



www.calgarychamber.com



C a l g a r y

**Chamber of  
Commerce**

in business together

# 2010 Federal Pre-Budget Submission

## Increasing Economic Opportunities

**December 2, 2009**

For new policy ideas and constructive solutions visit: [www.calgarychamber.com](http://www.calgarychamber.com)



# **TABLE OF CONTENTS**

<b>EXECUTIVE SUMMARY .....</b>	<b>3</b>
<b>INTRODUCTION.....</b>	<b>5</b>
<b>1 PRUDENT FISCAL MANAGEMENT .....</b>	<b>6</b>
1.1 DEFICIT LIMITATION POLICY .....	6
1.2 DEFICIT REDUCTION POLICY.....	7
1.3 EXPENDITURE MANAGEMENT POLICY.....	7
1.4 EXPENDITURE REVIEW POLICY .....	8
<b>2 ELIMINATE INTERNAL BARRIERS TO TRADE AND MOBILITY .....</b>	<b>8</b>
2.1 STRENGTHEN THE AGREEMENT ON INTERNAL TRADE .....	8
2.2 REFORM CANADA'S EMPLOYMENT INSURANCE SYSTEM .....	10
<b>3 LOWER PERSONAL INCOME TAX RATES .....</b>	<b>11</b>



## 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 and deficit levels and competitive taxes contribute to a strong and sustainable economy that encourages investment and wealth creation. The Calgary Chamber of Commerce, on behalf of its members, present the following recommendations to address members' priorities.

### 1. Prudent Fiscal Management

Chamber members identified managing spending to eliminate the deficit and controlling program spending as their top two priorities for 2010.

#### 1.1. Deficit Limitation Policy

It is recommended that the Government of Canada 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).

#### 1.2. Deficit Reduction Policy

It is recommended that the Government of Canada adopt a deficit limitation policy that:

- Reduce the deficit by a minimum of 30 per cent annually, escalating 10 per cent each year to avoid structural deficits.

#### 1.3. Expenditure Management Policy

It is recommended that the Government of Canada:

- 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 3.0 and 4.3 per cent for 2010).

#### 1.4. Expenditure Review Policy

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

### 2. Eliminate Internal Barriers to Trade and Mobility

Chamber members identified reducing internal barriers to trade, investment and labour mobility as the number three priority for the federal government to improve the business environment.

#### 2.1. Strengthen the Agreement on Internal Trade

It is recommended that the Government of Canada:

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



## **2.2. Reform Canada's Employment Insurance System**

It is recommended that the Government of Canada:

- Adjust the variable entrance requirement for the EI program by setting a standard qualifying rate of 560 hours across the country with the weeks of benefits payable according to the three-month moving average of the regional unemployment rate.
- Maintain current features of the system that promote labour market mobility such as:
  - Keeping the two-week waiting period to enhance EI's program efficiency.
  - Maintaining the maximum weekly payouts at 55% of income.

## **3. Lower Personal Income Tax Rates**

Chamber members identified tax competitiveness as a top priority to improve business conditions.

It is recommended that the Government of Canada:

- As economic conditions improve, reduce personal tax revenues (as a percentage of GDP) below the OECD average by 2015. Important steps to achieve this objective include:
  - Raising the basic personal amount to \$12,500 by 2015.
  - Reducing the middle two tax brackets (22 per cent and 26 per cent) by two percentage points each by 2015.
  - Reducing the highest tax bracket (29 per cent) by one percentage by 2015, 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 and deficit levels and competitive taxes contribute to a strong and sustainable economy that encourages investment and wealth creation. 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 Chamber conducts annual pre-budget surveys to canvas its membership on the spending and fiscal management priorities of government. When asked about federal government priorities for 2010, Chamber members identified the following list:

1. Manage spending to eliminate the deficit
2. Controlling program spending
3. Reduce internal barriers to trade, investment and labour mobility
4. Corporate and small business tax competitiveness
5. Personal tax competitiveness

It should be noted that the Government of Canada has prioritized corporate tax competitiveness 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, a great accomplishment for which the Chamber applauds the government.

