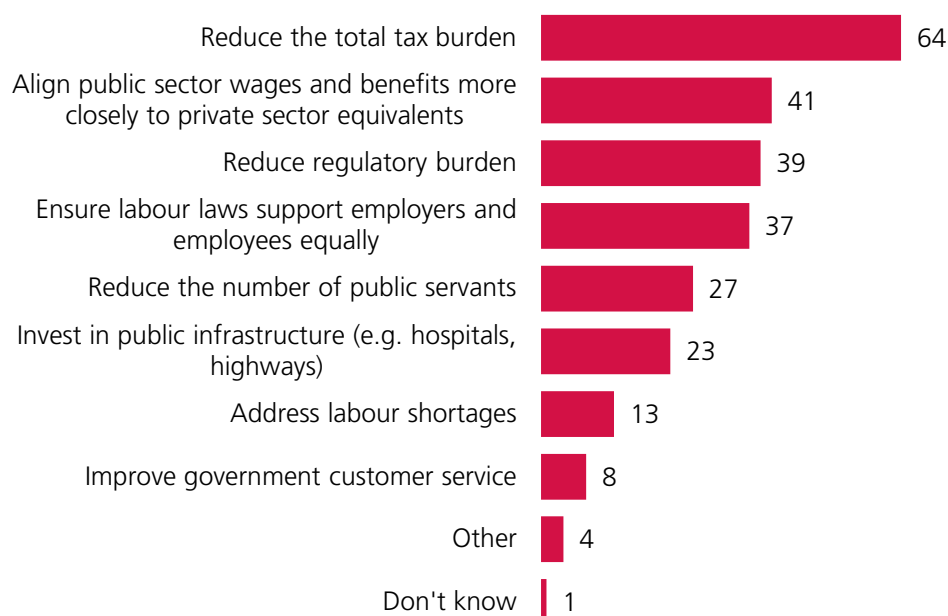
The last few years have seen a gradual worsening of the tax environment for small businesses in Nova Scotia. When the Small Business Corporate Tax Rate threshold was reduced to \$350,000 from \$500,000 in 2014, making it the lowest in Canada, small business owners were frustrated, especially in light of the recommendations contained in the Ivany Report which highlighted the important role entrepreneurs must play in growing the province's economy. Later, the recommendation contained in the Tax and Regulatory Review to increase the Small Business Corporate Tax Rate to off-set a decrease in the General Corporate rate was met with outrage. Most recently, the reduction to the Small Business Dividend Tax Credit in the 2015/16 budget came as further evidence of government's unwillingness to improve the current tax environment faced by small businesses.

"Nova Scotia is an increasingly less competitive location to establish and grow a business."

CFIB Member, Dartmouth

Figure 5:

Which of the following would help to support small business and entrepreneurship in Nova Scotia? (% response)



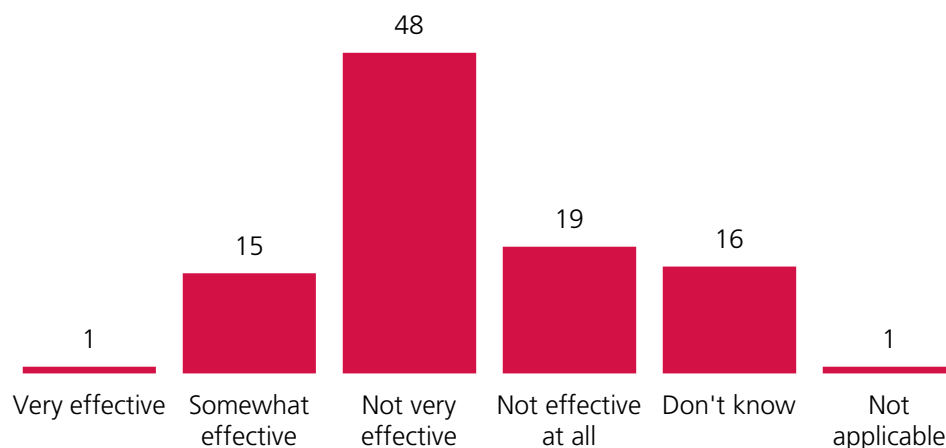
Source: CFIB, Pre-Budget Survey, October 2016, n = 170

When asked what measures would help support small business and entrepreneurship in Nova Scotia, members were clear in their desire to see the total tax burden reduced (Figure 5). Small businesses want action and leadership from government where taxes are concerned.

