INSTITUT C.D. HOWE INSTITUTE

COMMENTARY
NO. 567

Supporting Growth; Restoring Confidence: A Shadow Federal Budget for 2020

This Shadow Budget supports Canada's economy in the near term and enhances growth prospects in the longer term. Its measures to eliminate federal deficits will give Canadians badly needed confidence in the country's fiscal management.

Alexandre Laurin and William B.P. Robson

The C.D. Howe Institute's Commitment to Quality, Independence and Nonpartisanship

About The Authors

William B.P. Robson
is President and CEO
of the C.D. Howe Institute.

Alexandre Laurin
is Director of Research,
C.D. Howe Institute.

The C.D. Howe Institute's reputation for quality, integrity and nonpartisanship is its chief asset.

Its books, Commentaries and E-Briefs undergo a rigorous two-stage review by internal staff, and by outside academics and independent experts. The Institute publishes only studies that meet its standards for analytical soundness, factual accuracy and policy relevance. It subjects its review and publication process to an annual audit by external experts.

As a registered Canadian charity, the C.D. Howe Institute accepts donations to further its mission from individuals, private and public organizations, and charitable foundations. It accepts no donation that stipulates a predetermined result or otherwise inhibits the independence of its staff and authors. The Institute requires that its authors disclose any actual or potential conflicts of interest of which they are aware. Institute staff members are subject to a strict conflict of interest policy.

C.D. Howe Institute staff and authors provide policy research and commentary on a non-exclusive basis. No Institute publication or statement will endorse any political party, elected official or candidate for elected office. The views expressed are those of the author(s). The Institute does not take corporate positions on policy matters.

Commentary No. 567
March 2020
Fiscal and Tax Policy

Daniel Schwanen
Vice President, Research

$12.00
ISBN 978-1-989483-31-2
ISSN 0824-8001 (print);
ISSN 1703-0765 (online)

The Study In Brief

Early 2020 presents Canada with two challenges: amenic economic growth, and nervousness about the federal government's fiscal stewardship. The C.D. Howe Institute's Shadow Federal Budget for 2020 addresses both. It contains a number of measures to improve the rewards from work, saving and investment – initiatives that will support near-term spending and job creation, and raise Canada's growth prospects and opportunities over time. It also contains measures that will enhance the efficiency of federal revenue collection, control spending, and eliminate federal government borrowing by the end of the projection period – initiatives that will give Canadians confidence in their national finances.

Highlights of the 2020 Shadow Budget's measures to support economic growth are changes to personal and corporate income taxes that will encourage talent and investment, elimination of distorting taxes and border frictions, more focused infrastructure investments, and measures to support Canada's labour market. The Shadow Budget would foster opportunity and well-being by supporting saving for, and income in, retirement, establishing more generous treatment for medical expenses, supporting charitable giving, and implementing a more growth-friendly strategy to reduce greenhouse gas emissions with a new GST rate on motive fuels. It would further support fiscal sustainability through new regimes for federal estimates, federal employee pensions and compensation, levelling the playing field for taxation of digital services, and rationalizing ineffective tax expenditures.

The result is a fiscal framework that will support growth now and in the future, and let Canadians work, save and invest with confidence, knowing that the federal government is dealing successfully with the country's longer-term challenges.

C.D. Howe Institute Commentary© is a periodic analysis of, and commentary on, current public policy issues. Barry Norris and James Fleming edited the manuscript; Yang Zhao prepared it for publication. As with all Institute publications, the views expressed here are those of the authors and do not necessarily reflect the opinions of the Institute's members or Board of Directors. Quotation with appropriate credit is permissible.

To order this publication please contact: the C.D. Howe Institute, 67 Yonge St., Suite 300, Toronto, Ontario M5E 1J8. The full text of this publication is also available on the Institute's website at www.cdhowe.org.

Canada faces two related challenges: economic growth, and fiscal sustainability. The federal government's 2020 Shadow Budget addresses both.

It contains a number of measures to improve the rewards from work, saving and investment – measures that will raise Canada's growth prospects and the opportunities for Canadians to thrive in the future. It also contains measures to eliminate federal government borrowing over time, putting in place a fiscal framework that will give Canadians confidence in their national finances.

Confidence in national finances is a precondition for the confidence that will let the growth-oriented measures in this Shadow Budget achieve their maximum effect. In October 2015, a new government took office in Ottawa. Federal finances at that point were on track for balance in the 2015/16 fiscal year (Canada 2015). The government's election platform promised deficits of less than $10 billion in the first two fiscal years, followed by a return to balance in 2019/20. The actual result for its first fiscal year, 2016/17, was a deficit of $19 billion and the outlook for 2019/20 is for a deficit of $25 billion. The ratio of federal debt to gross domestic product (GDP), which the Liberal election platform predicted would shrink below 27 percent by 2019/20, now appears likely to come in at 31 percent.

Deficits Canadians understood would be modest and temporary have become large and chronic. It is clear that embracing red ink has undermined the government's ability to make the choices Canadians need from the stewards of the national economy. In fiscal year 2018/19, revenues came in $11.5 billion higher than budgeted in 2018. The government spent the bulk of this bonus, so the deficit came in almost as projected. Since 2015/16, actual expenses have exceeded budget expectations by a cumulative $13.2 billion – Ottawa's sticking to its budgets would have almost wiped out last year's deficit.[1]

Voting ourselves benefits, and passing forward the part of the bill we are not willing to pay ourselves, is neither fair nor economically sensible. In the current uncertain environment, with worries about Covid-19, blockades and investor nervousness, the federal government's fiscal position should inspire confidence, not further anxiety. This Shadow Budget proposes a wiser and more promising course. It would put federal finances back in the black through a combination of economic growth–oriented policies, measures to improve individual opportunities and well-being and fiscal restraint. Table 1 summarizes the anticipated impact of these measures on the bottom line. The discipline of a firm target for the bottom line would ensure that its measures meet a higher standard of value in relation to potential alternative uses of money than has been the case since 2015.

Of note in Table 1 is that the improvement in the annual balance would halt the increase in federal debt – not just as a share of GDP, an indicator that

The authors are grateful for ideas and comments on earlier drafts from many contributors and reviewers, notably Daniel Schwanen, Donald Drummond, Nick Pantaleo, anonymous reviewers and members of the C.D. Howe Institute's Fiscal and Tax Competitiveness Council. The authors alone are responsible for the recommendations and views presented here, as well as for any errors.

1 These figures reflect the in-year accounting changes revealed in the fall 2019 Economic and Fiscal Update, notably the lower discount rates used to value deferred compensation.

Table 1: Medium-Term Fiscal Projections with Shadow Budget Initiatives

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
			($billions)			
Baseline Projections						
Revenues	348.7	361.7	378.5	394.5	409.9	427.3
Expenses	-374.1	-387.1	-397.6	-409.9	-423.2	-435.9
Budgetary Balance before Initiatives	-25.3	-25.4	-19.1	-15.4	-13.3	-8.6
Shadow Budget Initiatives (impact on budgetary balance)						
Addressing the Productivity and Growth Challenge		*-4.5*	*-4.7*	*-4.6*	*-4.5*	*-4.3*
Improving Canadians' Opportunities and Well-Being		*3.5*	*3.4*	*3.3*	*7.0*	*6.9*
Achieving Fiscal Sustainability		*2.6*	*3.5*	*5.7*	*6.7*	*8.0*
Changes to Debt Charges		*0.0*	*0.0*	*0.1*	*0.2*	*0.4*
Total		***1.6***	***2.3***	***4.5***	***9.4***	***11.0***
New Budgetary Balance	**-25.3**	**-23.8**	**-16.8**	**-10.9**	**-3.9**	**2.4**
Accumulated deficit	713.2	737.0	753.8	764.7	768.6	766.2
as % of GDP	*31.0*	*31.0*	*30.4*	*29.7*	*28.7*	*27.6*

Sources: Tables 3 below.

is too weak to constrain policy or inspire confidence, but in dollar terms. With this change, the federal government would reduce its draw on national saving, position Canada better should a downturn require a fiscal offset, and build household and investor confidence in the future.

