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# Achieving Balance, Spurring Growth: A Shadow Federal Budget for 2012

*With Canada exposed to financial accidents abroad and understated fiscal challenges at home, this Shadow Budget presents a focused and accelerated plan to achieve surplus and lays out clear steps to spur economic growth.*

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## The Study In Brief

Canada is in the happy position of being able to address its fiscal challenges not just through eliminating deficits, but also by promoting growth in the economy and the tax base. The C.D. Howe Institute's 2012 Shadow Budget accordingly takes a two-pronged approach: first, an accelerated plan to achieve budgetary surplus in three years; and second, a series of low-cost initiatives designed to foster economic growth.

On top of the strategic review of direct program spending announced in last year's federal budget, initiatives in this Shadow Budget can enhance federal cost savings, including:

**Restraining Federal Employee Compensation:** Excluding military and RCMP personnel, Ottawa's payroll expenditures and other employee benefits rose 130 percent from 1999/00 to 2010/11, about twice the increase in total Canadian labour income over the same period. Over the next three years, we propose to:

- eliminate some 15,000 positions through attrition;
- constrain growth of current compensation per employee to 1 percent annually;
- reform federal employee pensions, including those of MPs, by capping the taxpayer-paid portion of the cost at 9 percent of pensionable pay; and
- better fund other federal post-retirement employee benefits.

We anticipate that these initiatives will reduce Ottawa's compensation costs by $4.3 billion in 2014/15, on top of other savings embodied into the existing program review and temporary departmental freezes.

**Rationalizing Canada's Tax Base:** The federal tax system contains a myriad of exemptions, deductions, rebates, deferrals or credits to achieve various economic and social objectives. We propose reducing or eliminating preferences for activities, such as home buying, purchasing health insurance through employers, traveling by public transit, or fitness, that people would largely do anyway.

**Trimming Financial Assistance to Crown Corporations:** As a spur to greater efficiencies in consolidated Crown corporations, along the lines of what private-sector enterprises have achieved in recent years, their aggregate subsidies should fall by about half over five years.

These measures will accelerate Ottawa's return to budget balance, without raising taxes. Other initiatives will boost Canada's economic dynamism without compromising the return to fiscal health, including: raising reference ages for seniors' programs and taxes; adopting uniform employment insurance (EI) Rules; liberalizing trade and investment; and modernizing Canada's corporate income tax.

This Shadow Budget builds on Canada's fiscal and economic advantages, simultaneously steering quickly back to fiscal balance and spurring growth and higher living standards.

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## Canada is in better fiscal shape than most developed democracies. By the fiscal measures typically used for international comparisons, the budget plans of Canadian governments would eliminate net public-sector borrowing in the second half of this decade, and Canada would have the lowest net public-sector debt relative to its economy in the G7 (IMF 2011).

We know, however, how vulnerable these fiscal plans are. Chronic balance-sheet problems in most of the world and fiscal crisis in Europe continue to weigh on the world outlook. The federal Update of Economic and Fiscal Projections last November (Fall Update; Canada 2011a) postponed Ottawa's planned return to surplus to 2016/17, two years later than targeted in the 2011 budget. The schedule for eliminating deficits of the largest province, Ontario, is similarly relaxed and vulnerable to setbacks, while the second-largest province, Quebec, is relying on a 2-percentage-point hike in its HST (to 15 percent) to get to surplus by 2013/14.

Less well known is that the conventional fiscal measures are misleading, especially in stating government liabilities and future obligations. In most cases, including Canada's, they count social security assets for programs such as the Canada and Quebec Pension Plans, but not the much larger liabilities those assets must help cover. They also understate – more typically, ignore completely – promises of future pension and health benefits to government employees. Adjust for those omissions, and Canada is still better than its peers – but, like its peers, is worse than the conventional measures suggest.

One imperative for this budget, therefore, is accelerating the return to surplus. Budget surpluses are desirable for many reasons: in the current context, aggressive expansion of central bank balance sheets and slipping credit ratings, even on the debt of G7 nations, show that current low interest rates will not persist. Canada will benefit if Ottawa competes less for credit with other levels of government and private businesses by the time rates return to levels consistent with growing economies, moderate inflation, and heightened sovereign risk.

A second imperative for this budget is supporting medium- and long-term growth. Unlike the most beleaguered European countries, Canada can hope for rising output and incomes, as well as fiscal consolidation, to put it on a sustainable path. While productivity increases have been disappointing, Canada has led the G7 in job creation. With growth of the traditional working-age population decelerating, the imperatives are to encourage workforce participation, foster more capital investment, and support the translation of new ideas into productivity-raising innovation.

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## Setting the Stage

The Fall Update drew on a September 2011 survey of private-sector economists who had downgraded their growth forecasts in response to deteriorating global conditions since the tabling of the 2011 budget. They expected this more subdued environment to cut federal revenues by some $9 to $12 billion annually from the budget projections. While lower projected interest rates also cut some $5 billion annually from projected debt-service costs, the Fall Update anticipated a return to surplus in 2016/17, two years later than the 2011 budget.

The Update included a provision for near-term risks to the economic outlook, reducing planned budgetary revenues by $4.5 billion in 2012/13, $3.0 billion in 2013/14, and $1.5 billion thereafter. The baseline for this Shadow Budget subtracts a further prudence buffer of $0.5 billion annually from the revenue projections in the Update (Table 1), mainly because we judge the situation in Europe to be more threatening than what most private-sector economists incorporate in their "most likely" scenarios.

## Balancing the Budget

This Shadow Budget proposes to accelerate the return to surplus, eliminating deficits two years ahead of the Fall Update's baseline. The projections in Table 1 run only to 2014/15 instead of the Update's end year of 2016/17, intensifying the focus on the period from now to restoration of surplus. This more ambitious plan will require further action on federal payrolls, pensions and other post-retirement benefits, as well as tax preferences.

### Achieving Program Review Savings

The 2011 budget launched a one-year strategic review of direct program spending aiming for at least $4 billion in ongoing annual savings – roughly 5 percent of direct program spending – by 2014/15. The Fall Update reaffirmed the objective and committed to report on the results in the 2012 budget. We assume the government will deliver on this plan, and therefore book savings of $1 billion in 2012/13, $2 billion in 2013/14, and $4 billion annually thereafter.

### Trimming Financial Assistance to Crown Corporations

Federal backing for Crown lenders, the Canada Housing and Mortgage Corporation, Business Development Bank of Canada, Export Development Corporation and Farm Credit Canada, jumped sharply with the 2008-2009 economic slump to provide capital support and stimulus for recovery. These emergency measures were temporary. Other Crown corporations such as the Canadian Broadcasting Corporation and VIA Rail rely on annual funding from the government to support their regular activities, and financial assistance to them has risen steadily since 2001/02 (Figure 1). The need to operate in a commercial environment means that they must return, individually and collectively, to a sustainable position rather than perpetually drawing on public funds.

Some of the appropriate savings will occur as a consequence of the program review exercise. The longer-term goal, however, should be to put all federal Crown corporations on a self-sufficient basis for all of their market-oriented activities. This budget therefore initiates a five-year phase-out of half of Crown corporation subsidies (excluding social housing investments funneled through the CMHC), which would set back their overall level closer to that of 10 years ago. To alleviate the large legacy costs associated with their defined-benefit pension plans, an additional $100 million a year will be provided during the phase-out period, over which time these corporations will transition to defined-contribution arrangements. The additional savings during the projection period from this phase-out will be $300 million in 2012/13, $700 million in 2013/14, and $1.1 billion in 2014/15.

