



# Canadian Labour Congress Analysis of the 2005 Economic and Fiscal Update

## Introduction

While obviously intended to be a pre-election mini-Budget and political platform largely centered on personal income tax cuts, the Update put forward a longer term economic agenda which has several positive elements. Most notably, the labour movement welcomes the increased emphasis upon workplace-based skills training and accessible post-secondary education as central parts of the much-heralded productivity agenda. This may move us closer toward the goal of lifelong learning for all, including workplace-based development of the skills of lower paid and less secure workers which have been a particular CLC priority. We welcome the new commitments to literacy programs, and support for funding innovative workplace training pilot projects.

While new workplace skills' programs will be negotiated with the provinces and territories, this partial return of the federal government as an active player in the area of training is important since we face the prospect of growing national skills shortages in some important areas, such as health care and the skilled trades. In a period of major economic restructuring, it is critically important that workers be enabled to retrain and upgrade their skills to move to new jobs in growing sectors and regions. Government action has long been needed to address the long-standing failure of employers to invest sufficiently in the skills of workers, particularly those who entered the workforce without post-secondary qualifications. Significant action to recognize and upgrade the skills and qualifications of

recent immigrants is also badly needed and is welcome. The government also promises long-awaited action to include Aboriginal persons in the labour force.

Less positive, this mini-Budget reintroduces the Liberal commitment in the original 2005 Budget to across-the-board corporate tax cuts. The general corporate income tax (CIT) rate is to be cut from 21% to 19%, and the capital tax which applies only to large corporations is to be abolished from next year.

We would have preferred to see much more selective support for corporate investment in machinery and equipment, in innovation, and in training. The main problem with an across-the-board tax cut is that it will swell already very high after-tax profits in sectors — such as energy and finance — where companies do not need additional incentives to invest, while shrinking the capacity of the federal government to invest directly in needed programs.

The income tax changes for middle-class Canadians which are to be introduced immediately are modest in terms of the overall impact on individuals, and do not make the personal income tax system more fair since tax cuts for higher earners kick in by 2010. It can be questioned whether the fiscal capacity of the federal government moving forward should be reduced by personal income tax cuts totalling about \$7 billion per year in lost revenues by 2010 (up from the \$5 billion personal tax cut this fiscal year) given the pressing challenges of education, an ageing society, health care, and renewal of public infrastructures. The last two of these areas receive almost no attention in this Economic Update.

While the federal government has a very large underlying surplus of close to \$15 billion which makes these kind of personal and corporate tax cuts affordable, the provinces face major spending pressures, and only Alberta has a significant fiscal surplus. Federal surpluses might have been better deployed to assist the provinces in crucial areas of social investment. Hard-pressed provinces may yet offset some of the increased federal spending on students by raising tuition fees.

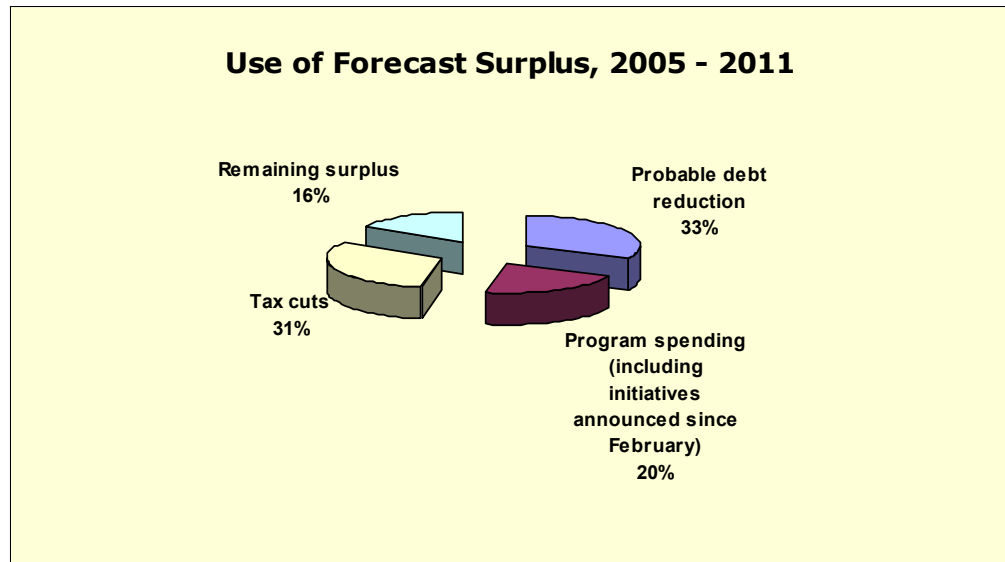
While some assistance has been given to working Canadians in the form of immediate tax breaks, it should be clearly understood that improving the quality of jobs and raising pay for lower paid workers are a much more important way of raising living standards of working families than are tax cuts. Improved access to EI benefits for the many, mainly women, part-time, and contract workers who now fall through the cracks, would also help. The CLC has called for a uniform entrance requirement of 360 hours of work compared to current requirements of as many as 900 hours, as well as increased coverage of lost earnings. From a gender equity perspective, working women would benefit much more from better jobs and more accessible EI than from the family income-based tax credits for the working-poor which are promised from 2008.