Parallel with the promise to give Canadians confidence in the federal government's fiscal framework and the longer-term prospects for Canada's economy is a commitment to greater transparency and accountability in the budgeting process. The C.D. Howe Institute's latest fiscal accountability report (Robson and Omran 2019) gave the federal government a B+ – good, but not the top-rank position appropriate to the national government. Obscure presentation of key budget numbers, estimates that do not match the budget projections and late production of the Public Accounts and Main Estimates were the defects that kept the government from achieving a top grade.

These defects are not hard to fix. The estimates should reconcile straightforwardly with the fiscal plan in the budget. The federal government should publish its financial statements before the end of June, matching the best performance among Canada's senior governments. As for straightforward presentation, unlike the 2019 Budget, which buried the key numbers on page 321 in an annex, our Shadow Budget puts the fiscal plan summary (Table 1) right at the front.

The Economic and Fiscal Framework

The baseline for the fiscal plan in this Shadow Budget is the economic and fiscal outlook from

the December 2019 Economic and Fiscal Update (Canada 2019a).

The average of private-sector economic forecasts used by Finance Canada puts growth of real GDP at 1.6 percent in 2020 and 1.8 percent in 2021 and 2022. Allowing for inflation, the corresponding figures for nominal GDP growth are 3.7 percent in 2020 and 3.8 percent in 2021 and 2022. Longer term, GDP growth is projected at 3.9 percent for both 2023 and 2024.

We have marked the forecast down slightly in 2020, reflecting disruptions and a blow to confidence from Covid-19. Our expectation at this point is that these impacts will be worst in the first half of the year, with rebounds making up much of the lower spending and economic activity by the end of 2021. Our outlook for short-term interest rates in 2020 is also lower, which slightly reduces expected debt-servicing costs in fiscal year 2020/21.

These interest rate projections are down significantly since the 2019 budget, with the five-year forecast average for short-term interest rates declining from 2.2 percent to 1.8 percent in the Fiscal Update, and that for long-term interest rates registering a decline from 2.9 percent to 2.0 percent. Much lower interest-rate projections make the cost of servicing the debt cheaper, but they also make future employee benefits, discounted at market rates, more expensive to fund.

The projections show revenue increasing 8.5 percent in total over the next two fiscal years, reaching $378.5 billion in 2021/22, and expenses, excluding debt charges, rising 5.9 percent to $361.0 billion. Based on these projections, our Shadow Budget planning baseline starts with a $25.3 billion deficit in 2019/20 ($8.7 billion higher than was planned just a year ago in the 2018 Fiscal Update), followed by another $25.4 billion deficit in 2020/21 and a $19.1 billion deficit in 2021/22 (Table 2).

With no near-term commitment or pressure to achieve a balanced budget, the long-standing practice of building a contingency reserve – lately termed an "adjustment for risk" – into each year's fiscal plan has little justification. These adjustments create room for unbudgeted in-year spending when negative shocks do not materialize (Busby and Robson 2017). The Fiscal Update included $3 billion annually for such contingencies. Our Shadow Budget ceases this practice (Table 2).

Addressing the Productivity and Growth Challenge

Canada's population is aging. In the decades ahead, the working-age population is expected to grow at about half the rate it did in the 1980s, 1990s and 2000s. Simple arithmetic dictates that, to maintain the growth in living standards Canadians have enjoyed in recent decades, output and incomes per working-age person will need to rise faster. As highlighted in the Fiscal Update (Canada 2019a, chart 1.3), "sustaining economic growth will require productivity growth to almost double from previous decades" to make up for slower employment growth. That is a core policy challenge, one that federal fiscal policy can address by making taxes less distorting, investing wisely, and promoting investments in human capital and innovation.

Improving Canada's tax competitiveness is a good place to start. Too much discussion of the tax system treats it as a tool with one purpose only: to redistribute from less-favoured groups to more-favoured groups. This view is unhelpful. Spending programs are superior – better targeted and more transparent – ways to benefit particular people. The key objective of the tax system should be to raise sufficient government revenues at the least economic cost. Canada's tax policies could be better in this regard.

Compared to other member countries of the Organisation for Economic Co-operation and Development (OECD), Canada relies more on income taxes levied at relatively high rates on relatively low incomes, and less on social security contributions and consumption taxes. In the past decade, Canada's senior governments have raised their tax rates on higher-income earners: the combined federal/provincial top tax rate is now

Table 2: Shadow Budget Assumptions and Projections

	2019/20	2020/21	2021/22
		($Billions except as noted)	
Economic Growth (*percent*)			
Real GDP growth	1.6	1.5	2.0
GDP inflation	2.0	2.0	2.0
Nominal GDP growth	3.6	3.5	4.0
Revenues			
Taxes on incomes, payroll, consumption and other transactions	310.9	322.6	336.7
User fees and charges for government services and products	17.7	18.1	18.4
Investment income	20.2	21.0	23.4
Total Revenues	**348.7**	**361.7**	**378.5**
Expenses			
Direct program expenses	165.0	168.8	167.6
Transfers to persons and governments	175.8	184.8	193.4
Gross debt charges	33.3	33.5	36.6
Total Expenses	**374.1**	**387.1**	**397.6**
Summary of Revenues, Expenses and Balance			
Taxes, fees, and other charges	328.6	340.7	355.1
Program spending and transfers	-340.8	-353.6	-361.0
Debt charges net of investment income	-13.1	-12.5	-13.2
Budgetary Balance	**-25.3**	**-25.4**	**-19.1**

Notes:

Totals may not add due to rounding.

Investment income projections include expected return on average market-related value of pension plans' investments, interest income, net income from enterprise Crown corporations, foreign exchange revenues, and other returns on investment.

User fees and charges include miscellaneous penalties and interests.

Contrary to budget figures, debt charges shown gross of investment income on pension investment.

Sources: Canada (2019); authors' calculations.

more than 50 percent – a threshold typically seen as psychologically and economically important – in eight provinces and almost 50 percent in two others. Increasing the income threshold at which the top tax rate applies would improve work incentives and reduce many Canadians' incentive for tax avoidance in the short term, while encouraging greater entrepreneurial activity and private investment in the long term, thereby attracting talent and fuelling the innovation necessary for a productive and successful economy.

Meanwhile, lower corporate income tax rates in other developed countries, and especially in the United States, have eroded a long-standing Canadian advantage in corporate income tax rates. In the short term, lowering the corporate income tax rate would provide additional locational incentives for investments and profits in Canada. In the longer term, a modernization of taxation of capital income would transition to a growth-oriented tax base that is neutral with respect to business investment and financing decisions through an Allowance for Corporate Equity or a cash-flow tax. In light of recent international tax developments, Canada should participate in multilateral arrangements to tax global corporate intangible income, instead of going it alone.

Income tax policy is an important lever the federal government uses to foster economic growth, but it is not the only one. Canada's economy could also benefit from enhancing its international trade performance, domestic regulation, educational and labour market outcomes, and modernizing public infrastructure.

Reducing trade frictions could enhance Canada's ability to expand domestic production to serve markets at home and abroad. Import tariffs increase costs to Canadian businesses and, since they vary by country and product, they distort purchasing decisions. When a Canadian buyer chooses a product from a preferentially treated trade partner over a superior product affected by a tariff, Canadian businesses and consumers suffer. Ideally, Canada would lower tariffs through negotiations that induce its trading partners to lower theirs, but with the momentum of international trade liberalization currently weak, Canada is better served by a unilateral elimination of import tariffs.

