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# THE Quarterly

FALL 2018

## Government Policies Hurting Entrepreneurs



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**Niels Veldhuis**  
President, Fraser Institute

**Dear Fraser Institute Friends and Supporters,**

Entrepreneurship is the heart of our economy and a driving force in our high standard of living. Entrepreneurs create new ideas, products, services, and ways of doing things more efficiently in manufacturing, mining, oil and gas, technology, social services, education, and health care, to name just a few sectors.

In every corner of the world, there are millions of hardworking, innovative, and entrepreneurial people, who, like all of us, strive for a better tomorrow. But their aspirations can only be achieved in countries with sound government policies—countries that have secure property rights, respect the rule of law, have effective limits on taxation and regulation, ensure free trade, and whose governments reduce the burdens on entrepreneurs to ensure greater economic opportunities.

This issue of the *Quarterly* highlights some important work my colleagues have done on entrepreneurship and, in particular, on policies our governments have implemented that are adversely affecting entrepreneurs.

On page 2 you can read about the Fraser Institute's new book: *Demographics and Entrepreneurship: Mitigating the Effects of an Aging Population*. We can't do much to stem the aging of our populations, but we do have a number of policy levers that can strengthen incentives for entrepreneurship and improve the likelihood of successful new business start-ups. The book was published in collaboration with the Center for Strategic and International Studies (CSIS) in the US, the Adam Smith Institute's The Entrepreneurs Network in Britain, and the Institute of Public Affairs in Australia.

On page 16, Douglas Cumming, professor of finance and entrepreneurship at York University's Schulich School of Business and Fraser Institute author, highlights that while the Trudeau government has said that it wants to support entrepreneurship in Canada, its tax policies have worked against entrepreneurs.

And on page 18, my colleagues Elmira Aliakbari and Ashley Stedman note that while the federal government is finally acknowledging Canada's competitiveness problem, it is not doing enough to keep up with sweeping policy reforms south of the border.

Of course, chasing away investment and entrepreneurs is certainly not in the best interest of Canadians and our overall economy. To help us get this message out, please pass this issue on to your friends, family, and colleagues once you are finished with it.

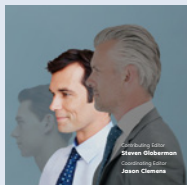
As always, thank you for your ongoing support.

Best,

A handwritten signature in blue ink, appearing to read 'Niels Veldhuis', written in a cursive style.

Niels

## New Research



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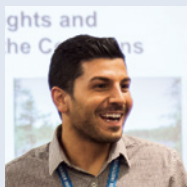
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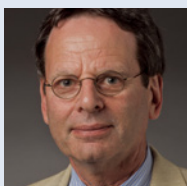
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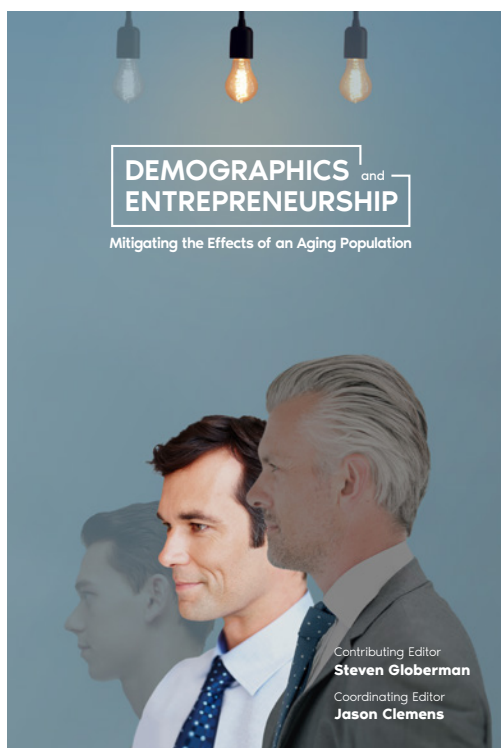


# Stemming the Demographic Tide on Entrepreneurship in Canada

Steven Globerman and Jason Clemens

**Entrepreneurship is widely acknowledged to be the basis for innovation, technological advancement, and economic progress—and subsequently, a driving force for improved living standards. Yet there’s little discussion, let alone action, among governments in Canada to stem the adverse effects of demographic change on entrepreneurship, specifically, the aging of our population.**

**M**ost Canadians are aware that our population is aging. However, it’s not generally understood that as our population ages, the share of the population best positioned to be successful entrepreneurs—individuals in their late-20s through to their early-40s—



will shrink. People in this age group drive entrepreneurship because they are both willing to take risks to start their own business and they possess real-world business experience, which increases the likelihood of success.

Consider that the share of Canadians between the ages of 30 and 39 has already declined

16.6 percent since the 1980s, and is expected to decline by another 11.4 percent by the 2040s. There has also been a corresponding decline in the rate of small business start-ups, a key measure of entrepreneurship. The rate of small business start-ups declined by 8.5 percent when comparing the six years (2001-07) before the Great Recession to the following six years (2008-14), the most recent data available.

And this is not a uniquely Canadian experience. Almost all industrialized countries have seen declines in small business start-ups. For example, the United States experienced an 18.6 percent decline over the same period outlined above, while Australia (20.3 percent) and the United Kingdom (7.5 percent) also saw declines.

It's also worth noting that the total productivity performance of many OECD countries, including Canada, has declined along with the observed fall in entrepreneurship, which highlights the far-reaching effects and implications of less entrepreneurship.

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*A number of policy levers are available to strengthen incentives for entrepreneurship and improve the likelihood of successful new business start-ups.*

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No doubt there are a host of country-specific explanations for the varying rates of decline in entrepreneurship. However, the fact that all industrialized countries are experiencing population aging—at the same time as entrepreneurship is declining—underscores the potential adverse effects of demographic changes on entrepreneurship.

While there's little that governments can do to stem the aging of populations, a number of policy levers are available to strengthen incentives for entrepreneurship and improve the likelihood of successful new business start-ups. A recent set of essays in the book *Demographics and Entrepreneurship: Mitigating the Effects of an Aging Population* by leading scholars in Canada, the United States and Europe explored possible policy reforms to promote and improve entrepreneurship.

Key among the potential policy reforms is tax relief, both in the form of reductions in marginal tax rates for individuals and businesses, and reductions (or even the elimination) of capital gains taxes. These reforms were broadly determined to strengthen the incentives for people to start and grow businesses (i.e., take risks) and expand the pool of entrepreneurial capital.

Other key potential reforms include reducing red tape to make it easier to start new businesses and grow existing ones, changes to banking and financial regulations that would make it easier for entrepreneurs to access the financial capital needed to start and grow their businesses, and policies encouraging increased immigration of individuals with skills and other attributes that make them potential entrepreneurs. Moreover, improving educational programs that help build entrepreneurial skills, and strengthening networks connecting universities to businesses and researchers in other institutions, could also increase the supply of entrepreneurial talent.

Finally, in one of the book's more provocative essays, noted economists Deirdre McCloskey and Art Carden explore the positive effects of a culture that values and promotes enterprise and entrepreneurship, as opposed to disparaging such activities. The importance of their essay cannot be overstated given the recent anti-business rhetoric in Canada and many other industrialized countries.

The various policy initiatives to encourage entrepreneurship put forth by the scholars in the essay series will apply to different countries in varying degrees. It's clear, however, that developed countries, including Canada, face a long-term decline in entrepreneurship that is at least partially driven by demographics. Since demographic trends cannot be easily reversed, countries will have to improve the environment in which entrepreneurs and businesses operate to encourage more and better entrepreneurs. [FI](#)



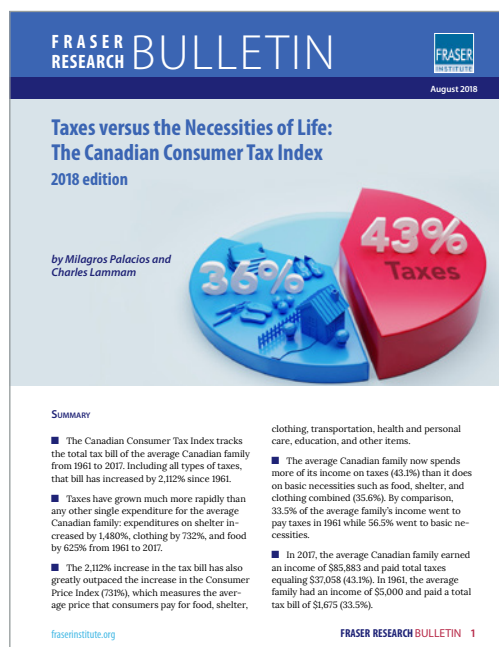
Steven Globberman is resident scholar and Addington Chair in Measurement at the Fraser Institute and Jason Clemens is executive vice-president. They are the editors of the collected essays *Demographics and Entrepreneurship: Mitigating the Effects of an Aging Population*.

# The Average Canadian Family Spends More Than \$37,000 per Year on Taxes

Milagros Palacios and Charles Lammam

Have you ever wondered what the most expensive annual budget item is for the average Canadian family? If housing is the first thing that comes to mind, then you'd be surprised to find out you're wrong. In reality, the average Canadian household spends more on taxes than any other single expense—more, in fact, than housing, food, and clothing all combined.

It's easy to be misled into thinking that the income and payroll tax deductions on our paycheques are the extent of our tax burden. But that's a mistake. To understand the full cost of taxation, you must consider all the taxes—both visible and hidden—that we pay throughout the year to federal, provincial, and municipal governments including sales taxes, property taxes, fuel taxes, carbon taxes, import taxes, alcohol taxes, and much more. All these taxes add up and make our family's total tax bill expensive.



Specifically, in 2017, the average Canadian family (including single Canadians) earned \$85,883 in income and paid \$37,058 in total taxes. That's 43.1 percent of income going to taxes.

