CANADIAN FEDERATION OF INDEPENDENT BUSINESS

Submission

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Toward Fiscal Sustainability

Addressing economic challenges with long-term planning

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The severity of the demographic challenges facing Nova Scotia means past approaches to budgetary planning are no longer an option for government. To mitigate the impact of population challenges, Nova Scotia's small businesses are asking the Nova Scotia government to encourage economic growth through tax reduction and regulatory reform, as well as taking a long-term approach to planning for future demands on spending and limitations in revenue growth.

Introduction

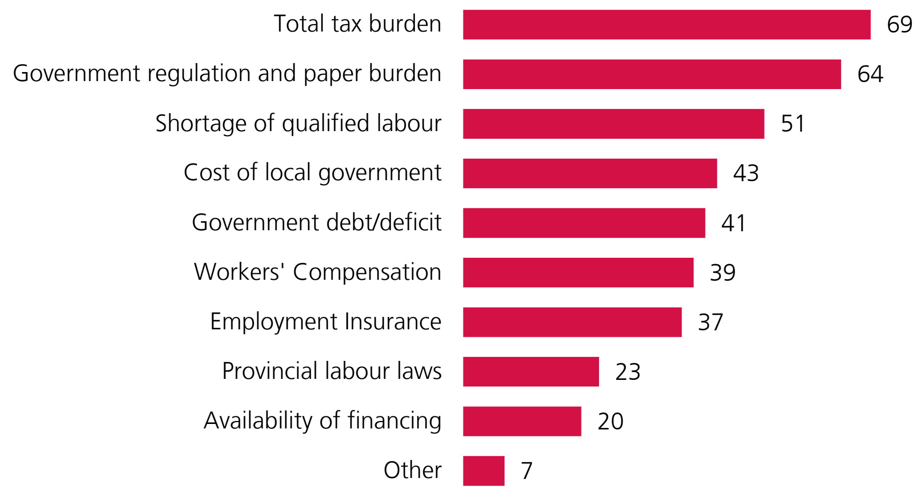
The Canadian Federation of Independent Business (CFIB) is a non-partisan, not-for-profit advocacy organization representing the views of 110,000 small and medium-sized enterprises (SMEs) across the country, including 5,200 in Nova Scotia. Our membership consists of businesses in every sector and every region of the province. Our members share their concerns and priorities with us through regular CFIB surveys. In addition, CFIB representatives meet with each of our members at least once a year. As well, CFIB's Nova Scotia Business Resource Counsellor fields upwards of 1000 member calls annually, providing even more opportunity to gather and understand business owners' and entrepreneurs' top-of-mind business issues.

Small business concerns in Nova Scotia

Our members are concerned about the impact of changing demographics on the province's economy and are telling us government must prepare by reducing spending and implementing long-term fiscal planning to align with projected fiscal demands and economic conditions. Business owners are stressing the need to keep efforts around reducing the total tax burden and red tape reduction focused on delivering tangible results. (see figure 1).

Figure 1:

Serious concerns for Nova Scotia's small and medium-sized business owners



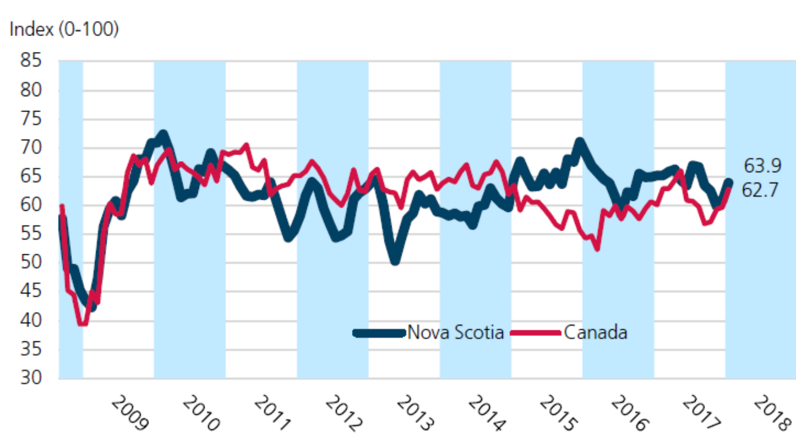
Source: CFIB, Our Members' Opinions, Nova Scotia results, n=432, January 2017.

