

Back to the Future

Small Business Recommendations on the 2018 Newfoundland and Labrador Budget

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Given so much public discourse on the province's public finances, there does not appear to much in the way of action by the provincial government. The government admits there is a spending problem, but continues to pursue a fiscal plan of relatively flat spending and increased revenue to achieve a balanced budget. The government is able to pursue this agenda without any apparent consequence because it is meeting the weighty expectations of Newfoundlanders and Labradorians. Small business owners are feeling a lot of pressure to keep their businesses going and want to see government do better to address its serious fiscal situation. They have hope that progress will be announced in Budget 2018.

Introduction

In the last few years, Newfoundland and Labrador has been dealing with an economy in recession and a fiscal situation that is very serious. Large development projects, which have been a main driver of economic growth for nearly a decade, are winding down or are completed. The province has been in this situation before. In 1991, Finance Minister Hubert Kitchen delivered, by his own admission, a severe Budget to deal with the financial and economic issues facing the province at the time.¹

There is no doubt that Newfoundlanders and Labradorians have expectations of their government. Minister Kitchen alluded to these expectations as being an underlying reason why the province was facing a financial crisis in 1991. As the ensuing years would show, governments would capitulate, as they turned significant surpluses generated by oil revenues into deficits. Structural deficits are a feature of the

¹ House of Assembly Proceedings; Vol. XLI No. 5; March 7, 1991. Accessed January 12, 2018.
<http://www.assembly.nl.ca/HouseBusiness/Hansard/ga41session3/91-03-07.htm>.

provincial government's fiscal policy and an indication that governments in this province have a history of poor fiscal management.

Yet, with the approval of the bond rating agencies, the government has adopted a fiscal plan to achieve a balanced budget by 2021-22. Spending is expected to increase in fiscal year 2018-19 and then decrease to slightly above current levels by 2021-22. For all intents and purposes, the government plans to balance its budget with an increase in revenue of over \$800 million. This plan is fraught with risk in that oil revenues may not be realized and there is no recognition of the fiscal effects of rate mitigation related to the completion of the Muskrat Falls project.

CFIB represents over 2,000 small- and medium-sized businesses in Newfoundland and Labrador, and almost 109,000 nationally, from all sectors of the economy. Policy positions are taken at the direction of the membership through surveys and discussions with members. This budget submission was completed using data gathered from members in Newfoundland and Labrador as well as secondary sources, such as the government's public accounts.

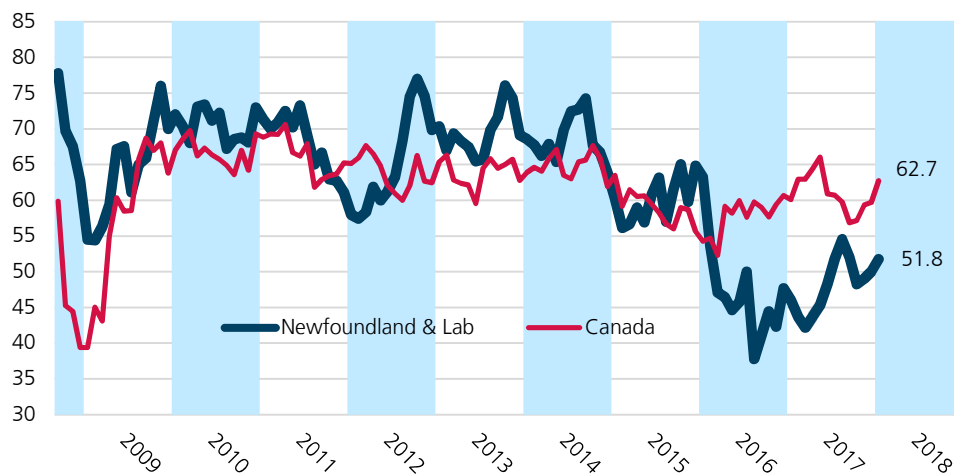
Economic and Fiscal Context

The trend for optimism amongst business owners in Newfoundland and Labrador showed improvement in 2017 after substantial decline in 2016 (see Figure 1). Newfoundland and Labrador's small business confidence index is well below the national number.