Nova Scotia's small businesses don't operate in a vacuum. They look beyond our borders (many conduct business well beyond Nova Scotia's borders) and are keenly aware of how Nova Scotia's tax environment stacks up. Business owners believe the tax environment in Nova Scotia is more punitive than in other jurisdictions and they aren't wrong. According to our recent survey a strong majority of members (67%) believe the government has not been effective in addressing the provincial portion of the current tax burden compared to 16% who believe government has been effective (Figure 6).

Figure 6:

How effective has the current provincial government been in addressing the provincial portion of the total tax burden faced by your business in the past three years?



Source: CFIB, Pre-Budget Survey, October 2016, n = 170

When asked to rank a list of potential provincial tax reforms, members placed strong emphasis on increasing the Small Business Corporate Income Tax Threshold and increasing the Basic Personal Exemption (BPE) (Figure 7). This is revealing since these are the two areas where Nova Scotia stands out

as a laggard behind other Canadian provinces and territories. This also emphasizes the fact that Nova Scotia small business owners are also residents of our province and therefore feel the impact of the tax environment both on a personal income tax level (lowest BPE, no indexation on tax brackets, high HST) and business income tax level (Low Small Business Tax Threshold and high Small Business and Corporate Tax Rates).

Raising the Small Business Corporate Income Tax Threshold and the BPE in line with national averages are both priority tax reforms small businesses urgently require and

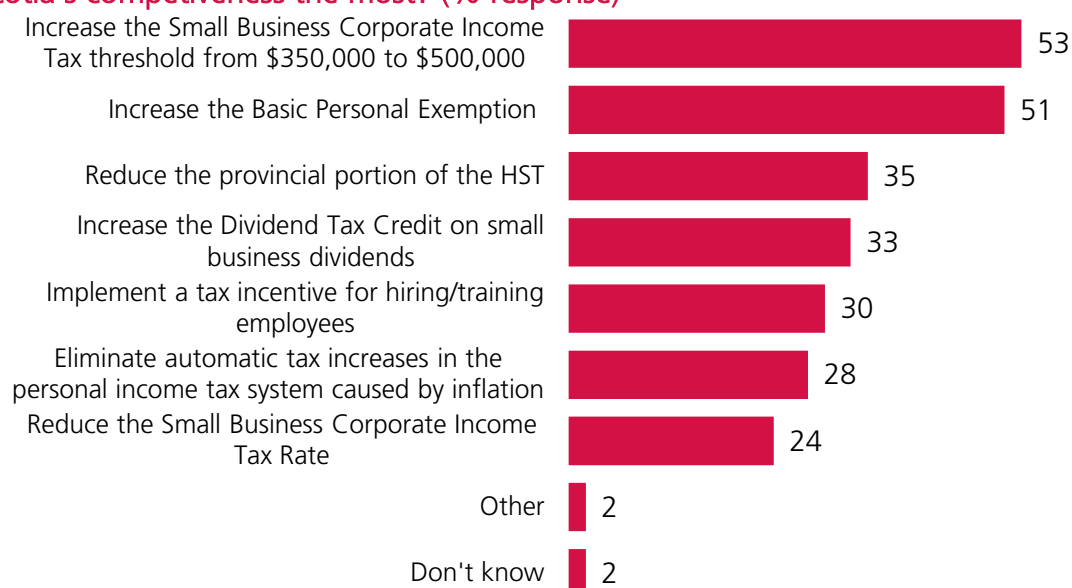
"Personal and business tax rates are the highest in Canada, driving businesses and clients to other provinces."

CFIB member, Clare

would have a positive impact, not only on the small business community, but Nova Scotians in general.

Figure 7:

Which of the following provincial tax reforms would you choose to improve Nova Scotia's competitiveness the most? (% response)



Source: CFIB, Pre-Budget Survey, October 2016, n = 170

The positive spin-offs resulting from tax reductions are significant.

With lower taxes, CFIB members identified several areas where savings would be invested (Figure 8). Investing in new equipment placed first and this is a very important finding. Investments in new equipment, machinery and technology enable workers to produce more and create higher value output for each hour of work, increasing productivity. Because increased productivity leads to higher wages, workers also benefit from tax reductions targeted at businesses that lead to investment in new equipment and technology. Investment in new equipment is also an important element needed for small businesses to increase participation innovative activities.

"I would love to expand or upgrade equipment but the options are not there for me."