## Table 1: Assumptions and Projections, 2011-2015[1]

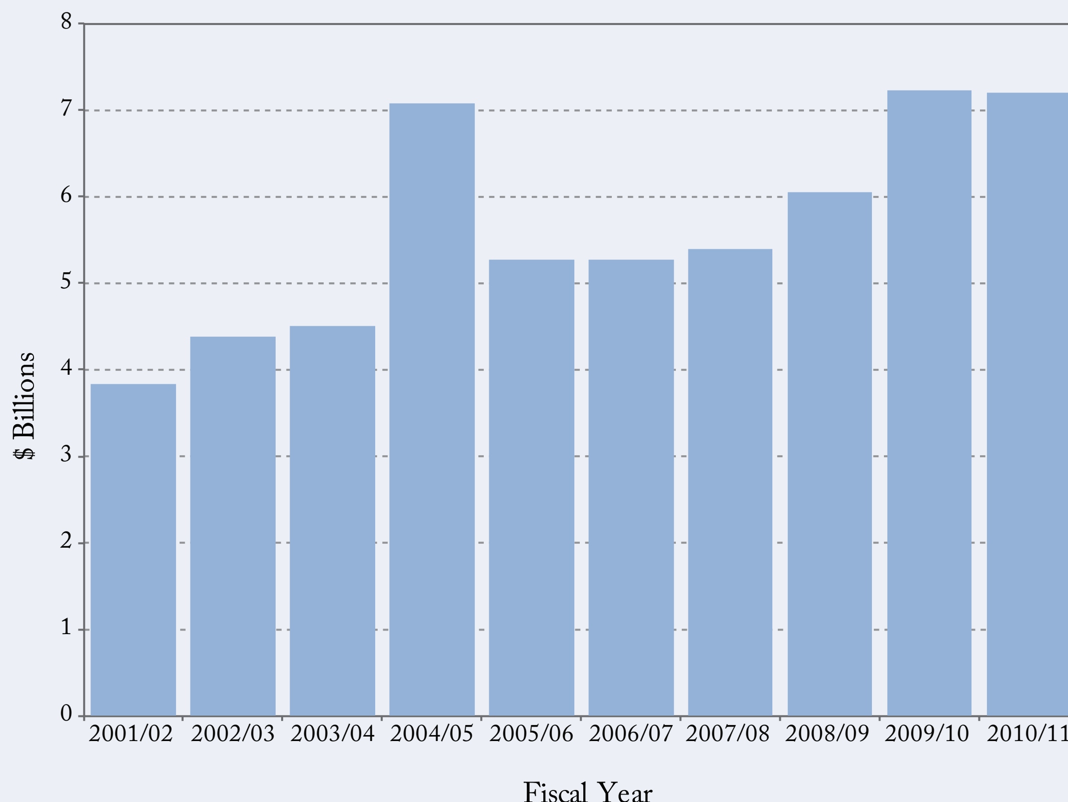
| | *($ billion except as noted)* | | | |
|---|---|---|---|---|
| | **2011/12** | **2012/13** | **2013/14** | **2014/15** |
| **Economic Growth** (percent) | | | | |
| Real GDP Growth | 2.2 | 2.1 | 2.5 | 2.5 |
| GDP inflation | 3.0 | 2.0 | 2.0 | 2.0 |
| Nominal GDP Growth | 5.3 | 4.1 | 4.5 | 4.5 |
| **Federal Revenues** | | | | |
| Taxes on Incomes, Payroll, Consumption and Other Transactions | 217.8 | 225.7 | 241.2 | 256.3 |
| User Fees and Charges for Government Services and Products (2) | 12.4 | 12.8 | 13.2 | 13.6 |
| Investment Income (3) | 13.3 | 13.4 | 14.4 | 15.2 |
| **Total Revenues** | **243.5** | **251.8** | **268.8** | **285.1** |
| **Federal Expenditures** | | | | |
| Direct Program Expenses | 117.4 | 118.0 | 117.8 | 117.6 |
| Transfers to Persons and Governments | 125.7 | 129.4 | 134.8 | 140.0 |
| Gross Debt Charges | 31.5 | 31.9 | 33.3 | 35.0 |
| **Total Expenditures** | **274.5** | **279.2** | **285.8** | **292.6** |
| **Fiscal Prudence** | | | | |
| Shadow Budget Revenue Adjustment for Economic Prudence | -3.5 | -5.0 | -3.5 | -2.0 |
| *less:* Fiscal prudence already included in projections | 3.0 | 4.5 | 3.0 | 1.5 |
| **Net Adjustment for Fiscal Prudence** | **-0.5** | **-0.5** | **-0.5** | **-0.5** |
| **Summary of Federal Revenue, Expenditure and Balance** | | | | |
| Taxes, Fees, and Other Charges | 230.2 | 238.5 | 254.4 | 269.9 |
| Program Spending and Transfers | -243.1 | -247.4 | -252.6 | -257.6 |
| Debt Charges Net of Investment Income | -18.2 | -18.5 | -18.9 | -19.8 |
| Net Adjustment for Fiscal Prudence | -0.5 | -0.5 | -0.5 | -0.5 |
| **Budgetary Balance Adjusted for Fiscal Prudence** | **-31.5** | **-27.9** | **-17.5** | **-8.0** |

Notes:
(1) Based on Fall Update (Canada 2011a).
(2) Includes earnings of consolidated Crown corporations.
(3) Interest income, net income from enterprise Crown corporations, foreign exchange revenues, and other returns on investment.
Sources: Canada (2011a); authors' calculations. Columns may not sum exactly due to rounding.

### Restraining Federal Employee Compensation

Notwithstanding the restraint in compensation costs embodied in the program review savings, the federal government must do more. Its compensation bill has risen startlingly since the return to budget surplus at the end of the 1990s. From $11.9 billion in 1999/00, Ottawa's personnel expenditures

**Figure 1: Net Federal Subsidies to Crown Corporations, 2001/02 to 2010/11**




Note: Figure presents external expenditures net of external revenues of Crown corporations whose financial statements are consolidated with the annual financial results of the government.
Source: Public Accounts of Canada, various years.

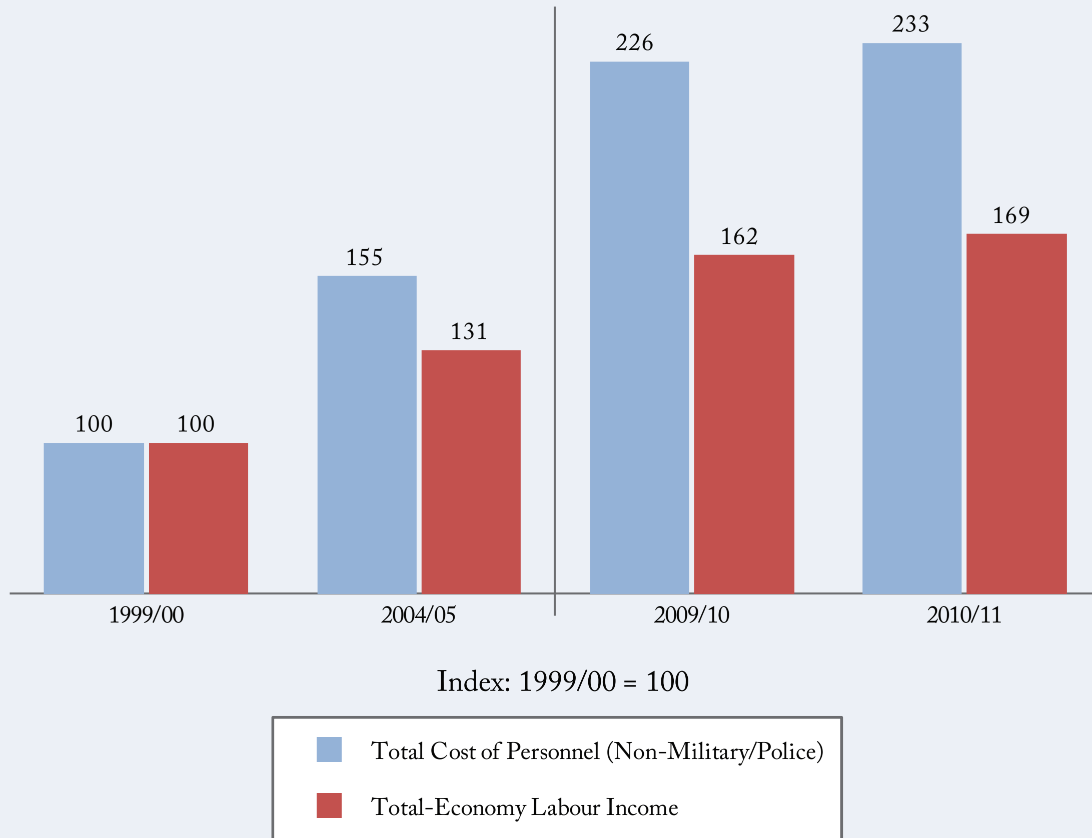
(excluding the military and RCMP[1]) rose to $27.7 billion in 2010/11.[2] This 130 percent growth contrasts sharply to the 69 percent increase in total labour income in Canada over that period (Figure 2): if non-uniformed federal personnel costs had grown in line with the economy-wide measure, they would have been some $8 billion smaller in 2010/11.

