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2009 Federal Pre-Budget Submission

Increasing Economic Opportunities

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TABLE OF CONTENTS

EXECUTIVE SUMMARY3

INTRODUCTION4

I. ELIMINATE INTERNAL BARRIERS TO TRADE AND MOBILITY BY 2010...5

II. PRUDENT FISCAL MANAGEMENT.....6

 A. REALIZE COST-EFFICIENCIES IN PROGRAMS AND INSTITUTIONS THROUGH
 CONTROLLED EXPENDITURE POLICIES6

 B. ADOPT A DEFICIT LIMITATION POLICY7

 C. IMPROVE EFFICIENCY AND EFFECTIVENESS OF GOVERNMENT SPENDING THROUGH
 EXPENDITURE REVIEW8

**III. LOWER PERSONAL TAX RATES AS PART OF ANY STIMULUS
PACKAGE.....8**

SUMMARY OF RECOMMENDATIONS11



EXECUTIVE SUMMARY

Given current economic challenges, setting the right conditions for business success is more important than ever. Free trade, prudent government spending, manageable government debt levels and competitive taxes contribute to a strong and sustainable economy that encourages investment and creates jobs. The Calgary Chamber of Commerce, on behalf of its members, has for many years brought forward recommendations on these issues to increase economic opportunities and raise Canadians' standard of living.

For the 2009 federal budget, the Calgary Chamber of Commerce provides the following recommendations to address members' priorities:

I. ELIMINATE INTERNAL BARRIERS TO TRADE AND MOBILITY BY 2010

1. Work with the provinces and territories to eliminate the remaining interprovincial trade barriers by 2010 through the Agreement on Internal Trade (AIT) process.
2. Change the dispute resolution mechanism set out in the AIT to give the ability to issue a legally binding settlement.
3. Use the federal trade and commerce powers in the *Canadian Constitution* to eliminate trade barriers if AIT negotiations do not progress sufficiently.
4. As an immediate interim step, encourage expansion of the *Trade, Investment, and Labour Mobility Agreement* (TILMA) to other provinces and territories.

II. PRUDENT FISCAL MANAGEMENT

5. Adopt a bandwidth approach to government spending, by targeting expenditure increases within a range delimited by population and inflation growth, and real GDP and inflation growth (between 2.0 and 2.7 per cent for 2009).
6. Adopt a deficit limitation policy that:
 - Allows deficits only when negative real GDP is forecast; and
 - Limits the size of the deficit, as a proportion of total government expenditures, to the percentage decrease in GDP (e.g. if GDP is forecast to contract by 1 per cent, the size of the deficit should be a maximum of 1 per cent of total government expenditures).
7. Continue with the *Expenditure Management System* in the next three years to find further program savings.

III. LOWER PERSONAL TAX RATES AS PART OF ANY STIMULUS PACKAGE

8. Reduce personal tax rates as part of any stimulus package.
9. As economic conditions improve, bring personal tax revenues (as a percentage of GDP) below the OECD average by 2013. Important steps to achieve this objective include:
 - Raise the basic personal amount to \$12,500 by 2013.
 - Reduce the middle two tax brackets (22 per cent and 26 per cent) by two percentage points each by 2013.
 - Reduce the highest tax bracket (29 per cent) by one percentage by 2013, and raise the threshold of the highest marginal rate to \$200,000.



INTRODUCTION

Given current economic challenges, setting the right conditions for business success is more important than ever. Free trade, prudent government spending, manageable government debt levels and competitive taxes contribute to a strong and sustainable economy that encourages investment and creates jobs. The Calgary Chamber of Commerce, on behalf of its members, has for many years brought forward recommendations on these issues to increase economic opportunities and raise Canadians' standard of living.

