POLICY PERSPECTIVES

Business Council of British Columbia
Est. 1966

VOLUME 25, ISSUE 3, OCTOBER 2018

GROWING GREY: FISCAL POLICY AMID AN AGING POPULATION

HIGHLIGHTS

- Population aging promises to create significant fiscal challenges for governments in many jurisdictions, including Canada, where there are now more people aged 65 and older than under age 15.
- As labour force growth slows and seniors account for a larger fraction of the population, the tax system will come under strain. This is particularly true in the case of personal income taxes, where revenue growth is likely to downshift as the population ages.
- Government should be looking to re-tool the tax system to reduce reliance on personal income taxes and garner larger proportions of revenues from other sources, such as taxes on consumption, property, and wealth.
- Other fiscal policy changes that can help to manage the pressures associated with population aging include tax reforms to accelerate investments in productivity-augmenting forms of capital (machinery, equipment, and digital and other advanced process technologies); greater support for child care to increase female labour force participation; and measures to encourage more people to stay in the workforce beyond age 65.

For the first time in our country's history, there are now more Canadians over the age of 65 than there are young people under the age of 15. The latest Census counted 5.9 million people aged 65 or older, compared with 5.8 million under 15 years. Like most industrialized countries, Canada's population is aging at an accelerating pace, due to lower fertility rates and longer life expectancy. The combined effect is transforming population structures across the country. As we look to the future, the share of individuals 55 years and older will continue to climb (Figure 1). By 2036, this group is forecast to almost equal the size of the core working age population (aged 25 to 54).

As the population ages and more people exit the workforce than naturally enter it,[1] policy-makers will be presented with significant challenges. This short paper looks at some of the fiscal stresses that demographic change will pose, with a specific focus on British Columbia, and suggests options that could help to ease the looming fiscal crunch.

POPULATION PROJECTIONS

B.C.'s population is among the fastest greying in Canada. Two main factors are at play - natural birth rates are down, and B.C. offers an attractive and temperate climate for retirees and people approaching retirement. Among the western provinces, B.C. has the largest share of the population aged 65 and over (18.3%). The comparable shares in the Atlantic provinces are somewhat higher (Figure 2), which reflects the fact that young adults in these provinces often migrate to other parts of Canada. In terms of the rate of "greying," B.C. and Alberta have seen the biggest increases in the proportion of the population aged 65+ in the last several years.

The burden of paying for government services will tend to increase as

[1] It should be noted that B.C.'s workforce will still be growing over the next decade due to international immigration and net in-migration from other provinces. In this respect, B.C. is in a more favourable demographic position that many other jurisdictions, including the four Atlantic provinces in Canada.

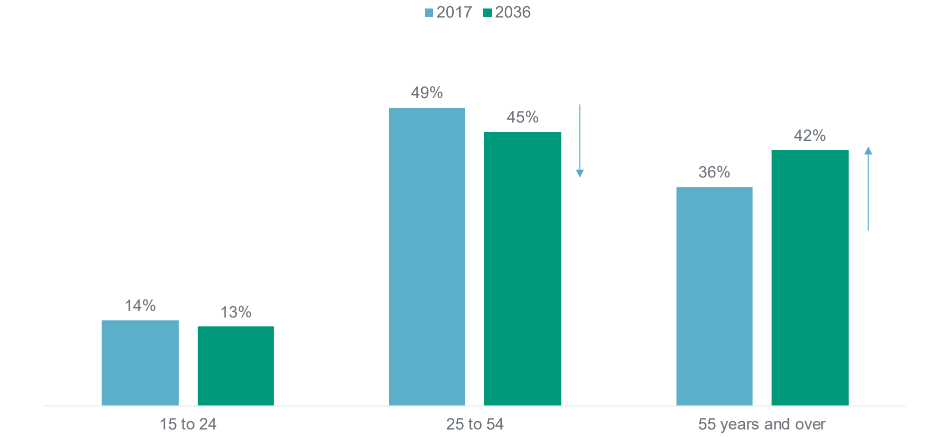
the ratio between the non-working and the working population (what economists call the dependency ratio) continues to rise. Looking at demographic trends in B.C. (Figure 3), the province is likely to soon experience slower natural labour force growth which, in turn, will increase the dependency ratio. Slower labour force growth will also put downward pressure on overall economic growth, translating into smaller gains in government revenue at a time when population aging will require more resources and spending on health care and some other social programs.

MAKE WAY FOR FISCAL POLICY

Population aging means governments will need to spend more to support the steadily expanding cohort of seniors. The cost burden will be most acutely felt in the areas of health care and pensions, but the need for more care facilities, seniors' housing, and transportation options will also require additional resources. Provinces — and countries, for that matter— that have not built sufficient and sufficiently resilient revenue streams into their budgets to cover these prospective aging-related demands are likely to get into trouble.