## **Canada's fiscal outlook: huge surplus confirmed**

The Economic Update goes at great lengths to explain the appearance of yet another large unforeseen surplus for the current fiscal year of \$11.1 billion as opposed to the forecast of

\$1 billion laid out in last February's Budget. Once again, the Department of Finance greatly understated tax revenue growth and overestimated (fairly predictable) debt charges.

Based on reasonable economic assumptions (but more suspect revenue forecasts), the Update identifies no less than \$96.8 billion worth of underlying surplus to be allocated between now and 2010-11. Of this, about \$50 billion are planned for tax and spending initiatives proposed since last February (including the Update), \$31.5 is earmarked for 'prudence,' and \$15.5 remains for future allocation.



Taken as a whole, the identified fiscal 'dividend' is divided in the following ways: 20% for program initiatives, 30% for tax cuts, 33% for probable debt reduction, and the remainder to be decided upon later. To keep things in proportion, the infusion of money for education and training initiatives, while laudable, amounts to less than 1% of annual GDP, and is spread over five

years. Federal program spending stabilizes at 12% of GDP, up just a bit from the low point which was reached in the process of deficit elimination.

If everything goes according to plan, by 2011, tax revenues will account for 14.4% of GDP (a drop of 1% from today); federal program spending will account for 11.9% of GDP (about the same proportion as today), and public debt charges will drop to 2.0, from 2.6% now.

In sum, for all of the right-wing charges of out-of-control spending, this is still a government that gives high priority to tax cuts and debt reduction.

## **The productivity agenda**

The labour movement recognizes the critical importance of business investment in new machinery and equipment, research, and training. The link between higher productivity and better jobs is not automatic, but workers want to work with innovative companies investing in new technology and in workforce skills. It is a cliché, but also true, that Canada has to become an investment-led, knowledge-based economy to prosper in a changing world.

Record-high corporate after-tax profits, which are forecast to continue at record-high levels as a share of national income, do not necessarily translate into more business investment and better jobs. Many corporations are hoarding cash, parking it in offshore tax shelters, or paying out big dividends to

shareholders. Real business investment has failed to grow in line with soaring profits and the major corporate tax cuts which have already been introduced.

Some businesses are, of course, investing. High resource prices are driving an investment boom in the oil and gas and mining sectors. The across-the-board corporate tax cut will simply swell already bloated profit margins in these booming sectors, and hinder the ability of all Canadians to fairly share in the benefits of new wealth creation.

There is a case to be made for selective tax and spending measures to help hard-pressed manufacturers to invest in new machinery to adjust to the higher dollar, and also a case for supporting major corporate investments in research and development, and in training. In both of these important areas, firms which invest benefit the economy as a whole, but do not necessarily recoup all of their costs. The Update promises increased support for university-based research and development, for workplace-based training, and for post-secondary education, which are generally welcome, but the government can be criticized for too strong an emphasis on corporate tax cuts.

## **Investment in skills and training**

The CLC believes that Canada can become a more productive economy as well as a fairer society by investing more in people.

We have heard a lot of rhetoric about the need for lifelong learning in a knowledge-based economy. To begin to turn it into reality, we need to invest in a serious way in early learning programs which give all of our children a good start in life. (The Update promises that the new national program will continue beyond 2010, though no new funding has been announced.) We also need to recognize that 40% of younger adults, aged 25 to 35, do not hold a post-secondary educational qualification, and that the so-called lower skilled workers get very limited training in the workplace. Many young workers, as well as recent immigrants, face a future of low-wage, dead-end jobs, even while employers complain about growing skills shortages.