The federal government is in the process of, or has implemented many of these recommendations as part of Budget 2008 and its October 30, 2007 Economic Statement. Important measures include:

- Reduction in the general corporate income tax rate from 20.12 per cent today to 15 per cent by 2012, giving Canada the lowest statutory tax rate in the G7.
- Decrease in the small business tax rate from 13.12 per cent today to 11 per cent in 2008.
- Reduction in the lowest federal personal income tax rate from 15.5 per cent today to 15 per cent retroactive to 2007, together with an increase in the basic personal amount.
- Reduction of the federal debt by \$10.2 billion in 2007-08, \$2.3 billion in 2008-09 and \$1.3 billion in 2009-10, allowing the government to reach its commitment to reduce the debt-to-GDP ratio to 25 per cent by 2011-12.
- Commitment to limit program expense growth, on average, to below the rate of nominal growth of the economy.

Our members are encouraged by these initiatives and urge the federal government to follow through with its commitment to lower the general corporate tax rate as planned. This change will position Canada more competitively for the long-term as well as providing short-term stimulus to the economy.

Building upon these positive achievements, the Chamber conducts annual pre-budget surveys to canvas its membership on the spending and fiscal management priorities of government. When asked how the federal government can improve the business environment, members identified the following list of ranked priorities:

1. Reduce internal barriers to trade, investment and labour mobility
2. Limit spending increases to population and economic growth
3. Reduce personal taxes
4. Continue planned corporate tax reductions
5. Increase business opportunities through new international free trade agreements
6. Invest in R&D and skills training to improve Canadian productivity
7. Invest in infrastructure
8. Pay down federal debt
9. Adjust small business corporate tax eligibility thresholds

These results have been taken into account in this pre-budget submission, which is structured around three priority areas: [1] eliminate internal barriers to trade and mobility by 2010; [2] prudent fiscal management; and [3] lower personal tax rates as part of any stimulus action.



I. ELIMINATE INTERNAL BARRIERS TO TRADE AND MOBILITY BY 2010

In a 2009 pre-budget survey, Chamber members identified reducing internal barriers to trade as the number one priority for the federal government to improve the business environment. The cost of barriers in Canada is estimated to be one per cent of Canada's gross domestic product.¹ The Government of Alberta believes trade barriers cost the Canadian economy \$14 billion per year.²

As explicit tariffs between the provinces are strictly prohibited under Section 121 of *The Constitution Act of 1867*, most interprovincial barriers are the result of differing rules, regulations and regional programs. These internal trade barriers are enforced by provincial legislation that attempts to protect local vested interests at the expense of interprovincial competition.

To address these concerns, an *Agreement on Internal Trade* (AIT) was signed by the provinces in 1994. The objective of this agreement is for "parties to reduce and eliminate, to the extent possible, barriers to the free movement of persons, goods, services and investment in Canada, and to establish an open, efficient and stable market."

The AIT is a commitment to agree to fairer trade in principle; it lacks any legal effect at the provincial or federal level. The dispute resolution mechanism is extremely complex and cumbersome, making it difficult to obtain a timely and inexpensive decision. Further, the dispute resolution mechanism is not enforceable by law.

The Government of Alberta is a strong proponent of the AIT, but recognizes the challenge in moving forward with consensus among all provinces and territories. Consequently in April 2006, British Columbia and Alberta signed the *Trade, Investment, and Labour Mobility Agreement* (TILMA). The agreement aims to eliminate all barriers to trade between the two provinces, creating the second largest economic region in Canada. The Conference Board of Canada estimates that TILMA has the potential to add \$4.8 billion to real GDP and create 78,000 new jobs in BC.³

The agreement commenced in 2007, with a transition period until April 2009 to allow both governments to bring measures into conformity. It has a stronger dispute resolution process than the AIT, is legally enforceable and has fiscal penalties for non-compliance.

In the November 2008 Speech from the Throne, the federal government committed to work with the provinces and territories to eliminate barriers that restrict or impair trade, investment and labour mobility between provinces and territories by 2010. In its party platform, the government announced that it is prepared to use its constitutionally mandated trade and commerce powers, which give Ottawa general jurisdiction over trade and commerce, to step in if the AIT process does not show progress. These powers are rarely exercised for fear of irritating the provinces, but these recent statements are the strongest made by a federal government to date on this issue, and could signal a break with tradition.