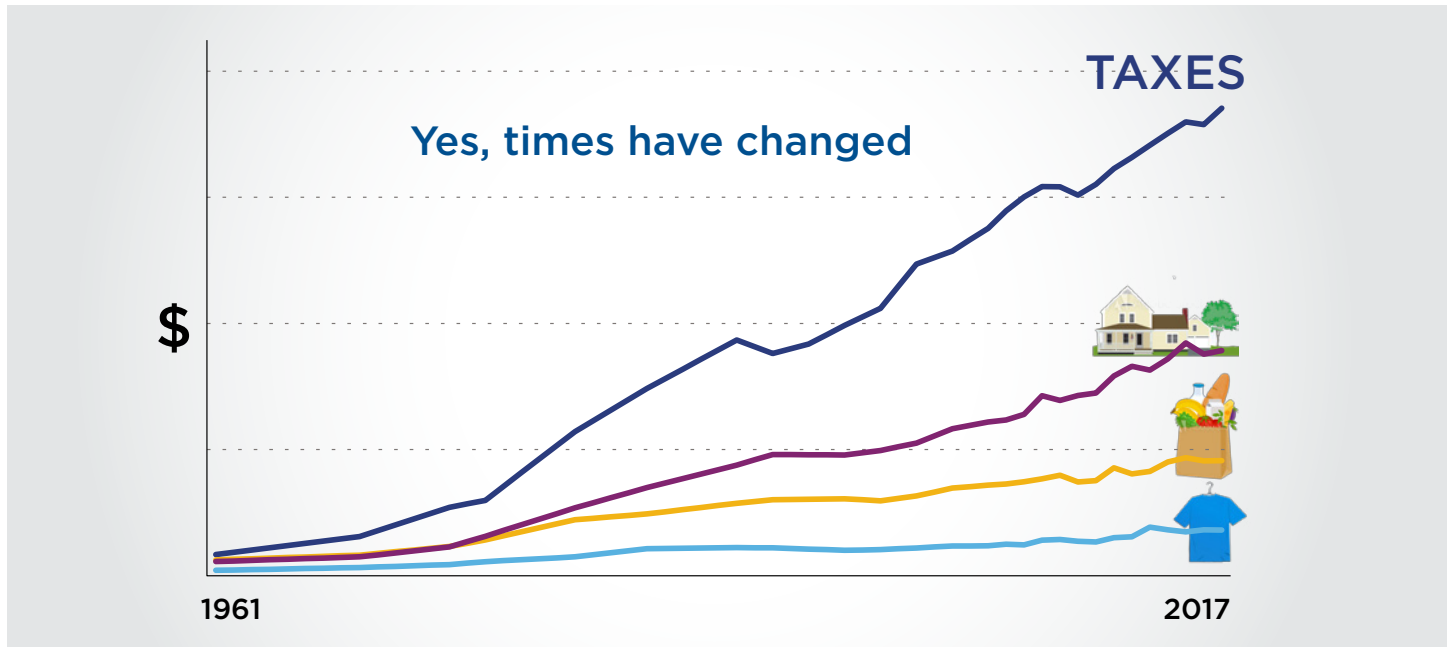
So how does the overall tax bill compare to housing costs?

Last year, the average Canadian family spent \$17,856 on housing (including rent and mortgage payments), which is the equivalent of 20.8 percent of its income. Put differently, the average family spends about half as much on housing as it spends on taxes.

In fact, taxes consume more of the average family's income than all the basic necessities of life combined. If you add up the average family's spending on housing, food, and clothing in a year, it comes to \$30,597 or 35.6 percent of their income—still quite a bit less than what we pay in taxes.

It wasn't always this way. The current situation represents a marked shift compared to 1961, the earliest year for which we have data, when the average Canadian

## TAXES AND BASIC EXPENDITURES OF THE AVERAGE CANADIAN FAMILY, 1961-2017



family spent much less on taxes (33.5 percent) than on food, clothing and housing (56.5 percent).

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*Taxes fund important government services, but we shouldn't simply assume that higher taxes always provide better government services.*

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Since 1961, the average Canadian family's total tax bill increased by 2,112 percent, dwarfing increases in annual housing costs (1,480 percent), clothing (732 percent), and food (625 percent). Even after accounting for inflation, the tax bill has still increased 166.4 percent over this period.

With 43.1 percent of income now going to taxes, Canadian families are right to wonder whether they get the best value for their tax dollars. Of course, taxes fund important government services, but we shouldn't simply assume that higher taxes always provide better government services.

While it's ultimately up to individual Canadians and their families to decide if they're getting the best bang for

their money, you must know how much you pay in total taxes to make an informed assessment.

That's where these calculations help. They give an estimate of the cost of government for the average family. Armed with this knowledge, Canadians can then determine if they think they're getting good value in return.

Bottom line—if Canadians are more informed about the true cost of government, they will be better equipped to hold government accountable for how it spends our tax dollars. And that leads to a more robust public debate about the overall tax burden and whether we're getting our money's worth. **FI**



MILAGROS PALACIOS



CHARLES LAMMAM

Milagros Palacios is associate director of the Addington Centre for Measurement and Charles Lammam is the former director of fiscal studies. They are co-authors of the Fraser Institute report, *Taxes versus the Necessities of Life: The Canadian Consumer Tax Index 2018 edition*.

# Canada Can Eliminate Supply Management by Following Australia's Lead

Jon Berry, Alan Oxley, with Dan LeRoy

**As trade tensions between Canada and the United States over NAFTA renegotiations continue, and President Trump places Canada's protection of various sectors of its agricultural industry front and centre, Canadian policymakers would be well advised to learn lessons from their Commonwealth cousins in Australia about phasing out supply management.**

Canada's policy of supply management means that Canadians pay much higher prices for staple foods such as milk, cheese, eggs, and poultry. These higher prices are enforced in two ways. First, the amount of domestic production is limited by government regulation. And second, imports face stiff penalties (tariffs), making them markedly more expensive than domestically-produced substitutes. The tariffs range from 168 percent for eggs to almost 300 percent for butter.

Crucially, the higher prices on agricultural staples disproportionately hurt lower-income families across



Canada, who spend a much higher share of their household income on food than families with higher incomes.

However, the increasing trade tension caused by Canada's supply management presents an opportunity for Canada to phase out a policy it should have eliminated years—if not decades—ago. And Australia provides a real world, working example.

In 2000, Australia dismantled agricultural subsidies that had protected the dairy industry since the 1920s. For most of the 20th century, successive governments stabilized the supply and price of milk, butter, and cheese through protectionist policies and subsidies, which, like in Canada, meant higher prices for consumers and less efficient farms.

A series of policy reforms starting in the 1980s addressed some of these issues and in 2000 the industry was deregulated. State marketing authorities, which had been responsible for setting prices and managing supply, were abolished along with the premium paid for drinking milk.



## WHAT CAN CANADA LEARN FROM AUSTRALIA'S EXPERIENCE PHASING OUT DAIRY SUPPLY MANAGEMENT?



Alongside these reforms, the Australian federal government introduced a package of measures worth more than AUD\$2 billion (paid for by a temporary levy on the reduced price of milk), to assist farmers with the transition. Put simply, the opening of the dairy market was not abrupt, but was introduced systematically over an eight-year period to allow time for farmers to make the transition.

The results of these reforms have been unambiguously positive. Consumers have benefited from lower prices for milk with prices falling by 12 cents per litre in the first six months following deregulation.

While there has been consolidation in the industry, surviving farmers have benefited from a 56 percent increase in wholesale prices for their milk. National milk supply has been maintained, and larger farms are driving much greater productivity. Exports of milk have increased as Australian dairy farmers have become more efficient and milk is now the third most important agricultural export after beef and wheat, with earnings of roughly AUD\$3 billion annually.

The key to this success was the transition period for the industry. Farmers were given only nine months advance notice of the reforms—but again, received a transition period of almost nine years. Farmers had three choices: exit, expand or make the transition. Whichever option they chose, farmers were given financial and policy support to adjust to the new policy environment.

The Australian reforms reduced consumer prices, which disproportionately benefits lower-income households, while also making the industry much more efficient and internationally competitive. Additionally, the transition period and the funding provided to many farmers, particularly those who chose to leave the industry, meant the reforms were implemented with minimum disruption.

There is a way for Canada to both resolve a major trade irritant and reform an outdated and frankly anachronistic policy that protects a small group of farmers at the expense of higher prices for staples. Australia's experience shows there's a better way forward for Canadians, including Canadian farmers. [FI](#)



JON BERRY



ALAN OXLEY



DAN LeROY

Jon Berry and Alan Oxley are trade analysts in Australia with ITS Global and authors of the recent Fraser Institute study *Phasing Out Supply Management: Lessons from Australia's Dairy Industry*. Dan LeRoy is a Fraser Institute senior fellow and an agricultural economist at the University of Lethbridge.

# Independent Schools Deliver Higher Student Test Scores at Lower Costs

Angela MacLeod



Here in British Columbia, independent schools—operating outside the public system—provide the bulk of educational choice. There are many benefits to the B.C. model of educational delivery, but they are often ignored by those who prefer less choice and advocate for a more homogenous system.

It's first important to understand that because K-12 education is a provincial responsibility, there are different delivery and financing approaches across Canada. For instance, Alberta offers considerable education choice for parents through competing public schools. Fully funded Catholic schools are available through the separate system, and religious schools (Christian, Jewish and Islamic) are also available within the public system. Alberta is also the only province to offer specialized education through charter schools,