CFIB member, Truro – Bible Hill

Investments in new equipment, machinery and technology enable workers to produce more and create higher value output for each hour of work, increasing productivity. Because increased productivity leads to higher wages, workers also benefit from tax reductions targeted at businesses that lead to investment in new equipment and technology. Investment in new equipment is also an important element needed for small businesses to increase participation innovative activities.

An additional added benefit of tax reductions was also revealed. After paying down debt, members planned to invest tax savings in increasing employee wages and hiring additional employees. Increasing tax competitiveness encourages businesses to grow, to increase wages and to hire new employees.

Figure 8:

If the provincial government reduced taxes how would you use the savings? (% response)



Source: CFIB, Pre-Budget Survey, October 2016, n = 170

With the vast majority of our members pointing to reducing the total tax burden as the best way for government to encourage small business growth and entrepreneurship, CFIB recommends government address taxes as a priority in order to demonstrate its commitment to creating the conditions conducive to small businesses success.

Recommendation #3: Take immediate action on tax reform to encourage small businesses growth and entrepreneurship.

Recommendation #4: Increase the small business threshold from \$350,000 to \$500,000.

Recommendation #5: Increase Nova Scotia's Basic Personal Exemption from \$8,481 to \$11,000.

Recommendation #6: Reduce the provincial portion of the HST.

Red Tape Reduction

Small business owners accept that a certain amount of regulation is needed to protect public safety and the environment; however, excessive regulation has serious negative consequences on economic growth and is felt most acutely by small businesses. While big businesses have staff devoted to regulatory compliance, the vast majority of small businesses have fewer than five employees and struggle to comply with regulations that are overly complex, duplicative, time consuming and unnecessary. Nova Scotia businesses that operate or trade within the Atlantic region and beyond are even more highly impacted.

The Joint Office of Regulatory Affairs recently commissioned the Atlantic Provinces Economic Council to investigate and quantify the regulatory burden faced by businesses in Atlantic Canada. The resulting report, *Trade Barriers in Atlantic Canada: Opportunities for Regulatory Reform*, revealed that the overall amount of red tape is

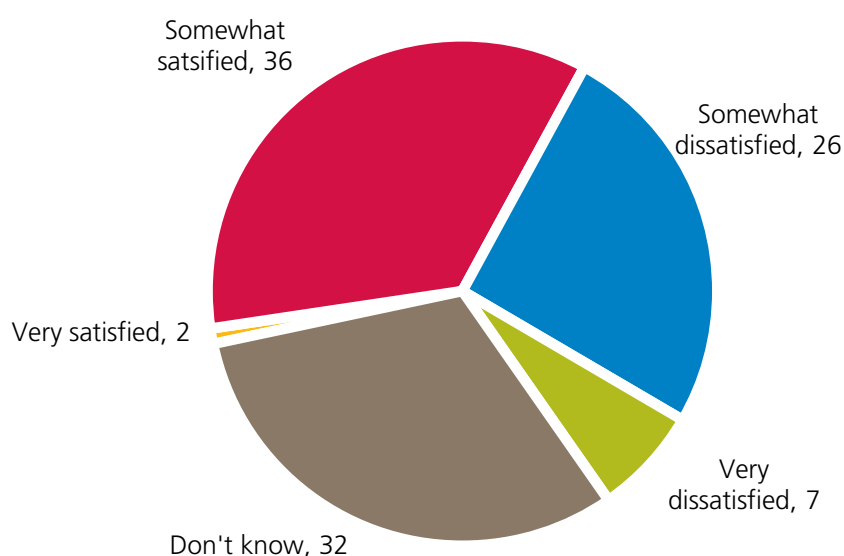
disproportionately high relative to the size of our market. It significantly increases costs, reduces efficiency, lowers revenue and reduces investment. Reducing red tape and improving the regulatory environment has the potential to boost output, which is especially important given Nova Scotia's economic, demographic and fiscal outlook.¹

CFIB applauds the leadership shown by the current government on red tape in Nova Scotia. We were pleased to award Premier McNeil with a Golden Scissors Honourable Mention Award during Red Tape Awareness Week in 2016 for his work on removing red tape for apprenticeship labour mobility within Canada. We are also encouraged by ongoing efforts in Nova Scotia including; the *Regulatory Accountability and Reporting Act*, the creation of the Joint Office of Regulatory Affairs and Service Effectiveness, the *Premiers' Charter of Governing Principles for Regulation*, and the development and implementation of the ground-breaking business economic impact analysis tool. Combined, these pieces create the groundwork needed for the regulatory reform that's being undertaken by the small group of dedicated individuals that make up the Office of Regulatory Affairs and Service Effectiveness led by Chief Regulatory Officer, Fred Crooks.