These results suggest that Chamber members prefer that the federal government focus its efforts on managing expenditures, facilitating the mobility of people and goods, and creating a competitive taxation climate as key priorities for 2010. These priorities form the basis of the Chamber's budget submission, which is structured around three main themes: [1] prudent fiscal management; [2] eliminating internal barriers to trade and mobility; and [3] lower personal tax rates.



# 1 PRUDENT FISCAL MANAGEMENT

Chamber members identified managing spending to eliminate the deficit and controlling program spending as their top two priorities for 2010. In response, the Calgary Chamber proposes that the federal government adopt federal expenditure management and deficit limitation policies that encourage sustainable and fiscally sound fiscal management decisions.

## 1.1 Deficit Limitation Policy

Maintaining balanced budgets has been a long-standing recommendation of the Calgary Chamber of Commerce. 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 providing an injection of capital into the economy.

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.<sup>1</sup> 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 would have enabled government to offer manageable amounts of stimulus to the economy during tough economic times, while ensuring deficits are eliminated during periods of economic growth.

In contrast to this proposed deficit limitation policy, government increased spending by 16.4 per cent in 2009, which created a record federal deficit of \$55.9 billion. Given the massive stimulus package and the record deficit, the Chamber's principled approach to deficit spending must be put aside for the moment in an effort to withdraw stimulus spending in a non-disruptive fashion. As the government returns to balanced budgets, however, a more disciplined approach to deficit spending should be developed.

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

**1. Upon returning to balanced budgets 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.**

---

<sup>1</sup> Since 1962, negative GDP growth has occurred only twice, in 1982 and 1990.

## 1.2 Deficit Reduction Policy

As a result of its unprecedented deficit position government should seriously consider binding itself to a deficit reduction strategy until the deficit is eliminated. The federal government anticipates reducing the deficit to \$5.2 billion by 2015<sup>2</sup>, but Canadians and businesses alike require greater assurance that the structural deficits of the past do not become normal practice now and in the future. Consequently, the Chamber is calling for the government to adopt a disciplined approach to deficit reduction that calls for reducing the deficit by 30 per cent in the first year, with reductions escalating by 10 per cent each year (i.e. by 40 per cent in 2011-2012, 50 percent in 2012-2013, etc.) until such time as it feasible to eliminate the entire deficit.

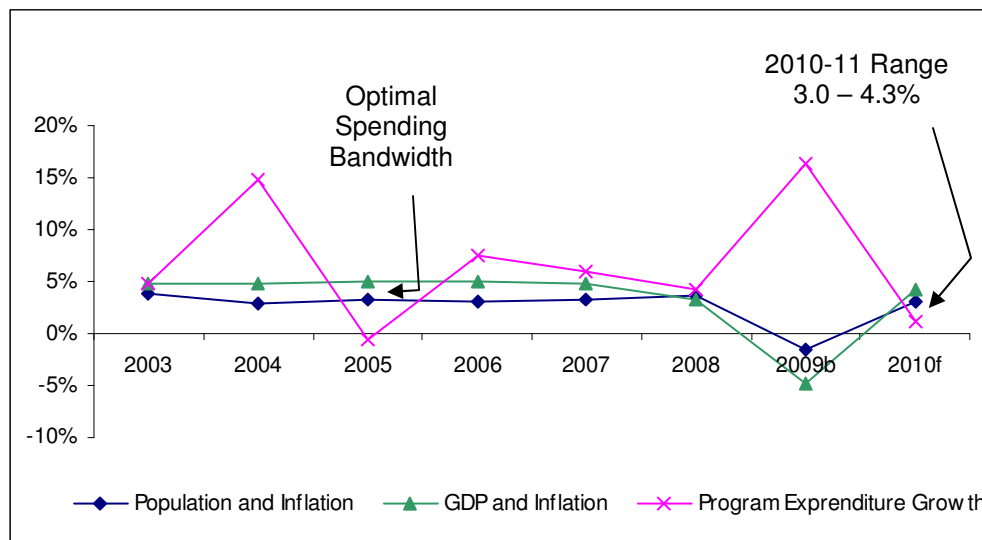
**The Calgary Chamber of Commerce recommends that the Government of Canada:**

- 2. Reduce the deficit by a minimum of 30 per cent annually, escalating 10 per cent each year to avoid structural deficits.**

## 1.3 Expenditure Management Policy

Government spending restraint provides an opportunity for deficit reduction, meaningful tax relief and repayment of debt. The business community is clearly concerned with deficits and growing debt. Government increased spending by 16.4 per cent in 2009, which created a record federal deficit of \$55.9 billion. 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). For 2010-11 this range is forecast to be between 3.0 and 4.3 per cent.