The small business perspective on the economy

Optimism among Nova Scotia's small business owners improved in January, 2018. Its Business Barometer® Index of 63.9 (see figure 2) is just above the national average and the strongest in Atlantic Canada. Short-term employment plans remain weak, with 11 per cent looking to hire while 10 per cent are planning to decrease full-time employment (see figure 2). About 55 per cent of business owners are reporting their firms are in good shape while only 4 per cent say their firms are in bad shape.

Figure 2:

Business Barometer® Index, Nova Scotia vs. Canada



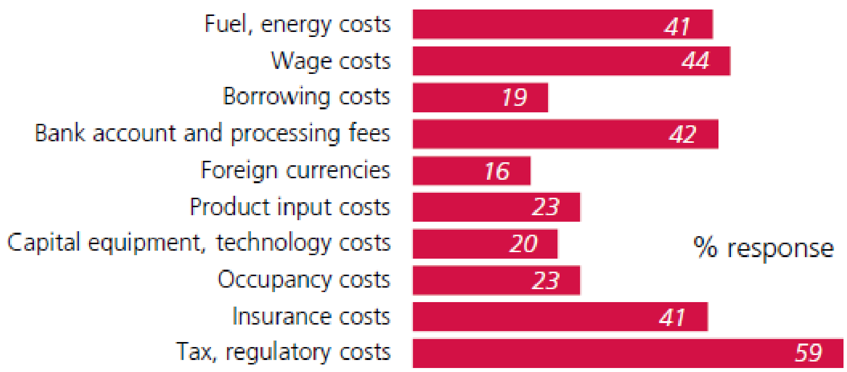
	Index		Mthly chg
Canada	62.7	↗	3.0
Newfoundland & Lab	51.8	↗	1.8
Prince Edward Is.	52.4	↘	-4.1
Nova Scotia	63.9	↗	3.1
New Brunswick	56.9	↗	6.1
Quebec	71.3	↗	5.0
Ontario	58.7	↗	1.2
Manitoba	61.6	↗	4.2
Saskatchewan	53.6	↗	2.7
Alberta	59.4	↘	-0.7
British Columbia	66.7	↗	2.4

Source: CFIB, Business Barometer® Index, Nova Scotia results, January 2018.

Business owners are being affected by increasing operating costs in a number of areas, however, small firms in Nova Scotia point to tax and regulatory burden as the most restrictive business cost followed by wage costs (see figure 3). The $15 minimum wage trend in other jurisdictions is worrying business owners in Nova Scotia. As recently witnessed in Ontario, sharp minimum wage hikes and burdensome labour standards legislation are resulting in negative consequences. Government can improve the climate for Nova Scotia's small business by improving the tax and regulatory environment, not by introducing wage policies that are harmful to the sustainability of SMEs.

Figure 3:

Business Barometer® Index, Major Costs Constraints (% response)



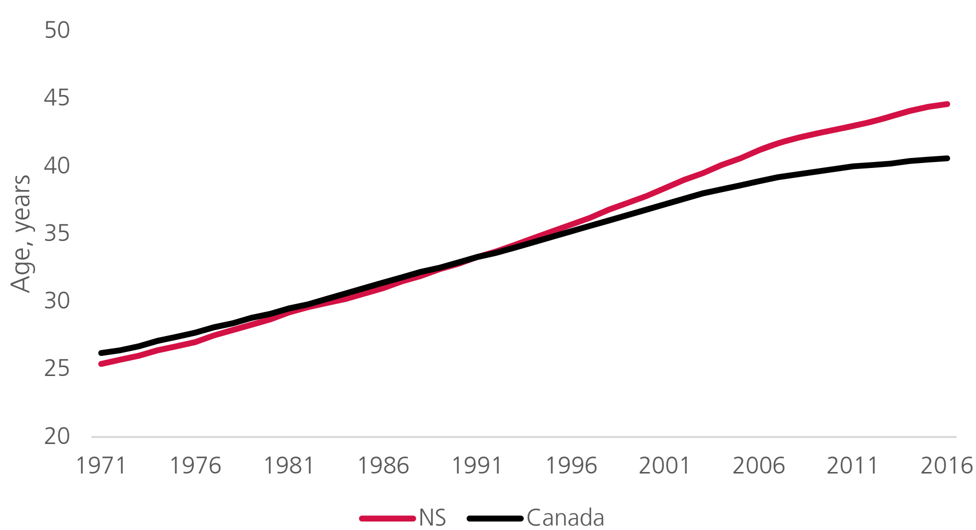
Source: CFIB, Business Barometer Index, Nova Scotia results, January 2018.