In particular, the *Premiers' Charter of Governing Principles* is a beacon of hope for small businesses in Nova Scotia. The commitments made in the Charter to enact fewer and better regulations, as well as the the cost-for-cost rule, are important for small businesses as they ensure government is focused how regulations impact businesses and the need to cap and reduce the amount of red tape. The new business economic impact analysis tool makes understanding the real costs associated with new or existing regulations an essential part of the solution.

Figure 9:

How satisfied are you with the current provincial government's efforts to reduce red tape in Nova Scotia? (% response)



Source: CFIB, Pre-Budget Survey, October 2016, n = 170

¹ Chaundy, David. (2016) Trade Barriers in Atlantic Canada: Opportunities for Regulatory Reform, APEC, Halifax.

When asked how satisfied they were with the current government's efforts to reduce red tape, CFIB members' opinions were split; 36 per cent were satisfied, 33 per cent were dissatisfied, and 32 per cent have not made up their minds (Figure 9). This shows a positive shift in members' attitudes over last year when 64 per cent of members ranked the government's efforts as poor, 20 per cent as good, and 15 per cent as undecided.

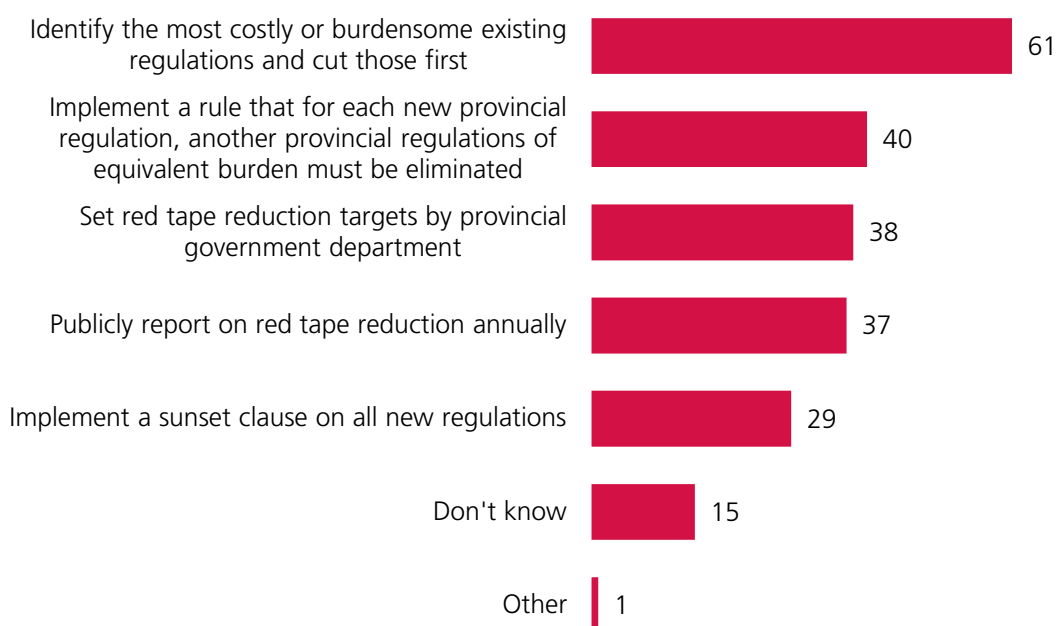
While small businesses recognize the work that has taken place to reach this point, many are impatient to begin feeling the results. In order to improve satisfaction levels in government's red tape reduction efforts, business owners must feel the impact in terms time and/or money saved. When asked which measures would help to reduce red tape faced by businesses members pointed to identifying the most costly or burdensome regulations and cutting those first (Figure 10).

"The government is not reducing red tape; however, it's not increasing it either."

CFIB Member, Kings - North

Figure 10:

Which of the following provincial measures would help to reduce red tape faced by business? (% response)



Source: CFIB, Pre-Budget Survey, October 2016, n = 170

Small businesses have firsthand knowledge of which regulations are the most time consuming, unnecessarily complex, duplicative and burdensome on their business and can easily point to examples of red tape that if cut would not negatively impact the public and would greatly lessen their compliance load. Cutting the most burdensome regulations would free up valuable time and money that business owners would much rather spend on business growth.