Figure 1:

CFIB's Business Barometer

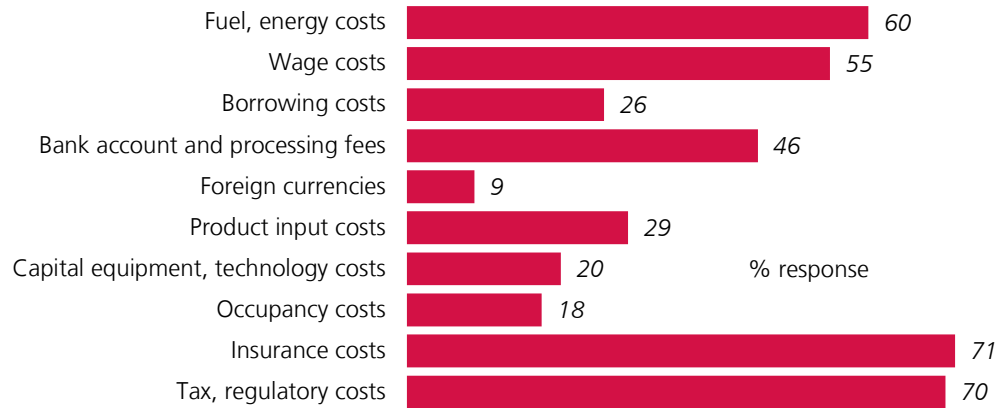
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Source: CFIB, Business Barometer Index, January 2018.

The costs of doing business in Newfoundland and Labrador are substantial and small businesses are feeling constrained in a number of areas. Figure 2 shows the current major cost constraints are insurance costs (71 per cent), tax and regulatory costs (70 per cent); and fuel and energy costs (60 per cent).

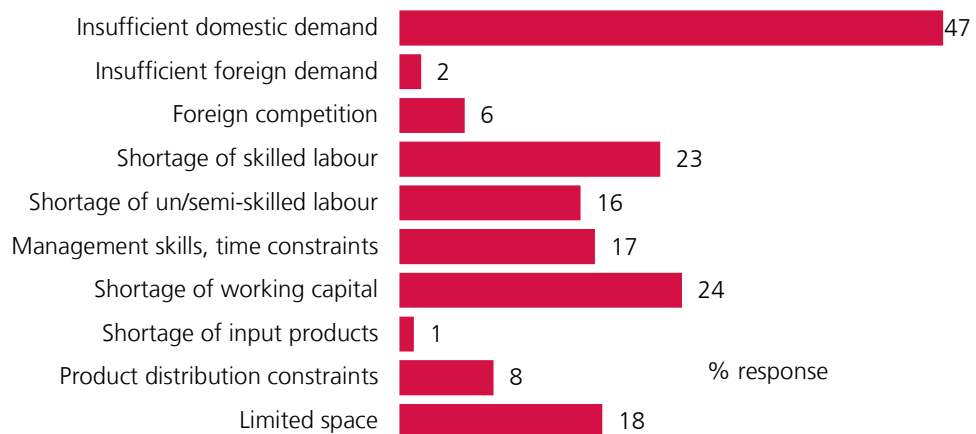
Figure 2:

Major cost constraints

Source: CFIB, Business Barometer Index, January 2018.

There are limitations on the ability of small business owners to generate sales and grow their businesses. By far, the greatest limitation on growth currently is insufficient domestic demand (see Figure 3). As per the government's 2016-17 Public Accounts, every Newfoundlander and Labradorian paid \$1,200 more in taxes and fees than in 2015-16. As the cost of living (including interest rate increases) continues to grow in Newfoundland and Labrador, there will be far less disposable income available to spend as consumers search for the cheapest option. In the retail sector, this may mean further growth in online shopping as an example.