Nova Scotia's demographic shift

Nova Scotia's population is getting older (see figure 4). This fact will have important implications for how government conducts its business. A declining tax base resulting from baby boomers exiting the workforce, reductions in labour participation, high out-migration (particularly of youth), low immigration, and declining family sizes mean new approaches to fiscal planning are needed.

Figure 4:

Median age 1971-2016, Nova Scotia and Canada



Source: Statistics Canada. Table 051-0001.

Nova Scotia is not alone in facing the stark reality of population decline. In a recent CFIB report, *Winter is coming: Why Atlantic Canada's aging population should scare governments (and the people who pay for them)*[1], these challenges were explored in-depth from a regional perspective. Long-term fiscal analysis is now considered necessary to understand the impact changing demographics have on government programs and their sustainability. Currently, Nova Scotia is trapped in election cycle budgetary planning and projections included in the budget only provide data for a few additional years. In the absence of long-term projections and planning, policy decisions lack the foresight needed to "future-proof" the economy.

Therefore, we recommend the Nova Scotia government begin including long-term projections in the budget. It is essential government makes the long-term fiscal implications of the demographic shift public. Australia's intergenerational reports and the U.S. Congressional Budget Office's forecast offer useful forecasting models.

Recommendation

- Include long-term projections in the budget to provide clarity on the implications of population change on fiscal sustainability.

Nova Scotia's spending problem

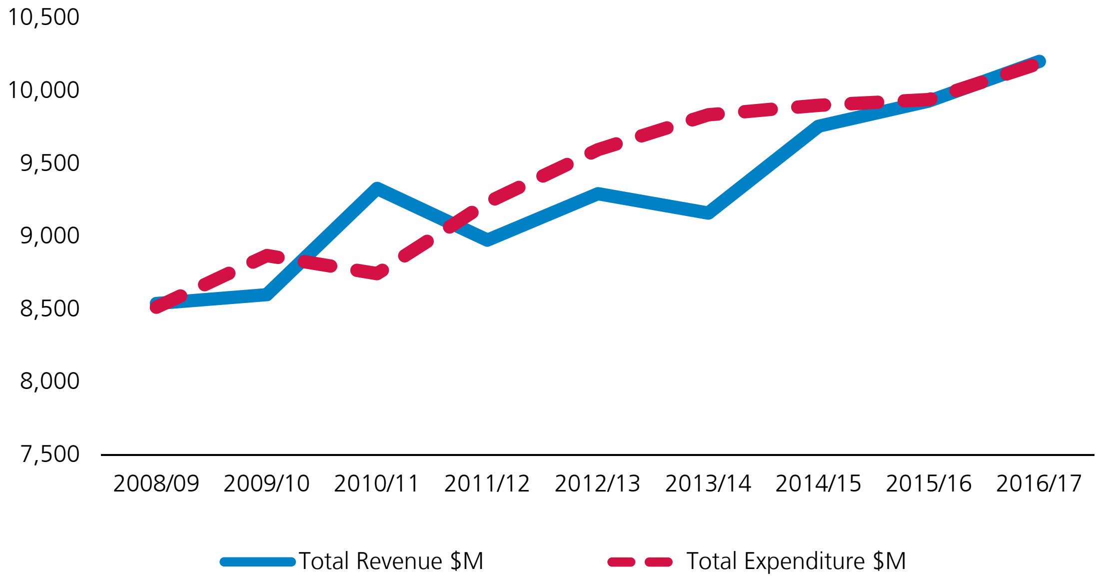
Many small business owners operate on thin margins. Without a keen eye on the bottom line, many business owners would find themselves reducing hours, laying off staff or closing their doors. Business owners want government to understand the realities they face and, in turn, want government to exercise the same restraint over the public purse.