Nova Scotia's recent progress on red tape has been recognized in the dramatically improved grades awarded over the last few years in CFIB's Red Tape Report Card which is presented annually during Red Tape Awareness Week. Nova Scotia's grade has shown the most improvement over the last three years than any other province in Canada. This is a remarkable achievement. In order to maintain momentum on red tape reduction CFIB makes the following recommendations.

Recommendation #7: Establish a baseline measurement of the existing red tape burden faced by Nova Scotia's small businesses, set clear targets for reduction, and publicly report on red tape annually, if not more.

Recommendation #8: Consult with Nova Scotia's small businesses to determine which regulations are the most burdensome and expensive to comply with. Provide an online portal for small businesses to share their feedback to support this initiative.

Recommendation #9: Eliminate the most costly and burdensome regulations first as identified by the small business community.

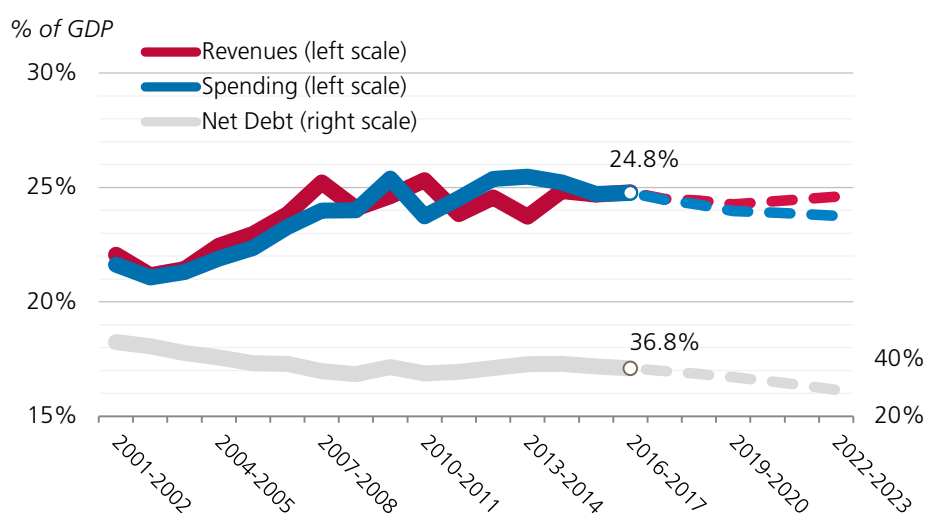
Nova Scotia's Fiscal Fitness

Many small business owners operate on thin margins and without a keen eye on the bottom line many business owners would find themselves reducing hours, laying off staff, or closing their doors. Business owners want government to understand the fiscal restraint they exercise and want government to use the same restraint.

Figure 11 shows total revenues, expenditures and net debt levels for Nova Scotia, expressed as a percentage of total economic output (GDP). Compared to the rest of Canada, Nova Scotia has seen relatively good economic conditions. We were pleased to see government achieve a balanced budget in 2015-16 and acknowledge the effort required to make this possible. Nova Scotia is on track to deliver a string of balanced budgets or modest surpluses for the remainder of the forecast horizon. Government, however, will remain a much bigger share of the economy than in past decades.

Figure 11:

Nova Scotia's Fiscal Fitness



Source: Canada's Fiscal Fitness: Report on the financial health of federal and provincial governments, CFIB, February 2016.

A significant contributor to Nova Scotia's spending problem can be attributed to be the size of Nova Scotia's public sector and the costs associated with maintaining excessive public sector wages and benefits. A new report from the Atlantic Institute for Market Studies (AIMS), *The Size and Cost of the Public Sector in Atlantic Canada, 2015*, revealed that

"Competing against government to find, hire and keep good employees is my biggest challenge."