Reducing the remaining interprovincial trade barriers is a vital part of creating an efficient and streamlined regulatory environment in which Canadian firms can flourish. Internal barriers only serve to decrease trade between provinces, encourage regional disparities and undermine

¹ Conference Board of Canada. 2005. "An Impact Assessment of the BC/Alberta Trade, Investment and Labour Mobility Agreement." Available online:
http://www.gov.bc.ca/ecdev/down/conf_board_impact_assessment_2005.pdf

² Government of Alberta. 2008. "FAQ's on the Agreement on Internal Trade (AIT)". Available online:
<http://www.international.alberta.ca/658.cfm>

international competitiveness. They represent a significant cost to doing business, and must be eliminated.

The Calgary Chamber of Commerce recommends that the Government of Canada:

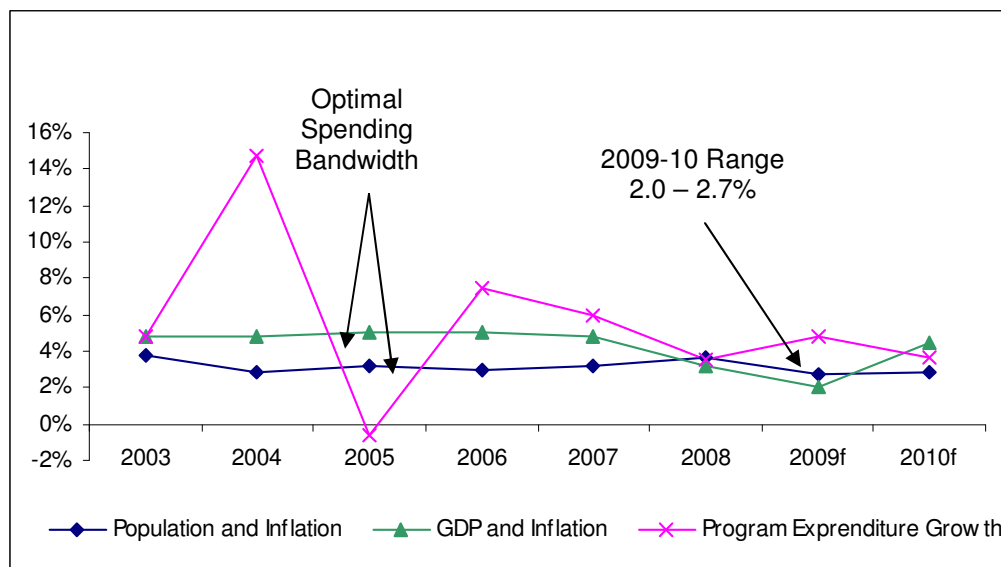
1. **Work with the provinces and territories to eliminate the remaining interprovincial trade barriers by 2010 through the *Agreement on Internal Trade (AIT)* process.**
2. **Change the dispute resolution mechanism set out in the AIT to give the ability to issue a legally binding settlement.**
3. **Use the federal trade and commerce powers in the *Canadian Constitution* to eliminate trade barriers if AIT negotiations do not progress sufficiently.**
4. **As an immediate interim step, encourage expansion of the *Trade, Investment, and Labour Mobility Agreement (TILMA)* to other provinces and territories.**

II. PRUDENT FISCAL MANAGEMENT

A. Realize cost-efficiencies in programs and institutions through controlled expenditure policies

Chamber members identified limiting spending increases to population and economic growth as the second priority to improve the business environment. Government spending restraint provides an opportunity for meaningful tax relief and repayment of debt. In its 2008 pre-budget submission, the Chamber recommended that government adopt a bandwidth approach to spending, by targeting expenditure increases within a range delineated by population and inflation growth, and real GDP and inflation growth (Figure 1).⁴ For 2009 this range is forecast to be between 2.0 and 2.9 per cent.