The Government of Nova Scotia tabled balanced budgets in 2016-17 and 2017-18, however, government has struggled to restrain spending growth over time (see figure 5). This spending, if left unchecked, is not only unsustainable but potentially destructive to the provincial economy and could further constrain small business growth if taxes are increased as a result. Furthermore, according to Statistics Canada's recent report, *The Effect of Labour Demand on Demographics,* Nova Scotia's working age population base has declined in all areas of the province except Halifax from 2001 to 2015. Growth in paid employment has also declined in all areas of the province except Halifax and the Annapolis Valley[2]. Government spending must reflect the fact Nova Scotia's tax base is declining.

[1] CFIB, McGrath-Gaudet, Erin, *Winter is coming: Why Atlantic Canada's aging population should scare governments (and the people who pay for them),* November 2017.
[2] Statistics Canada, *The Effect of Labour Demand on Regional Demographics, Economic Insights,* January 2018.

Figure 5:

Cumulative growth in revenue and expenditures (2008/09 – 2016/17), Nova Scotia

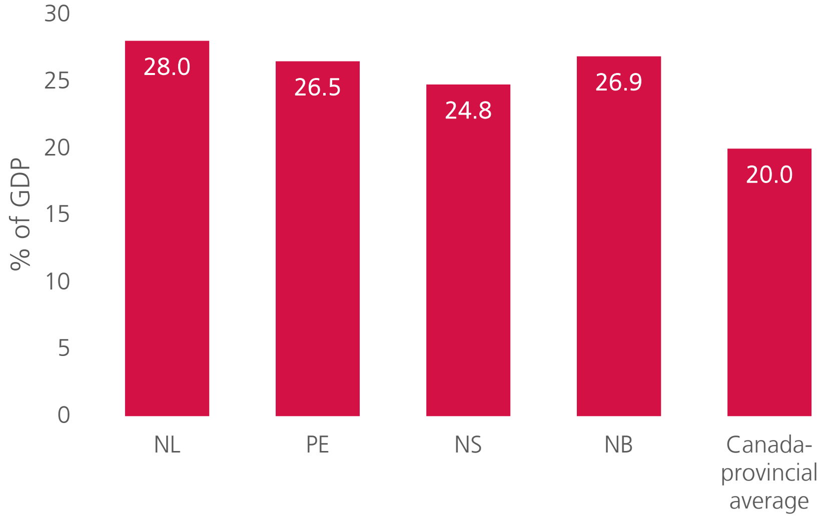


Source: Nova Scotia Department of Finance – Public Accounts (2008/09 – 2016/17)

The Parliamentary Budget Office's *2017 Fiscal Sustainability Report* suggests Nova Scotia is in a slightly better fiscal position relative to the other Atlantic Provinces[3]. However, Nova Scotia's readiness to deal with the challenges a changing populations brings should not be overestimated. Without spending cuts, now and in the long-term, the slight advantage the province has will be lost. While Nova Scotia does have the lowest provincial government expenditures in the Atlantic region at 24.8% of GDP, it exceeds Canada's provincial average by nearly 5% (see figure 6). The province's expenditures as a percentage of GDP will be need to be lower still to ensure long-term fiscal sustainability.

[3] Source: Parliamentary Budget Office, *2017 Fiscal Sustainability Report*.

Figure 6:
Provincial government expenditures, 2016-2017 (% of GDP)



Source: Provincial government budget documents.

Calls for new spending and new programs are inevitable but even in the absence of new spending, government will struggle to maintain key programs. Program costs and spending related to an aging population will increase significantly. Health care, long-term care, and support for seniors (housing and other social programs) will all experience increased demands (see figure 2). Even with the tightest control over spending, maintaining balanced budgets will become more challenging for government as the tax base continues to decline and demand for age-related spending escalates.