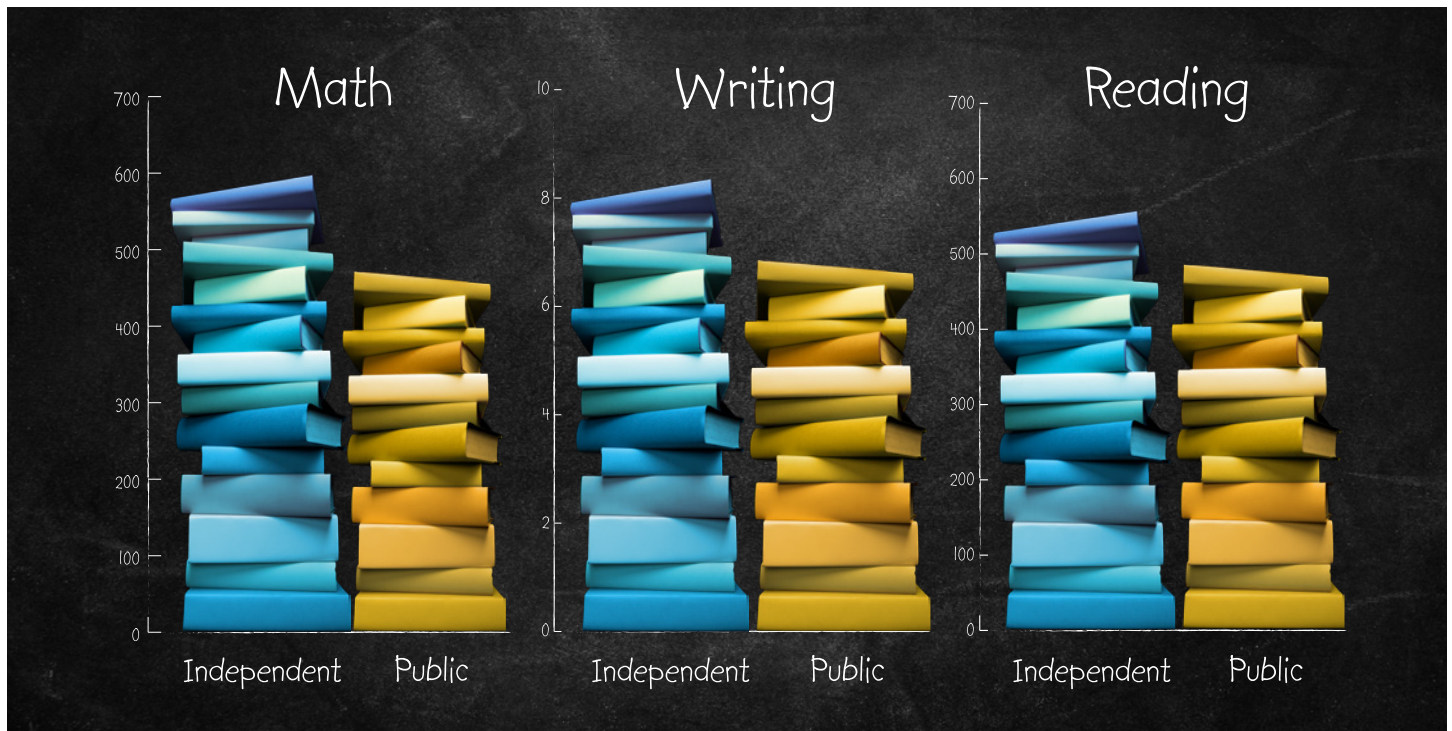
which are semi-independent schools operated within the public system. In contrast, B.C. doesn't provide any religious and almost no specialized education in the public system.

B.C. does, however, support parents who choose qualifying independent schools by

providing funding of either 35 or 50 per cent of the per-student operating amount provided to public schools. This helps keep independent schools accessible to middle- and even some lower-income families.

Indeed, a recent analysis found that the after-tax incomes of families who choose “non-elite” independent schools were essentially the same to those with children attending public schools. In 2013-14, only 8.2 per cent of B.C.'s independent schools in 2013-14 were categorized as elite, which are typically university prep schools that tend to charge significant tuition rates

## B.C.'S NON-ELITE INDEPENDENT SCHOOLS OUTPERFORM THEIR PUBLIC COUNTERPARTS ON STANDARDIZED TESTS



By contrast, non-elite independent schools in B.C. tend to offer a wider range of religious and pedagogical approaches not available in the public system. And parents are responding. In fact, roughly one-in-eight K-12 students in B.C. now attend an independent school, and the trend is increasing.

But independent schools deliver more than just diversity in K-12 education. In a new study, we examined school performance on the province's standardized tests and compared the results between public, elite and non-elite independent schools using the same approach used to compare family income levels.

In 10 of the 11 tests included in the analysis, students at non-elite independent schools outperformed their public school counterparts by a statistically significant margin including in all six Foundation Skills Assessment (FSA) tests in elementary school and all five provincial exams, though the difference for English 12 was not statistically significant.

The largest differences were in the elementary FSA, particularly for writing and numeracy. The gaps in performance were smaller, though still meaningful, for the provincial exams administered for secondary

students. (Students at elite independent schools outperformed students at both public and non-elite independent schools on all 11 exams by a statistically significant amount.)

The reality of K-12 education in B.C. is that independent schools deliver much of the choice, and parents are increasingly choosing those schools for their children's education. The results of several studies now show that those choices may be rooted in not only religious or alternative pedagogies, but also in better educational outcomes, even for families with similar income levels. [FI](#)



Angela MacLeod is a senior policy analyst at the Fraser Institute. She is a co-author of *Comparing the Standardized Test Scores of British Columbia's Public and Independent Schools*.



# Supreme Court Rejects Canada as an Economic Union

Bruce Pardy

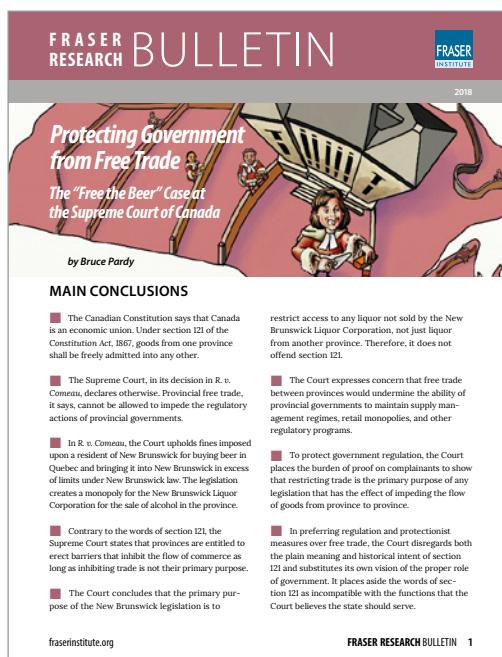
When President Donald Trump announced tariffs for Canadian steel and aluminum, Prime Minister Justin Trudeau was indignant. Trade barriers hurt everyone, he said, and imposing them on a friend is an insult. Pretty rich stuff from a country that cannot achieve free trade within its own borders. Provincial monopolies, supply management regimes and regulatory restrictions hinder the passage of goods between provinces. In the recent “free the beer” case, the Supreme Court of Canada regarded internal free trade as so dangerous that it ignored the clear words of the Constitution in order to avoid it.

In 2012, Gerald Comeau, a resident of New Brunswick, was fined for buying beer in Quebec and taking it home. A New Brunswick law gives the New Brunswick

liquor corporation a monopoly on the sale of alcohol in the province. Comeau challenged the fine by citing section 121 of the *Constitution Act, 1867*, which says that goods will be “admitted free” from any province into any other. In its decision released this April, the Supreme Court shredded section 121 and left it for dead. Instead of striking down the restrictions in the New Brunswick statute, the Court said provincial governments can impede the flow of beer and other goods for any reason at all, as long as limiting trade is not their “primary purpose”. So much for economic union. To protect government from the perils of free trade, the Court remade the Constitution, and by extension the country, by rendering plain words impotent and substituting its own preferences.

So much for the rule of law.

Canada is built to be a free trade country. There are few Constitutional provisions stated more clearly than section 121. Historical evidence confirms that its purpose





was to guarantee unrestricted passage of goods. In his oft-quoted speech of February 8, 1865, George Brown said that the idea behind Confederation was to “throw down all barriers between the provinces—to make a citizen of one, citizen of the whole.” But in Comeau, the Supreme Court feared that internal free trade threatened the modern regulatory state. If to be “admitted free” is a constitutional guarantee of free trade, the Court trembled, “the potential reach of s. 121 is vast. Agricultural supply management schemes, public health-driven prohibitions, environmental controls, and innumerable comparable regulatory measures that incidentally impede the passage of goods crossing provincial borders may be invalid.”

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*The Court has invented a variety of Constitutional rights and requirements, including a Constitutional right to strike, a Crown duty to consult Aboriginal groups, and a government obligation to maintain, once established, injection sites for illegal drugs. These features are not found in the text of the Constitution, but are products of the Court's roaming.*

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It was not the Court's finest moment. The judgment is “legally wrong, historically flawed, metaphysically rotten and destructive. It is post-truth jurisprudence” says John Robson in a *Financial Post* comment. According to Professor Malcolm Lavoie of the University of Alberta, counsel for an intervener in the case, the Court's decision “is not dictated by either the Constitution's text or its underlying principles.” Constitutional law scholar Leonid Sirota says the Court is the spoiled child of the Constitution, who throws tantrums whenever its parent does not conform to its demands. Columnist Andrew Coyne calls out the Court's “shoddy reasoning, the tendentious reading of simple declara-

tive statements, the selective approach to history, the willful naiveté... (and) the grating hypocrisy.”

The job of courts used to be to apply the law but not to make it. A judge, wrote US Supreme Court Justice Benjamin Cardozo in 1921, “is not to innovate at pleasure. He is not a knight errant, roaming at will in pursuit of his own ideal of beauty or of goodness.” The Supreme Court of Canada has for years disagreed. It has insisted that the Constitution is a “living tree,” which gives license to interpret the Constitution “in a manner that is sensitive to evolving circumstances” (translation: we'll do whatever we think is right).

The Court has done so on numerous occasions. It has invented a variety of Constitutional rights and requirements, including a Constitutional right to strike, a Crown duty to consult Aboriginal groups, and a government obligation to maintain, once established, injection sites for illegal drugs. These features are not found in the text of the Constitution, but are products of the Court's roaming. Talented at finding things that are not there, the Court showed in Comeau that it's also able and willing to ignore things that are. In preferring protectionist measures to free trade, it placed aside the words of the Constitution to protect its own vision of the proper role of government and to validate its conviction that free trade is for dummies.

Economic union? Plain meaning? Historical evidence? Original intent? Not for us, the Court sniffed. The Constitution is a “living tree,” don't you know, and we will protect government from the perils of free trade. Surely you did not expect Canada's Constitution to mean what it says. **FI**



BRUCE PARDY

Bruce Pardy is professor of law at Queen's University. He is the author of the Fraser Institute study, *Protecting Government from Free Trade: The “Free the Beer” Case at the Supreme Court of Canada.*

# Understanding the Regulatory Framework Governing Private and Public Pensions

Moin A. Yahya and Ashton Menuz

A common argument made to expand the Canada Pension Plan (CPP) is that it is cheap to administer. While many studies have cast doubt on this claim, why would a public pension plan be cheaper to administer than a private one? Many factors affect the cost of running a pension plan, but a crucial yet overlooked factor is the regulatory landscape that private pension plan.

Our study, *Understanding the Regulatory Framework Governing Private and Public Pensions*, examines the regulatory requirements among various types of public and private pension plans to determine whether private pension plans are at a cost disadvantage with respect to public ones, with a specific focus on the CPP. In short, we find that the CPP—due to its characteris-

## Understanding the Regulatory Framework Governing Private and Public Pensions

Moin A. Yahya and Ashton Menuz



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tics and legal obligations—enjoys a marked cost advantage over other pension plans.