The Main Estimates tabled in Parliament on March 1, 2011 reflect the 2010 budget commitment to freeze departmental operating budgets at their

1 About 55 percent of RCMP expenses are recovered through revenues from provincial and municipal policing service contracts, justifying the exclusion of RCMP personnel costs from the above figures. Military personnel expenditures are also driven by considerations vastly different from other program expenditures – peace-making missions, humanitarian missions, or the Afghan mission are prime examples – justifying their exclusion from the figures presented above.

2 2010/11 figure is based on RCG (2011). Volume II, Table 3a (Reconciliation of External Expenditures by Standard Object to Expenses: Personnel) shows personnel costs by ministries. We subtract personnel costs for National Defence, the RCMP, and Parliament from the total, and make a small pro rata adjustment for reconciliation with net external expenses. We use the same approach based on the public accounts for previous years.

**Figure 2: Growth of Ottawa's Personnel Costs (excluding Military/Police) and Total-Economy Labour Costs**




Sources: Public Accounts of Canada, various years; Statistics Canada Table 380-0016. Authors' calculations as explained in footnote 2.

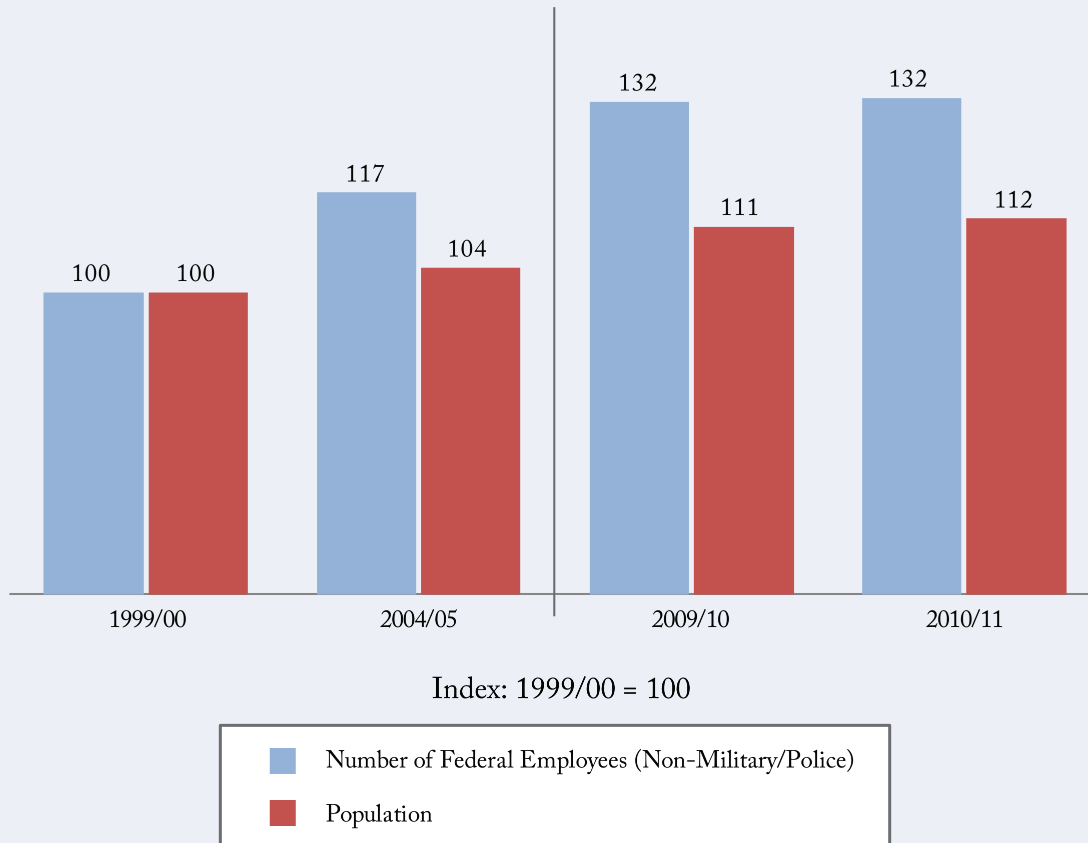
2010/11 levels for two years, and the Fall Update baseline shows little growth in operating expenses for 2011/12 and 2012/13. We anticipate that the freeze and program review will further reduce these costs by $2.1 billion in 2012/13, with the saving rising to $4.4 billion in 2014/15: our initiatives below aim to subtract a further $4.3 billion by 2014/15.

*Containing Employment:*

Excluding military and RCMP personnel, the number of federal public servants jumped 32 percent from 1999 to 2010 (Figure 3). One might expect that maintaining constant quality in the services delivered per Canadian requires numbers of public servants to grow in line with population – assuming no increase in labour productivity in government – and requires slower public-service growth if productivity improvements are possible. Yet Canada's population grew by about 12 percent over that period – some 20 percentage points less (Figure 3). If the two growth rates had been the same, the tally of wage and benefits would be $4 billion smaller today.

Federal-government workforce practices make it hard for departments to shape employment on considerations of merit and value for money.

**Figure 3: Growth of the Number of Federal Employees (Non-Military/Police) and Canadian Population**



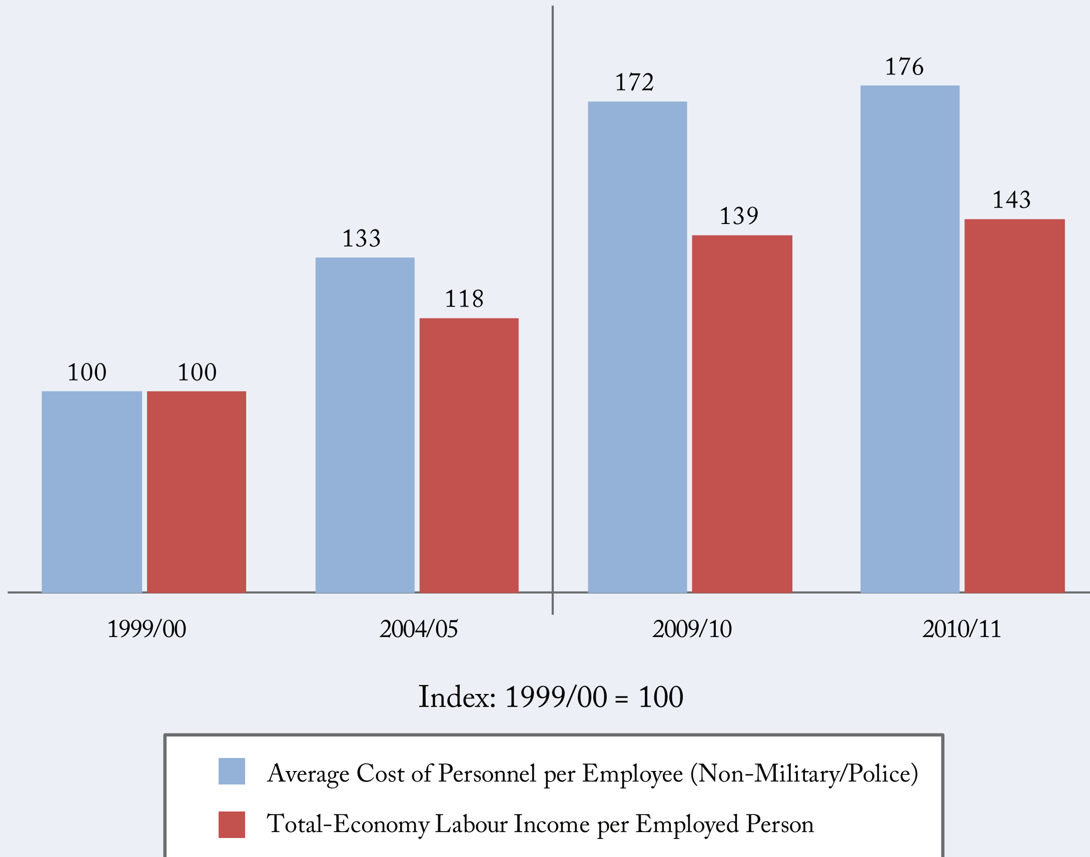

Sources: Authors' calculations. Number of employees calculated from Statistics Canada's CANSIM Table 183-0021, Public Service Commission's Annual Report 2010-2011, and Canadian Broadcasting Corporation's website information. The head-count is total federal government employees as per Statistics Canada's statistical universe, less Department of National Defence military and civilian personnel, Royal Canadian Mounted Police uniformed and civilian personnel, and CBC personnel. (The same methodology applies to other years' estimates.)