Despite this, the Parliamentary Budget Office suggests Nova Scotia has fiscal room to implement permanent tax reductions or spending increases amounting to 0.4 per cent of provincial GDP ($200 million in current dollars) while maintaining fiscal sustainability. This is equivalent to a permanent 1 per cent decrease in the tax burden (including federal transfers) or a 1 per cent increase in program spending. In order to encourage economic growth that will lead to increased government revenue, small business owners prioritize tax reductions over increased program spending. Indexing personal income tax brackets to inflation (eliminating “bracket creep”), implementing a tax incentive for hiring and training employees, and reducing the HST are all tax reduction measures that are strongly supported by small businesses in Nova Scotia.

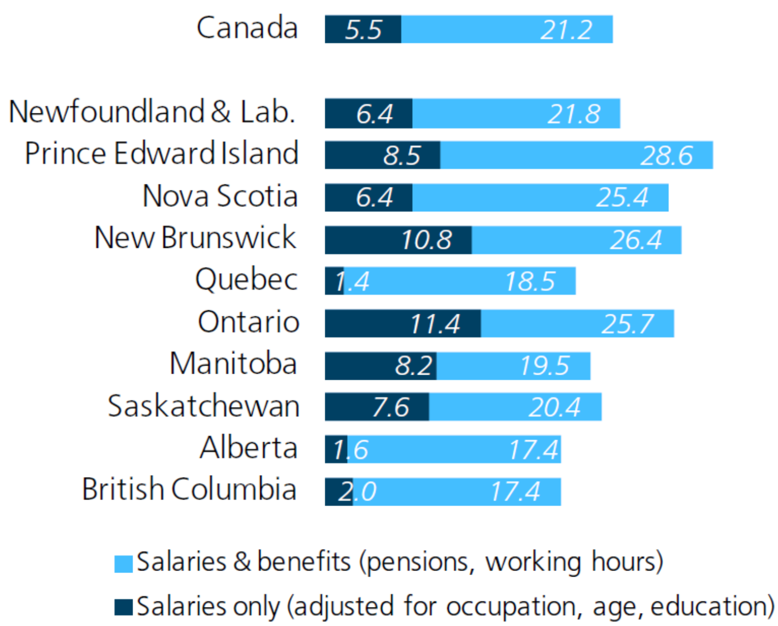
A significant contributor to Nova Scotia’s budgetary pressures can be attributed to the size of Nova Scotia’s public sector. A report published by the Atlantic Institute for Market Studies (AIMS), *The Size and Cost of the Public Sector in Atlantic Canada*, revealed Nova Scotia’s public service is disproportionately large compared to those in the rest of Canada.[4] Additionally, the size of Nova Scotia’s public service has been trending upward over the last five years. With 25 percent of Nova Scotia’s public servants due to retire in the next few

[4] Doughart, Jackson and Marco Navarro-Génie, *The Size and Cost of Atlantic Canada’s Public Sector*, Atlantic Institute for Market Studies, 2016.

years, government should use this opportunity to reduce the overall size of government through attrition.

Figure 8:

Nova Scotia's Public Sector Wages and Benefits



Source: CFIB, Ted Mallet, Wage Watch, 2015.

The other key contributor to the high cost of government is the cost associated with maintaining public sector wages and benefits far in excess of those in the private sector. CFIB's *Wage Watch* report shows provincial government employees in Nova Scotia enjoy a wage and benefits advantage 25 per cent higher than private sector counterparts (see figure 8). This reflects an overall decrease in the wage gap of only 1 per cent since CFIB's previous public sector wage analysis which was conducted in 2008. Reducing the wage gap must be a priority for government and progress must be made quickly in light of the impact of demographic challenges.

Recommendations

- Balance the budget.
- Reduce government spending to no more than 20 per cent of GDP (Canada's national average).
- Introduce tax reforms including indexing personal income tax brackets, providing a tax incentive for hiring and training employees, and reducing the HST.
- Reduce Nova Scotia's public sector employment rate to the national average.
- Align public sector wages and benefits with private sector levels.

