Canadian Union of Public Employees
preliminary submission to the

House of Commons Standing Committee on Finance

2007 Pre-Budget Consultations

August 2007

---

www.cupe.ca
21 Florence St
Ottawa, Ontario
K2P 0W6
613 237-1590

Executive Summary

CUPE's submission addresses both the Standing Committee on Finance's theme and questions related to "the tax system the country needs for a prosperous future" and presents CUPE's recommendations for the 2008/9 federal budget.

Decisions about tax levels and rates should be guided by the widely-recognized purposes and principles that underline good tax systems – and not based on narrow and simplistic comparisons. Since the primary purpose of a tax system is to raise revenues to fund public services, full consideration must be given to the levels and types of public goods provided.

Canada's business and personal taxes are well below the OECD average and among the lowest in the G-7. There is no evidence that our tax rates are too high. In fact, evidence shows that relatively higher-taxed Nordic countries perform better than low tax countries on a wide range of social, economic and environmental outcomes because they provide better public services.

The effectiveness of our tax system has deteriorated in recent years: corporate tax cuts have not helped spur investment and innovation; inequality has worsened; climate pollution has increased; and the tax system has been made more complicated with an increasing number of loopholes, exemptions, deductions and credits. In most of these cases, the goals could be achieved more effectively and at less cost through direct public spending than through tax measures,

CUPE's recommendations for the 2008/9 federal budget include:

- Commit $1.2 billion as the first step to provide early learning and child care for all 3-5 year old through a national public/non-profit program.
- Increase transfers for post-secondary education by $1 billion to reduce tuition fees, expand access and improve conditions for students and staff.
- Commit to a long-term plan to eliminate the infrastructure deficit by providing municipalities with access to a substantial and growing source of revenues.
- Stop pushing privatization on provinces and local governments by eliminating the $1.25+ billion Fund for P3s, the P3 Office, and the requirement to consider P3s.
- Strengthen public health care and build a national pharmacare program.
- Increase federal investments in skills, literacy, workplace training and labour market development with an increased and active federal role.
- Reform the EI system to include training, broader coverage and improved benefits for workers in all forms of employment and unemployment.
- Meet our commitments to Aboriginal Canadians and First Nations with funding for health, housing, education, training and job opportunities.
- Use federal tax incentives, subsidies, transfers and regulations to encourage sustainable regional economic development of our resources rather than export of unprocessed resources.
- Develop and lead a national action plan and sector plans on jobs, including incentives for investment in manufacturing and processing.
- Public leadership in building a green economy and sustainable future, with a credible action plan, investments and putting a price on pollution.
- Progressive tax reform and closing of tax loopholes.

INTRODUCTION

The Canadian Union of Public Employees is Canada's largest and most diverse union, representing over 560,000 members in communities all across our country. We welcome this opportunity to present our views on the theme identified by the Standing Committee on Finance for this year's pre-budget consultations: "the tax system the country needs for a prosperous future."

This submission:

1) briefly summarizes the main purposes and principles of good tax systems;
2) addresses specific questions identified by the committee; and
3) summarizes CUPE's recommendations for the 2008/9 Budget.

Purpose and principles of a good tax system

Tax systems are widely recognized as having four main purposes to: 1) raise revenues to fund public services, 2) increase equity through redistribution, 3) create incentives and disincentives for different activities, and 4) promote economic and social wellbeing.

To fulfill these purposes effectively, tax policy must be guided by a number of fundamental principles. These include: equity and fairness, progressivity, simplicity, transparency, certainty, administrative efficiency, stability and predictability. The precise terminology may vary but the general principles are widely accepted.

Federal decisions about taxes, as well as their form and level, should be based on these purposes and principles – and not set by pre-determined notions nor by simplistic and narrow comparisons. These purposes and principles will not always align: it is essential to balance and consider broader factors.

There should be no question about whether the federal government should fully consider the various levels and types of public goods in determining tax rates: businesses, individuals and international competitiveness rankings certainly do.