In the next few years, as many as 50,000 non-uniformed employees will have accumulated pension entitlements that make retirement attractive to them.[3] We propose eliminating some 15,000 (30 percent) of these positions over the next three years, both through attrition and squeezing lower-value programs and associated personnel costs. We anticipate that the current review will yield some $3.2 billion in compensation savings by 2014/15; our eliminations will augment these savings by some $2.2 billion.[4]

3 Data from the Public Service pension plan suggest that nearly one-fifth of current contributors are nearing retirement – i.e., active contributors who have accumulated more than 25 years of service.

4 This proposed employment reduction interacts with per-employee compensation restraint proposed next. Therefore, to avoid any double counting, cost savings are computed based on the reduced estimate of compensation per employee.

**Figure 4: Growth of Total Federal Compensation per Employee (Non-Military/Police) and Total-Economy Labour Income per Employed Person**




Source: Authors' computations based on Statistics Canada Tables 282-0002 and 380-0016; authors' calculations based on estimates reported in Figures 2 and 3 (see footnotes 2 and 5 for more details).

*Containing Per-employee Compensation:*

From 1999/00 to 2010/11, Ottawa's annual total compensation per non-uniformed employee jumped 76 percent, from about $60,500 to $106,500.[5] Over the same period, total-economy labour income per employed person rose 43 percent, from about $35,000 to $50,000 (Figure 4). If the two growth rates had been the same, Ottawa's tally of wages and benefits would have been some $5 billion smaller in the most recent fiscal year.

Such escalation in per-employee costs is problematic. The burgeoning employment numbers imply that Ottawa is paying competitive wages. Indeed, the soaring value of deferred compensation of federal employees – mainly pensions – over this period should have allowed savings on current

5 Total compensation as reported in Figure 2 divided by number of employees as reported in Figure 3. For instance, in 2010/11, $27.7 billion divided by 260,290 employees equals $106,500 per employee.

compensation within an attractive overall package. So the escalation means that, for a given dollar spend and constant productivity, services delivered must fall. It also distorts labour markets, creating problems for the private sector and provincial governments, whose employee unions naturally use advantageous federal precedents in pressing their case.

This Shadow Budget therefore moves to constrain total per-employee current compensation to annual growth of 1 percent over the projection period – which lowers costs over the next three years by $0.1 billion, $0.4 billion and $0.7 billion more than the program review anticipates.

*Reforming Federal Employee Pensions:*

Declining rates of return make a given future payment more expensive to fund. Thus, lower interest rates have boosted the value of federal deferred compensation. The Public Accounts show Ottawa's obligation for employee pensions – net of the assets that have accumulated since these plans began operating on a partially funded basis in 2000 at $143 billion at the end of the 2010/11 fiscal year, but a market-based valuation yields a deficit of $223 billion at that date (Laurin and Robson 2011). From the point of view of the average participant, the annual accrual of retirement wealth in these plans is not the roughly 20 percent of pensionable pay as shown in their actuarial reports, but more than 40 percent of pay.

The largest federal-employee pension plans are those for the Public Service (PS), the RCMP and the Canadian Forces (CF). Employee contributions to these plans in 2011 were about 6.6, 6.8, and 6.5 percent of their average annual wages and salaries, respectively, while formal taxpayer contributions were about 12.3, 14.1 and 15.5 percent (OCA 2009a, 2009b, 2009c).[6] Since the annual accrual of wealth in these plans is some 20 percentage points higher than the total of these formal contributions, members of these plans are only covering about one-sixth of their benefit. Taxpayers – most of whom face the prospect of very low investment returns on their own RRSPs or money-purchase arrangements – cover the rest.

Notably, the formal contributions to these plans by employees and the employer exceed the 18 percent of pay – capped around $23,000 – limit that applies to participants in defined-contribution pension plans and RRSP savers. This highlights the unfairness in these arrangements. Fixing them requires one or both of two things: reducing the benefits so that they are affordable, and aligning the tax-deferral available to federal employees with that available to other Canadians.

To make benefits more affordable and cap taxpayers' exposure, this Shadow Budget initiates a transition to a defined-contribution pension plan for all new federal employees after 1 July 2012. Contributions to that plan will be 9 percent by employees and 9 percent by the employer. This will be the first pension plan created under the auspices of the new federal Pooled Registered Pension Plan legislation (Bill C-25, 41st Parliament, 1st Session). Existing employees will continue in their current plans, with two key changes.

First, taxpayers' contributions will be capped. The normal practice in large provincial public-sector pension plans is to split contributions and responsibility for funding shortfalls roughly equally

6 Authors' calculations based on OCA 2009a, 2009b and 2009c. The rates above represent average contributions for all employees. Individual contribution rates for employees in these plans in 2011 were 5.8 percent on pensionable earnings up to $48,300 and 8.4 percent on pensionable earnings above $48,300. For 2012, these rates were raised to 6.2 percent and 8.6 percent, respectively, leaving taxpayers covering about 64 percent of the total annual cost of contributions to these plans.

between employees and taxpayers.[7] Saskatchewan public-sector employees participate in a defined-contribution pension plan, with employers usually matching employee contributions.

In Saskatchewan's case, the defined-contribution plan protects taxpayers from shortfalls. Most other provincial plans mitigate taxpayers' exposure by splitting responsibility for shortfalls between employees, who may see higher contributions and reduced benefits, and taxpayers. Lately, this exposure-sharing has led to large increases in employee contributions, and some reductions in future-retiree benefits. For instance, Ontario teachers' contribution rate will be, in 2014, about 5 percentage points higher than that of federal public servants, while inflation indexation for teachers retiring after 2009 has been reduced.

Federal pensions should not provide more tax-deferred saving room than is available to people with money-purchase arrangements – defined-contribution (DC) pension plans and RRSPs. Furthermore, taxpayers should not have to fund more than 50 percent of the maximum tax-deferred saving room in these plans. Fifty percent of the 18 percent tax-deferred limit would cap taxpayer contributions to federal pensions at 9 percent of pay. The remaining contributions – the difference between the 9 percent paid by taxpayers and the current service cost of pension accruals – would be from employees. For 2012, employee contribution rates would need to increase by about 3.0 percentage points for PS employees, 4.6 percentage points for RCMP officers, and 6.0 percentage points for CF personnel.

Second, this Shadow Budget starts raising the age at which federal employees become eligible for a full pension. These adjustments are part of a larger program, described below, to raise the ages at which key programs and tax provisions apply. Federal pension benefits accrue at a rate of 2 percent per year of service, usually to a maximum of 70 percent – calculated in relation to the best five years of earnings – after 35 years. Commencing 1 July 2012, this accrual rate will fall to 1.8 percent annually.

This change will delay the date when a just-hired federal employee would otherwise reach maximum pension by four years. For employees already nearing retirement, it will delay the date by a few months. Those at their mid-career, say with 17.5 years of service, will have to work for another 19.4 years, instead of 17.5, to reach their maximum pension.

### *Reforming MP Pensions:*

While pensions for federal MPs are a small part of the overall federal pension picture, they are so rich and underfunded that parliamentarians must lead by example to gain the moral authority to make other necessary changes to the pension system. Therefore, an integral part of the pension reforms would involve changes to funding arrangements for the Pension Plan for Members of Parliament (MPs), which covers members of the House of Commons and the Senate.

The MPs' plan promises much higher retirement incomes than most Canadians can dream of: the implied accumulation of wealth in these plans amounts to more than 50 percent of pay – with today's very low yields on sovereign-grade securities, the accrual is arguably closer to 70 percent (Robson 2012a). Moreover, the plan has set aside essentially no assets to pay future benefits. A realistic appraisal of its financial condition would show, not the 'actuarial excess' of $176 million that appears in the latest actuarial report on the plans, but a deficit as large as $1 billion (Robson 2012a).