Revenue Growth

As greater numbers of workers leave the workforce for retirement without adequate workers to fill gaps, lower revenue growth and slower economic growth are expected, but exactly how much lower is uncertain. From 2001 to 2015, real GDP growth in Nova Scotia has averaged 1.3%. Richard Saillant, in *A Tale of Two Countries: How the great demographic imbalance is pulling Canada apart*[5], provides three possible scenarios for growth looking out as far as 2038. In the low-growth scenario, Saillant suggests GDP could see -0.1% growth. Medium-growth real GDP could be 0.2% and high-growth GDP could be as little as 0.3%. The Parliamentary Budget Office, in its *2017 Fiscal Sustainability Report*[6], makes slightly more optimistic projections (see figure 9). Notably, both sources predict rates of growth significantly lower than what Nova Scotia has experienced over the last decade.

Figure 9:

Economic Growth Projections

	Average 2001-2015	Saillant's "medium growth" projections 2013-2038	PBO real GDP growth projections 2017-2022	PBO real GDP growth projections 2023-2091
Nova Scotia's Real GDP annual growth	1.3%	0.2%	0.9%	0.5%

Source: Nova Scotia Department of Finance – Public Accounts (2001-2015), Richard Saillant – A Tale of Two Countries (2016) & Parliamentary Budget Office – Fiscal Sustainability Report (2017).

Recommendation

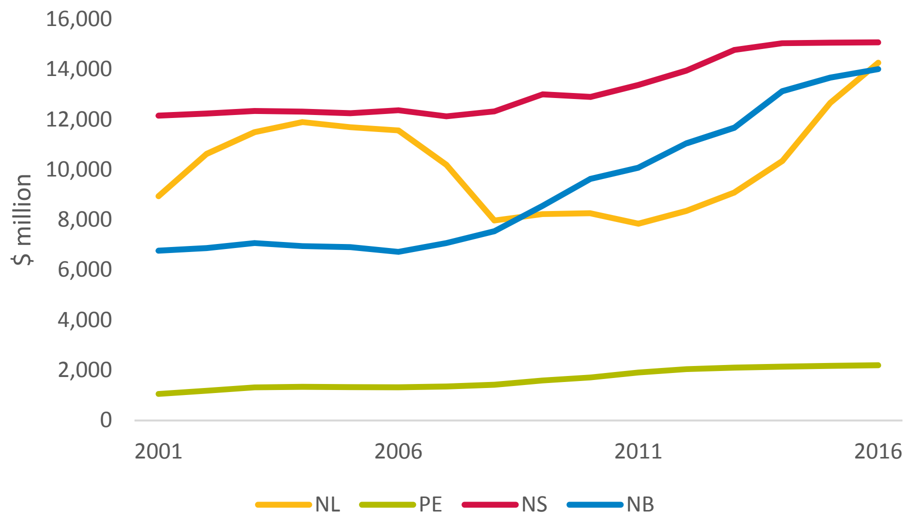
- Plan for lower GDP growth that reflects the impact of changing demographics on the economy.

Nova Scotia's debt load

Nova Scotia is saddled with the highest level of debt in the Atlantic region at $15,061 million or approximately $16 thousand per capita (see figure 10). Future interest rates and bond ratings must be considered in government's long-term fiscal plan. Following the 2008 global recession, governments across Canada, Nova Scotia included, benefitted from low interest rates. This allowed for greater borrowing at a lower cost and lessened the impact on annual budgets. However, as interest rates begin to climb, higher debt-servicing costs will be unavoidable. This new reality will be felt by all governments, but especially those facing increasing pressures due to demographic changes.

[5] Saillant, Richard, *A Tale of Two Countries: How the great demographic imbalance is pulling Canada apart*, Nimbus Publishing, Halifax, 2016.
[6] Parliamentary Budget Office, *2017 Fiscal Sustainability Report*.

Figure 10:
Net debt ($ million) Atlantic region, by province



Source: Provincial Public Accounts, 2005-2015; Provincial Budget 2016.

Recommendation

- Reduce the debt to mitigate the impact of increasing interest rates.