The CLC has called for major investments in skills by employers and governments, including through paid training leaves under Employment Insurance as part of a formal training plan. This would represent an extension of the current apprenticeship training provisions under EI, which provide income support for apprentices during the classroom part of their training.

We have proposed pilot projects in health care and manufacturing. It is envisaged that access to training leave benefits would replicate some key elements of the apprenticeship model, critically including a formal human resources planning-process that genuinely involves workers, employers, and educational institutions. Pilot projects could be developed by the existing sectoral skills' councils which have been sponsored by Human Resources Development Canada, or jointly by unions and employers at the workplace, or at the sectoral and community level. Several concrete proposals have

already been developed involving employers, unions, and educational institutions.

While no single policy lever is the answer to raising productivity and job quality in low paid/low-skill work, paid training leaves under EI have the potential to help build more effective workplace and sector-level training institutions of the kind which have worked well elsewhere.

## **The Economic Update and workplace-based skills development — a new framework for action?**

The Update provides a major cash injection of \$3.5 billion over this year and the next five years to increase workplace-based training — with funding climbing to \$500 million in 2006-07, and to about \$800 million per year after 2008. This is intended to support apprenticeship training, literacy and essential skills, and enhancing workplace participation of persons with disabilities and Aboriginal Canadians. The programs will be developed through new Labour Market Partnership Agreements with the provinces and territories, with input from “business and labour partners.” In his speech, the Minister also made reference to “working with labour and employers to pilot-test the most creative new techniques to advance workplace skills.”

While this announcement of financial support is positive, and provides a possible umbrella and framework for implementation of labour’s workplace training and literacy agenda, much will clearly depend on what is negotiated with the

provinces and territories. Our experience is that some labour market development agreements with the provinces — which now cover training mainly for unemployed workers — work fairly well, while others do not. It will be important for the federal government to use these new resources to ensure that we develop an effective national workplace-training system.

Resources are also allocated for improved gathering and dissemination of data on skill needs and labour force trends, and for promoting labour mobility.

## **Inclusion of immigrant workers**

The Update proposes an additional \$1.3 billion over this year and the next five years to enhance settlement and integration programs, including language programs. This is welcome, and will clearly be important given the enormous difficulties faced by recent immigrants and workers of colour in terms of accessing decent jobs.

## **Inclusion of persons with disabilities**

There is an additional \$265 million allocated over five years for persons with disabilities, including measures to increase workplace participation.

## **Inclusion of Aboriginal workers**

While thin on details, the Update speaks at some to the importance of inclusion of Aboriginal persons in the governments overall skills' agenda.

## **Post-secondary education**

The government proposes an increase of \$2.2 billion in assistance to students from low- and middle-income families over the next five years. Special efforts will be required to ensure that potential students from low-income and middle-income families actually access the increased loans and grants. The Canada Access Grant — which has provided grants covering partial tuition for eligible students of very low income families in their first year of studies — will be extended to cover up to four years of undergraduate study. However, at an additional investment of only \$110 million per year, this will have only a very limited impact.

The government has also pledged \$1 billion this year only to provinces and territories for “urgent” investments to improve depleted post-secondary infrastructures, to improve access for persons with disabilities, *and* to improve underfunded northern and Aboriginal institutions. In a letter to the Council of Ministers of Education, Canada, in October of this year, the Public Education Network/ *Reseau pour l'education publique* called for an annual federal transfer increase of at least \$4 billion per year.

The danger is that provinces will hike tuition fees to offset underfunding, undoing any benefits from increased financial support for students.

## **Across-the-board corporate tax cuts — the wrong way to go**

As first proposed in the original 2005 Budget, the federal corporate tax rate is to be cut from 21% to 19% by 2010, building on the large rate reduction from 28% to 21% which took place over the five years between 2000 and 2005. Each one percentage point cut in the rate reduces federal government revenues by about \$1.4 billion. The corporate surtax will be eliminated by 2008, on top of the elimination of the federal capital tax on corporations as of 2006, two years ahead of the schedule in the 2005 Budget. The total corporate tax package will reduce federal tax revenues by another \$4 billion per year by 2010.