Notwithstanding much talk about federal infrastructure investment over the past five years, follow-through has been disappointing. Much of the money has not been spent as planned (Canada 2018), and some of the federal support to provinces might have displaced provincial funding for existing infrastructure plans (Canada 2019b). Most public infrastructure investment occurs at the provincial and local level, which requires intergovernmental coordination and cost sharing, and means that much of the needed planning, consultation and permitting occur outside the federal government's purview. Prioritizing funding for projects the federal government can manage itself, such as investments in marine, rail and air transportation, would deliver benefits more reliably.

Keeping the cost of regulations proportional to their benefits is a never-ending task. The multiplication of rules about products and behaviour in recent decades threatens to limit the availability of some goods and services and raise the costs of others. Accordingly, achieving equivalent protections at a lower cost in areas such as the environment, health and safety should be a priority.

Since demography is a constraint on growth, enhancing Canada's human capital stands out as a way to improve the country's economic outlook. Supporting the benchmarking of student achievement both across the country and internationally would promote the spread of effective practices and highlight areas that need improvement. Canadian workers and employers would find and engage better with each other if they had access to better information about job opportunities and worker qualifications. They would also benefit from employment insurance (EI) reforms that reduce regional unemployment and encourage investments in human and physical capital.

Below, we profile these productivity-enhancing initiatives, including references to relevant research, and outline their fiscal impact.

Double the Top Personal Income Tax Threshold

Our Shadow Budget would reduce the number of people subject to the highest personal income tax rate by doubling the threshold at which it applies, from the current $214,368 to $428,736. The positive response to this lower rate would expand the tax base for both the federal and provincial governments. The boost to provincial tax revenue from an expanded tax base would amount to some $775 million – a better way for the federal government to support provincial finances than increasing transfer payments (Robson and Laurin 2019).

After accounting for changes in taxpayers' decisions about when and how they report taxable income and higher levels of activity, the net cost to the federal budget would be around $378 million.[2]

Lower the Corporate Income Tax Rate

Canada improved its tax environment for business investment during the early 2000s, and its relative performance in capital invested per worker responded. More recently, however, Canada has lost its competitive edge. Other countries have been lowering their corporate income tax rates, and changes in the United States in 2018 – dropping the corporate income tax rate from 35 percent to 21 percent and temporarily expensing many capital investments – dramatically boosted its attractiveness for new equity-financed business investment (Bazel and Mintz 2017; McKenzie and Smart 2019).

Our Shadow Budget would reduce the corporate income tax rate by two percentage points, from 15 percent to 13 percent, effective immediately. This change would provide additional locational incentives for investments and profits in Canada while a more comprehensive review of the tax system is underway. On a static basis, this change initially would reduce federal revenues by $3.8 billion annually. As investors and business managers responded positively, however, the base for the corporate income tax would expand, reducing the impact over time (Robson and Laurin 2019).

Transition to a Neutral Corporate Tax System

Our Shadow Budget calls for a comprehensive review of the tax system. On the corporate side, that review would explore different ways to lower the marginal effective tax rate (METR) on business investment, such as providing an Allowance for Corporate Equity (Boadway and Tremblay 2016; Milligan 2014) and reforming the tax base to tax only cash flows (McKenzie and Smart 2019). Both options would result in a growth-oriented tax system that is neutral with respect to business investment and financing decisions. Either change would be calibrated to be revenue neutral in the short run. Both would produce additional revenues over time thanks to faster economic growth.

Eliminate the Excise Tax on Aviation Gasoline and Jet Fuel

The Shadow Budget would abolish federal excise taxes on aviation fuel. They are inferior to value-added taxes such as the goods and services tax (GST) because they tax an intermediate input, thus raising costs throughout the economy and making Canadian exports less competitive (Robson and Laurin 2019). Aviation fuel would be subject to the same higher GST rate that would apply to other

2 This estimate uses the same methods as described in Laurin (2015) – that is, the median taxpayer response-elasticity coefficient is 0.62.

motive fuels (as we outline below), with rebates through the same invoice-credit system that relieves intermediate users of tax.

The revenue cost of this change would be about $120 million per year.

Eliminate Tariffs

Our Shadow Budget would phase out all of Canada's remaining tariffs on imports. Canada is a party to several international trade agreements that provide duty-free access to participants' imports and exports. It is also a party to the World Trade Organization (WTO), which means that Canada's duties on imports from other WTO member countries are usually low. Although multilateral liberalization offers greater benefits overall, holding onto tariffs as a "bargaining chip" is unhelpful if – as the current environment makes likely – the multilateral liberalizations they are supposed to help us achieve happen only with a long delay, or never. Removing remaining tariffs on imports would create additional benefits for Canadian consumers and businesses. The resulting boost to GDP would be about 1 percent – a larger effect than any preferential trade agreement available (Ciuriak and Xiao 2014). On its own, this reduction would eventually reduce federal revenues by more than $5 billion annually. The offset in lower administrative costs and additional tax revenues from a higher GDP, however, would reduce the net fiscal cost to about $2 billion once the phase-out was complete.

Rationalize Tariffs and Sales Taxes on Small-Value Imports

This Shadow Budget would increase the current $20 *de minimis* threshold for the application of the harmonized sales tax (HST/GST) or customs duties on products imported by mail or courier. The administrative costs and border frictions created by this low threshold exceed the value of the revenue collected. Under the Canada-United States-Mexico trade agreement, the de minimis threshold on shipments by private courier from the United States and Mexico will increase to $40 with respect to HST/GST and to $150 for customs duties. These thresholds should apply to all shipments by private courier from abroad.

In view of the accompanying proposed phase-out of import tariffs, the revenue impact of this measure would be negligible.

Prioritize Infrastructure under Federal Control

This Shadow Budget would prioritize direct funding for infrastructure projects that the federal government, on its own, can implement expeditiously. New funds would be devoted to projects where the national interest makes government involvement uniquely appropriate, such as investments in capacity and added security for marine, rail and air transportation. Unlike transfers that appear as expenses in the short run, these investments would be amortized over the period – typically 20–30 years – during which the asset in question would be expected to deliver its services.

The second phase of the Invest in Canada Plan, which began in fiscal year 2018/19, envisioned grants in support of provincial and local infrastructure projects of about $6 billion in 2020/21, rising to an extraordinarily ambitious $11 billion in 2027/28. Reprofiling about one-quarter of the amounts budgeted for phase 2 infrastructure funding over the projection period to projects under federal control would reduce expenses by an average of about $1.5 billion annually over the period.

Reduce Red Tape

Our Shadow Budget would renew the federal government's commitment to ensuring that regulations achieve their objectives at the lowest practical cost to Canadians and Canadian businesses. Excessive red tape – regulatory costs beyond those necessary to achieve a given benefit to health, safely or consumer protection – hurt consumers and make businesses uncompetitive.

The 2015 *Red Tape Reduction Act* required offsets for any new or amended regulation that increased the administrative burden on business. The Shadow Budget would build on this progress, mandating annual reductions, including for regulations related to tax or tax administration, that are currently exempt. The reductions for calendar years 2020 and 2021 would be $25 million each. During that period, the government should review its framework for regulation, with a view to employing "negative list," mutual recognition and equivalent-outcome approaches to achieve health, safety and consumer-protection goals at less cost to efficiency and innovation.

This proposal would have no fiscal implications over the budget-planning horizon.

Enhance Benchmarking of Education Results

This Shadow Budget would provide new funding to enhance our understanding of how well Canadian students are learning. Although the provinces deliver elementary and secondary education services, the federal government helps support the benchmarking of student achievement across the country and internationally. This benchmarking promotes the spread of effective practices and highlights areas that need improvement. At the national level, the Pan-Canadian Assessment Program (PCAP) evaluates performance in reading, writing, mathematics and science. At the international level, the Program for International Student Assessment (PISA) benchmarks the performance of Canadian students in math, science and reading against peers abroad. Federal support helps Canada to include enough students in each province to allow comparisons among the provinces and of provinces against other countries. Currently, Indigenous students on-reserve do not benefit from these benchmarking measures. The Shadow Budget would augment funding for these student assessment programs over the next five fiscal years, including support for PCAP and PISA assessments of students in on-reserve schools.