**Figure 1 – Government program spending increase versus recommended bandwidth**



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

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

- 3. 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 3.0 and 4.3 per cent for 2010).**

<sup>2</sup> Canwest News Service. 2009. Canada's deficit to balloon to \$55.9 B: Flaherty. September 10, 2009. <http://www.canada.com/life/Federal+deficit+could/1980442/story.html>



## 1.4 Expenditure Review Policy

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.<sup>3</sup> 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:**

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

## 2 ELIMINATE INTERNAL BARRIERS TO TRADE AND MOBILITY

Chamber members identified reducing internal barriers to trade, investment and labour mobility as the number three priority for the federal government to improve the business environment. The Chamber's position calls for government to strengthen the Agreement on Internal Trade and reform Canada's Employment Insurance system to improve trade investment and mobility.

### 2.1 Strengthen the Agreement on Internal Trade

The cost of barriers in Canada in 2005 was estimated to be one per cent of Canada's gross domestic product.<sup>4</sup> The Government of Alberta stated in 2008 that internal trade barriers cost the Canadian economy \$14 billion per year.<sup>5</sup>

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.

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

<sup>4</sup> 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](http://www.gov.bc.ca/ecdev/down/conf_board_impact_assessment_2005.pdf)

<sup>5</sup> Government of Alberta. 2008. "FAQ's on the Agreement on Internal Trade (AIT)". Available online: <http://www.international.alberta.ca/658.cfm>



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.”<sup>6</sup>

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 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.

On the heels of the full implementation of TILMA, Saskatchewan signed the Western Economic Partnership with Alberta and British Columbia. This document promises to continue along the path of trade liberalization. While these piecemeal approaches are the best alternative in the short term, a longer term approach incorporating all provinces and territories led by the federal government is needed.

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 Conservative Party 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 party in power 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 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:**

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

<sup>6</sup> Government of Canada. 2007. “Agreement on Internal Trade: Consolidated Version”. Available online: [http://www.ic.gc.ca/eic/site/ait-aci.nsf/vwapi/AIT\\_agreement\\_2007-05\\_en.pdf/\\$FILE/AIT\\_agreement\\_2007-05\\_en.pdf](http://www.ic.gc.ca/eic/site/ait-aci.nsf/vwapi/AIT_agreement_2007-05_en.pdf/$FILE/AIT_agreement_2007-05_en.pdf)



## 2.2 Reform Canada's Employment Insurance System

As part of Budget 2009, the federal government sought to extend EI benefits by five weeks and froze premiums until September 2010. Under existing rules, EI premium levels are set to ensure the EI Program breaks even on a yearly basis. Employers pay a 1.4 multiple of the employee premium rate. TD Economics estimates that the EI Account will have \$19 billion in cumulative deficits over 2009-2012.<sup>7</sup>

Proposals to create more generous EI benefits, such as increasing the EI payment rate as a percentage of income, eliminating the two-week waiting period, or reducing qualifying hours would cost billions.<sup>8</sup> Changes would force EI premium rates to rise, effectively increasing Canada's "employment tax" and impeding economic recovery. It would slow hiring or re-hiring decisions, and lower wages that employers can afford to pay. Upward pressure on EI rates will keep unemployment rates higher than necessary, for longer than necessary – and will extend the recessionary impacts – countering to any positive effects from government economic stimulus initiatives.

As an "automatic stabilizer", the EI Program has played a critical role in mitigating the severity of the economic downturn. The Calgary Chamber of Commerce believes that adjustments to the variable entrance requirement (VER) for the EI program can be improved to promote higher employment, streamlined processes and labour mobility and offer a more fundamentally sound program over the long term.