First, consider the legal responsibilities of the various plan administrators. Broadly speaking, private pension plans are subject to a variety of statutory and common law regulations. These require the pension plan administrators to act as fiduciaries. While the administrators of the CPP are also under these requirements, as a practical matter, the CPP is seldom entangled in any lawsuits regarding

the administration and management of its assets. On the other hand, private and some public pension plans (mostly provincial) are always under threat of litigation, whether by an individual pensioner or through a class action. Although public pension plans do face litigation rarely, and usually prevail in court, the CPP is almost never sued at all. There are almost no laws allowing for private

enforcement of governance laws against the administrators of the CPP, so the CPP enjoys substantial cost savings from not having to anticipate or defend against any liabilities that may arise from bad governance, something private pension plans must account for.

Private pension plans are also subject to far more disclosure and customer-related regulations; the CPP faces no such requirements. For example, anti-money laundering laws—sometimes known as “Know Your Customer” laws— affect individual pension plans, such as RRSPs and TFSAs, and any other private pension plans that engage the use of a bank or brokerage services. While a public pension plan could be engaged by such laws, there does not seem to be any focus on such plans by enforcers of these laws.

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*There is no accountability to the employees or even employers for the management of the CPP funds.*

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Moreover, because the CPP is a federally constituted entity (legally speaking), it is not subject to any provincial regulations. Nor is it subject to the jurisdiction of any regulations by industry organizations. As a practical matter, the CPP and its administrators carry on their business without any real consciousness of legal or regulatory sanction. Private pension plans, as well as RRSPs and TFSAs, all have to pay filing and administrative fees. The CPP pays no such fees. Private plans, depending on the province, have to constantly file reports with their provincial pension superintendent. Again, the CPP does not.

Now consider differences concerning pension plan characteristics. Private and public pension plans have multiple characteristics and options for their members. For example, there are different rules governing contribution rates for each plan, and early withdrawal triggers various consequences depending on the specific pension plan. Payouts also vary depending on whether the member retires early or waits till 65. If a member leaves their employment early, they have several choices regarding whether to take the accumulated funds or not, known as the lock-in rules. Generally speaking, even if they cannot access the pension funds accumulated, they can still transfer the funds to

another plan. These possibilities create more uncertainty for the pension plan administrator. It requires more planning and safeguards, and thus costs.

In contrast, the CPP rules are quite rigid, thereby simplifying the administrative costs of running the plan. There is no ability to take the accumulated funds and transfer them to another pension plan. In contrast, RRSPs and TFSAs allow for individuals to withdraw their contributions at any time (although there may be consequences for doing so). All contributions are invested by the CPP administrator in whatever funds they choose, and, unlike an RRSP, TFSA, or even some defined contribution pension plans, individual CPP contributors have no flexibility to dictate where their funds are invested. Any actuarial surplus in the CPP fund, i.e., any excesses not needed to fund current payouts, remain with the CPP and must be invested by the CPP Investment Board.

Additionally, the number of CPP contributors is large and diverse, giving the CPP a diversified set of contributors and payees. A private pension plan may have a skewed demographic in terms of its employee age profiles, which can pose its own unique challenges which the CPP does not face.

Finally, contribution rates that employees and their employers pay are set by CPP administrators and enforced by the federal government without much choice or input from employees. Private and public pension payouts are usually set by a bargaining between employers and employees, whether it is done formally in a unionized setting or whether it is done informally in a competitive marketplace. This means there is no accountability to the employees or even employers for the management of the CPP funds. [FI](#)



MOIN A. YAHYA



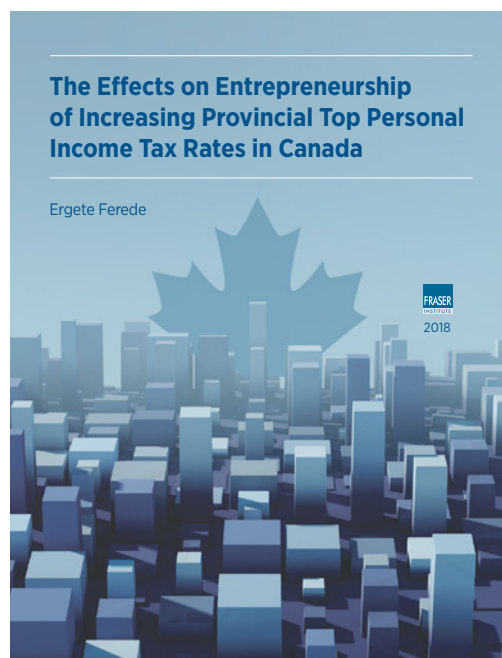
ASHTON MENUZ

Moin A. Yahya is a senior fellow with the Fraser Institute. Ashton Menuz graduated with a J.D. (with Distinction) from the University of Alberta Faculty of Law in 2017. They are co-authors of the study *Understanding the Regulatory Framework Governing Private and Public Pensions*.

# The Effects on Entrepreneurship of Increasing Provincial Top Personal Income Tax Rates in Canada

Ergete Ferede

Entrepreneurship is a crucial source of innovation, employment, and growth in an economy. Consequently, it is a recurring theme in many academic and policy debates. While there is no single, comprehensive measure of entrepreneurship, most studies and policymakers commonly use business entry-rate—defined as the number of new businesses as a ratio of total businesses—as a key indicator of entrepreneurship. In recent years, Canada's federal and some provincial governments have raised their top marginal income tax rates and increased the progressivity of the personal income tax system. Since earnings from entrepreneurship, including capital gains, are subject to the personal income tax system in Canada, the recent increases in top income tax rates have also increased the country's capital gains taxes.



Various recent government reports indicate that the Canadian business entry rate has been declining over the past three decades. This downward trend in entrepreneurship is certainly a great concern to society as business creation is often directly related to productivity and employment growth. Considering the current state of entrepreneurship, some commentators and analysts wonder whether it is possible

to increase entrepreneurship and encourage more business creation through various income tax policies. What is the impact of a progressive income tax system on entrepreneurship? Is it possible to stimulate entrepreneurship through appropriate income tax policies? Our recent study, *The Effects on Entrepreneurship of Increasing Provincial Top Personal Income Tax Rates in Canada*, seeks to answer these questions empirically using Canadian provincial data over a 30-year period.



Economic models show that the personal income tax system can influence entrepreneurship in many ways. According to one strand of the literature, higher income tax discourages entrepreneurship. This is because entrepreneurial activity is inherently risky, and entrepreneurs pay significant taxes on all their incomes (labour income, capital gains, or dividends) when they are successful. However, when they incur a loss, the tax savings are quite limited. Consequently, higher personal income tax can be viewed as a tax on “success” and may discourage entrepreneurial activity. On the other

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*The downward trend in entrepreneurship in Canada is a great concern to society as business creation is often directly related to productivity and employment growth.*

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hand, other studies argue that entrepreneurs have relatively more tax planning opportunities and the potential tax-saving benefits increase with the income tax rate. According to some of the theoretical models that emphasize this issue, higher income tax rates can encourage entrepreneurship, even if it is not productive entrepreneurship. Ultimately, the effect of income tax on entrepreneurship is an empirical question.

Previous empirical studies have examined the relationship between income tax and various measures of entrepreneurship, but the results from these studies are mixed. To shed more light on this important issue, we have investigated the effect of the top personal income tax rate on entrepreneurship using data from Canadian provinces over the period 1984–2015. In addition to the top income tax rate in each province, the empirical analysis controls for the various factors that are generally considered important determinants of entrepreneurship.

The empirical findings show that a higher provincial top income tax rate has a negative and statistically significant effect on entrepreneurship, both in the short- and long-term. The results indicate that an increase in the top marginal income tax rate discourages entrepreneurship

as measured by the business entry rate. This suggests that raising the top income tax rate exacerbates the decline in business creation. Based on the empirical results, a one percentage-point increase in the top statutory marginal income tax rate is associated with a 0.06 percentage-point decrease in the business entry rate in the short-term, and a 0.21 decrease in the long-term. Considering the long-term results, a province that raises its top personal income tax rate by one percentage point can expect to have fewer new businesses enter its economy. That drop ranges from 14 (in the case of Prince Edward Island) to 696 (in the case of Ontario). Notably, in recent years, many provinces have raised their top personal income tax rates—Alberta raised its top rate by five percentage points, Ontario raised its top rate by 3.1 percentage points, and BC raised its top rate by 2.1 points. The federal government’s recent four percentage point hike to its top rate will only serve to exacerbate the provincial increases.

Our research suggests that these increases in top personal income tax rates have resulted in a significant loss to the Canadian economy, which has been experiencing a decline in entrepreneurship for a long time. In sum, the empirical results show that an increase in the top marginal income tax rate discourages entrepreneurship as measured by the business entry rate. This finding suggests that the adverse effect of a higher personal income tax rate on risk-taking by entrepreneurs outweighs the potential tax planning opportunities entrepreneurs may have. Our study’s empirical analysis includes extensive robustness checks, which shows that in all cases, the negative effects of a higher income tax rate on entrepreneurship remain significant. The results yield an important policy implication: Canadian governments can encourage entrepreneurship with personal income tax rate cuts. [FI](#)



Ergete Ferede is associate professor of economics at MacEwan University and is author of the study, *The Effects on Entrepreneurship of Increasing Provincial Top Personal Income Tax Rates in Canada*.

# Trudeau Government can Spur Entrepreneurship with Genuine Tax Reform

Douglas Cumming



**The Trudeau government is on record saying that it wants to support entrepreneurship in Canada. It even included \$2 billion in its last budget to help female entrepreneurs.**

**But so far, the government's tax policies have worked against—not for—entrepreneurs.**

**T**he two primary forms of taxation in Canada include income taxation and capital gains taxation. These forms of taxation can influence the level and quality of entrepreneurship, and the level and quality of entre-

preneurial finance. In general, lower levels of taxation promote entrepreneurial activity because lower tax rates mean entrepreneurs keep a greater share of their profits.

However, taxation can be too low and distort the economic infrastructure and investment, which in turn hurts economic activity and the environment for entrepreneurship. To strike the right balance, governments should maintain relatively higher levels of income taxation and lower levels of capital gains taxation. This encourages more employees to engage in entrepreneurship, as the relative costs of taxation are higher by remaining an employee.

Capital gains tax relief is therefore associated with superior entrepreneurial performance, while non-performance based tax schemes such as the Labour Sponsored Venture Capital Corporations (LSVCC) program and the small business tax scheme are associated with lower-performing entrepreneurial and venture capital markets.