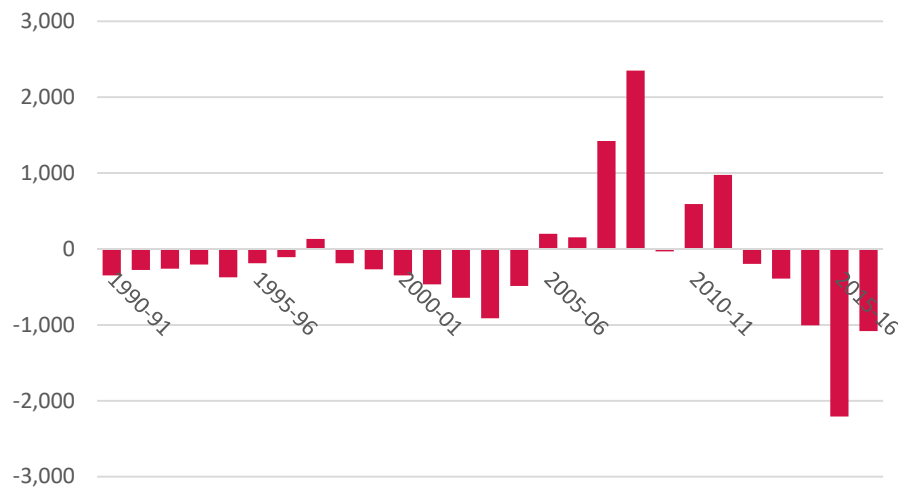
Figure 3:

Limitations on sales or production growth

Source: CFIB, Business Barometer Index, January 2018.

Despite the significant growth in the late 2000s and early 2010s, fuelled by oil and mineral extraction, the province now finds itself mired in deficits and high unemployment no different than over 25 years ago. In the last 27 years, the province has recorded only seven surplus budgets (see Figure 4). Newfoundlanders and Labradorians seem to have a high tolerance level for deficits and debt.

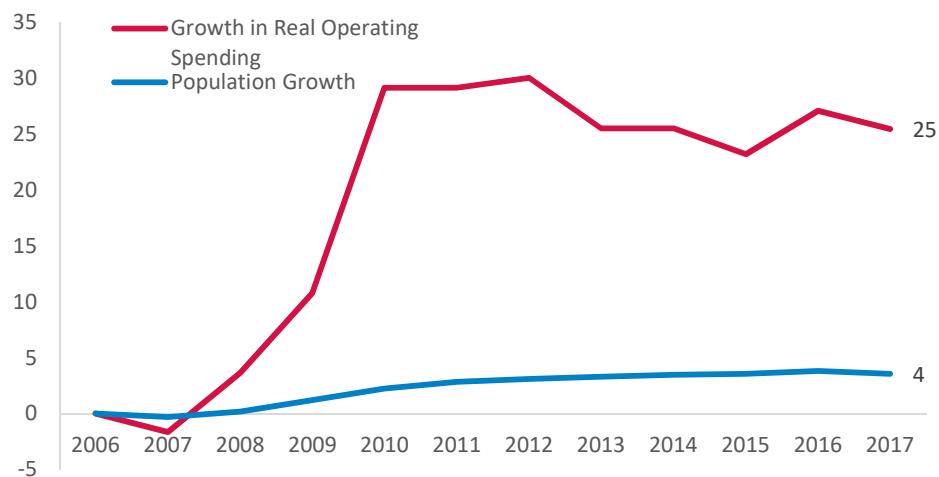
Figure 4:

NL Fiscal Position (1991-2017)

Source: Fiscal Reference Tables, NL data, 1991-2017.

In 2008-09, the province had a \$2.35 billion surplus due to high oil royalty revenue. However, the next fiscal year, there was a small deficit of \$33 million, which was not the result of dropping oil royalty revenue, but rather increased spending. Oil royalty revenue remained flat, though spending increased by over 25 per cent in two fiscal years (see Figure 5). The government's fiscal plan released in Budget 2017 shows its deficit targets will not be met with reduced spending, but rather increased revenue. When the government reaches fiscal balance in 2021-22, compared to 2017-18, it is forecasted spending will have increased by \$7 million and revenues will have grown nearly \$830 million. There is inherent risk in the government's fiscal plan if revenue targets are not met. Should the government choose to keep electricity rates at 17 cents/kWh when the Muskrat Falls development project is completed, the current fiscal plan seems unachievable. It is necessary to update the fiscal plan released in Budget 2017 to present a credible path to balancing the government's budget.