7 The public-service pension plans in British Columbia and New Brunswick, along with the Ontario hospitals pension plan, have similar contribution ratios, with employers covering about 55 percent of contributions. The Ontario Teachers' Pension Plan (Teachers) and the Ontario Municipal Employees Retirement System (OMERS) split contributions equally.

This plan subjects taxpayers to financial risks few appreciate, and puts Ottawa in a weak position to lead Canada's search for a better retirement income system. The Shadow Budget proposes to cease further accruals in the MPs' plan at 1 July 2012. From that day forward, MPs will save for their retirements in a properly funded Pooled Registered Pension Plan, the same as that proposed for newly hired federal employees. Contributions to the new plan will be 18 percent of pay up to the same maximum that applies to participants in other DC plans, split equally between the MPs and the government. This change will, on its own, have a negligible effect on the federal bottom line, but will lend momentum to the other pension and age-related changes in this budget.

*Funding Other Federal Post-retirement Benefits:*

Ottawa promises a variety of non-pension benefits to its employees, valued at $74 billion as of 31 March 2011.[8] These obligations are completely unfunded: Ottawa holds no assets with which to meet them when they come due. That Ottawa shows them in its accounts at all is commendable – not all governments record such obligations – but they are buried in the details of net federal debt, and recent declines in interest rates mean that their carrying cost is, like that of federal pensions, understated. Even the understated costs are considerable, however: in 2010/11, the accumulation of future non-pension benefits – $5 billion in accruals plus $3 billion in notional interest charges on these liabilities – added $8 billion to recorded federal expenses (RGC 2011, p. 2.19).

This budget proposes to begin funding these benefits, with contributions shared between employees and the government as employer. Over time, the split of those contributions should be 50 percent each, but to limit the initial impact on net compensation, the employee contribution will begin at 10 percent of the value of post-retirement benefits accruing annually, increasing by 5 percentage points per year for eight years. This will improve the bottom line by $0.1 billion in the first year, $0.2 billion in the second year, and $0.3 billion in the third year.

Funding these obligations creates a model that other employers may desire to imitate. At present, they cannot do so tax-effectively. Like pension wealth that accrues above the rates the *Income Tax Act* permits for other Canadians, the federal government's non-taxability means returns on funds invested for future health-related use escape taxation. Extending the same tax-deferral opportunity to non-federal employees, and indeed to Canadians generally, would enhance their ability to provide for healthcare beyond that provided by the tax-funded healthcare system when they retire. Consultations on the appropriate framework for tax-deferred saving to fund health benefits will commence immediately, with a view to implementation with Budget 2013.

8 The largest obligation is to veterans of the CF, recorded at $42 billion. Second is the Public Service Health Care Plan (PSHCP), which provides benefits to retired public service employees who opt to retain the coverage they had while working, at almost $20 billion. Severance and other benefits to retiring PS employees come to $6 billion. Disability and other benefits along similar lines to those available to veterans provided to retired members of the RCMP, were shown at $4 billion. The Pensioners' Dental Services Plan (PDSP), a voluntary plan providing benefits similar to those offered to employees to pensioners and their eligible family members tallies more than $2 billion. Finally, Ottawa pays workers' compensation benefits to employees (or their survivors) injured on the job, suffering from an occupational disease, or killed on duty: an amount recorded at slightly less than $1 billion (RGC 2011, Table 6.29).

## Rationalizing Canada's Tax Base

The federal public accounts and budgets net many tax credits against revenue. Some generally available deductions aimed at defining an appropriate tax base merit this treatment. However, most credits targeted to particular recipients and/or not directly driven by recipients' tax rates are preferences that would more properly appear as spending. Among the reasons they do not is desire to avoid the legislative and public scrutiny appropriations of public funds normally receive, and generally to obscure government's influence over the economy.[9]

The federal tax system contains many exemptions, deductions, rebates, deferrals and credits to achieve various economic and social objectives. Ottawa's 1999 assessment of "tax expenditures" listed 227 such measures; its 2011 counterpart listed 263 (Canada 1999, 2011b). Given that the marginal costs of raising a dollar in additional personal or corporate income taxes are much greater than a dollar, compensating for taxes foregone through preferences comes at a high cost (Dahlby and Ferede 2011). The overall return to society from preferences therefore ought to be very high.

Many tax preferences do not meet such a test. Among them: preferences for activities, such as home buying, volunteering, arts and crafts, traveling by public transit, or fitness, that many recipients would have done anyway; preferential taxation of employer-paid benefits that would likely be available to employees in almost as large amounts without it; and preferences that prompt suppliers to increase prices, transferring wealth rather than influencing behaviour.

Others create problematic distortions in investment decisions. A prominent example is the federal credit for investment in labour-sponsored venture capital corporations (LSVCC), which have crowded out alternative private venture investments for the sake of portfolios that can be unsuitable for retail investors both because they tend to concentrate their equity investments in risky assets, and because portions of them must be kept highly liquid to deal with potential withdrawals.

This Shadow Budget proposes a panel of independent academics and tax experts to conduct a rigorous review of all tax preferences to identify those failing the tests of economic efficiency and cost effectiveness. Following public consultations on the panel's report, the government should phase out those that do not pass the tests. For example, the complete elimination of tax preferences mentioned above would have yielded more than $3 billion of additional tax revenue in 2011. The overall target for this exercise is $2 billion by 2014/15.

## Extending and Indexing More Federal Debt

The joint commitment by the federal government and the Bank of Canada to hold consumer price index inflation at 2 percent, which has successfully delivered low and stable inflation since the mid-1990s, creates an opportunity to reduce Ottawa's interest costs in the short term and restrain their increases in the longer term. Alongside its ordinary debt securities, Ottawa issues real-return bonds (RRBs) with principal repayments that are indexed to inflation. This protection means that their current yield is lower than the yield on ordinary bonds, yet the difference between the two yields is typically larger than the 2 percentage points that the Bank of Canada's 2 percent inflation target would imply. While the spread between the two bonds has recently been narrower than in the past, it was some 2.14 percentage points at the time of writing, and under more normal economic circumstances can be expected to rise again.

9 Commentators have suggested that tax preferences appeal to policymakers because they make program costs less visible and therefore contribute to the growth of governments' fiscal influence over the economy (Burman and Phaup 2011).

One common explanation for the wider-than-2-percent spread is that the limited supply of RRBs raises their price and depresses their yields. These bonds are an excellent investment for pension funds and retirement savers generally, and these long-term investors hold most of the outstanding float of about $40 billion. Provided that the Bank of Canada continues to produce 2 percent inflation, issuing more RRBs would let Ottawa fund its debt more cheaply than through issuing nominal-return bonds with yields that are more than 2 percent higher.

Another plausible reason for the wider spread is that investors doubt that the Bank will actually produce 2 percent inflation. Holders of ordinary nominal-return bonds demand an insurance premium against the possibility that inflation ends up being higher. Such a premium presents an additional opportunity: Ottawa could make its commitment to lower inflation more credible by issuing more debt –RRBs – that it cannot debase through surprise inflation. That more credible commitment could, in turn, reduce the interest rate on its nominal-return bonds.

In each of the past three years, Ottawa issued $2.2 billion in real-return bonds. This Shadow Budget proposes to increase this issue to $10 billion annually for the next five years. Along with the anticipated reduction in overall borrowing, that pace of issue would markedly raise the share of these bonds in total federal debt.

We estimate two types of interest saving from more real-return bonds. They lower the cost of servicing new debt. At a typical pre-crisis spread between the two types of bonds,[10] the saving from lower interest payments would exceed the cost of indexing the principal of the real-return bonds by some $60 million in the final year of the projection period. It could also enhance the credibility of the 2 percent inflation target and thereby reduce yields on nominal bonds. Any such effect would noticeably improve the bottom line, since new debt issuance and rollover will be large over the projection period. Net of the offset such a yield reduction on nominal bonds would subtract from the initial savings achieved by larger RRB yields, we put the savings from this effect at $145 million in the final year of the period.