This new support would amount to $200 million annually.

Improve Labour Market Information

Our Shadow Budget would allocate new funding in support of better labour market information in Canada. The 2009 report of the Advisory Panel on Labour Market Information identified data gaps with respect to vacancy rates, employment figures, Indigenous people, immigrants and education. Progress has occurred since – notably, the launch of Statistics Canada's Job Vacancy and Wage Survey in 2015 – yet gaps remain, especially the Labour Force Survey's absence of coverage of the on-reserve Indigenous population and lack of systematic data that track the transition from formal education to work.

The new funding to implement the Advisory Panel's recommendations would amount to $25 million annually.

Phase Out Regional Differences in Employment Insurance

The Shadow Budget would initiate reforms to the EI program to eliminate its perverse support of industries that tend to lay off more workers. EI currently features shorter qualifying periods and longer benefit periods in areas with higher unemployment. These features subsidize industries and regions where prospects for long-term, stable jobs are poor, and discourage workers from moving to jobs and regions where prospects are brighter (Busby, Laurin, and Gray 2009). These subsidies for industries with poor prospects also discourage hiring of more skilled labour and investments in productivity-enhancing technology. Phasing out EI's regionally differentiated entrance and benefit provisions would eliminate these distortions, while tying new uniform provisions to the national unemployment rate would preserve a countercyclical income stabilization element in the program.

Because it makes sense to accelerate EI access for workers in regions where past low unemployment rates currently impede it, the transition would ease the stringent requirements before tightening the looser ones. This Shadow Budget would allocate $300 million annually over three years to cover these transition costs.

Incentivise the Adoption and Commercialization of Innovation

Research and development (R&D) expenditures reflect both supply-push and demand-pull drivers. On the supply side, the Scientific Research and Experimental Development (SR&ED) credit decreases the direct cost to firms of initial knowledge creation. On the demand side, however, Canadian companies show a discouragingly low propensity to incorporate such knowledge in their production. To address this R&D demand-side shortfall, this Shadow Budget would establish a "Patent Box" tax mechanism in which income derived from patents developed through Canadian R&D face a lower corporate tax rate – a mechanism similar to that adopted by Saskatchewan and Quebec in recent years. The rationale for such a mechanism is to encourage Canadian businesses to actively pursue commercialization of innovation. Evidence suggests that firms would undertake R&D in Canada if the returns, or fruits of their efforts, were taxed at a lower rate (Parsons 2011). The Patent Box has the added benefit of incentivizing production related to Canadian patents to remain within our borders, thus capturing much of the beneficial spillover effects. The measure also seeks to balance the tax benefits of the R&D credit with those related to adopting, commercializing or otherwise employing the new knowledge (Pantaleo, Poschmann and Wilkie 2013).

The revenue cost of this measure would increase gradually over time with heightened R&D activity and its adoption through commercial activities, but it would be partially offset by tax revenue generated from the beneficial spillover effects. This Shadow Budget allocates $500 million per year.

Improving Canadians' Opportunities and Well-Being

Canadians' well-being and fulfilment depend in large part on their opportunities to earn, save and enjoy income in retirement. Life expectancy in Canada has risen by more than two years per decade since the 1960s, and more and more Canadians now rely on accumulated capital, as opposed to a pension for life, to fund their retirement years. A number of tax policy changes would contribute to improving retirement and financial security for seniors.

To encourage older Canadians to stay in the workforce longer and reduce the chances that they will outlive their savings, the age at which contributions to tax-deferred retirement saving schemes are no longer allowed should rise, mandatory drawdowns from registered retirement income funds (RRIFs) should shrink, life annuities held in tax-free savings accounts (TFSAs) should be allowed, and eligibility for public pension benefits should come at a later age. Increasing tax-deferred saving limits, creating tax-free pension accounts to complement tax-deferred accounts, putting savers in group registered retired savings plans (RRSPs) on a more equal footing with savers in pension plans, and broadening access to pension credit and income splitting will also improve retirement income adequacy.

A key principle in taxing personal income is that people who would be equally well off without taxation should be equally well off with it. If people who face unavoidable costs related to medical expenses pay tax on the income that covers those costs, they will end up with lower discretionary income than people who do not face such costs. The Canadian tax system only partially recognizes medical expenses. Greater recognition would help people who pay for healthcare directly or who pay health-related insurance premiums not covered by their employers – and therefore do not benefit from the non-taxation of employer-paid health premiums.

When philanthropists donate publicly traded shares to registered charities, the determination of

their income for tax purposes excludes any capital gain on those shares. In contrast, a donation of private company shares and non-environmentally sensitive land might leave the donor with a capital gains tax liability. Extending the same treatment that applies to donations of publicly traded shares to donations of private company shares and real estate would unblock major new support for Canada's charities.

Canada has committed to reducing greenhouse gas emissions to 30 percent below 2005 levels by 2030. The current national "carbon" price and scheduled increases will not induce enough of a change in behaviour to hit that target, and further increases might make Canadian products uncompetitive. An increase in the GST rate on fossil fuel products would provide further incentives for consumers to reduce their emissions.

Below, we profile these productivity-enhancing initiatives and outline their fiscal impact.

Increase Age Limits for Tax-Deferred Saving

Our Shadow Budget would increase the age at which Canadians must stop contributing to, and start drawing down, tax-deferred saving, currently set at 71. This is too soon: it discourages Canadians who would like to work and/or save longer, and increases the likelihood that retirees will exhaust their savings in these accounts. The age at which contributions to tax-deferred retirement saving schemes must end should rise to 72, beginning at the start of the next calendar year, and rise one further month at six-month intervals thereafter.

The cost implications would be small on an annual basis, and negligible on a present-value basis.

Shrink Mandatory Minimum Withdrawals from RRIFs

This Shadow Budget would lessen the requirements for older Canadians to draw down tax-deferred savings. The 2015 federal budget's reduction of mandatory minimum withdrawal amounts from RRIFs and similar tax-deferred accounts reduced the risk that many Canadians would outlive their savings. Yet, as noted, longevity is increasing, yields on safe investments are very low and the mandatory minimums still put many Canadians at risk of running out (Robson and Laurin 2015). Our Shadow Budget would institute an immediate one-percentage-point reduction of minimum withdrawals mandated for each age, beginning with the 2021 taxation year.

The cost implications would be small on an annual basis, and negligible on a present-value basis.

Allow Life Annuities to Be Held in TFSAs

This Shadow Budget would make it possible to buy annuities within a TFSA. Tax-deferred saving, as in RRSPs, and tax-prepaid saving, as in TFSAs, are symmetrical ways to avoid double-taxing savings. Annuities are a valuable tool for people who have saved for retirement to insure against outliving their savings. When an RRSP holder buys an annuity with those savings, the investment-income portion of the annuity continues to benefit from the tax-deferred accumulation that applied to the RRSP. But TFSA holders cannot buy annuities inside their TFSAs, which means that they end up paying tax on money that should have been tax-free. This difference disadvantages people who would be better off saving in TFSAs, and discourages a much-needed expansion of the market for annuities in Canada (Laurin 2019). New legislation would allow purchases of annuities – including the advanced deferred life annuities introduced in the 2019 budget and variable payment life annuities – within a TFSA.

The cost implications of this measure would be small.