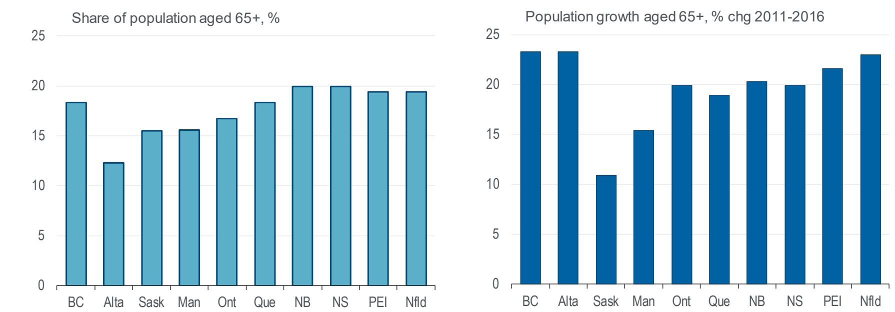
Where does fiscal policy fit into all of this? With population aging, there is a strong case for looking at how to modify policy in ways that will ease spending pressures and/or result in more revenues being collected -- at a minimal cost to the economy, and without imposing intolerable burdens on younger generations and the core working-age population. One option is to trim social programs and old age benefits. However, this may not be politically feasible, nor equitable.

FIGURE 1: **AGE DISTRIBUTION (%) OF THE CANADIAN POPULATION, 2017 (MODELED) AND 2036 (PROJECTED)**



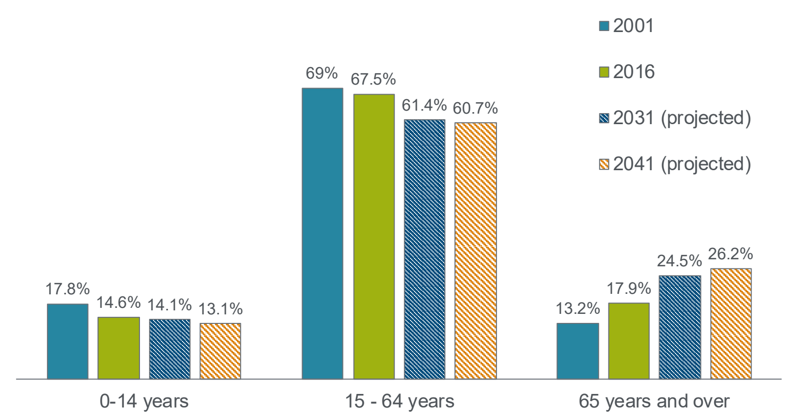
Source: Statistics Canada, Labour Force Projections.

FIGURE 2: **B.C. POPULATION RELATIVELY OLDER AND AGING MORE QUICKLY THAN MOST OTHER PROVINCES**



Source: Statistics Canada, 2016 Census.

FIGURE 3: **AGE DISTRIBUTION (%) OF B.C. POPULATION, SELECT AGE GROUPS, ESTIMATES AND PROJECTIONS**



Source: BC Stats, 1971-2016 Estimates, 2017-2041 Projections.

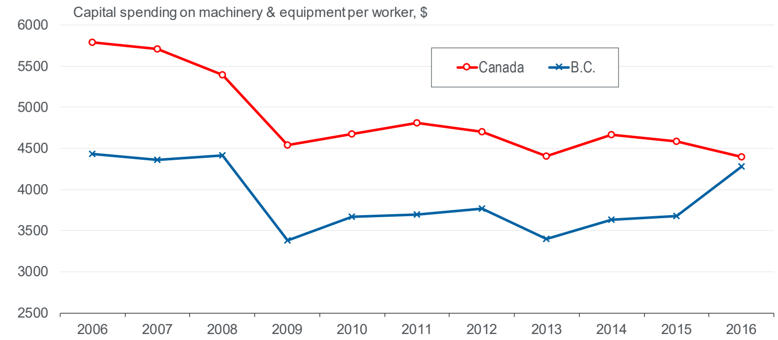
Another option is to tweak features of the tax structure and tax mix to account for demographic change.

In this regard, there are five main things that fiscal policy generally aims to do:

- Collect revenues to finance government services and benefits;
- Redistribute income;
- Incentivize labour force participation and household savings;
- Mitigate business cycle fluctuations;
- Improve resource allocation and correct for externalities/other market distortions.

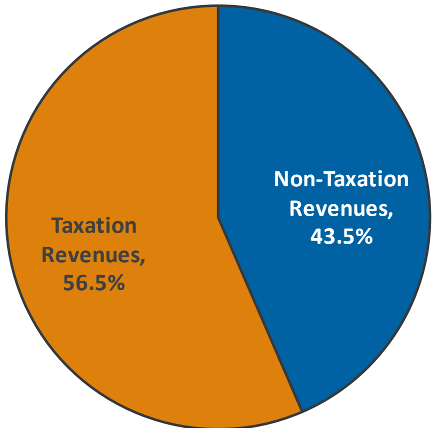
If greater spending demands from an aging population and slower revenue growth lead to escalating government deficits, policy-makers may be cornered into choosing between raising taxes or chronically adding to the stock of public debt. Hiking taxes is politically contentious and can negatively impact economic performance and competitiveness. On the other hand, endless deficits may erode investor confidence and risk fiscal stability in the long-term. What's a government to do?