In the past, more aggressive RRB issuance has appeared unattractive because more RRBs might oblige Ottawa to curtail issues of other bonds used as bellwethers by portfolio managers and other financial market participants. The larger amounts of federal debt now outstanding mute this concern. Moreover, the federal government has unfunded obligations that RRBs are well suited to offset, such as the unfunded liabilities in its pension plans and for its other post-retirement obligations already mentioned, and additional potential liabilities such as buying out some of the production quotas held by farmers of cartelized goods (Robson and Busby 2010). To the extent it issues additional RRBs to fund these liabilities – an attractive proposition with the RRB yielding less than 0.50 percent – it will increase their float without distorting the market for other federal bonds.

### Ensuring Budget Balance by 2014/15

The cumulative impact of these measures on the bottom line appears in Table 2. They will ensure surplus by the end of the three-year projection period in 2014/15.

## Fostering Growth

The worst indebted countries in Europe are reminders that, when governments fail to curb excessive borrowing, growth prospects become so bleak that prolonged, deep fiscal austerity is their

10 36 basis points on average from 2001 to 2007.

**Table 2: Fiscal Projections with Spending Restraint Measures ($ billion)**

| | 2011/12 | 2012/13 | 2013/14 | 2014/15 |
|---|---|---|---|---|
| **Baseline Projections (Table 1)** | | | | |
| Projected Revenues | 243.5 | 251.8 | 268.8 | 285.1 |
| Projected Expenditures | -274.5 | -279.2 | -285.8 | -292.6 |
| Net Adjustment for Fiscal Prudence | | -0.5 | -0.5 | -0.5 |
| **Budgetary Balance before Initiatives** | **-31.5** | **-27.9** | **-17.5** | **-8.0** |
| **Spending Restraint Initiatives** | | | | |
| Achieving Program Review Savings Targeted in Budget 2011 | | 1.0 | 2.0 | 4.0 |
| Trimming Financial Assistance to Crown Corporations | | 0.3 | 0.7 | 1.1 |
| Containing Federal Public-Service Employment | | 0.7 | 1.5 | 2.2 |
| Containing Growth in Per Federal Employee Compensation | | 0.1 | 0.4 | 0.7 |
| Capping the Cost of Federal Employee Pension Plans | | 1.1 | 1.1 | 1.1 |
| Partly Funding Other Post-Retirement Benefits | | 0.1 | 0.2 | 0.3 |
| Rationalizing Canada's Tax Base | | 1.5 | 1.5 | 2.0 |
| Issuing More RRBs | | 0.1 | 0.1 | 0.2 |
| **Total** | | **4.9** | **7.5** | **11.6** |
| Change to Debt Charges | | 0.3 | 0.4 | 0.6 |
| **New Budgetary Balance** | **-31.5** | **-22.7** | **-9.6** | **4.2** |
| **Accumulated Deficit** | 585.2 | 607.9 | 617.5 | 613.3 |
| *as % of GDP* | *34.2* | *34.1* | *33.2* | *31.5* |

Sources: Table 1 above; authors' calculations. Columns may not sum exactly due to rounding.

only hope for avoiding default. Canada is not in that situation, and can expect growth to add to its fiscal capacity, not just in the long term, but during the projection period as well.

This situation is good in its own right: adept fiscal management is a means to the end of higher living standards, for which economic growth is a key driver. It is also an appropriate focus for the 2012 Budget, since slowing workforce growth combined with Canada's weak record of productivity-enhancing investments have been slowing growth in Canadian incomes. Fiscal policy needs to support work, investments in human and physical capital, and innovation, and reduce tax-driven activity, including unnecessary administration and compliance. This budget therefore launches several initiatives, most of which have no, or small, impacts on the near-term bottom line, but can boost Canada's economic dynamism during the projection period.

## Adopting Uniform EI Rules

The Employment Insurance (EI) program has too many objectives. Mixing regional income supports with regular benefits vitiates its ability to insure most Canadians against involuntary, temporary and unanticipated loss of income. Uniform entrance requirements and benefit durations would eliminate the unfairness of benefits based on regional unemployment rates (Busby et al. 2009) and mitigate the development of regional pockets of

high, chronic unemployment. As currently designed, the program has encouraged EI dependency for many workers and discouraged migration of potential workers to areas where job prospects are brighter (Busby and Gray 2011).

This budget starts phasing out regionally differentiated entrance requirements and benefit periods. By 2014/15, the minimum qualification threshold for EI will be 560 hours worked, for a minimum benefit period of 22 weeks across the country, so that the system treats Canadians equally regardless of location and does not discourage migration in search of work (Busby et al. 2009). Since the premium rate will adjust over time to balance the impact of the changes on benefits, the impact on the bottom line will be small in the first year and negligible over the projection period.

## Raising Reference Ages for Seniors' Programs and Taxes

The ages at which various government programs assume older people stop work, start depleting their wealth, lose their independence and die have not kept pace with improvements in life expectancy. In 1966, when the outlines of most of these programs took shape, life expectancy at age 65 was 16.9 years for women and 13.6 years for men; the Chief Actuary's latest estimates put them at 22.6 years and 20.2 years, respectively. Partly because of these improvements, the ratio of people age 65 and up to those 18 to 64 will double in 30 years, and the growth in living standards today's youngsters could otherwise hope for as they mature may be largely or entirely preempted by the rising bill for their predecessors' healthcare, income supports, and government-employee pensions – as well as by the frictional and deadweight costs of the higher taxes to pay them all. To encourage people to work longer, save more, and draw less in old age, thereby supporting growth in living standards for people at all ages, many tax and program provisions need to raise the dates at which they start paying and/or clawing back, or force decumulation of wealth.

### *Allowing and Rewarding Later Take-up of OAS and GIS Benefits:*

Old Age Security (OAS), Guaranteed Income Supplement (GIS) and Allowance payments are key income supports for Canadian seniors. They facilitate retirement and the end of saving for those who are, or choose to become, inactive, and have clawbacks that discourage continued work and saving by some who might otherwise continue to do so. Because they are tax-funded on a pay-as-you-go basis, they will add to federal program spending during the period when the babyboomers pass age 65, raising the prospect of heavier federal taxation during a period when the working-age population will be growing very slowly and provincial governments will be struggling with rising healthcare costs. Adopting a feature from the Canada and Quebec Pension Plans (C/QPP), whereby potential recipients of OAS, GIS and the Allowance can delay take-up of their benefits and receive larger benefits when they do start, could encourage longer work life and saving, and alleviate pressure on the federal budget.

C/QPP benefits do not start automatically at age 65. Participants can choose to take them as early as age 60 and as late as age 70. In the past, early take-up lowered payments by 0.5 percent for every month before age 65, and late take-up increased them by the same amount. To maintain the plans despite adverse demographic and economic circumstances, the adjustment factors are changing: by 2016, early take-up will lower payments 0.6 percent per month before age 65 and raise them 0.7 percent per month after it.

This Shadow Budget will establish a schedule for OAS and GIS payments that lets potential recipients defer take-up past age 65, and increases the benefit they would otherwise receive by 0.7 percent per month of deferment, to come into effect at the beginning of 2013. This change will give potential recipients a valuable tool: while those who wish to take up their benefits at age 65 (or 60 in the case of the Allowance) will be able to do it;

those who prefer to wait for the sake of the richer benefit, and also possibly to avoid clawbacks, will have that option.

We anticipate that take-up will initially resemble the pattern of benefit take-up in the CPP, with 96 percent of potential recipients of OAS and GIS commencing at the earliest possible age and equal numbers starting at every age after that until all are receiving benefits by age 70. This change will yield some improvement in the bottom line. Over time, as larger cohorts reach age 65 and the average age of take-up rises, this improvement will grow. Higher administration costs will likely offset the savings otherwise available in the first year; in the next two years of the projection period, net spending on OAS and GIS is expected to be lower by $260 million and $335 million, respectively.[11]

*Raising the Age at which Tax-deferred Saving Must Stop and Drawdowns Must Start:*

It makes no sense to force Canadians and their employers to stop contributing to tax-deferred retirement saving vehicles at age 71 and begin drawing down their wealth. This budget proposes to increase this age to 72 on 1 January 2013, and begin increasing it by one month for every six-month interval after that. This change will have a small negative impact on federal personal income-tax collections.