Figure 1 – Government program spending increase versus recommended bandwidth



Source: Statistics Canada, Economic and Fiscal Statement (Nov 2008)

⁴ Real GDP plus CPI inflation is used rather than nominal GDP because nominal GDP presents too volatile a target for government budgeting purposes.



In the federal government's first fiscal term (2006-07), the program spending increase was approximately 7.4 per cent and in 2007-08 it was 5.3 per cent. This clearly exceeds the proposed range of inflation adjusted population and GDP growth, which was between 3 and 5 per cent over this period.

The government, however, has committed to further restraint in its future budgets and intends to limit program expenditure growth, on average, to a rate below the nominal growth of the economy. The Economic and Fiscal Statement (November 2008) projects spending increases of 3.6 per cent in 2008-09, 4.8 per cent in 2009-10 and 4.1 per cent (on average) annually until 2012-13. The Chamber applauds the government's commitment to fiscal restraint.

The Calgary Chamber of Commerce recommends that the Government of Canada:

- 5. Adopt a bandwidth approach to government spending, by targeting expenditure increases within a range delimited by population and inflation growth, and real GDP and inflation growth (between 2.0 and 2.7 per cent for 2009).**

B. Adopt a deficit limitation policy

Maintaining balanced budgets has been a long-standing recommendation of the Calgary Chamber. In strong economic times, where real GDP is growing, this is a sensible approach that encourages governments to live within their means and pay down debt where possible. However, the Chamber acknowledges that at certain economic periods, this recommendation may not be the most advantageous for the economy. Severely constraining spending during an economic downturn may prevent government from investing in much needed fiscal stimuli.

Canadians are clearly concerned with deficits and growing debt. The current federal government has worked diligently to reduce the debt burden. In the event that government chooses to go into deficit to stimulate the economy during an economic downturn, it is important that Canadians are provided with assurances that the recurring deficits of the past do not become normal practice now and in the future.

Consequently, the Chamber proposes that the federal government adopt a new deficit limitation policy, which would allow deficits on those extremely rare occasions when GDP growth is negative.⁵ The proposed approach would limit the size of the deficit, as a proportion of total government expenditures, to the percentage decrease in GDP. For example, if GDP is forecast to contract by 1 per cent, the deficit should be a maximum of 1 per cent of total government expenditures (which would be approximately \$2.2 billion based on total expenditures of \$220 billion). When there is GDP growth, government would not be able to run a deficit.

This approach enables government to stimulate the economy during tough economic times, while ensuring deficits are eliminated during periods of economic growth.

⁵ Since 1962, negative GDP growth has occurred only twice, in 1982 and 1990.



The Calgary Chamber of Commerce recommends that the Government of Canada:

6. Adopt a deficit limitation policy that:

- **Allows deficits only when negative real GDP is forecast; and**
- **Limits the size of the deficit, as a proportion of total government expenditures, to the percentage decrease in GDP (e.g. if GDP is forecast to contract by 1 per cent, the size of the deficit should be a maximum of 1 per cent of total government expenditures).**

C. Improve efficiency and effectiveness of government spending through expenditure review

One of the key challenges in managing government expenditures is ensuring sufficient safeguards are in place to justify additional program spending. To this end, the federal government announced a new *Expenditure Management System* (EMS) in 2007 to ensure that Canadians receive value for money by reducing waste and making government more efficient through ongoing reviews of all department spending in a four-year cycle.⁶ These reviews assess whether the existing programs are achieving their intended results, are managed effectively, and are aligned with the priorities of Canadians and federal responsibilities.

The federal approach has three key functions:

- Increase efficiency and effectiveness – investigate ways to deliver programs and services more cost effectively and with better results;
- Focus on core roles – ensure programs are consistent with the responsibilities of the federal government and work with the province to fund those that are not; and
- Prioritize – eliminate programs that are no longer needed.