- Canada's comparatively efficient public medicare system gives businesses a large competitive advantage compared to the high costs of private health care in the United States: net benefits are estimated at over $1,000 per vehicle for Canadian auto manufacturers.

  At this rate, the net value of just public health care for this industry – about $3 billion a year – is far more than the sector pays in taxes, without even accounting for the benefit of other public services.

- Good quality public services provide Canadians with a higher quality of life, even if average income levels may be lower than the United States and other countries.

- International competitiveness rankings give relatively little weight to taxes. The quality of a country's health, education, training and public institutions are much more important than taxes in international competitiveness rankings (such by the World Economic Forum, representing the world's 1,000 leading companies). Finland and other Nordic countries – with high taxes and quality public services – have consistently ranked as the most competitive in the world, while Canada's standing has plummeted.

To assess how well our tax system meets the purposes and principles outlined above, let's assess the evidence:

Are Canada's taxes and costs for business too high?

According to the World Bank's *Doing Business 2007* report, Canada's total tax rate on business is well below the OECD average and is the 2nd lowest in the G-8[1]. While Canada's corporate tax rate on profits remains below the OECD average, corporate income taxes should not be looked at in isolation.

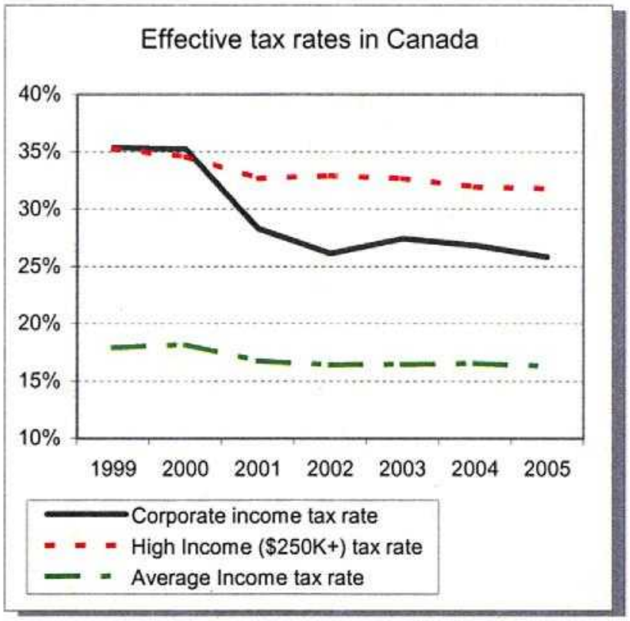
Our payroll and labour taxes are far below the OECD average. Canada's total representative tax rate on business is about four percentage points below the OECD average - also considerably below the average and median of 175 countries around the world. Many countries – from Afghanistan to Zimbabwe – have a lower total tax rate on business, but clearly taxes should not be considered alone in determining competitiveness.

Canada ranks as the 4th best in the world in terms of the ease of doing business, a measure that takes consideration of the regulatory cost of doing business in 175 countries around the world.

Regulatory and tax costs should not be considered in isolation either.

1 World Bank, *Doing Business in 2007* http://www.doingbusiness.org/

KPMG's detailed survey of international business costs ranks Canada as the lowest cost country for business costs among the G-7 and second only to Singapore among all the countries analyzed[2]. Singapore's costs are lower than Canada mostly because of lower wage and salary costs – an "advantage" that most working Canadians would not want to emulate. According to this study, Canada's cost advantage has shrunk mostly because of the higher dollar.



There is no evidence that Canadian businesses are suffering or in need of additional tax cuts, either. Corporate profits and surpluses are at record levels, yet business investment and productivity growth have been lagging.

Are Canada's personal taxes too high?

In the last few years, we have experienced a dramatic shift in the share of income from wages and salaries to corporate profits, and much higher income gains for the rich than for average working Canadians.