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*In general, lower levels of taxation promote entrepreneurial activity because lower tax rates mean entrepreneurs keep a greater share of their profits.*

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As noted in a recent Fraser Institute book chapter, “Financial Markets, Laws, and Entrepreneurship,” Canada provides the perfect lesson on failed tax policy towards entrepreneurship and entrepreneurial finance, particularly our experience with LSVCCs, which are retail venture capital funds. That is, they source capital from retail (individual) investors who have the incentive to invest due to generous tax incentives.

There are many problems with LSVCCs. For example, they compete with private venture capital funds for deal flow, they are not accountable to institutional investors demanding a significant rate of return, capital flows to LSVCCs regardless of performance (due to the tax incentive, they have so much capital, LSVCC managers have limited time to invest money contributed by retail investors), and finally, they do not have governance structures akin to private venture capitalists in the form of limited partnership covenants.

Overall, LSVCC structure, governance, due diligence, and value-added tends to be much worse than private venture capitalists.

In fact, LSVCCs are collectively negative value-added. According to the *Globe and Mail's* Globefunds, an online data provider on performance of Canadian funds, investors who put \$1 into LSVCCs in 2008 would have about \$0.50 in 2017. LSVCCs have performed worse than 30-day T-bills, with the sole exception of the Internet bubble

in the late-1990s. The absence of economic returns to LSVCCs highlights their direct cost. Some commentators apologize or excuse their poor performance by claiming that LSVCCs create jobs. However, the absence of the economic rate of return clearly shows that any job created is not sustainable in the long run in the absence of the LSVCC tax subsidy.

Ontario announced the phase-out of the LSVCC tax credit in 2005, which became effective in 2011. The Harper government tried to phase-out the LSVCC tax credit in 2011. However, Liberal federal election campaign promises in 2016 included a promise to reinstate the federal LSVCC tax credit. This election promise underscores the strong ties between Quebec politicians and LSVCCs. The Solidarity Fund is the largest and oldest LSVCC in Canada, manages more than \$10 billion in capital, and is very influential in Quebec economics and politics. The Liberal reinstatement of the LSVCC tax credit has taken effect, highlighting the difficulty of removing legislation that inflicts capital losses on particular segments of society.

Finally, Canadian small business tax rates allow a reduced corporate tax for firms with revenues less than \$500,000. Rates in Canada have been lowered in recent years, as promised by the Trudeau Liberals during the 2016 election. These policies are widely recognized in policy and empirical studies worldwide to encourage small firms to stay small and do little to promote scale-up and growth.

Again, tax policy has the potential to do tremendous good for entrepreneurship. However, it can also cause serious harm. Tax policies should be structured to strengthen incentives. Otherwise, if tax policies are distortionary and provide relief in the absence of strengthening incentives, they can cause more problems and even undermine their legislative intent, as we've seen in Canada. [FI](#)



Douglas Cumming is a professor of finance and entrepreneurship at York University and is co-author of the recent Fraser Institute book on entrepreneurship, *Demographics and Entrepreneurship: Mitigating the Effects of an Aging Population*.



# Canada's Competitiveness Problems Go Beyond Carbon Tax

Elmira Aliakbari, Ashley Stedman, and Niels Veldhuis



The federal government's recent move to ease its carbon tax regime for big emitters is promising—the government is finally acknowledging Canada's competitiveness problem. However, these recent changes are not enough to keep up with sweeping policy reforms south of the border. Washington has eschewed carbon pricing and implemented investment-friendly policies while Ottawa adds costs and regula-

tions, likely chasing away investment dollars in many key industries.

Initially, the government proposed taxing companies for emissions exceeding 70 percent of the average pollution intensity (amount of pollution generated per unit of activity) for any given industrial sector (cement, for example). Under the new changes, the tax only applies to emissions that exceed 80 percent of the average for any industrial sector and 90 percent in a



small number of sectors (iron and steel manufacturing, for example).

Simply put, the government is lowering the percentage of emissions it will tax large emitters, and offering larger exemptions for energy-intensive companies due to competitiveness concerns. Crucially, however, these changes don't reduce the rate of the carbon tax—rather, they just increase the carve-outs for specific industries.

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*Recent adjustments to the federal government's carbon tax system will not solve Canada's competitiveness concerns. Now that Ottawa has acknowledged we have a competitiveness problem, it should take action and enact comprehensive tax and regulatory reforms to make our investment climate more attractive.*

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While Ottawa's latest move addresses some competitiveness concerns for select industries, it's not nearly enough, particularly given that our largest competitor for business investment and entrepreneurs, the United States, has rejected a national carbon tax.

The Trump administration has also enacted sweeping business tax reforms and reduced personal income tax rates while Canadian governments moved in the opposite direction. Most Canadian provinces and the federal government have increased personal income tax rates on professionals, entrepreneurs, and business owners. The top personal income tax rate now exceeds 50 percent in seven provinces, with the remaining three provinces within a hair of 50 percent.

On the regulation and red tape front, Washington has rescinded or scaled back many regulations that impeded resource development. For example, it's eased vehicle emissions standards, rolled back controls on power-

plant emissions, and repealed a regulation on hydraulic fracturing (or fracking) on federal lands.

Meanwhile, our federal government adds more red tape and makes its regulatory processes for the approval of major energy projects more complex and uncertain, which will further discourage investment in Canada. In particular, Bill C-69, currently under House of Commons review, includes a large number of subjective criteria—namely, the social impact of energy investment and its “gender” implications—which most observers conclude will increase uncertainty and further politicize the regulatory process.

But don't take our word for it. Look at the data.

Foreign direct investment (FDI) in Canada was \$31.5 billion in 2017, down 56.0 percent since 2013 when it totalled \$71.5 billion. And since 2014, total business investment (adjusted for inflation and excluding residential housing) has declined by almost 17 percent. Moreover, as shown in a recent Fraser Institute analysis of business investment within industrialized countries, *Business Investment in Canada Falls Far Behind Other Industrialized Countries*, Canada ranks second last among 17 advanced countries for its level of business investment.

Again, recent adjustments to the federal government's carbon tax system will not solve Canada's competitiveness concerns. Now that Ottawa has acknowledged we have a competitiveness problem, it should take action and enact comprehensive tax and regulatory reforms to make our investment climate more attractive—for the benefit of Canadians and our overall economy. [FI](#)



ELMIRA ALIAKBARI



ASHLEY STEDMAN



NIELS VELDHUIS

Elmira Aliakbari is associate director of natural resource studies, Ashley Stedman is senior policy analyst, and Niels Veldhuis is president of the Fraser Institute.



**One of the most important numbers in the world goes by the catchy title of Equilibrium Climate Sensitivity, or ECS. It's a measure of how much the climate responds to greenhouse gases. More formally, it is defined as the increase, in degrees Celsius, of average temperatures around the world, after doubling the amount of carbon dioxide in the atmosphere and allowing the atmosphere and the oceans to adjust fully to the change. The reason it's important is that it's the ultimate justification for governmental policies to fight climate change.**

**T**he United Nations Intergovernmental Panel on Climate Change (IPCC) says ECS is likely between 1.5 and 4.5 degrees Celsius, but it can't be more precise than that. Which is too bad, because an enormous amount of public policy depends on its value. People who study the impacts of global warming have found that if ECS is low—say, less than two—then the impacts of global warming on the economy will be mostly small and, in many places, mildly beneficial. If it is very low, for instance around one, it means greenhouse gas emissions are simply not worth doing anything about. But if ECS is high—say, around

four degrees or more—then climate change is probably a big problem. We may not be able to stop it, but we'd better get ready to adapt to it.

So, somebody, somewhere, ought to measure ECS. As it turns out, a lot of people have been trying, and what they have found has enormous policy implications.

To understand why, we first need to delve into the methodology a bit. There are two ways scientists try to estimate ECS. The first is to use a climate model, double the modeled CO<sub>2</sub> concentration from the pre-industrial level, and let it run until temperatures stabilize a few hundred years into the future. This approach, called the model-based method, depends for its accuracy on the validity of the climate model, and since models differ quite a bit from one another, it yields a wide range of possible answers. A well-known statistical distribution derived from modeling studies summarizes the uncertainties in this method. It shows that ECS is probably between 2.0 and 4.5 degrees, possibly as low as 1.5 but not lower, and possibly as high as 9.0 degrees. This range of potential warming is very influential on economic analyses of the costs of climate change.

The second method is to use long-term historical data on temperatures, solar activity, carbon-dioxide emissions, and atmospheric chemistry to estimate ECS using a simple statistical model derived by applying the law of conservation of energy to the planetary atmosphere. This is called the Energy Balance method. It relies on some extrapolation to satisfy the definition of ECS but has the advantage of taking account of the available data showing how the actual atmosphere has behaved over the past 150 years.

The surprising thing is that the Energy Balance estimates are very low compared to model-based estimates. The two methods give differing answers, and the question of which one is more accurate is important.

Climate modellers have put forward two explanations for the discrepancy. One is called the “emergent constraint” approach. The idea is that models yield a range of ECS values, and while we can’t measure ECS directly, the models also yield estimates of a lot of other things that we can measure (such as the reflectivity of cloud tops), so we could compare those other measures to the data, and when we do, sometimes the models with high ECS values also yield measures of secondary things that fit the data better than models with low ECS values.

This argument has been a bit of a tough sell, since the correlations involved are often weak, and it doesn’t explain why the Energy Balance results are so low.

The second approach is based on so-called “forcing efficacies,” which is the concept that climate forcings, such as greenhouse gases and aerosol pollutants, differ in their effectiveness over time and space, and if these variations are taken into account the Energy Balance sensitivity estimates may come out higher. This, too, has been a controversial suggestion.

A recent Energy Balance ECS estimate was just published in the *Journal of Climate* by Nicholas Lewis and Judith Curry. There are several features that make their study especially valuable. First, they rely on IPCC estimates of greenhouse gases, solar changes, and other climate forcings, so they can’t be accused of putting a finger on the scale in their choice of data. Second, they take into account the efficacy issue and discuss it at length. They also take into account recent debates about how surface temperatures should or shouldn’t be measured, and how to deal with areas like the Arctic where data

are sparse. Third, they compute their estimates over a variety of start and end dates to check that their ECS estimate is not dependent on the relative warming hiatus of the past two decades.

Their ECS estimate is 1.5 degrees, with a probability range between 1.05 and 2.45 degrees. If the study was a one-time outlier we might be able to ignore it. But it is part of a long list of studies from independent teams, using a variety of methods that take account of critical challenges, all of which conclude that climate models exhibit too much sensitivity to greenhouse gases.