The case that has been put forward for these deep corporate tax cuts is that Canada will lose out on new business investment if our corporate tax system is not “competitive” with that of the US and other major economies.

However, the international business consulting firm, KPMG, recently found that effective corporate income tax rates in Canada are already lower than in the US. In short, Canada does not have an overall corporate tax-competitiveness problem.

Recent, widely publicized studies by the C.D. Howe Institute have put forward the case that Canada's marginal effective corporate tax rates (that is, the tax on a new capital investment at the margin of profitability) are sometimes higher than in the US. These studies seem to have been given a great deal of credibility by the government. However, these calculations look at many aspects of the business tax system (including depreciation rates for tax purposes, tax treatment of inventories, capital taxes, and sometimes, sales taxes on capital goods as well as payroll taxes on employers). Therefore, they do not support the conclusion that the Canadian corporate tax rate as such is too high. Moreover, studies by Department of Finance economists show that the impact of tax measures on investment is much greater if these measures are targeted, as in increases in depreciation rates for machinery and equipment. The Update promises only very minor measures of this kind tilted towards green energy measures.

Public investment in infrastructures can play a major role in increasing our productive capacities, but such investment has been sacrificed to corporate tax cuts.

## **Personal income tax cuts – small pre-election tax cuts for all today, cuts for higher income earners tomorrow**

The Update announces immediate personal income tax cuts tilted to lower and middle earners, and later, tax cuts for high earners.

Retroactive to the start of 2005 (and thus showing up when taxes are calculated next spring) the basic personal amount is to be increased by \$500 — for a tax saving of \$75 for almost all taxpayers (with the exception of those paying very small amounts of tax). The exemption will be increased by another \$200 in 2006 (for another tax saving of \$30). This accelerates earlier-announced increases in the basic personal amounts to \$10,000 (due in 2009) from the current level of just over \$8,000. In addition, a 16% tax rate on taxable incomes of less than \$35,595 will be cut to 15% — for a maximum tax saving of about \$250.

In short, there will be an immediate tax cut of about \$350 for most taxpayers, less for those earning less than about \$35,000.

In 2010, the upper-middle class gets an additional tax cut. The middle rate of 22% will be cut to 21%, for a maximum tax saving of about \$360 for people earning between \$35,000 and \$71,000, and the 26% rate on income of \$71,000 to \$116,000 will be cut to 25%, for a maximum tax saving of about \$500.

People earning more than \$116,000, but less than \$200,000, will get another tax cut, with the rate on income between \$116,000 and \$200,000 falling from 29% to 26%, for a maximum tax saving of about \$2,500. Thus someone earning \$200,000 will get a total tax cut well in excess of \$3,000. The cost of this tax cut is \$730 million per year in foregone revenues.

The government argues that the share of all taxes paid by each major income group will remain essentially unchanged under the proposed new plan in 2010.

However, 14% of the total tax saving will go to the 6% of tax filers with incomes more than \$100,000.

The personal income tax cuts will reduce federal revenues by about \$5 billion this year (2005-06) rising to about \$7 billion per year in 2010.

## **Taxation of the working-poor**

The Update promises and provides sketchy details on a Working Income Tax Benefit, to be introduced in 2008–09, and providing about \$1 billion to working-poor families by 2010. This is modelled on the US Earned Income Tax Credit and a similar scheme in the UK. Details are to be worked out with the provinces. The basic aim is to ensure that people leaving welfare for work are better-off and do not experience punitively high tax rates.

This initiative is one possible basis for more comprehensive welfare reform in the years ahead, a process which is under active discussion in Ontario.

While welcome in some respects, an earned income tax credit raises some concerns. Unless well-designed, it can serve as a subsidy to low wage employers, and certainly publicly financed tax credits for low-wage workers should not be seen as

an alternative to higher minimum wages and other improvements to the quality of low-wage jobs. Further, the fact that the new tax credit would be based on family income is problematic, since it could lead to high rates of tax on secondary earners within a family, such as young adults at home. Finally, the phasing-out of tax credits for the working-poor will, in tandem with the phasing-out of child tax benefits, potentially raises effective tax rates for many working families with average earnings.

## **Conclusion**

This Economic Update contains welcome new support for training and education, recognizing that investing in people makes a central contribution to our social as well as economic well-being. It is flawed by the unproductive across-the-board corporate tax cut.

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