Tax revenues from corporations and high income earners have increased, but at a slower rate than their incomes thanks to regressive tax cuts. The effective tax rate on corporate income and on high incomes has dropped much more than average tax rates.

Our average tax rates and "tax wedges" on incomes are below the OECD average, but Canada's personal income tax system is less progressive than many other comparable countries, particularly for higher incomes.

Just as corporate tax rates should never be considered in isolation, neither should personal income taxes. Taxes are what we pay for public services – and for civilized society.

Nordic countries, which combine higher taxes with quality public services and investment in human capital, have performed significantly better than low tax Anglo-American countries for a wide range of social and environmental outcomes: including economic security, equality, education, and environmental sustainability[3].

The results for economic outcomes are mixed: low tax countries lead on some indicators such as GDP, but Nordic countries lead on more economic indicators – and particularly on those which point towards a more prosperous future, such as innovation, R&D and creativity.

Does our tax system promote productivity and prosperity?

Canada has one of the most generous tax regimes for research and development in the world, yet our investment in R&D and especially business investment in R&D is far below the OECD average[4].

Taxes on corporate income, corporate capital and capital gains have all been cut significantly since 2000. Corporate profits have increased at an average rate of 11% a year since 1998, but corporate taxes have only increased by 6.5%. This has cut the average tax on corporate profits from 35% for the years before 2000 to only 25% in recent years.

Canadian corporations have accumulated record profits and massive surpluses – well over $300 billion since 1998 – but done little to increase their productive investment. These surpluses have increasing gone into mergers and acquisitions, share buybacks, speculative financial investments – and investments outside Canada.

---

2 KPMG Competitive Alternatives 2006. http://www.competitivealternatives.com/

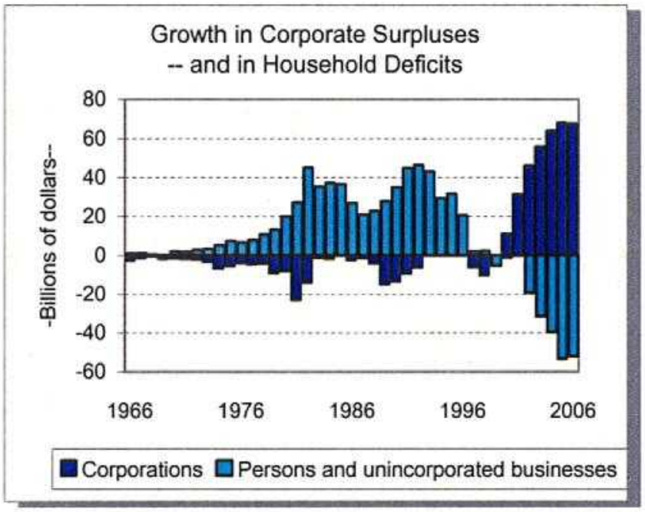
3 Brooks, Neil and Thaddeus Hwong (2006). *The Social Benefits and Economic Costs of Taxation.* Canadian Centre for Policy Alternatives. December 2006. http://policyalternatives.ca/Reports/2006/12/ReportsStudies1507/index.cfm?pa=0284E013

4 OECD Main Science and Technology Indicators. http://www.oecd.org/document/14/0,3343,en_21571361_33915056_39054478_1_1_1_1,00.html

Domestic business investment has only increased by 5.2% a year since 1998 and investment in machinery and equipment by only 3%.

As a result, Canada's productivity growth has been anaemic: one of the worst in the OECD and the second worst in the G-7 since 2000[5].

In other areas, the effectiveness of our tax system has worsened in recent years:



- The progressivity of our personal tax system has deteriorated for higher incomes.
- Capital gains and stock options are taxed at half the rate as wage income for no justifiable reason, making the tax system even less equitable and progressive.
- Despite escalating costs of climate change, we still don't effectively tax carbon emissions and other forms of pollution.
- An increasing number of tax exemptions, deductions, credits and other loopholes of dubious effectiveness have made the tax system more complicated, less fair and more administratively expensive. In most cases, the desired policy objectives can be much more effectively achieved by direct public spending than through tax incentives.