Figure 5:

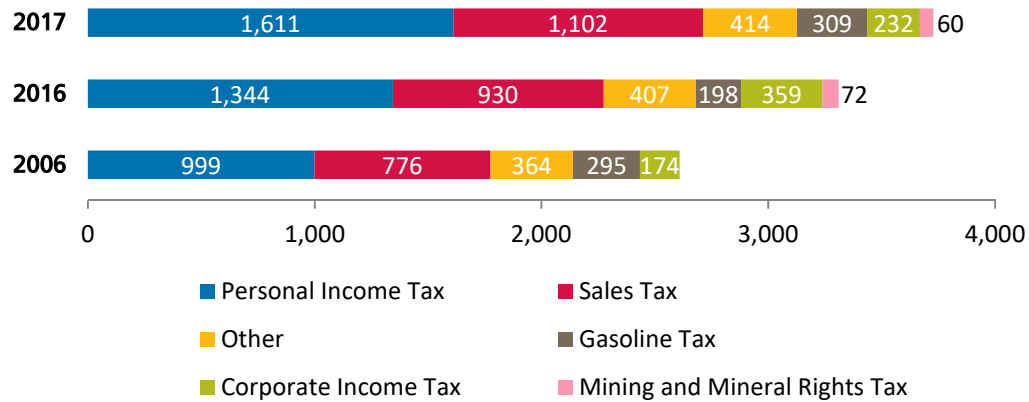
Real Operating Spending 2006 to 2017 (%)

Source: CFIB calculations based on Government of Newfoundland and Labrador Public Accounts (Volume I) 2006-2017; Annual Estimates of Population for Canada, Provinces and Territories, from July 1, 1971 to July 1, 2017, NL Statistics Agency; Consumer Price Index, All Items, NL Statistics Agency.

Small business owners recognize the provincial fiscal situation is urgent and would like to see action being taken sooner rather than later. The taxation burden for residents and businesses in Newfoundland and Labrador has grown overall in the last decade. Inflation-adjusted taxation has increased nearly 43 per cent between 2006 and 2017 (see Figure 6). Between 2016 and 2017, the taxation burden increased by 13 per cent. As the population grew by close to four per cent, the residents and businesses in the province are bearing a much greater burden.

Figure 6:

Taxation, inflation-adjusted, 2017 vs 2016 vs 2006 (in 2017 million \$)

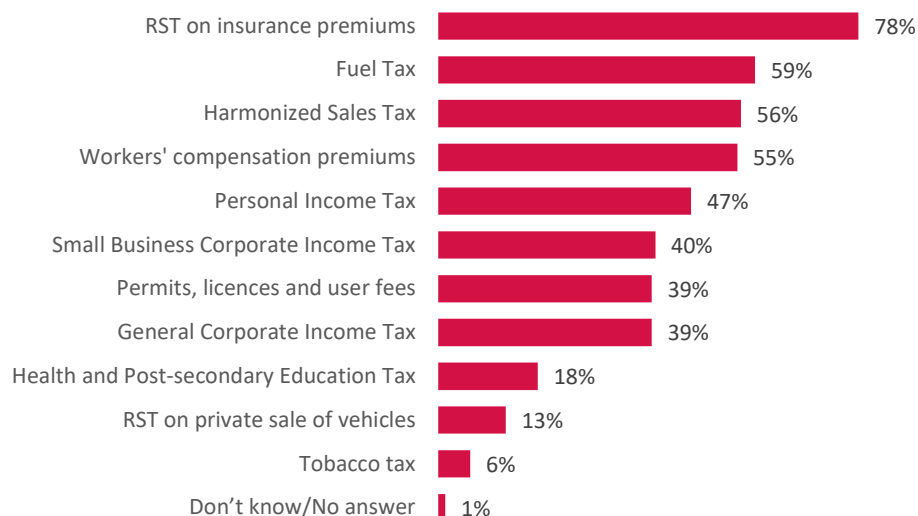


Source: CFIB analysis of Government of Newfoundland and Labrador Public Accounts (Volume I) 2006-2017; Consumer Price Index, All Items, NL Statistics Agency.