The current structure of the VER is aimed to ensure "that the amount of assistance provided increases as the unemployment rate rises, and that support flows to regions and communities that are most in need."<sup>9</sup> In reality, the variable entrance requirement has distorted labour market signals and punishes those who, by no fault of their own, have become unemployed in low unemployment areas. The recession has served to highlight the inequity of the current program structure as those who were laid off in regions with previously low unemployment found that Canada's social safety net is dependent upon geographical location more than any measure of need.

The VER distorts labour market signals by rewarding individuals who choose to stay in areas with high unemployment instead of seeking employment in other regions. This may result in persistent unemployment in high unemployment areas and more acute labour shortages in low unemployment regions. A simple solution that allows for some responsiveness to regional differences would be to set the qualifying rate on a national basis (560 hours) and to determine the weeks payable for regular benefits by the regional unemployment rate.<sup>10</sup>

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

- 9. Adjust the variable entrance requirement for the EI program by setting a standard qualifying rate of 560 hours across the country with the weeks of benefits payable according to the three-month moving average of the regional unemployment rate.**
- 10. Maintain current features of the system that promote labour market mobility such as:**
  - **Keeping the two-week waiting period to enhance EI's program efficiency.**
  - **Maintaining the maximum weekly payouts at 55% of income.**

<sup>7</sup> TD Economics. (April, 2009) "Is Canada's Employment Insurance Program Adequate?" Available online: [http://www.td.com/economics/special/gb0409\\_EI.pdf](http://www.td.com/economics/special/gb0409_EI.pdf) p. 1.

<sup>8</sup> TD Economics, p. 2- 4.

<sup>9</sup> Human Resources and Skills Development Canada. (2009). "Fact Sheet - Variable Entrance Requirements and Extended Employment Insurance Benefits". Available online: <http://www.rhdcc-hrsdc.gc.ca/eng/corporate/budget/2009/vereeib.shtml>

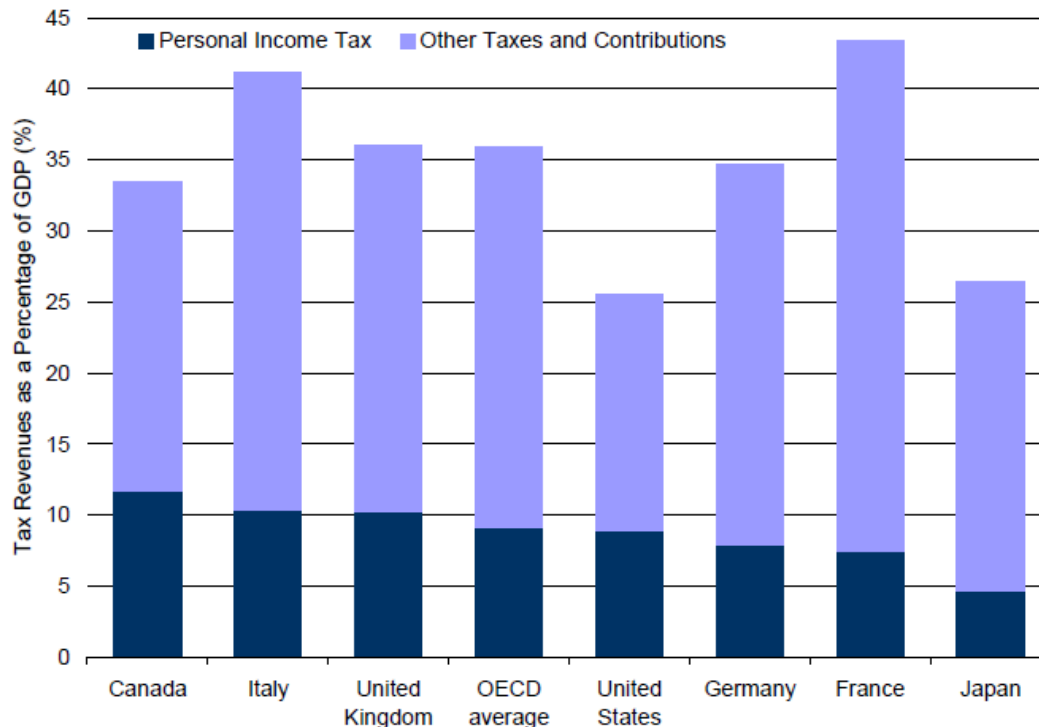
<sup>10</sup> TD Economics suggests the use of the unemployment rate as an indicator has many problems and a suite of readily available indicators may be a better way to ensure program responsiveness.