In 2007, the first year of the EMS review, 17 organizations (15 per cent of total spending) were evaluated, resulting in savings of \$386 million. The federal government intends to continue reviewing spending during the next three years, an initiative that is strongly supported by the Chamber.

The Calgary Chamber of Commerce recommends that the Government of Canada:

- 7. Continue with the *Expenditure Management System* in the next three years to find further program savings.**

III. LOWER PERSONAL TAX RATES AS PART OF ANY STIMULUS PACKAGE

In a pre-budget survey of membership, Calgary's business community ranked reducing personal taxes as the third priority to improve business conditions. High personal taxes are harmful to the economy. They discourage working, saving, and investing. Lowering taxes would provide a stimulus to a struggling economy.

⁶ Government of Canada. *Budget 2008. Annex 3 – Responsible Spending*. Available online: <http://www.budget.gc.ca/2008/plan/ann3-eng.asp>



According to the Federal Department of Finance, Canada's personal income tax burden is the highest of the G-7 nations and is above the average of the OECD countries (Figure 2).

Figure 2 – Tax Revenues as a Percentage of Gross Domestic Product, 2004



Source: A Primer on Federal Income Taxes, Economics Division, Government of Canada, August 27, 2007
Available online: <http://www.parl.gc.ca/information/library/PRBpubs/prb0707-e.htm>

Other OECD countries have recognized the importance of competitive tax rates. Most have top marginal personal income tax rates below 40 per cent, whereas in Canada, the federal/ provincial combined average is 45.3 per cent. This compares to approximately 41 per cent (federal/state combined) in the U.S.⁷

Canada's top marginal rate also commences at much lower level of income (\$123,185) than in the U.S. (\$178,851 for married individuals filings separate returns).⁸ To remain competitive and to continue to address skilled labour shortages, Canada must make changes to attract engineers, doctors, and other professionals, many of whom can live anywhere in the world and earn between \$75,000 and \$150,000.

Additionally, more must be done to improve the situation for low- and modest-income earners. In Alberta, effective marginal tax rates rarely fall below 60 per cent for a couple with two children earning \$30,000 to \$40,000, and effective marginal tax rates approach 80 per cent for incomes around \$37,000.⁹ This is a disincentive to work, save, or invest in upgrading one's skills.

⁷ The Canadian Chamber of Commerce. September 2008. "An Action Plan for a Competitive Canada." Available online: <http://www.chamber.ca/cmslib/general/Election200892312915.pdf>

⁸ KPMG. November 17, 2008. "Individual Income Tax Rate Survey 2008." Available online: <http://www.kpmg.ca/en/news/documents/Incometaxratesurveyweb.pdf>

⁹ Mintz, Jack. September 2006. "The 2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform." *C. D. Howe Institute Commentary* 239.



The federal government's October 2007 Economic Statement offered some improvement in this area. The lowest federal personal income tax rate will be reduced from 15.5 per cent today to 15 per cent retroactive to the start of 2007. The basic personal amount, the amount that an individual can earn without paying federal income tax, will increase to \$9,600 in 2007 and \$10,100 in 2008.

The Chamber acknowledges that in the current economic environment any substantial reduction in personal tax rates would jeopardize the government's ability to balance its budget. However, as the economic situation improves, the Chamber believes a bold move to bring personal tax revenues, as a percentage of GDP, below the OECD average by 2013, would position Canada more competitively and increase business opportunities.

The Chamber believes personal tax relief should be a major component of any stimulus package. Money in the hands of consumers is the best method to introduce stimulus, rather than additional government spending.

The Calgary Chamber of Commerce recommends that the Government of Canada:

8. Reduce personal tax rates as part of any stimulus package.

9. As economic conditions improve, bring personal tax revenues (as a percentage of GDP) below the OECD average by 2013. Important steps to achieve this objective include:

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