According to a recent CFIB survey, the provincial tax and charge that affects small business the most is the Retail Sales Tax (RST) on insurance premiums. This is followed by the fuel tax, Harmonized Sales Tax, and workers' compensation premiums (see Figure 7).

Figure 7:

Which of the following provincial taxes and charges are most harmful to the operation of your business?



Source: CFIB, Newfoundland and Labrador Tax and Insurance Survey, October 2017, 156 responses.

CFIB fully understands the government is dealing with a desperate situation and it is unreasonable to expect significant tax reductions at this time. However, the 2016 Budget has had a huge effect on business owners and their consumers. It is clear additional increases in taxes and fees would exacerbate the situation. Rather, relieving some of that pressure by eliminating the RST on insurance premiums would be welcome. CFIB estimates the tax costs small- and medium-sized businesses roughly \$40 million a year (see Appendix I). This, of course, excludes residents who have to pay the tax on insurance for their properties.

Government Savings and Efficiencies

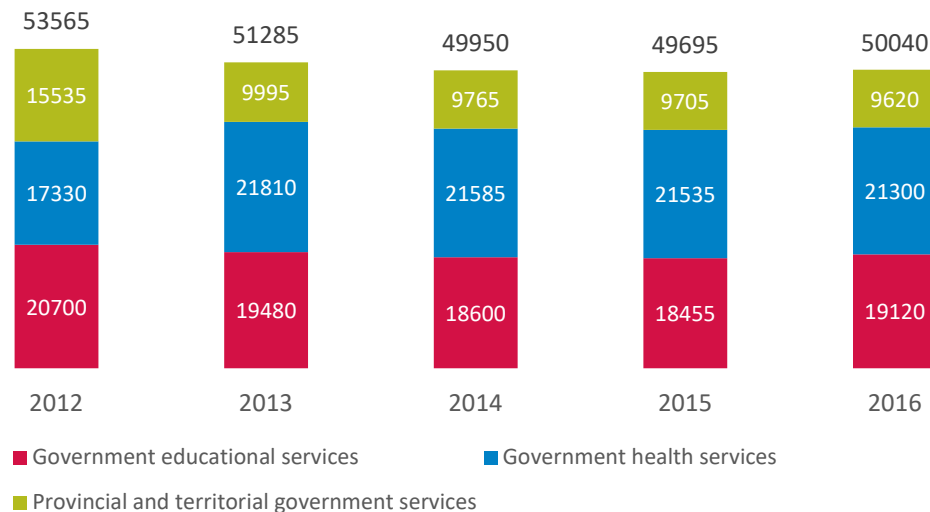
There are a number of areas within government where it can become more efficient and generate savings for taxpayers. To aid government in reducing its expenses, CFIB offers the following recommendations, which have the potential to save hundreds of millions of dollars.

- ▶ **Find efficiencies in the health care system.** In a recent survey, members overwhelmingly support a need for improved efficiencies and cost savings in the health care system. In order to bring greater efficiencies to the delivery of health care services, CFIB recommends the government consider the initiatives advocated by Choosing Wisely NL, which have the potential to save 20 per cent (\$600 million) of the health care budget.
- ▶ **Eliminate provincial training and business development programs.** The vast majority of CFIB members state they do not use the provincial training and business development programs nor do they find those programs beneficial. Many of the programs are not reasonably accessible to small business as excessive paperwork is a deterrent. It is poor economic development policy to increase the taxes of the many in order to provide direct funding for a few. Government is advised to replace the current training programs with a training tax credit to lower costs, with as little red tape as possible, and make the tax credit available to all sectors and business sizes.
- ▶ **Introduce a legislative and regulatory framework to govern public-private partnerships (P3) in a transparent and accountable manner.** In recent years, there has been much discussion and debate about public-private partnerships (P3s) in Newfoundland and Labrador. However, this discussion has become polarized, which is unfortunate because there is often merit in a P3 approach. CFIB members are supportive of more private sector involvement in the delivery of public services. When deemed necessary, they see this as an appropriate way to help control spending in health care, post-secondary education and other social priorities, while providing the level of service Newfoundlanders and Labradorians expect. While recognizing the important role the private sector can play in public service delivery, the major concerns CFIB members have with P3 infrastructure projects are transparency, accountability and true value-for-money. A legislative and regulatory framework governing P3 projects would provide the clarity and assurances Newfoundlanders and Labradorians deserve.