CUPE FEDERAL BUDGET RECOMMENDATIONS

CUPE has the following recommendations for the 2008/9 federal budget:

Early Learning and Child Care: develop a vision and plan to provide early learning and care for all Canadian children.

As a first step commit $1.2 billion for an early learning and child care program to guarantee a space in a public or non-profit program for all 3-5 year olds, growing by $1.2 billion a year until it reaches $4.8 billion. Analysis has shown that high quality public child care provides economic benefits of at last $2 for every $1 invested. In contrast, the so-called "child care benefit" costs $2.4 billion a year, but has not created a single child care space.

Post-Secondary Education: This coming year, federal transfers for post-secondary education will still be $1 billion less than they should be to restore what was cut in the early 1990s. Increased transfers need to be provided as part of a separate post-secondary transfer, together with accountability guarantees that public funds will only go to public non-profit institutions to reduce tuition costs, end the trend to privatization, increase access and improve working and studying conditions on campus.

Municipal Infrastructure: The gas tax transfer has helped municipalities contain the growing $100 billion infrastructure deficit, but it isn't reducing it. With inflation and population growth, the $2 billion transfer will lose about 23% of its value in seven years. Local governments need access to a growing source of revenues to meet their increasing responsibilities.

To regain ground lost since 1995, transfers to municipalities should be approximately $5 billion higher. Instead of reducing the GST by another percentage point – much of the past cut wasn't even passed on to consumers – these funds should be transferred to municipalities. Each dollar invested in public infrastructure provides an average of 17 cents in cost savings to businesses on top of social and environmental benefits: far more than private investments or tax cuts would generate.

P3s and Privatization: The 2007 Budget provided very little additional funding for infrastructure but at the same time forced provincial and municipal governments to consider public-private partnerships as a condition for receiving federal for large projects. It also included $1.25 billion in a Fund for P3s as a pay-off for other governments to privatize public services through P3s. Local governments and provinces should not be forced to engage in risky, expensive and accountable P3s and the P3 Fund and office should be eliminated.

Health care and pharmacare: Canada's public health care system delivers better health care at less than half the cost per person of the privatized U.S. system.

5 Growth rates for multifactor productivity, OECD Productivity Database.

Our public medicare advantage needs to be strengthened with measures to ensure that public funds go only to publicly delivered health care and not to subsidize the profits of private health care companies.

Wait lists can be shortened through investment in health human resources, primary and continuing care and through better public management. The federal government also needs to tackle the fastest growing health care expense: the escalating cost of prescription drugs.

Establishing a national pharmacare program and a national drug formulary in cooperation with the provinces would ensure that all Canadians, rich or poor, young or old, no matter where they live or work, have access to the medicine they need. Preliminary estimates are that this could cost about $2 - $3 billion a year at first, but savings would be achieved by reduced use of the $1 billion medical expense tax deduction. All Canadian businesses, big or small, would gain an additional competitive advantage.

Training, labour market development and Employment Insurance. Improvements to basic skills, literacy and workplace training would not only provide the greatest productivity payoff, but would also significantly reduce inequality and alleviate labour market pressures.

Unfortunately, Canadian companies only invest a small share of their payroll on workplace training – less than half the OECD average – and much of this goes to higher income employees. The federal government's cuts to community-based literacy, women's, culture, and aboriginal health programs and the forced closure of the Canadian labour business centre last year made the situation even worse. The federal government needs to play an increased and active role to improve workplace skills and labour force development. With few exceptions, devolution to the provinces has not worked and makes no sense as we develop an increasingly national labour market. Federal funding for literacy, training and labour market development programs must be increased, delivered through the public/non-profit system where possible. The EI system should be reformed to provide training benefits for employed and unemployed workers. The EI system also needs to be fundamentally reformed to increase benefits and coverage and to protect workers in all forms of employments.