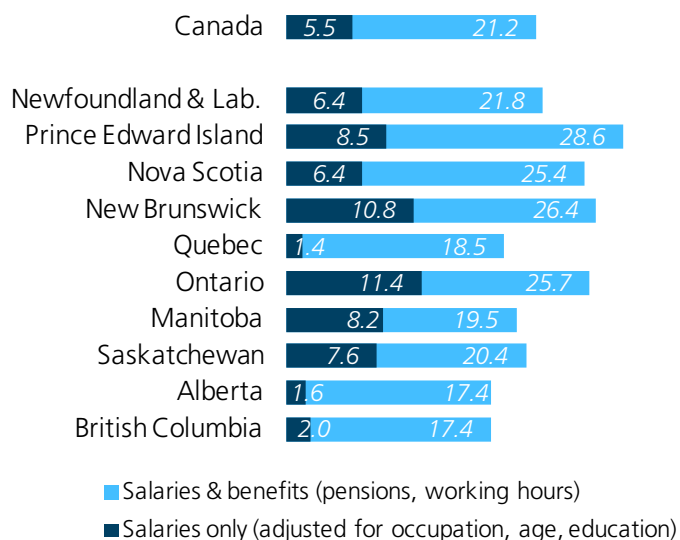
CFIB Member, Richmond

Nova Scotia's public service is unusually large compared to the rest of Canada. Just as disturbing was the fact that the size of Nova Scotia's public service has been trending upward over the last five years.²

CFIB's recent *Wage Watch* Report showed that provincial government employees in Nova Scotia have a wage and benefits advantage of 25 per cent over private sector counterparts (Figure 12). This showed an overall decrease in the wage gap of only 1 per cent since CFIB's last public sector wage analysis in 2008. In light the size of the public service and the challenges associated with negotiating collective agreements, a one per cent reduction in the wage gap is positive. However, the rate of improvement is far too slow and too expensive for Nova Scotians to continue to pay for now and over the longer term.

Figure 12:

Nova Scotia's Public Sector Wages and Benefits



Source: *Wage Watch*, CFIB, March 2015.

Despite widespread agreement surrounding the urgent challenges faced in Nova Scotia, this reality was not reflected in government's spending patterns until very recently. In

² Doughart, Jackson/Navarro-Genie, Marco. (2016) *The Size and Cost of the Public Sector in Atlantic Canada, 2015*. AIMS, Halifax.

addition to working to bring wages and benefits in line with the private sector – and within a range that Nova Scotians can afford – CFIB recommends the following measures to restrain spending.

Recommendation #10: Reduce Nova Scotia's public sector employment rate to Canada's national average through attrition, wage restraint, and implementation of management methods focused on efficiency and effectiveness.

Recommendation #11: Commit in legislation to limit government spending to no more than population growth plus inflation.

Recommendation #11: Set aggressive targets to align public sector wages and benefits with private sector levels that can be sustained by Nova Scotia's tax base.

Small Business Innovation

Nova Scotia's interest in investing in innovation holds great potential for small businesses in our province but government must be cautious to ensure small businesses are a central part of the plan. CFIB's recent national report, *Beyond the Big Idea: Redefining and rethinking the innovation agenda*³, revealed small businesses don't see themselves as part of the conversation on innovation mostly because the definition used by governments is limited to preferred sectors and focuses on creating the next high-profile "big" idea. This definition leaves out the vast majority of types of innovation that are relevant to small businesses.

The organization for Economic Co-operation and Development's (OECD) *Oslo Manual: Guidelines for Collecting and Interpreting Innovation Data*⁴ includes in its definition four different types of innovation: product innovation, process innovation, organizational innovation and marketing innovation. OECD goes on to say that innovation goes far beyond the confines of research labs and crosses borders, sectors and institutions. This broad and inclusive definition represents best practices in the field of innovation. Nova Scotia would benefit by adopting this definition and the resulting approach.

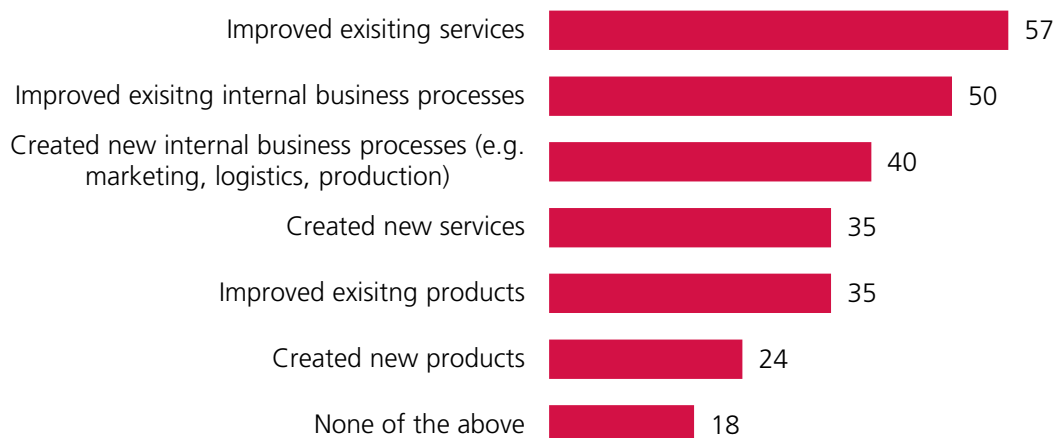
When asked what innovative activities small businesses have been involved in the past five years, the vast majority indicate they have engaged in innovative activities that improve internal elements of the business (Figure 13).