- **Release independently verified data on the size of the public sector (i.e. departments, agencies, boards and commissions) on a quarterly basis.** CFIB has long advocated for the use of attrition in reducing the public sector workforce. Given the demographics of the public service, there should be a number of employees who will soon be eligible for retirement. However, Statistics Canada data show that attrition may not be working, despite the government's claims. According to the data (see Figure 8), the size of the public sector increased in 2016 after declines since 2012. The government has included a no layoff clause in the collective bargaining agreements. There must be assurances the public sector is not growing to an extent that the government will not be able to address any fiscal shocks with a reduction of its workforce. The data should be gathered and released by an independent body like the NL Statistics Agency.
- **Proclaim the Public Procurement Act.** In December 2016, the House of Assembly passed legislation that would update the public tendering process in Newfoundland and Labrador. While the legislation will be very good in bringing greater transparency and accountability in the procurement system, the regulations will be important in providing assurances that small business will benefit from the new legislation. It is possible the government is paying more than it should be for many goods and services procured through the current tendering process, so this provides an opportunity for cost savings. It is necessary for the government to proclaim the legislation sooner rather than later.

Figure 8:

Size of the Newfoundland and Labrador Public Sector, 2012-2016



Source: Statistics Canada, CANSIM 383-0033, NL data, Total number of jobs.

Conclusion

The provincial government has recognized it has a spending problem. This spending problem is structural and largely driven by political ambition and short-term

thinking. However, as long as Newfoundlanders and Labradorians maintain high expectations for service delivery and the bond rating agencies accept the government's fiscal plans, the political leaders of the province will lack any aspiration to deal with the government's spending problem in a meaningful way. The 2018 Budget provides the government with an opportunity to present a true plan to return the province to a strong fiscal position.

Summary of recommendations

- ▶ **Release an updated fiscal plan that credibly identifies the path to reaching fiscal balance.**
- ▶ **Eliminate the Retail Sales Tax on insurance premiums immediately; do not increase any taxes and fees.**
- ▶ **Eliminate provincial training and business development programs; replace the non-LMDA funded training programs with a training tax credit.**
- ▶ **Find efficiencies in the health care system.**
- ▶ **Introduce a legislative and regulatory framework to govern public-private partnerships (P3) in a transparent and accountable manner.**
- ▶ **Release independently verified data on the size of the public sector (i.e. departments, agencies, boards and commissions) on a quarterly basis.**
- ▶ **Proclaim the Public Procurement Act.**

Appendix I

Estimated Cost of Retail Sales Tax on Insurance Premiums By Size of Business

Size	Number of businesses	Average annual cost	Total annual SME cost	Average annual insurance tax
1-4	8411	\$11,233	\$94,476,558	\$14,171,483
5-19	5408	\$18,874	\$102,071,133	\$15,310,670
20-499	1848	\$38,245	\$70,676,760	\$10,601,514
Total	15667		\$267,224,450	\$40,083,668

Source: 128 responses to NL Tax and Insurance Survey (54 – 1-4 employees, 54 – 5-19 employees, and 20 – 20-499 employees; Number of Businesses by Employment Size Range, Trade and Business Statistics, Newfoundland and Labrador Statistics Agency (excludes Public Administration sector), http://www.stats.gov.nl.ca/Statistics/Trade/PDF/BR_NL_Size_2016.pdf. Accessed on May 24, 2017.