Aboriginal Canadians and First Nations. Our inability to share the fruits of our economic growth and wealth is nowhere more apparent than with Canada's Aboriginal peoples and First Nations. Adequate, predictable and sustained funding needs to be provided, especially for health, housing, education and economic opportunity programs, both on- and off-reserve. We all suffer unless everyone, and especially Canada's first peoples, has the ability to contribute, develop and prosper.

Resources and regional development. The resource boom has generated much economic activity and many jobs in some parts of Canada.

Unfortunately, federal tax incentives and subsidies for the oil sands continue to contribute to an overheating of the Alberta economy while other regions, such as Atlantic Canada, benefit little from their offshore revenues, with few sharing in the prosperity.

The Atlantic Accords were an attempt to enable Atlantic Canadians to share more in the region's resource wealth, but the recent federal budget slammed that door of opportunity shut. Federal tax incentives, subsidies, transfers, regulations and trade agreements should be directed to activities that encourage sustainable regional economic development of our resources – and away from the unsustainable export of our unprocessed resources by foreign-owned companies.

Manufacturing and processing. While the media headlines focus on Canada's loss of corporate headquarters, the real suffering from this hollowing-out of our industrial base is felt much more on Main Street than on Bay Street. More than 250,000 decent paying jobs in manufacturing have been lost in the past five years, affecting families in communities all across Canada, but particularly in Ontario, Quebec and in regions dependent on the forest industry. The high dollar and rising interest rates are causing more unnecessary job loss in this sector. Canada's overall corporate income tax rates should not be cut and in fact could be raised. The manufacturing sector would benefit much more from targeted tax credits, differential rates and incentives for investment. But these need to be combined with a real and comprehensive action plan, sector-specific strategies, and an overall vision for Canadian industry in the 21st century. The federal government has ignored the crisis in manufacturing for far too long.

Building a Green Economy and Sustainable Future. Despite rising levels of hot air for more than a decade, the federal government has also neglected to take real action to control greenhouse gas emissions. If any progress is to be achieved, the federal government must take a leading role and not privatize the problem.

This needs to involve: developing a credible national action plan; setting an example with a large-scale program to retrofit public buildings and operations; investing in infrastructure and public transit; funding for health, social and community services to help with the impact of climate change; developing new technologies and standards; creating a Green Jobs Investment Fund and a Just Transition Fund to help industry innovate and workers adapt; improved tax incentives and subsidies; and, critically, by putting a price on carbon pollution.

The federal government needs to set a price of $30 a tonne for CO^2 emissions, with a clear commitment that the price will rise, applied through a broad-based carbon tax and/or sale of emission permits. Misdirected and ineffectual measures, such as the ethanol subsidies to turn food into fuel and the Vehicle Efficiency Incentive, should be removed.

Progressive Tax Reform: As corporate profits rise and the incomes of the affluent escalate, hard working Canadians are increasingly excluded from our nation's prosperity. Investing in an education and getting a job no longer provides enough to get ahead, especially for recent immigrants, women, aboriginal Canadians, and those from lower income families or with other disadvantages. Lower income and middle-income families will be disproportionately affected both by climate change and by measures to reduce emissions. Revenues from carbon taxes and emission permit sales will be more than sufficient to finance environmental actions to combat climate change and progressive tax reform.

CONCLUSION

Real prosperity and productivity can only be gained by improving our overall quality of life and by ensuring that all citizens have the ability and means to achieve their potential.

Quality public services contribute to this in a myriad of different ways. The main goal of a tax system is raise funds to finance these public services and this must be preserved. The federal tax system potentially raises enough to fund the quality public services that Canadians need and deserve, but improvements need to be made.

Our tax system can be improved and revenues increased by closing tax loopholes, realigning corporate taxes to encourage productive investment in the economy, putting a price on pollution and increasing equity through progressive tax reform.