*Raising the Age of Maximum RRIF Withdrawals and Annuity Contracts:*

Rising life expectancy and lower yields make existing provisions for Registered Retirement Income Funds (RRIFs) problematic, since large mandatory withdrawals – though advantageous for federal revenue collections – put increasing numbers of seniors at risk of outliving their savings. Age 90 is now the date at which RRIF holders must begin withdrawing 20 percent of their balances every year, and is also a key age restricting annuity contracts. These ages will also rise by one year on 1 January 2013, and begin increasing at a rate of one month every six-month interval after that. This change will have a very small negative impact on federal revenue.

### Raising the Years of Service at Which Federal Employees Become Eligible for Full Pensions

As noted above, this Shadow Budget commences adjustments to the age at which federal employees become eligible for full pensions, which will improve the quality of federal services provided per dollar of compensation cost. Federal pension benefits accrue at a rate of 2 percent per year of service, usually to a maximum of 70 percent – calculated in relation to the best five years of earnings – after 35 years. Commencing 1 July 2012, this Shadow Budget proposes to reduce the accrual rate to 1.8 percent annually. The ultimate saving in annual pension accrual costs arising from this measure will be known only once actual retirement patterns change, and will appear in future federal budgets along with a restatement of federal employee pension costs based on evaluation using the RRB rate, to reflect their true value as assets to employees and as liabilities to taxpayers.

### Leveling the Retirement Saving Playing Field

Once savers have moved into the decumulation phase of their retirement plans, through RRIFs or Life Income Funds (LIFs), the Pension Income Tax Credit should apply regardless of age. They should also have the same spousal income-splitting

11 Robson (2012b) elaborates this idea and explains the simulation of its impact more fully. The savings outlined here assume that take-up of OAS and GIS benefits changes, but that take-up of Allowance benefits does not.

opportunities as registered plan members. This Shadow Budget also proposes to alleviate the tax disadvantages of group RRSPs by (i) letting sponsors and/or participants deduct some administrative expenses currently levied against plan assets from outside income, and (ii) removing federal payroll taxes from employer contributions. These changes will have very small impacts on federal revenue during the projection period.

## Liberalizing International Trade and Investment

The benefits to consumers of lowering policy barriers to international trade in goods and services are familiar. It is also becoming increasingly evident that, for Canadian businesses seeking to build or compete within global value chains, lower barriers to imported inputs are a necessary foundation on which to create Canadian value-added content and jobs. Improving access to inputs from all over the world is a necessary complement to the government's strategy of securing better global access for products with high Canadian value-added, and as such can be an extraordinarily cost-effective form of economic stimulus.

Indeed, the government is pursuing an aggressive market-opening strategy. Examples include the Action Plan for Perimeter Security and Economic Competitiveness with the United States, the Joint Action Plan for the Canada-United States Regulatory Cooperation Council, the Comprehensive Economic and Trade Agreement which we expect to soon conclude with the European Union, as well as Canada's request to join the Trans-Pacific Partnership negotiations. These and other key Canadian international trade and investment initiatives all have one common, central objective: to increase the advantages of living, working and investing in Canada, through a greater ability to benefit from global economic opportunities from a Canadian base.

### *Phasing Out All Remaining Tariffs on Manufactures and Machinery Equipment:*

This budget anticipates and supports a positive conclusion from the above-mentioned trade-related initiatives. Past multi- and bilateral trade agreements have reduced the average tariff on imports of manufactures to Canada to about 1.28 percent on a trade-weighted-average basis in 2010 (World Bank 2012). More than 90 percent of the non-electrical machinery and 80 percent of the electrical machinery identified by separate lines in the tariff schedule now enter Canada duty-free (WTO 2011), figures that will increase further under the gradual, broad import-tariff elimination on essential industrial inputs and machinery and equipment announced successively in the 2009 and 2010 budgets.

In order to, first, simplify the administrative burden on business, the government will unilaterally move to zero MFN tariff for 50 percent of tariff lines in transportation equipment and 75 percent of tariff lines in all other manufacturing, over a five-year period. Furthermore, in due course, we expect that trade negotiations, which Canada is conducting, or is hoping to conduct, with economies representing a large fraction of its non-NAFTA trade, will result in a virtual elimination of remaining duties on manufactures. This Shadow Budget reflects these hoped-for outcomes through assuming an initially small, but eventually almost complete elimination of remaining tariffs on manufactured items, which will reduce revenues by amounts between $200 and $600 million over the projection period.

### *Lowering Tariffs on Cartelized Agricultural Products:*

The cartelization of dairy products, poultry and eggs under Canada's supply management system forces consumers to pay higher prices, discourages food processing and retailing, and inhibits innovation and quality improvements. Although retention of

trade barriers as bargaining chips can make sense, Canada is not using these barriers to advantage in negotiations: in fact, they stand as obstacles to economic agreements that would benefit the broader economy. Prohibitive tariffs on these goods, with only small quantities entering the country at lower rates, are therefore durable supports for these cartels, blocking competitively priced imports.

Only the fear of Canadian governments to tackle a powerful interest group explains the durability of supply management, and that fear alone should not preclude measures that would stimulate the economy at no cost – more likely, at modest benefit – to the Treasury. This Shadow Budget therefore announces that the government will reduce its over-the-quota tariff rate unilaterally by 50 percentage points in five-year increments. In addition, we anticipate that the result of negotiations currently underway will result in at least some incremental increase in the import quota at the lower rate for certain supply-managed product; an outcome that would preserve supply management, but would make it less detrimental to consumers and the food processing industry. We expect that these measures will result in a modest increase in both the quantity and quality of imports of such products into the Canadian market, and thus in tariff revenues for the government.

## Modernizing Canada's Corporate Income Tax

Recent research reinforces a long-standing concern of economists about the impacts of taxes on behavior and consequent costs to the economy and society – especially allowing for the negative impact of tax increases by one level of government on the tax base of others. Dahlby and Ferede (2011) estimate the marginal cost of raising an additional dollar in federal taxes on goods and services is more than $1.10 while the cost of an additional federal personal-income-tax dollar is almost $1.20, and the cost of an additional corporate-income-tax dollar is more than $1.70. The large economic burden of corporate income taxes particularly underlines the welfare gains available by reducing governments' reliance on corporate taxes and relying more on taxes on goods and services that typically do less economic damage per additional dollar raised.

A distorting and non-neutral tax system can discourage the movement of resources to sectors with higher returns, and in a world where not only goods but services more frequently cross international borders, is likelier to influence where people and firms locate their activities. This budget proposes four changes that, individually and even more taken together, would make Canada a more supportive country for investment and innovation.

### *Moving to Corporate Group Taxation:*

Finance Canada recently held consultations on Canada's current restrictive approach to corporate group taxation, with a view to moving to a formal system of profits and/or loss sharing among eligible members of a corporate group. Such consolidation would lower many administrative and transaction costs, alleviate unfairness among different types of corporations, make Canada's corporate taxes more internationally competitive, and reduce the number of instances where tax considerations drive business decisions about where and whether to operate.

Allowing the transfer of profits and losses among domestic members of a corporate group for federal and provincial tax purposes would address these problems (Laurin 2009). This budget proposes to begin implementing a new system on 1 January 2013. The revenue impact of the change will be small.

### *Implementing an Allowance for Corporate Equity:*

Canada's corporate income tax lets businesses deduct interest related to debt-financed investments, but not dividends related to equity-financed investments. While the dividend tax credit and the partial inclusion of capital gains in personal taxes provides some relief for corporate-level taxes paid on income received by individuals, this tax asymmetry creates several distortions. Especially

when investors are tax-exempt, as is the case with pension funds, it may induce excessive borrowing. It likely impedes investment by companies with limited access to collateral capital, such as small businesses or companies with intangible assets. It encourages cross-border tax planning that creates no economic value and complicates enforcement through such mechanisms as thin capitalization rules (Advisory Panel 2008).

An allowance for corporate equity (ACE) provides a deductible allowance for corporate equity in computing taxable profits. The allowance, an estimate of "normal" corporate profits, is calculated by multiplying shareholders' equity by an appropriate nominal interest rate. Its purpose is to recognize the opportunity cost of equity financing so that the corporate income tax applies only to profits exceeding normal returns (Mirrlees et al. 2011). Eliminating tax on normal profits would greatly reduce the marginal tax bite on new business investment, making physical investment in Canada more attractive relative to alternatives such as lending to government or physical investment abroad.