FIGURE 4: **INVESTMENT PER WORKER HISTORICALLY LOW IN B.C.**



Source: Statistics Canada, Table 34-10-0063-01.

FIGURE 5: **B.C. GOVERNMENT REVENUES, TAXATION AND NON-TAXATION SOURCES, 2018-2019**



Source: Statistics Canada, Table 34-10-0063-01.

POLICY DIRECTIONS

1. Broaden the tax base and shift dependence on various revenue sources

With a larger share of the population moving into retirement or working less, the trend growth of personal income tax revenues will weaken. Considering that PIT is the largest source of provincial government revenue, the implications of this are sobering from a tax collection perspective (Figure 5). When labour force growth declines or turns negative, personal income tax revenues flowing to government will be under significant downward pressure. The solution isn't to boost tax rates on the most productive portions of the working-population: Canada already stands out for its unusually heavy reliance on personal income taxes, especially on the top 10% of tax-filers.

One idea is to shift the tax system towards a more consumption-based model. In this regard, a value-added consumption tax is often seen as good policy because it creates a reliable revenue stream while producing fewer economic distortions than other types of taxes. The B.C. government decided to harmonize the provincial sales tax with the federal GST back in 2009-10 — mainly because policy-makers wanted to eliminate taxation of business inputs and reduce the administrative and compliance burden associated with two sales tax systems. However, the move was also forward-looking, considering the province's aging population and workforce. The HST broadened the tax base because it applied to the consumption of goods as well as most services, unlike the PST. In this way, the consumption tax system under the HST was more resilient than the narrowly-based PST that B.C. has today. In the future, a broader consumption tax base could be structured to reduce the government's dependence on income taxes and lessen the distortions inherent in the existing PST regime. Implementing a value added consumption tax is the single most important thing the B.C. government could do to improve the outlook for business investment and productivity growth, while also strengthening the resilience of the tax system in an era of shifting demographics.

2. Spur more productivity enhancing capital investment

Improving productivity is imperative, but it becomes even more urgent with an aging population and slower workforce growth. With fewer workers per B.C. resident, it will become even more critical to ensure that the workforce we have is highly productive. To that end, the province could consider offering tax credits to stimulate additional investment in productivity-enhancing machinery, equipment/software, and advanced process technologies (including digital technologies). Again, widening the tax base and moving the PST closer to the model of the federal GST (which removes tax from equipment and other inputs that businesses use) would support the goal of increasing capital investment. Of concern, B.C. performs poorly on capital spending on machinery and equipment (Figure 4). This does not bode well for future living standards or the ability to raise real incomes for workers.

3. Redistributing income, incenting work, and retaining older workers

One strategy to address the effects of higher dependency ratios is to pursue policies that reduce obstacles to workforce participation. Women's participation in the labour force, especially women in their prime working age years, has stayed the same over the last 30 years. For men, overall participation rates are slowly declining. Finding ways to lift participation rates of both groups would be beneficial for two main reasons: first, because greater participation in the workforce will increase tax revenues; and secondly, with more people employed, there will be less pressure on social and income support programs.

There are ways to modify tax systems to encourage labour force participation and/or working more hours. For example, expanding the Canada Workers Benefit (formerly known as the Working Income Tax Benefit) would help to incentivize work and raise incomes for the working poor. A more generous Canada Workers Benefit would increase the after-tax earnings of lower-income workers, while maintaining an overall incentive to participate in the labour market. Expanded access to child care and child care subsidies targeted at low and middle-income families would also help to increase labour force participation, especially for second earners who frequently opt out of the labour force during child-raising years.

Lastly, there is more that can be done to support — and keep — older workers in the workforce. What motivates people to work past the "normal" retirement age? The answer comes down to a mix of public policy and personal circumstances. Flexible work arrangements, tweaks to retirement and pension policies and programs, and more upskilling opportunities for workers aged 45 and over are instruments that can encourage labour force participation among the 55+ cohort (see our recent blog).

CONCLUSION: MANAGING THE CONSEQUENCES OF TURNING GREY

No one can doubt that B.C.'s population will continue to age in the coming decades. No single policy or program can solve the economic and fiscal challenges of an aging population. However, governments would be wise to plan for a future in which personal income tax revenues are growing more slowly, while health and pension costs increase at a steady clip. From a tax policy perspective, it is clear that a larger share of government revenues will need to be obtained from other, non-income sources – including consumption taxes and perhaps property and other wealth taxes, as well as user fees and taxes on activities that produce "negative externalities" (e.g., pollution). Population aging also calls for a concerted focus on fostering stronger and longer attachment to the labour force, including by individuals approaching retirement as well as women, First Nations and other groups. Already in Canada and the US workforce participation is rising among the 55+ age cohorts. This is a trend that public policy should actively seek to support.

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