Red Tape Reduction

The regulatory burden faced by small business owners continues to be a top concern. Regulation is necessary to protect public health, safety and the environment. However, excessive, duplicative and unnecessarily complex regulations combined with service delivery that is disconnected from business realities have a serious dampening effect on economic growth and trade.

In CFIB's newest report, *The Cost of Government Regulation on Canadian Business*, the cost to businesses from the three levels of government is estimated at $36 billion in 2017. Compared with 2014 levels, the regulatory costs are stable but remain high.[7] According to business owners, red tape accounts for approximately 30 per cent of the total cost of regulation.[8] In Nova Scotia, the Office of Regulatory Affairs and Service Effectiveness publicly reported the cost of the overall regulatory burden on Nova Scotia business to be approximately $560 million. Of that amount $170 million can be considered red tape[9].

It's important to understand small businesses face significantly higher annual compliance costs than larger businesses on a per employee basis. In Nova Scotia, the cost of red tape on businesses with fewer than five employees is estimated to be $7,164 per employee[10]. When compared to the national average, Nova Scotia's smallest businesses (fewer than 5

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[7] CFIB, Wong, Queenie, *The Cost of Government Regulation on Canadian Businesses,* January 2018.
[8] CFIB, *Regulation and Paper Burden Survey,* 2017.
[9] Regulatory Affairs and Service Effectiveness, https://novascotia.ca/regulatoryopportunity/target.asp, visited January 2018.
[10] CFIB, Wong, Queenie, *The Cost of Government Regulation on Canadian Business,* January 2018.

employees) spend $420 more on red tape (see figure 11). This represents 38 hours spent on compliance costs if the business owner were to pay themselves or an employee $11/hour to do the work. This is the equivalent of one week of full-time employment annually devoted to regulation that adds no value, does not increase productivity, or encourage growth in the business.

Figure 11:

The cost of regulation for Canadian businesses by size of business Nova Scotia vs. Canada

Cost of regulation per employee by size of business (2017 dollars)

	Fewer than 5 employees	5 - 19	20 - 49	50 - 99	100+
Canada (national average)	$6,744	$3,489	$2,549	$1,711	$1,253
Nova Scotia	$7,164	$2,864	$2,433	$1,711*	$1,253*

**Where sample size n<20 formula replaces provincial employee costs with national employee costs.*
Source: CFIB, Queenie Wong, The Cost of Government Regulation on Canadian Business, January 2018.

With lower GDP projected in the long-term as a direct result of demographic changes, the opportunity to boost output by reducing the regulatory burden is more important now than ever before. In *Trade Barriers in Atlantic Canada: Opportunities for Regulatory Reform* (an APEC report commissioned by the Joint Office of Regulatory Affairs) it was determined that reducing regulatory costs by 10% has the potential to boost GDP by a combined 1.4% across the region.[11]

Recommendation

- Intensify regulatory reform efforts to maximize the opportunity for GDP growth.

Conclusion

CFIB appreciates the opportunity to present our members' views for the upcoming provincial budget. Small businesses are very concerned that changing demographics will have a profound impact on the provincial economy and the province's long-term fiscal sustainability. To combat slower economic growth and increasing demands for program spending related to an aging population, we encourage the Minister of Finance to consider the following recommendations.

Summary of Recommendations

- Include long-term projections in the budget to provide clarity on the fiscal implications of population change on sustainability.
- Balance the budget.
- Reduce government spending to no more than 20 per cent of GDP (Canada's national average).

[11] APEC, Chaundy, David, *Trade Barriers in Atlantic Canada: Opportunities for Regulatory Reform,* 2016.

- Introduce tax reforms including indexing personal income tax brackets, providing a tax incentive for hiring and training employees, and reducing the HST.
- Reduce Nova Scotia's public sector employment rate to the national average.
- Align public sector wages and benefits with private sector levels.
- Plan for lower GDP growth that reflects the impact of changing demographics on the economy.
- Reduce the debt to mitigate the impact of increasing interest rates.
- Intensify regulatory reform efforts to maximize the opportunity for GDP growth.