Policymakers should pay attention, because this debate directly affects the carbon-tax discussion.

The Environmental Protection Agency uses social cost of carbon models that rely on the model-based ECS estimates. Last year, two colleagues and I published a study in which we took an earlier Lewis and Curry ECS estimate and plugged it into two of those models. The result was that the estimated economic damages of greenhouse gas emissions fell by between 40 and 80 percent, and in the case of one model the damages had a 40 percent probability of being negative for the next few decades—that is, they would be beneficial changes. The new Lewis and Curry ECS estimate is even lower than their old one, so if we re-did the same study we would find even lower social costs of carbon.

If ECS is as low as the Energy Balance literature suggests, it means that the climate models we have been using for decades run too hot and need to be revised. It also means that greenhouse gas emissions do not have as big an impact on the climate as has been claimed, and the case for costly policy measures to reduce carbon dioxide emissions is much weaker than governments have told us. For a science that was supposedly “settled” back in the early 1990s, we sure have a lot left to learn. [FI](#)

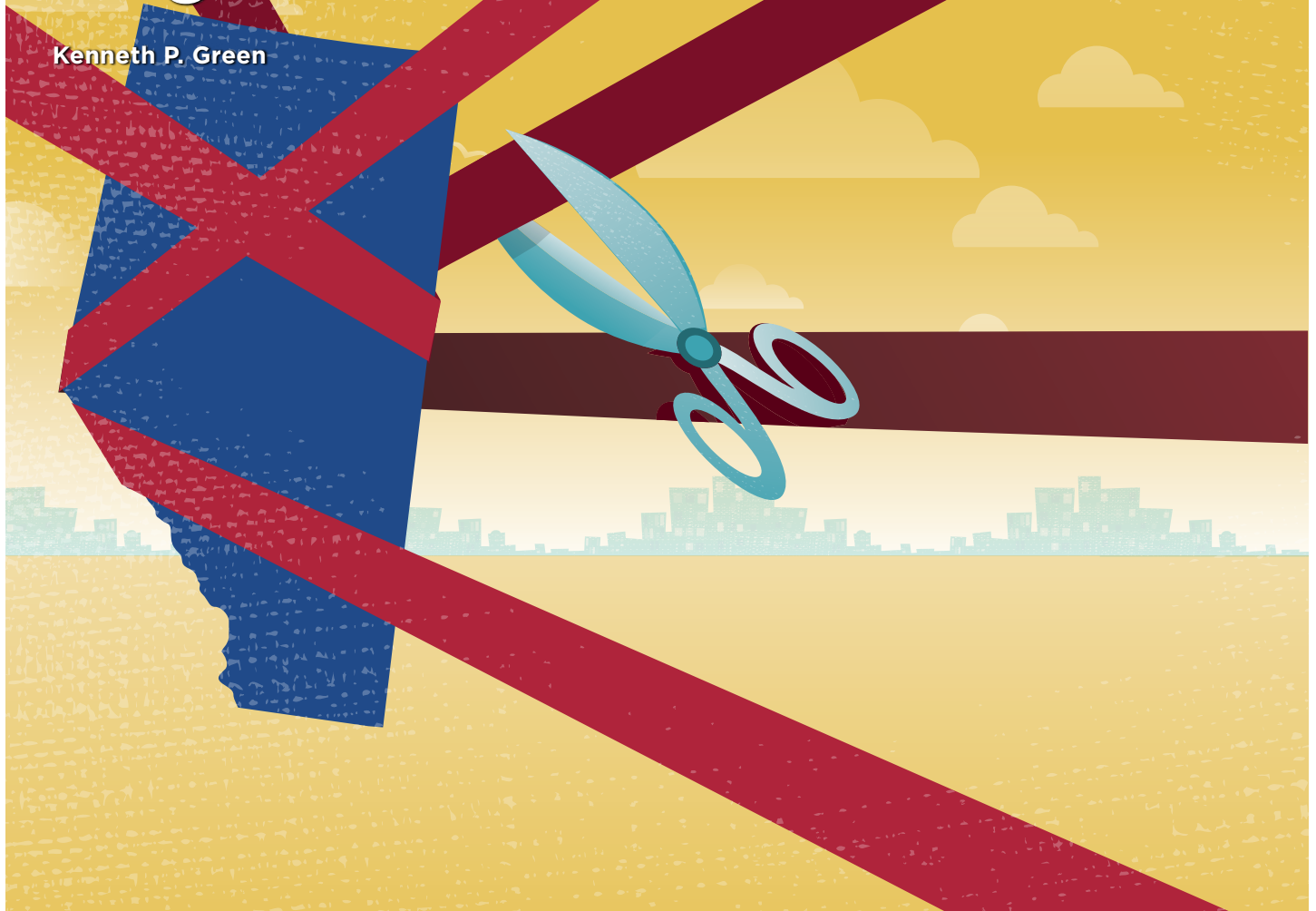


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# Time to Roll Back the NDP's Onerous Energy Regulations

Kenneth P. Green



Recently in Ontario, Premier Doug Ford summarily scrapped Ontario's cap-and-trade program, which would have burdened Ontario companies with costly carbon accounting and sent millions of Ontario's dollars to California to buy carbon credits. Since 2017, Ontarians paid nearly \$2 billion annually as the cost of cap-and-trade was passed onto consumers. More-

over, Ontario will cancel some 758 contracts for renewable power, saving the province another \$790 million while helping reduce power prices for Ontarians.

**B**esides partying at Stampede and doing aerial acrobatics, what has Premier Rachel Notley done to increase investment attractiveness in Alberta?



Let's review. Since coming to office, she raised corporate income taxes to 12 percent from 10 percent—a hike of about 20 percent. And she's discouraged wealthier folks, who might live and invest here, by killing Alberta's highly attractive flat income tax rate. Due to this tax hike, which went from 10 percent up to 15 percent for high earners, Albertans who earn more than \$300,000 per year saw their taxes rise 50 percent.

The NDP government has also stacked a daunting pile of regulatory bricks onto the back of a prostrate industry when it was reeling from a massive drop in oil prices. While Canada's energy sector was down, it was hit with Premier Notley's Climate Leadership Plan, which expanded and increased Alberta's carbon tax

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*Alberta's NDP government has stacked a daunting pile of regulatory bricks onto the back of a prostrate industry when it was reeling from a massive drop in oil prices.*

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to \$30/tonne of emissions, and will ostensibly follow the Trudeau government's federal plan to raise the tax to \$50/tonne by 2022, as her contingent condition of getting a pipeline built was satisfied by Ottawa's purchase of the Kinder Morgan Trans Mountain expansion project.

In addition to the tax hikes, the government put a hard cap on the emissions of greenhouse gases from the oil sands, limiting them to 100 megatonnes per year, a constraint which could start to bite in the mid-2020s, threatening the viability of long-term projects and costing the economy billions in lost production.

Alberta's Climate Leadership Plan also includes a commitment to phase out coal-generated electricity by 2030, triple renewable energy to supply 30 percent of generation by 2030, further reduce methane emissions from the oil and gas sector, and create a new agency to spend Alberta's carbon tax revenues on energy-

efficiency programs which, according to the study *Canada's Climate Action Plans: Are They Cost-effective?* have a very poor record of success. These are the kinds of policies that drove up energy prices in Ontario and drove investment and jobs out of the province.

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*As Ontario steps back from cap-and-trade and wind and solar power, Alberta forges ahead with burdensome regulations, renewable energy subsidies, and higher taxes.*

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Simply put, as Ontario steps back from cap-and-trade and wind and solar power, Alberta forges ahead with burdensome regulations, renewable energy subsidies, and higher taxes. And all of this after the spectacular failure of Premier Notley's "social license" dream that was never going to be granted by environmentalists. Instead, we now have a precedent that, if pipelines are to be built, the government must fund them or indemnify them with Alberta's and Canada's tax dollars.

If the premier is serious about rebuilding Alberta's oil and gas sector, she should get off the Stampede zip-line and start removing the bricks she put on the back of Alberta's energy economy, to make Alberta a profitable place to invest with a more predictable and affordable regulatory system. [FI](#)



Kenneth P. Green is a resident scholar and chair in energy and environmental studies at the Fraser Institute. He is the author of *Canada's Climate Action Plans: Are They Cost-effective?* and co-author of *How Alberta's Carbon Emission Cap Will Reduce Oil Sands Growth*.

# Referendum May Grant More Power to BC Politicians and Bureaucrats

Lydia Miljan

**This fall, British Columbians will vote in a referendum on what voting system they prefer for provincial elections. The mail-in ballot will give voters two choices—they can opt for BC’s current “first-past-the-post” (FPTP) system or “proportional representation.”**

If voters choose proportional representation (or PR) on the ballot, they then answer a secondary question, which asks them to indicate what type of proportional representation system they favour if PR is adopted. Legislators will use the results as a guide as they design a PR system. Put differently, voters will not select a specific PR alternative, but rather will give general direction, leaving politicians (and bureaucrats) to fill in the details.

The three PR reform options include Dual Member Proportional (DMP), Mixed Member Proportional (MMP) and Rural-Urban Proportional (RUP). Critically, of these three options, only one—MMP—has been used in practice. Clearly, the BC public needs more information before it can sensibly choose the best voting system for the province. We have summarized the proposed electoral systems in our study *Proportional Representation in Practice: An International Comparison of Ballots and Voting Rules*.

## DUAL MEMBER PROPORTIONAL (DMP)

Under DMP, BC’s electoral map will be redrawn. Several constituencies will be amalgamated into two-member districts, although some large rural ridings will remain unchanged. Decisions on redistricting will be made after the referendum. In DMP, parties will be able to nominate up to two candidates per electoral district in the dual ridings. Voters cast a single vote for a pair of candidates.

Seats are allocated in three ways to give an overall result that is “proportional” province-wide. Crucially, while voters will have a theoretical notion of how this system works, there are no international examples that voters can look to to judge its efficacy. Numerous decisions on the system’s use and proportionality will be made after the vote. Unknowns include the total number of MLAs and the ballot design. Simply put, this electoral system is largely theoretical with many ambiguous characteristics.