Increase the Age of Eligibility for Public Pension Benefits

This Shadow Budget launches a consultation on linking the future age of receipt of seniors' benefits

to longevity. Canada's aging population will create many fiscal strains, and Ottawa should take the lead in ensuring that Canada will deal with those strains. One straightforward way to mitigate the impact of longer life on old age benefits would be to calibrate the age of eligibility for public pension benefits such that the proportion of an average person's adult life spent in retirement stays constant (Brown and Aris 2017). To keep that proportion at its current level, Canada would need to raise the normal age of eligibility for Old Age Security and the Canada Pension Plan from 65 at the beginning of 2023 to 66 in 2025. The same actuarial adjustments that penalize or reward early and later commencement of benefits could apply from the new age. This flexibility would ensure that people who cannot work past the current earliest age of eligibility could still collect reduced benefits, while further encouraging later receipt by people who wish to work and save for longer.

This change would have no implications over the budget-planning horizon.

Increase Tax-Deferred Saving Limits

This Shadow Budget would update limits on tax-deferred saving in defined-contribution pension plans and RRSPs. Current limits on saving in these plans assume that the cost of providing a dollar of income in these plans is nine times the rate at which benefits accrue in a typical defined-benefit pension plan. But increases in life expectancy and lower yields on safe investments have dramatically increased the cost of providing a dollar of income in retirement. A more realistic equivalency measure would now be around 15 (Robson 2017). To reduce the disadvantage this tax provision creates for savers in defined-contribution plans and RRSPs relative to participants in defined-benefit plans, this Shadow Budget would raise the limit for contributions to these plans by three percentage points of income per year over four years – from the current 18 percent to 30 percent of income staged over four years.

The fiscal cost of this measure, on a present-value basis, would be small.

Introduce a New Tax-Free Pension Account

People who want to save for retirement on a tax-prepaid basis need fairer treatment. Many low- to mid-income workers face lower effective tax rates while working than they will when they draw on their savings in retirement (Pierlot and Laurin 2012). They would be better off saving on a tax-prepaid basis, as TFSAs allow, rather than in tax-deferred plans like RRSPs and defined-contribution pension plans. However, lower annual contribution limits on TFSAs constrain their ability to save as much as they can in tax-deferred plans. This Shadow Budget would create a new tax-free pension account (TFPA), which would allow tax-prepaid retirement saving beyond what TFSAs allow, and would fit within the workplace pension system. The TFPA contribution limit would be integrated with those of RRSPs and defined-contribution pension plans, and would rise with them (as described in the preceding section). As group TFSAs become a more widespread employer-supported option, it is reasonable to expect that TFPAs would rapidly become widely available (Laurin 2019).

Since it would share its maximum contribution limit with the existing tax deferral regime, the TFPA would not create any additional room to save on a tax-preferred basis. Its cost implications would be small.

Level the Field for Savers in Group RRSPs

This Shadow Budget would remove some costs and tax inefficiencies that disadvantage people saving in RRSPs relative to people who save in registered pension plans. The majority of working Canadians in the private sector do most of their retirement saving through RRSPs and other capital accumulation plans. Many employers support such saving by organizing group RRSPs, and many

match at least part of their employees' contributions. Sponsors of defined-contribution pension plans and pooled registered pension plans can help their participants prepare for retirement by paying some administrative expenses themselves – payments that do not affect participants' contribution limits. But participants in group RRSPs pay these expenses from their assets inside the plan – money that is subject to contribution limits. This difference means that savers in group RRSPs will retire with less than those in defined-contribution or pooled registered plans who have identical work histories and contributions. Moreover, unlike their contributions to defined-contribution and pooled registered pension plans, employers' contributions to group RRSPs are subject to payroll tax – which also tends to reduce the retirement wealth of participants in such plans. Our Shadow Budget would address these discrepancies by letting group RRSP sponsors and/or participants pay some of the administrative expenses currently levied against plan assets from outside income. The Budget would also relieve employers' contributions to group RRSPs from payroll tax (Robson 2010).[3]

These changes would have little effect on federal revenue over the projection period.

Broaden Access to the Pension Tax Credit and Income Splitting

Another unfairness in the tax treatment of people using different retirement saving vehicles is that both the pension income tax credit and pension income splitting are available to pension annuity recipients before age 65, but recipients of funds from other retirement saving vehicles, such as life-income funds, RRIFs and RRSPs, can use the tax credit and split income only at age 65. This Shadow Budget would make these tax provisions available to all recipients of income from retirement saving.

The fiscal cost implications of this measure would be small.

Make the Tax Treatment of Nondiscretionary Medical Expenses More Generous

This Shadow Budget would improve the recognition of medical expenses in the personal income tax. Canada's tax system recognizes that some medical expenses are non-discretionary – employer-paid premiums for health and dental plans, for example, are exempt from a person's taxable income – but its treatment of health-related expenses generally is highly restrictive. The current medical expense tax credit applies only to expenses exceeding 3 percent of net income, or $2,397, whichever is lower, and is calculated at the bottom tax rate. This Shadow Budget would lower the threshold on such expenses to 1.5 percent of net income, or $1,150, whichever is lower.

The fiscal cost of this measure would be $450 million per year. Employer-paid health premiums would continue to be untaxed.

Facilitate Donations of Private Company Shares and Real Estate

Our Shadow Budget would exempt donations to charity of privately held securities and real estate from capital gains tax. Taxpayers who donate publicly traded securities that have increased in value pay no capital gains tax on those securities. But taxpayers who donate private company shares or real estate are liable for capital gains tax if the donation has increased in value – even though the charity, not the taxpayer, benefits from the increase.

3 Existing tax penalties on early withdrawals from RRSPs will discourage employers from compensating employees in this way simply to avoid payroll taxes.

The 2015 federal budget proposed to equalize this treatment, and it would be straightforward to do so while preserving the integrity of the tax system (Aptowitzer 2017). This Shadow Budget proposes that the *Income Tax Act* be amended to exempt donations of privately held securities from tax. To maintain the incentive to donate environmentally sensitive land to charities dedicated to its conservation, only a partial exemption would apply to donations of other real estate.

The cost of this measure is likely to be small.

Raise the GST Rate on Transportation Fuels

This Shadow Budget would set a new course with respect to controlling emissions of carbon dioxide by increasing the GST rate applied to transportation fuels. The federal government's current national "carbon" price, imposed on provinces that do not meet its standards, is scheduled to rise by $10 per tonne of CO_2-equivalent from its current level of $20 to $50 per tonne by 2022. Most studies of the response of households and businesses to higher prices conclude that this levy will be insufficient to hit Canada's 2030 emissions target. But raising it further would increase the pressure on Canadian businesses whose competitors abroad pay no equivalent levy, and subjecting emitters to quantitative limits is a much more costly approach, since it does nothing to ensure that the biggest reductions will occur in sectors that add the least value. Raising the GST on transportation fuels would be a better approach because the tax effectively would be paid only on the net value added when goods and services are purchased by the final consumer. Although this feature would attenuate the incentive to reduce CO_2 emissions on intermediate activities, it would protect Canada's international competitiveness and avoid the distortions that occur when taxes "cascade" on intermediate inputs bought and sold but not on internal firm transactions. Increasing the GST on transportation fuels to 10 percent, starting in the next fiscal year, moving up to 15 percent in 2023/24, would give consumers a strong price signal to discourage CO_2 emissions. By helping Canada achieve its emission targets at less cost to investment and jobs than a regulatory approach, and financing the federal government through a relatively growth-friendly tax, this change supports the environment and the economy.

This measure would generate about $4 billion[4] in additional revenues in the first year. These amounts would gradually shrink over time as demand adjusted. It would also help to finance a return to budget balance in the medium term.