### 3 LOWER PERSONAL INCOME TAX RATES

Chamber members identified tax competitiveness as a top priority to improve business conditions. High personal taxes, especially high marginal effective tax rates, are harmful to the economy as they discourage the drive to achieve.

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.<sup>11</sup>

Canada's top marginal rate also commences at much lower level of income (123,185 USD) than in the U.S. (178,851 USD for married individuals filings separate returns).<sup>12</sup> 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 USD and 150,000 USD.

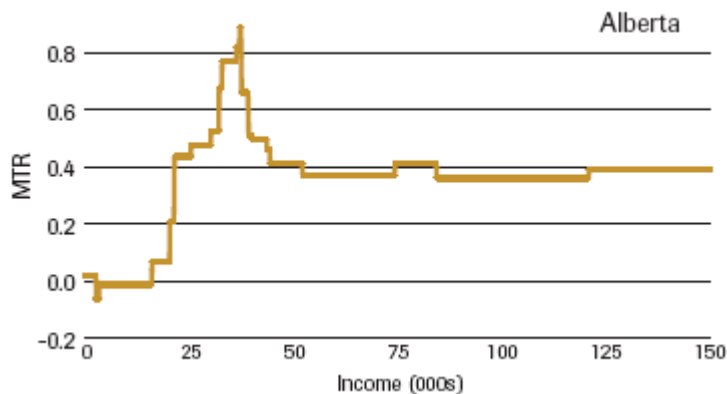
More must also be done to improve the situation for low and modest income earners. Due to clawbacks from the National Child Benefit System, the effective marginal tax rates on a couple,

<sup>11</sup> The Canadian Chamber of Commerce. September 2008. "An Action Plan for a Competitive Canada." Available online: <http://www.chamber.ca/cmslib/general/Election200892312915.pdf>

<sup>12</sup> KPMG. November 17, 2008. "Individual Income Tax Rate Survey 2008." Available online: <http://www.kpmg.ca/en/news/documents/Incometaxratesurveyweb.pdf>

living with two children in Alberta, rarely fall below 60 per cent.<sup>13</sup> For incomes around \$37,000, effective marginal tax rates approach 80 per cent (see Figure 3).<sup>14</sup> These clawbacks act as a significant deterrent for individuals to upgrade their skills or take on an extra job as a large majority of the extra income they earn will be clawed back.

**Figure 3 Marginal Tax Rate with Refundable Tax Credits at Different Income Levels for Married Family with Two Children**



Source: Milligan, Kevin. (March 2009). "Time for a Tune Up: Personal Income Taxation in Western Canada". Available online: [http://www.cwf.ca/V2/files/GFG7\\_Milligan.pdf](http://www.cwf.ca/V2/files/GFG7_Milligan.pdf) p. 19.

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, increased to \$9,600 in 2007 and \$10,320 in 2009.

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 2015, would position Canada more competitively and increase business opportunities.

The Chamber believes personal tax relief should be a major component of any long term fiscal framework. Money in the hands of consumers rather than additional government spending is the best method to ensure prosperity looking forward.

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

**11. As economic conditions improve, reduce personal tax revenues (as a percentage of GDP) below the OECD average by 2015. Steps to achieve this objective include:**

- Raising the basic personal amount to \$12,500 by 2015.
- Reducing the middle two tax brackets (22 per cent and 26 per cent) by two percentage points each by 2015.
- Reducing the highest tax bracket (29 per cent) by one percentage by 2015, and raise the threshold of the highest marginal rate to \$200,000.

<sup>13</sup> Poschmann, Finn. (February 2008). "Still High: Marginal Effective Income Tax Rates on Low Income Families." *C. D. Howe Institute Backgrounder*. Available on: <http://ideas.repec.org/a/cdh/backgr/113.html>

<sup>14</sup> Milligan, Kevin. (March 2009). "Time for a Tune Up: Personal Income Taxation in Western Canada". Available online: [http://www.cwf.ca/V2/files/GFG7\\_Milligan.pdf](http://www.cwf.ca/V2/files/GFG7_Milligan.pdf) p. 19.