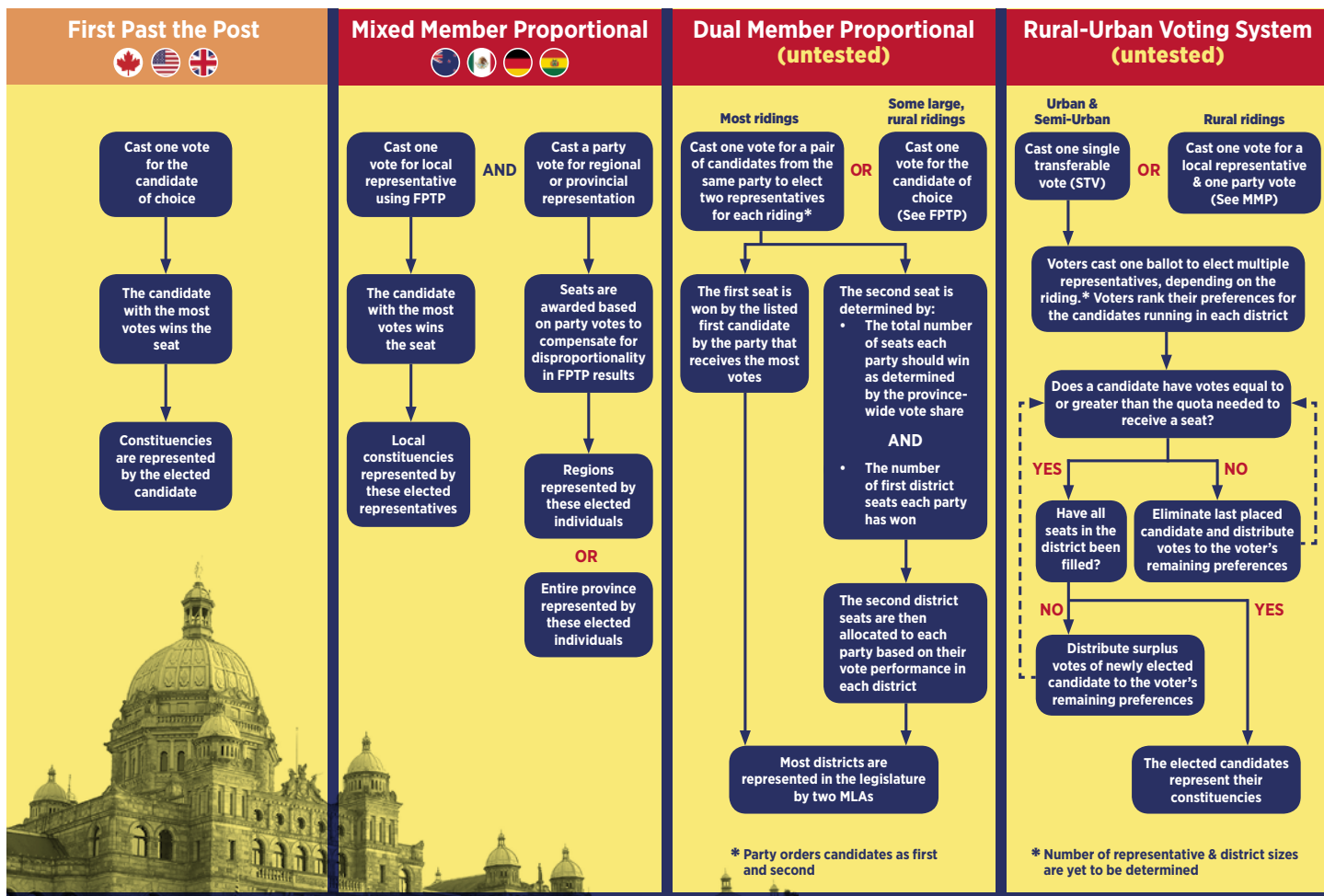
## MIXED MEMBER PROPORTIONAL (MMP)

Mixed electoral systems use both PR and majoritarian or plurality (like BC’s current first-past-the-post system) electoral rules to translate votes into seats. Often a certain proportion of seats in the legislature is awarded using plurality electoral rules, while the remaining seats are awarded using PR.

Four major democracies currently use this system—New Zealand, Bolivia, Germany, and Mexico. For BC, the MMP model recommended by Attorney General David Eby argues that our current first-past-the-post system be used to allocate 60 percent of the legislature, while 40 percent be “elected directly or allocated from the parties’ lists of candidates to compensate for any disproportional results for the FPTP vote.”

Voters will not know before the referendum how many MLAs the province will have under this system, whether voters will have one vote or two (one for the candidate and one for list), whether candidates can be placed on the party list and the local constituency, etc. In other words, while this system is used in other countries comparable to Canada, many influential details remain undetermined.

## A COMPARISON BETWEEN BC'S CURRENT VOTING SYSTEM AND PROPOSED PROPORTIONAL REPRESENTATION MODELS



### RURAL-URBAN PROPORTIONAL (RUP)

RUP voting uses a single transferable vote (STV) in urban and semi-urban areas (a system that enables voters to rank candidates from different parties, but also candidates from the same party), and mixed member proportional (MMP) in rural areas. This system is said to provide less regional proportionality but better local representation in rural areas, and greater opportunities for independent and smaller parties to get elected. However, it is the most complicated of the proposed systems because two voting systems run simultaneously.

RUP has similar unknowns as MMP and DMP, including the number and size of the electoral districts and the ratio of FPTP seats to list PR seats in MMP regions. These unknowns have the potential to have a profound impact on the outcome of any election.

Clearly, given the scant information provided to the public on the details of the systems they are voting for,

even if the referendum this fall produces a consensus that BC voters want a change to PR, they have no way of knowing exactly which PR system they'll end up using. Instead, the electorate risks empowering politicians to make discretionary decisions regarding election rules that could directly benefit them and their party—but not necessarily democracy. [FI](#)



LYDIA MILJAN

Lydia Miljan is an associate professor of political science at the University of Windsor, a senior fellow at the Fraser Institute, editor of last year's collected essays on federal reform, and contributing editor to the BC electoral reform series.

# Ontario Should Get Serious About It's Deficit

Ben Eisen



**Ontario's long string of operating deficits and resulting run-up in government debt (projected to hit \$325 billion this year) raises a \$325 billion question: How will Premier Doug Ford's new government tackle the province's fiscal woes, which have weighed heavily around the necks of Ontarians?**

**F**irst, let's review the situation. At the end of this year, Ontario will have run 10 operating deficits in 11 years. Because operating deficits largely exclude spending on long-term capital projects (roads, bridges, etc.), they're

a useful measure of whether or not the government is paying "day to day" bills in any given year with money coming in that year.

So why have Ontario's deficits lasted so long? To answer this, we must look at the previous Liberal government's deficit-reduction strategy following the 2008/09 recession.

Despite the big deficit and the rapid run-up in spending during the recession, the Liberal government under Dalton McGuinty (and later under Kathleen Wynne) refused to reduce spending to deal with the issue in a timely manner.



Instead, the government continued to increase spending—crucially, at a slower rate than the growth in revenue. The hope was that revenue would catch up to expenditures and the deficit would slowly shrink.

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*By choosing to shrink the deficit slowly, the government remained in the red year after year for a long time, adding to the provincial debt. Yes, from 2009/10 to 2016/17, the annual deficit got smaller most years. But the government still spent more than it took in, so the debt kept growing.*

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Ontarians are still paying for this strategy today. By choosing to shrink the deficit slowly, the government remained in the red year after year for a long time, adding to the provincial debt. Yes, from 2009/10 to 2016/17, the annual deficit got smaller most years. But the government still spent more than it took in, so the debt kept growing.

Moreover, these operating deficits were often accompanied by additional new debt for capital projects, accelerating annual debt growth. That's partly why the province's net debt soared from \$194 billion in 2009/10 (the year the deficit peaked) to \$308 billion the year the deficit was finally (briefly) eliminated in 2017/18.

And even in 2017/18, when the Wynne government claimed balance, independent analysts (including the province's own Financial Accountability Office) called those balanced budget claims into question.

Clearly, Ontario can't afford another slow ambling walk towards a balanced budget—as we have seen, the cost of debt accumulation is high.

Now, here we are again, but this time Doug Ford's Ontario PC government faces a budget deficit (thanks primarily to a big burst in government spending during the final two years of the last government), raising important questions about how to shrink it.

If the Ford government wants to get Ontario's fiscal house in order, reduce the amount of government debt interest paid by Ontario taxpayers, and make room for badly needed tax relief, a budget plan that calls for another string of deficits should be a non-starter. According to Canadian history, successful deficit-elimination efforts often move much faster than that.

Premier Ford and his cabinet should view rapid deficit-elimination as a priority while recognizing it may well require nominal spending reductions—not just a slowdown in the rate of spending growth—to achieve this goal.

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*The old maxim “slow and steady wins the race” does not apply to deficit reduction. If the Ford government is serious about repairing Ontario's finances, history suggests it must come out of the blocks running.*

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The old maxim “slow and steady wins the race” does not apply to deficit reduction. If the Ford government is serious about repairing Ontario's finances, history suggests it must come out of the blocks running. [!\[\]\(cf531ed27e91483460120fcc057b3901\_img.jpg\)](#)



Ben Eisen is a senior fellow with the Fraser Institute's Ontario Prosperity Initiative. He is co-author of the recent study *Restoring Ontario's Public Finances*.

# Incentives Matter for a Better Economy for Canadians

Jason Clemens, Elmira Aliakbari, and Ashley Stedman



**There have been many assessments, mostly critical, of the federal government's decision to purchase the Trans Mountain pipeline. And yet, a key aspect of the decision—this government's dismissive view of the role and importance of incentives—has been almost entirely ignored. Put simply, the federal government doesn't believe incentives matter all that much in the economic decision-making of individuals, families, entrepreneurs, and businesses.**

**F**inance Minister Bill Morneau announced the government's decision to buy the pipeline in a press

briefing on May 29, two days before Kinder Morgan's self-imposed May 31 deadline. In that briefing, the minister revealed the government's confidence in the public sector to undertake and complete activities as well, if not better, than the private sector. For example, while avoiding the specific question of how much the government expects to pay for the construction and ongoing operation of the pipeline, Morneau repeatedly assured Canadians that the value of the pipeline would be secured.

This assertion belies Canada's own experience—and international research. For example, Oxford University scholar Bent Flyvbjerg co-authored a study examining major government projects in 20 countries and found

that nine out of 10 public infrastructure projects incurred cost overruns. Flyvbjerg concluded that large projects done in the public sector are inefficient in minimizing costs. His findings support a large review from the OECD completed in the early 2000s on the benefits of transferring publicly-owned assets to the private sector.