Achieving Fiscal Sustainability

When, in the previous Parliament, the government abandoned its election platform commitment to achieve budget balance by the end of its term, it left Canada in a worrisome state. The ratio of federal debt to GDP might be a useful indicator for credit-rating agencies, but their primary concern is with the likelihood that a government will service its debt. For citizens concerned about the government's ongoing capacity to deliver high-quality services at reasonable tax rates, the debt-to-GDP ratio is a bad target for fiscal policy. In the short and medium term, it is a commitment to grow the debt as fast as the economy, which makes no sense. In the longer term, the ratio's abstract quality, and regular but unpredictable revisions both to measures of the debt and to GDP, make it a feeble constraint. The federal government has been running chronic

4 Based on a volume estimate of gasoline and diesel consumed in 2018/19 deducted from federal excise tax revenues and excise tax rates, and a $0.859 average per-litre pre-tax price of gasoline to which average taxable provincial and federal excise taxes are added.

deficits, which absorb national saving and herald a future with less infrastructure, housing, machinery and technology than Canadians otherwise would have enjoyed. The lack of a bottom-line constraint has removed the obligation – fundamental to smart budgeting – to justify individual tax and spending measures against potential alternative uses of funds. Rather than restoring a budget surplus during an economic expansion – thus ensuring that deficits during recessions will appear manageable and not sap confidence in the future – the current government has positioned itself badly for a potential downturn.

This Shadow Budget would aim to return to budget balance in five years. Eliminating new net borrowing would require a number of measures to rein in spending and encourage better stewardship of public funds through more meaningful presentations of the federal government's activities. Parliamentary scrutiny and control of government spending is weaker than it should be. Many provincial governments present the estimates that legislators vote on to authorize specific spending simultaneously with their budgets. Moreover, they do so using accounting practices that allow legislators to see whether or not their votes matched the budget's fiscal plan. The federal government should do likewise.

Another fiscal sustainability issue is that federal employees' pensions are fully backed by taxpayers. Indeed, the obligation to pay these pensions is a major component of the federal government's debt, and the annual accrual of pension benefits is a major component of the government's operating costs. For many years, the government has understated the true value of these pensions to their recipients, and their true cost to the taxpayer, by discounting future payments at unreasonably high rates. The gradual adjustment of these amounts is adding to federal expenses and deficits, revealing that the federal government's accumulated deficit is larger than recorded. Our Shadow Budget would commit to revealing the federal government's entire pension obligation at fair value. A process should also be launched to better manage the risk these arrangements create for taxpayers, and move federal employee pension plans to the jointly sponsored shared-risk model that has proved successful at the provincial level.

Overall, the compensation of federal employees, including pension benefits, exceeds private-sector benchmarks (Robson and Laurin 2017). A comparison of compensation per hour in federal government service jobs (excluding defence) with those in the private sector in fields requiring relatively advanced qualifications shows that federal compensation ($67 per hour) exceeds private-sector professional, scientific and technical service jobs ($42 per hour) as well as finance and insurance jobs ($49 per hour).[5] This margin is larger than necessary to attract and retain talent. Bringing it down to a more reasonable level over time would let the federal government provide services of equal quality at lower cost.

Budget balance could also be achieved by increasing the federal government's revenues. One way to do this would be to apply the GST to businesses that supply digital services for consumption within Canada, regardless of where the company is located, which would level the playing field for both domestic and foreign suppliers of entertainment and other digital services.

The federal tax system contains many exemptions, deductions, rebates, deferrals and credits, some of which attempt to recognize taxpayers' differing capacity to pay. Others, however,

5 Statistics Canada, "Labour Statistics Consistent with the System of National Accounts (SNA), by Job Category and Industry," table 36-10-0489-01.

are effectively disguised spending programs (Laurin and Robson 2017), a number of which might not pass muster if accounted for and voted on as government expenses. This Shadow Budget would rationalize the age credit, phase out the tax credit for first-time homebuyers and eliminate the tax credit for investment in labour-sponsored venture capital corporations.

The following subsections describe these initiatives in support of a sustainable bottom line. See Table 3 for their fiscal impact.

Improve the Estimates Process

This Shadow Budget would re-commit to presenting spending estimates that parliamentarians can readily reconcile with the budget projections. In the past, MPs received estimates after the budget has been presented, often after the fiscal year has begun, and those estimates did not follow the Public Sector Accounting Standards that underlie the federal government's financial statements and budgets, making it needlessly hard for MPs to reconcile the sums they are being asked to vote with past results and with the fiscal plan. In the 2016 Fall Economic Update (Canada 2016, 36), the government committed to providing better estimates, but its attempt to do so in 2019 prompted concerns that the reconciliation between the estimates and the budget required Parliament to approve far too much unexamined spending. Our Shadow Budget's fiscal year 2020/21 Main Estimates would follow Public Sector Accounting Standards, and appear before the start of that fiscal year, after appropriate vetting by the Treasury Board. The 2021/22 Main Estimates would appear simultaneously with the 2021 federal budget in February of that year, with more detail about the items making up the reconciliation amount.

Transition Federal Employees to Jointly Governed Shared-Risk Pension Plans

This Shadow Budget would initiate a plan to transition federal employees' pension plans to shared-risk plans in which taxpayers do not bear all the risks related to the future cost of these benefits, and where a joint governance structure would give employee representatives a voice in the long-term sustainability of the plans. The plan for federal MPs, which is completely unfunded and offers retirement benefits far richer than any other plan, would be at the top of the list for this transition.

This change would have no fiscal cost over the projection horizon.

Improve Reporting of the Federal Government's Pension Obligations

This Shadow Budget would improve the disclosure of the federal government's pension obligations. Fuller disclosure would involve discounting the pension obligations incurred after 2000 using the same bond-yield discount rate used in valuing the obligations incurred before 2000, and reporting changes in this value immediately, rather than smoothing it over long periods of time. This change would add about $115 billion to the federal government's accumulated debt – a valuation change that could be implemented retroactively in the Public Accounts – and, depending on the future path of the government bond yield, might add to or help the bottom line in any given year.

This change would add an estimated $1 billion annually to government expenses over the next two years.

Ensure Competitive Compensation for Federal Employees

This Shadow Budget would freeze departmental operating budgets, giving managers latitude to adjust compensation to better reward higher performers and reduce the number of less valuable positions. This approach could help achieve a better balance between federal public and private sector compensation with a low risk of disruption to public services (Lahey 2011).

The freeze would reduce federal spending by at least $1.0 billion in fiscal year 2020/21 and $1.9 billion in 2021/22.

Level the Playing Field in the Digital Economy

This Shadow Budget proposes that the *Excise Tax Act* be amended to apply GST to businesses that supply digital services for consumption within Canada, regardless of where the company is located, in compliance with international value-added tax/GST guidelines. At present, foreign providers of digital products and services over the internet need not collect and remit sales tax if they are not "carrying on business" in Canada (Wyonch 2017). Requiring all suppliers to pay GST/HST based on the location of consumers could help level the playing field for both domestic and foreign providers of such products. Some provinces have begun addressing these revenue and competition issues. For example, and following the example of many OECD countries, since 2019 Quebec and Saskatchewan have required foreign suppliers of digital goods and services to register for, collect and remit sales tax. The federal government should follow suit.

This measure would increase annual revenue by about $200 million annually.

Close Strike Pay Tax Loophole

This Shadow Budget would fix an anomalous feature of Canada's tax system that allows some income to escape income tax and subsidizes strikes. Union dues paid by employees are deductible from their taxable income, any returns on those funds invested by the unions escape tax, and amounts paid out in strike pay are not taxable. This tax-free treatment is unusual. It contrasts strongly with the treatment of ordinary compensation, which would attract tax when it was paid, and if not consumed would yield taxable investment returns. It also contrasts with the treatment of most tax-recognized saving, which may avoid taxation up-front, as in an RRSP, or on distribution, as in a TFSA, but does get taxed at least once. Providing a tax preference to income earned when on strike, this tax-free treatment subsidizes activity that harms the Canadian economy (Kesselman 1999; Alarie and Sudak 2006). This Shadow Budget would make strike pay taxable as ordinary income.