³ Parent, Louis-Martin/Poitevin, Emilie. (2016) *Beyond the Big Idea: Redefining and rethinking the innovation agenda*, CFIB, Toronto.

⁴ OECD and Eurostat. (2005) *Oslo Manual: Guidelines for Collecting and Interpreting Innovation Data*, 3rd Edition, The Measurement of Scientific and Technological Activities, OECD Publishing, Paris.

Figure 13:

Which of the following has your business done in the past five years? (% response)



Source: *Beyond the Big Idea: Redefining and rethinking the innovation agenda*, CFIB, 2016.

Small businesses often look inward when making innovative changes but the importance of these innovations should not be minimized as they have a direct impact on operations, productivity, competitiveness and profitability, all of which impact economic development. For these reasons, innovation must be understood by government to include the full range of innovative activities including, but not limited, to invention. Government must ensure its approach to innovation recognizes small business and supports their activities. Failure to do so will have consequences.

"I have developed a new digital record keeping service and implemented new and faster methods making it easier for my employees to do their jobs. Now I'm working on new marketing to increase our global market."

CFIB Member, Pictou Centre

When access to innovation support is limited to a preferred sector, small businesses will not be able to engage in innovation to the same extent as their selected counterparts. The disparity between business' innovation activities and use of new technologies can translate into substantial productivity gaps. The threat is that small business will operate less efficiently due to the use of old equipment and outdated technologies while preferred sectors will benefit from up-to-date leading technologies.

It is important government recognizes that small businesses engage in innovative activities and they will be put at a competitive disadvantage if they are not included in the innovation agenda. The aggregate cost to the economy will be substantial.

Recommendation #12: Include small businesses in Nova Scotia's innovation agenda and recognize and support a wide variety of innovative activities that can increase productivity and competitiveness.

Conclusion

CFIB appreciates the opportunity to present our members' priorities and perspectives for the upcoming provincial budget. We view the budget document an opportunity for government to demonstrate its commitment to small businesses and entrepreneurs in Nova Scotia by addressing fundamental small business priorities including: reducing the total tax burden, cutting red tape, reducing government spending, and supporting small business innovation. These are significant issues and they must be addressed. The future prosperity of Nova Scotia depends upon it.

Summary of recommendations:

Recommendation #1: Assist low income earners through tax relief measures and investments in skills development rather than minimum wage increases.

Recommendation #2: Focus on addressing fundamental small businesses issues including reducing the total tax burden, cutting red tape, addressing government spending, and supporting small business innovation.

Recommendation #3: Take immediate action on tax reform to encourage small businesses growth and entrepreneurship.

Recommendation #4: Increase the small business threshold from \$350,000 to \$500,000.

Recommendation #5: Increase Nova Scotia's Basic Personal Exemption from \$8,481 to \$11,000.

Recommendation #6: Reduce the provincial portion of the HST.

Recommendation #7: Establish a baseline measurement of the existing red tape burden faced by Nova Scotia's small businesses, set clear targets for reduction, and publicly report on red tape progress annually, if not more.

Recommendation #8: Consult with Nova Scotia's small businesses to determine which regulations are the most burdensome and expensive to comply with. Provide an online portal for small businesses to share their feedback to support this initiative.

Recommendation #9: Eliminate the most costly and burdensome regulations first as identified by the small business community.

Recommendation #10: Reduce Nova Scotia's public sector employment rate to Canada's national average through attrition, wage restraint, and implementing management methods focused on efficiency and effectiveness.

Recommendation #11: Set aggressive targets to align public sector wages and benefits with private sector levels that can be sustained by Nova Scotia's tax base.

Recommendation #12: Commit in legislation to limit spending to no more than population growth plus inflation.

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