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*The federal government doesn't believe incentives matter all that much in the economic decision-making of individuals, families, entrepreneurs, and businesses.*

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That's not to say the public sector is not staffed by well-intentioned, skilled bureaucrats. Indeed, Canada can be quite proud of having one of the best, most professional bureaucracies in the industrialized world.

The problem, however—and what the federal government seems oblivious to—is that government bureaucrats face markedly different incentives than do people in the private sector. If Kinder Morgan (or any private company) goes over budget on infrastructure projects, it's their owners and employees who pay the price through lower rates of return, lower share prices, and/or reduced compensation. In other words, the costs of missteps are borne directly by those responsible, which imposes real discipline on their financial and economic decisions.

This discipline is wholly absent in the public sector. If the construction of the pipeline is over budget, or if it sells in the future at a price below market, no politician or bureaucrat will lose their own money. It's a basic axiom in economics that people are far more careful with their own money than with other people's money.

Unfortunately, this federal government's misunderstanding of the role and importance of incentives is not limited to differences between the government sector and private businesses. Since coming to office, it has introduced a number of policies it believed would not

adversely affect the economy because the incentive effects were weak or non-existent.

For instance, the federal income tax increase, which affects entrepreneurs, professionals, and business owners, combined with similar policies implemented by many provinces, means that the top combined income tax rate now exceeds 50 percent in seven provinces with the remaining provinces just below 50 percent. And because Canada's capital gains tax is linked to personal income taxes, these rate changes have also increased our capital gains taxes. In other words, Ottawa doesn't believe that a tax rate near or above 50 percent changes the willingness of entrepreneurs, professionals, or business people to invest and start businesses.

Moreover, these tax changes are on top of other tax increases, new regulations, and a distinctly anti-business rhetoric from Ottawa and several provincial capitals. These policies—and the incentive changes they produce—have had adverse consequences for the economy. There's a general consensus, including in the federal department of finance, that economic growth will slow starting this year and continuing into the future. In addition, rates of entrepreneurship are declining, and investment, particularly by foreigners, is collapsing. This is not the basis for long-term prosperity.

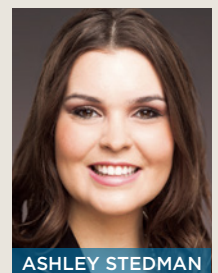
The foundation for a better economy and higher living standards relies on improving incentives for entrepreneurship, investment and work effort. That would require a wholesale reversal of many, if not most, of the economic policies enacted by this federal government and a recognition that incentives do indeed matter. **FI**



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Jason Clemens is executive vice-president, Elmira Aliakbari is associate director, natural resource studies, and Ashley Stedman is a senior policy analyst with the Fraser Institute.



Tawni Hunt Ferrarini gets the journalists engaged in a simulation that highlights the importance of private property rights.

**We recently completed the 2017-2018 series of education events by hosting three programs for journalists and a colloquium for university students.**

**B**uilding on the success of *Economics for Journalists*, of which we held two programs this May, we introduced an additional, advanced program called *Policy for Journalists*. This graduate-style seminar teaches journalists how to use an economic lens to analyze critical Canadian and global public policy issues. All told, in 2018 the journalism programs gave 74 journalists a better understanding of the economic way of thinking. In turn, those journalists reach millions of Canadians with their reporting and analysis.

An attendee from Edmonton commented on the new policy program: “It was an excellent session. My brain is still digesting so much information relevant to our jobs as commentators. I particularly enjoyed the talks on

Canadian energy, health, debt ‘management,’ housing, and the definition of poverty policies. I have no doubt that the arguments and reasoning presented will work their way into my on-going commentary...”

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*“It was a really worthwhile experience and I’ve recommended it to many other journalists”*

BRITISH COLUMBIA JOURNALIST

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*“I cannot stop talking about how amazing the program was. For the first time this week I was able to explain what economics is.”*

MANITOBA JOURNALIST

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Journalism participants engaging with our presenter, Tawni Hunt Ferrarini after a lively educational activity.



## STUDENT LEADERS COLLOQUIUM

Twenty outstanding undergraduate and graduate students identified at our student seminars were chosen to attend this expenses-paid three-day program held at the Fraser Institute's headquarters in Vancouver from June 13th to 15th.

The participants represented a variety of academic interests and educational institutions across Canada and were chosen for their potential to become future leaders.



Under the guidance of Institute research staff, these future decisionmakers and opinion leaders engaged in animated discussions and debated complex economic policy issues ranging from energy and human prosperity to housing and markets.

Planning is already well under way for an exciting schedule of events for the 2018/2019 year. [FI](#)

## STUDENT LEADERS COLLOQUIUM



Learn more: [fraserinstitute.org/education-programs/pmc/students](https://fraserinstitute.org/education-programs/pmc/students)

Peter Munk Centre for  
FREE ENTERPRISE EDUCATION





## Steven Globerman

### **Professor Emeritus Steven Globerman Appointed Addington Chair at the Fraser Institute**

The Fraser Institute is pleased to announce that Steven Globerman, Professor Emeritus of Economics at Western Washington University, has been appointed the Addington Chair in Measurement effective July 1, 2018. In addition to assuming the Addington Chair, Professor Globerman will also become a resident scholar at the Institute, in which capacity he will spend a significant amount of time in our offices interacting, mentoring, and assisting our team.

Professor Globerman has had an exemplary academic career with postings at York University, Simon Fraser University, the University of British Columbia, Copenhagen School of Business, and the Helsinki School of Economics. He has written more than 150 academic articles and monographs. He served as a researcher for two Canadian Royal Commissions as well as a research advisor to Investment Canada.

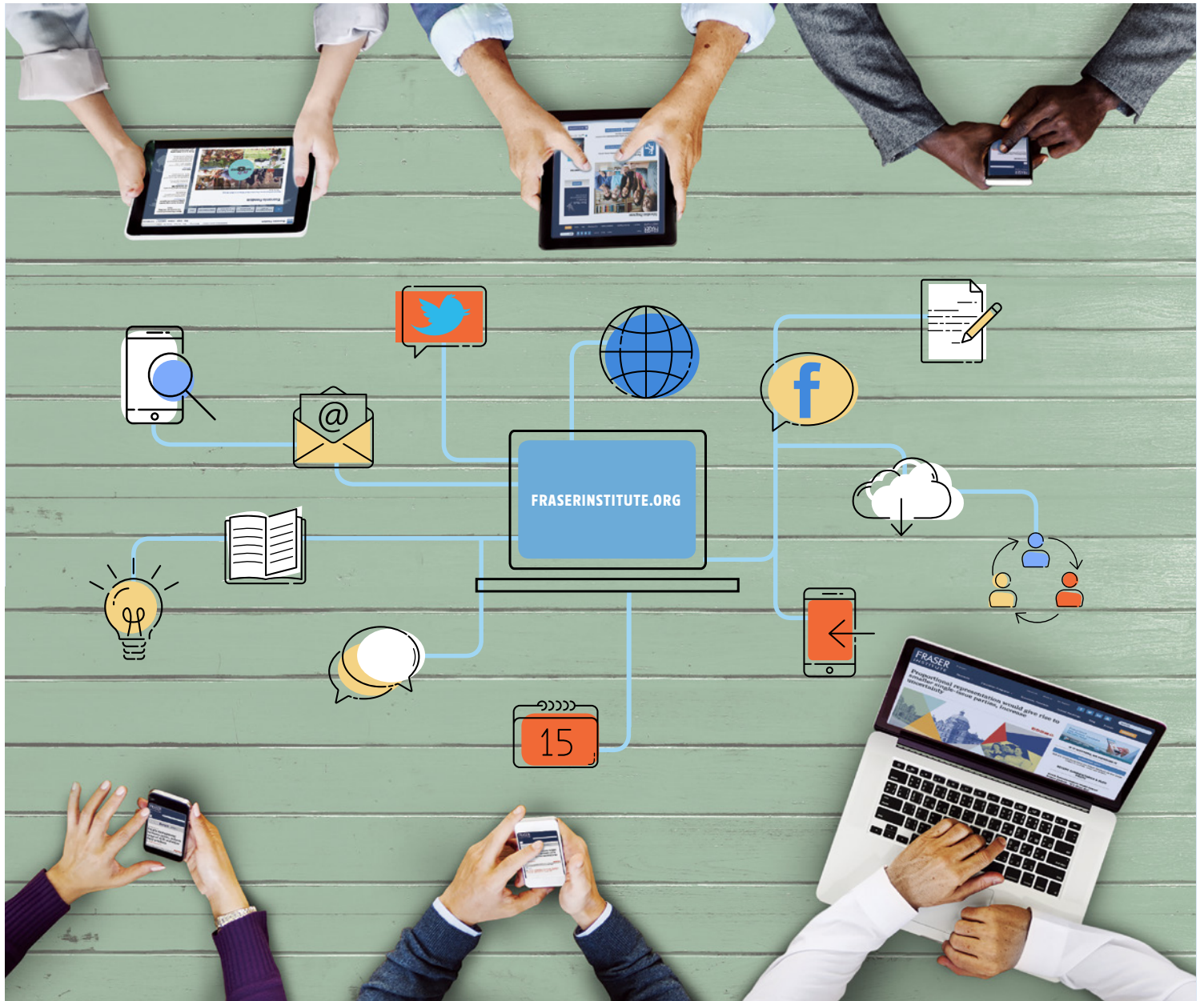
He earned his BA in economics from Brooklyn College, his MA from the University of California, Los Angeles, and his PhD from New York University.

Professor Globerman's involvement with the Institute extends back to the late 1980s when founding executive director Michael Walker asked him to edit and contribute

to a volume on immigration. That work led to Professor Globerman developing (along with Lorna Hoyer) the methodology for *Waiting Your Turn*, the first Canada-wide measurement of wait times for medical procedures, which continues to this day and remains one of the Institute's hallmark annual studies. In the early 1990s, Professor Globerman led one of the Institute's most influential research projects on North American Free Trade. The ultimate publication, *Assessing NAFTA: A Trinational Analysis*, included essays from leading researchers across North America and was a coordinated project with partners in the US and Mexico. It set the intellectual foundation and framework for NAFTA. In early 2013, Professor Globerman's involvement with the Institute was re-energized with work on regulation, telecommunications, health care, productivity, and, more recently, entrepreneurship.

The Institute is honoured that Professor Globerman has agreed to become even more involved in our research and education efforts in the years ahead—as well as regularly contributing to the intellectual life of the Institute. Professor Globerman's future work at the Institute will span a wide range of policy areas including trade, regulation economics, health care, innovation, and productivity.

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