The revenue impact of this measure would vary depending on the number and compensation of employees involved in work stoppages. It would usually be less than $10 million annually.[6]

Rationalize the Age Credit

The age credit provides a tax subsidy to seniors who already benefit from a number of federal and provincial transfers and in-kind benefits. Further, the amount is clawed back on incomes between $38,508 and $89,421, which increases the METR for such seniors. Earlier sections of this Shadow Budget presented measures to improve retirement security for Canadians by relaxing limits on saving and mandatory drawdown of income. It makes sense to accompany those improvements with reducing the base amount of the age credit from $7,637 to $4,000, which is closer to the amounts most provinces use for their old age tax credits.

This measure would produce a saving of about $2.1 billion annually over the next two fiscal years.

Phase Out the Tax Credit for First-Time Homebuyers

This Shadow Budget would phase out the tax credit

6 Estimate based on Alarie and Sudak (2005), updated to include more recent data on person-days not worked and average wages.

Table 3: Medium-Term Fiscal Path Including Shadow Budget Initiatives ($billions)

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Baseline Projections						
Revenues	348.7	361.7	378.5	394.5	409.9	427.3
Expenses	-374.1	-387.1	-397.6	-409.9	-423.2	-435.9
Budgetary Balance before Initiatives	-25.3	-25.4	-19.1	-15.4	-13.3	-8.6
Shadow Budget Initiatives						
Addressing the Productivity and Growth Challenge						
Double the Top Personal Income Tax Threshold		-0.4	-0.4	-0.5	-0.5	-0.5
Lower the Corporate Income Tax Rate		-3.8	-3.6	-3.3	-3.0	-2.6
Transition to a Neutral Corporate Tax System		n/a	n/a	n/a	n/a	n/a
Eliminate the Excise Tax on Aviation Gasoline and Jet Fuel		-0.1	-0.1	-0.1	-0.1	-0.1
Eliminate Tariffs		-0.5	-1.0	-1.5	-2.0	-2.0
Rationalize Tariffs and Sales Taxes on Small-Value Imports		s	s	s	s	s
Prioritize Infrastructure under Federal Control		1.3	1.4	1.8	1.8	1.6
Reduce Red Tape		n/a	n/a	n/a	n/a	n/a
Enhance Benchmarking of Education Results		-0.2	-0.2	-0.2	-0.2	-0.2
Improve Labour Market Information		s	s	s	s	s
Phase Out Regional Differences in Employment Insurance		-0.3	-0.3	-0.3	0.0	0.0
Incentivise the Adoption and Commercialization of Innovation		-0.5	-0.5	-0.5	-0.5	-0.5
Total		***-4.5***	***-4.7***	***-4.6***	***-4.5***	***-4.3***
Improving Canadians' Opportunities and Well-Being						
Increase Age Limits for Tax-Deferred Saving		s	s	s	s	s
Shrink Mandatory Minimum Withdrawals from RRIFs		s	s	s	s	s
Allow Life Annuities to Be Held in TFSAs		s	s	s	s	s
Increase the Age of Eligibility for Public Pension Benefits		n/a	n/a	n/a	n/a	n/a

Sources: Authors' calculations. More details in the main text.

Table 3: Continued

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Increase Tax-Deferred Saving Limits		s	s	s	s	s
Introduce a New Tax-Free Pension Account		s	s	s	s	s
Level the Field for Savers in Group RRSPs		s	s	s	s	s
Broaden Access to the Pension Tax Credit and Income Splitting		s	s	s	s	s
Make the Tax Treatment of Nondiscretionary Medical Expenses More Generous		-0.5	-0.5	-0.5	-0.5	-0.5
Facilitate Donations of Private Company Shares and Real Estate		s	s	s	s	s
Raise the GST Rate on Transportation Fuels		4.0	3.9	3.8	7.5	7.4
Total		***3.5***	***3.4***	***3.3***	***7.0***	***6.9***
Achieving Fiscal Sustainability						
Improve the Estimates Process		n/a	n/a	n/a	n/a	n/a
Transition Federal Employees to Jointly Governed Shared-Risk Pension Plans		n/a	n/a	n/a	n/a	n/a
Improve Reporting of the Federal Government's Pension Obligations		-1.0	-1.0	0.0	0.0	0.0
Ensure Competitive Compensation for Federal Employees		1.0	1.9	2.9	3.9	5.0
Level the Playing Field in the Digital Economy		0.2	0.2	0.2	0.2	0.2
Close Strike Pay Tax Loophole		s	s	s	s	s
Rationalize the Age Credit		2.1	2.1	2.3	2.3	2.5
Phase Out the Tax Credit for First-Time Homebuyers		0.1	0.1	0.1	0.1	0.1
Eliminate the Tax Credit for Labour-Sponsored Venture Capital Corporations		0.2	0.2	0.2	0.2	0.2
Total		***2.6***	***3.5***	***5.7***	***6.7***	***8.0***
Total Initiatives		***1.6***	***2.3***	***4.4***	***9.2***	***10.6***
Debt Charges Saving		0.0	0.0	0.1	0.2	0.4
New Budgetary Balance	**-25.3**	**-23.8**	**-16.8**	**-10.9**	**-3.9**	**2.4**
Accumulated Deficit	713.2	737.0	753.8	764.7	768.6	766.2
as % of GDP	*31.0*	*31.0*	*30.4*	*29.7*	*28.7*	*27.6*

Sources: Authors' calculations. More details in the main text.

for first-time homebuyers. Government measures that increase demand for housing are problematic, increasing price pressures in markets where housing supply is constrained and inducing households to take on debt that many will have trouble servicing in the event of an economic downturn or an increase in interest rates.

Phasing out this credit would generate a saving of about $100 million annually.

Eliminate the Tax Credit for Labour-Sponsored Venture Capital Corporations

This Shadow Budget proposes to end the tax credit for labour-sponsored venture capital corporations (LSVCCs), which notoriously distorts saving and investment. In general, venture capital funding spurs innovation, but among the various venture capital funds in Canada, LSVCCs are among the least efficient in this respect (Fancy 2012). In addition, LSVCCs crowd out alternative private venture investments and favour portfolios unsuitable for retail investors.

Eliminating the LSVCC credit would improve the federal government's bottom line by about $200 million annually.

The Bottom Line

This Shadow Budget's plans for addressing Canada's productivity challenge, supporting long-term growth, achieving a sustainable fiscal framework and improving Canadians' opportunities and well-being set a gradual path to balancing the federal budget by the start of the next Parliament and to budget surpluses as the economy continues to grow. As Table 3 details, the smaller debt resulting from the initiatives presented in the Shadow Budget would lower interest costs over time, leading to a projected $2.4 billion budget surplus in fiscal year 2024/25 and a corresponding decline in federal debt.

A commitment to more solid federal finances will reassure Canadians about the country's longer-term capacity to handle setbacks originating abroad or at home.

This fiscal framework would let Canadians work, save and invest with confidence, knowing that the federal government is dealing successfully with the country's economic and demographic challenges, supporting economic growth and promoting opportunities that help all Canadians prosper.

REFERENCES

Alarie, Benjamin, and Matthew Sudak. 2006. "The Taxation of Strike Pay." *Canadian Tax Journal.* (54) 2.

Aptowitzer, Adam. 2017. "No Need to Reinvent the Wheel: Promoting Donations of Private Company Shares and Real Estate." E-Brief 265. Toronto: C.D. Howe Institute. September.

Bazel, Philip, and Jack Mintz. 2017. "Tax Policy Trends: Whether It Is the U.S. House or Senate Tax Cut Plan – It's Trouble for Canadian Competitiveness." Calgary: University of Calgary, School of Public Policy. November.

Boadway, Robin, and Jean-François Tremblay. 2016. *Modernizing Business Taxation*. Commentary 452. Toronto: C.D. Howe Institute. May.

Brown, Robert L., and Shantel Aris. 2017. *Greener Pastures: Resetting the Age of Eligibility for Social Security Based on Actuarial Science*. Commentary 475. Toronto: C.D. Howe Institute. April.

Busby, Colin, Alexandre Laurin, and David Gray. 2009. "Back to the Basics: Restoring Equity and Efficiency in the EI Program." E-Brief. Toronto: C.D. Howe Institute. August.