Immediate implementation of a 5 percent ACE without other reforms would likely reduce federal revenues substantially – by as much as $10 billion a year – in the short term. In the longer term, however, offsetting factors would lessen this cost. Higher after-tax returns translating into higher dividends and capital gains taxed domestically at the personal level, along with proportional offsetting increases in the capital gains inclusion rate and decreases in the dividend tax credit to maintain current integration of personal and corporate income tax, would recoup about $4 billion of the loss at the individual level. Corporate income base broadening measures along the lines described above – for instance the elimination of the small business tax deduction along with a proportional increase in the corporate capital gains inclusion rate – would help to offset almost all of the remaining tax loss. In order to provide time for the design and implementation of these offsetting measures, the ACE will be phased in gradually. Especially after taking account of its positive impact on investment and economic activity, the net impact on federal revenues during the projection period will likely be negligible.

***Exempting Interest Payments Received from Active Income of Foreign Affiliates:***

Canada exempts from taxation eligible dividends paid from active income of foreign affiliates in countries with which Canada has a Tax Information Exchange Agreement, to avoid the double taxation that would otherwise hit dividend payments already subject to tax abroad. By contrast, foreign interest payments, rents and royalties received by Canadian shareholders are taxable in Canada, since these payments are usually deducted from taxable incomes in foreign jurisdictions.

Financial innovation is blurring the traditional distinction between debt and equity, however. Hybrid instruments, treated as debt by one country and equity in another, allow businesses to minimize their foreign tax burdens on foreign capital investments (Advisory Panel 2008). One such popular financial hybrid instrument is found in Luxembourg, where the stock of Canadian foreign direct investment exploded from $0.3 billion in 2005 to $7.3 billion in 2010. The cost and administrative burden of setting up and staffing foreign financing companies can be high, and absorb resources that could be deployed more productively in Canada.

Canadian companies can always capitalize their direct investments abroad using financial instruments yielding tax-exempt foreign dividends. The choice between equity and debt financing is, moreover, often primarily driven by tax considerations. So exempting from tax not just dividends but also interest payments paid by foreign affiliates – as suggested by the Advisory Panel on Canada's System of International Taxation (2008) – would likely be more economically effective. The cost to the federal treasury would be small.

### Tax Deduction for IP-related Income

While Canada's Scientific Research and Experimental Development (SR&ED) tax credit provides one of the world's most generous upfront incentives for domestic research and development, business R&D in Canada lags that in other advanced nations. This disappointing result likely arises because the rewards from R&D – income from intellectual property (IP) – are taxed at higher rates in Canada than in many other countries (Parsons 2011). As well, rents and royalties from IP received from foreign affiliates are fully taxable in Canada, discouraging their repatriation.

As suggested by Mustard et al. (2009), Parsons (2011) and the Advisory Panel on Canada's System of International Taxation (2008), preferential treatment of IP-related income could increase the level of business R&D and commercialization in Canada. Therefore this budget proposes to phase in, over 10 years, a 50 percent deduction of domestic IP-related income in arriving at taxable income. The impact of this policy on the federal bottom line will be small over the budget horizon because this policy will take time to implement, and because it will increase the likelihood that IP currently being carried out and developed in affiliates outside Canada will be transferred to Canada for commercialization and further development, and will reduce the likelihood that IP developed in Canada will be transferred abroad for tax considerations.

### Boosting Growth without Hurting the Bottom Line

As Table 3 indicates, the measures to enhance growth outlined in the second half of this Shadow Budget amount to very cost-effective stimulus. Their total net impact on the bottom line at the end of the projection period is $1.7 billion – a package that preserves the essential budget-balancing profile of the fiscal consolidation measures in the first half of the Shadow Budget.

## Pulling It Together

In a world of too much debt and risks of default, we Canadians can take pride in our relatively good performance, but must resist complacency. Canada is exposed to accidents elsewhere, and a deeper look at public finances at home, as abroad, reveals unfunded liabilities and other problems that many conventional measures obscure. Our relatively good position does mean, however, that we can enhance our position both through fiscal consolidation that improves our public-sector balance sheet and through economic growth that raises our fiscal capacity and living standards. This Shadow Budget accordingly focuses on both priorities.

It starts with a focused and accelerated plan to achieve surplus. Following through on program review and starting Crown corporations on the road to financial self-sufficiency will help. Most critically, restraining federal compensation – by containing growth in employment and growth in per-employee salaries, and by curbing and better-funding pensions and post-retirement benefits, including those of MPs – will improve Ottawa's ability to deliver services at reasonable cost for years to come. The budget also launches a rationalization of tax preferences, which will contribute meaningfully to the consolidation.

This Shadow Budget then moves to measures to stimulate growth. Adopting uniform EI rules will improve long-term job prospects for Canadian workers. Raising the ages at which various programs affecting seniors pay benefits, claw them back, or force saving to stop, and force decumulation will encourage more work and saving by Canada's growing older population, and complement changes to federal employee pensions to encourage longer work life. Liberalizing international trade by phasing out tariffs on manufactures and cartelized agricultural products will benefit consumers and stimulate production in Canada. Modernizing the corporate income tax with corporate group taxation, an Allowance for Corporate Equity, broader tax relief on repatriated income and a new lower tax

## Table 3: Fiscal Projections with Growth Measures ($ billion)

| | 2011/12 | 2012/13 | 2013/14 | 2014/15 |
|---|---|---|---|---|
| **Budgetary Balance after Spending Restraint (Table 2)** | | | | |
| Baseline Budgetary Balance | -31.5 | -27.9 | -17.5 | -8.0 |
| Impact of Spending Restraint Initiatives | | 5.2 | 7.9 | 12.2 |
| **New Budgetary Balance** | **-31.5** | **-22.7** | **-9.6** | **4.2** |
| **Initiatives to Enhance Growth** | | | | |
| Adopting Uniform EI Rules | | -0.5 | -0.3 | -0.1 |
| Allowing and Rewarding Later Take-up of OAS and GIS Benefits | | 0.0 | 0.3 | 0.3 |
| Raising the Age at which Tax-deferred Saving Must Stop and Drawdowns Must Start | | -0.2 | -0.2 | -0.2 |
| Raising the Age of Maximum RRIF Withdrawals and Annuity Contracts | | -0.1 | -0.1 | -0.1 |
| Raising the Years of Service at which Federal Employees become Eligible for Full Pensions | | n/a | n/a | n/a |
| Leveling the Retirement Saving Playing Field | | -0.2 | -0.2 | -0.2 |
| Phasing Out All Remaining Tariffs on Manufactures | | -0.2 | -0.4 | -0.6 |
| Lowering Tariffs on Cartelized Agricultural Products | | 0.1 | 0.1 | 0.1 |
| Moving to Corporate Group Taxation | | -0.1 | -0.1 | -0.1 |
| Implementing an Allowance for Corporate Equity with Proportional Reforms to Capital Gains and Dividend Taxation, and Small Business Deduction | | -1.0 | -0.8 | -0.5 |
| Exempting Interest Payments Received from Active Income of Foreign Affiliates | | -0.1 | -0.1 | -0.1 |
| Gradual Phase-In of 50-percent Tax Deduction for IP-related Income | | -0.1 | -0.1 | -0.2 |
| **Total** | | **-2.4** | **-1.9** | **-1.7** |
| Change to Debt Charges | | -0.1 | -0.1 | -0.1 |
| **New Budgetary Balance** | **-31.5** | **-25.2** | **-11.6** | **2.4** |
| Accumulated Deficit | 585.2 | 610.4 | 622.0 | 619.6 |
| *as % of GDP* | *34.2* | *34.3* | *33.4* | *31.9* |

Source: Table 2 above; authors' calculations. Columns may not sum exactly due to rounding.

rate for returns to inventions will also stimulate investment and production.

This Shadow Budget builds on Canada's fiscal and economic advantages, steering quickly back to fiscal balance, and charting a longer-term course toward higher living standards.

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**Notes:**

## Notes:

## Recent C.D. Howe Institute Publications

| | |
|---|---|
| March 2012 | Robson, William B.P. "What to do About Seniors' Benefits in Canada: The Case for Letting Recipients Take Richer Payments Later." C.D. Howe Institute E-Brief. |
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