Busby, Colin, and William B.P Robson. 2017. *Numbers You can Trust? The Fiscal Accountability of Canada's Senior Governments, 2017*. Commentary 476. Toronto: C.D. Howe Institute. April.

Canada. 2015. Department of Finance. *The Fiscal Monitor*, October 2015.

———. 2016. "Fall Economic Statement 2016." Ottawa: Department of Finance. November.

———. 2018. Parliamentary Budget Officer. *Status Report on Phase 1 of the Investing in Canada Plan*. Ottawa: Office of Parliamentary Budget Officer. August 22.

———. 2019a. "Economic and Fiscal Update 2019." Ottawa: Department of Finance. December.

———. 2019b. Parliamentary Budget Officer. *Infrastructure Update: Investments in Provinces and Municipalities*. Ottawa: Office of Parliamentary Budget Officer. March 13.

Ciuriak, Dan, and Xiao Jingliang. 2014. "Should Canada Unilaterally Adopt Global Free Trade?" Ottawa: Canadian Council of Chief Executives.

Fancy, Tariq. 2012. "Can Venture Capital Foster Innovation in Canada? Yes, but Certain Types of Venture Capital Are Better than Others." E-Brief 138. Toronto: C.D. Howe Institute. September.

Kesselman, Jonathan R. 1999. "Base Reforms and Rate Cuts for a Revitalized Personal Tax." *Canadian Tax Journal.* (47) 2.

Lahey, James. 2011. "Controlling Federal Compensation Costs: Towards a Fairer and More Sustainable System." In *How Ottawa Spends, 2011-2012*, edited by Christopher Stoney and G. Bruce Doern, 84–105. Montreal; Kingston, ON: McGill-Queen's University Press.

Laurin, Alexandre. 2015. "Shifting the Federal Tax Burden on the One-Percenters: A Losing Proposition." E-Brief. Toronto: C.D. Howe Institute. December.

Laurin, Alexandre. 2019. "TFSAs: Time for a Tune-Up." E-Brief 298. Toronto: C.D. Howe Institute. December.

Laurin, Alexandre, and William B.P. Robson. 2017. *Hidden Spending: The Fiscal Impact of Federal Tax Concessions*. Commentary 469. Toronto: C.D. Howe Institute.

McKenzie, Kenneth, and Michael Smart. 2019. *Tax Policy Next to the Elephant: Business Tax Reform in the Wake of the US Tax Cuts and Jobs Act*. Commentary 537. Toronto: C.D. Howe Institute. March.

Milligan, Kevin. 2014. "Tax Policy for a New Era: Promoting Economic Growth and Fairness." Benefactors Lecture. Toronto: C.D Howe Institute. November.

Pantaleo, Nick, Finn Poschmann and Scott Wilkie. 2013. *Improving the Tax Treatment of Intellectual Property Income in Canada*. Commentary 379. Toronto: C.D. Howe Institute. April.

Parsons, Mark. 2011. *Rewarding Innovation: Improving Federal Support for Business R&D in Canada*. Commentary 334. Toronto: C.D. Howe Institute. September.

Pierlot, James, and Alexandre Laurin. 2012. *Pooled Registered Pension Plans: Pension Saviour – or a New Tax on the Poor?* Commentary 359. Toronto: C.D. Howe Institute. August.

Robson, William B.P. 2010. "Cutting through Pension Complexity: Easy Steps Forward for the 2010 Federal Budget." Backgrounder. Toronto: C.D. Howe Institute. February.

———. 2017. *Rethinking Limits on Tax-Deferred Retirement Savings in Canada*. Commentary 495. Toronto, C.D. Howe Institute. November.

Robson, William B.P., and Alexandre Laurin. 2015. "Drawing Down Our Savings: The Prospects for RRIF Holders Following the 2015 Federal Budget." E-Brief 210. Toronto: C.D. Howe Institute. July.

———. 2017. "Premium Compensation: The Ballooning Cost of Federal Government Employees." E-Brief 258. Toronto: C.D. Howe Institute. May.

———. 2019. *Less Debt, More Growth: A Shadow Federal Budget for 2019*. Commentary 531. Toronto: C.D. Howe Institute. February.

Robson, William B.P., and Farah Omran. 2019. *Show and Tell: Rating the Fiscal Accountability of Canada's Senior Governments, 2019*. Commentary 545. Toronto: C.D. Howe Institute. May.

Wyonch, Rosalie. 2017. *Bits, Bytes, and Taxes: VAT and the Digital Economy in Canada*. Commentary 487. Toronto: C.D. Howe Institute.

Notes:

Notes:

Recent C.D. Howe Institute Publications

February 2020	Ciuriak, Dan, Ali Dadkhah, and Jingliang Xiao. "Quantifying CUSMA: The Economic Consequences of the New North American Trade Regime." C.D. Howe Institute Working Paper.
February 2020	Robson William B.P. *There is No Try: Sustainable Healthcare Requires Reining in Spending Overshoots.* C.D. Howe Institute Commentary 566.
February 2020	Omran, Farah, and William B.P. Robson. *What You See Is Not What You Get: Budgets versus Results in Canada's Major Cities, 2019.* C.D. Howe Institute Commentary 565.
February 2020	Kronick, Jeremy, and Steve Ambler. *Predicting Financial Crises: The Search for the Most Telling Red Flag in the Economy.* C.D. Howe Institute Commentary 564.
February 2020	Kronick, Jeremy, and Wendy Wu. *Water in the Wine? Monetary Policy and the Impact of Non-bank Financial Institutions.* C.D. Howe Institute Commentary 563.
January 2020	Kronick, Jeremy, and Francisco Villarreal. "Monetary Policy, Income Inequality, and Inflation – What's the Link?" C.D. Howe Institute E-Brief.
January 2020	Feldman, Michael K. "One More Case for Longer-term Mortgages: Financial Stability." C.D. Howe Institute E-Brief.
January 2020	Wyonch, Rosalie. *Work-Ready Graduates: The Role of Co-op Programs in Labour Market Success.* C.D. Howe Institute Commentary 562.
January 2020	Schirle, Tammy, and Moyosoreoluwa Sogaolu. *A Work in Progress: Measuring Wage Gaps for Women and Minorities in the Canadian Labour Market.* C.D. Howe Institute Commentary 561.
December 2019	Laurin, Alexandre. "TFSAs: Time for a Tune-Up." C.D. Howe Institute E-Brief.
December 2019	Robson, William B.P., and Farah Omran. *From A to F: Grading the Fiscal Transparency of Canada's Cities, 2019.* C.D. Howe Institute Commentary 560.
December 2019	Bishop, Grant. *Living Tree or Invasive Species?Critical Questions for the Constitutionality of Federal Carbon Pricing.* C.D. Howe Institute Commentary 559.
November 2019	Schwanen, Daniel. *Choosing Canada: Canadian Cultural Policy in the Twenty-first Century.* C.D. Howe Institute Commentary 558.

Support the Institute

For more information on supporting the C.D. Howe Institute's vital policy work, through charitable giving or membership, please go to www.cdhowe.org or call 416-865-1904. Learn more about the Institute's activities and how to make a donation at the same time. You will receive a tax receipt for your gift.

A Reputation for Independent, Nonpartisan Research

The C.D. Howe Institute's reputation for independent, reasoned and relevant public policy research of the highest quality is its chief asset, and underpins the credibility and effectiveness of its work. Independence and nonpartisanship are core Institute values that inform its approach to research, guide the actions of its professional staff and limit the types of financial contributions that the Institute will accept.

For our full Independence and Nonpartisanship Policy go to www.cdhowe.org.

C.D. HOWE
INSTITUTE

67 Yonge Street, Suite 300,
Toronto, Ontario
M5E 1J8

Canadian Publication Mail Sales
Product Agreement #40008848