09. Federal Fiscal Policy (Update/Renewal)

Issue

Persistently low commodity prices, energy sector layoffs, a tenuous recovery in Canadian manufacturing output and exports, combined with our rapidly aging population and slower growth in the labour force will continue to exert significant pressure on the public purse in the years ahead. Demand for publicly funded programs, like health care and elderly benefits, will rise significantly and a smaller number of workers will shoulder a larger share of the tax burden. With unbridled deficit financing of these social supports, future generations will face the challenge of potentially unmanageable debt levels.

The extremely difficult economic environment is for the most part externally driven and beyond our control. However, it is being exacerbated by actions of municipalities, provincial governments and the Government of Canada. Each order of government is announcing policy shifts that will impact the competiveness, sustainability and cost of doing business. A complete federal budget rethink is now necessary.

Background

The Canadian economy is experiencing weakened export activity and the full ripple effects of severe commodity price shocks. In particular, oil prices have fallen more than 70% since June 2014, one of the largest declines on record. As a result, the economic downturn will be deeper and longer than previously expected.

Internationally, the US economy is slowly exhibiting signs of strength but global economic conditions are barely improving. Across the Atlantic, the Euro zone is still facing fiscal challenges and with the "Euro Vote", geopolitical tensions are threatening to undermine the European economy for some time. In the Middle East, major political tensions continue with unrest still evident in countries like Saudi Arabia, Iran, Egypt, Israel, Syria, Libya and Iraq. This will continue to have a significant impact on global trading patterns. Continued monetary rebalancing in China is still unsettling financial markets around the globe and economic uncertainty has also been furthered by slower growth and military posturing in other parts of Asia.

This increased uncertainty about the economy overall continues to play on business confidence and the confidence of an already tapped out consumer, resulting in reduced private sector spending and a further dampening of the speed and extent of an economic rebuild. Government spending will also fail to provide much lift. The federal government is stretched thin with seemingly unbridled deficits and similarly, the provinces are mostly in cut-back and/or social support mode. With limited natural resources strength and an overbuilt housing market in Canada, that leaves exporting goods and services as our best option for full economic recovery and growth.

However, in following this path Canada must compete and succeed in a challenging global economy with huge gyrations in commodity prices, currencies and stock markets happening around the world. Competiveness has become even more critical to our growth and prosperity. To improve our competitive position, the Canadian Chamber of Commerce has identified the following issues that must be addressed:

- Skills and labour: Canadian business is facing skills gaps and mismatches right across the board. There is still a need for skills and education that are aligned with the needs of employers.
- Infrastructure: Strategic investments in infrastructure can make Canada more competitive, bring down costs and help get our goods to market. Business leaders emphasized that the priority has to be placed on trade-enabling infrastructure that will improve productivity along with extending existing incentive programs to encourage investment and value-added processing for oil sands projects.

- Environment and consultations: For years, Canadian business and the Canadian Chamber have called for a coherent plan to improve the environment and reduce green-house gases without damaging Canada's competitive position. There is a recognition that improved energy efficiency and green technology can be a source of competitive advantage. In addition, a stronger federal role is needed in consultations and outreach with First Nations and local communities.
- Innovation and the digital economy: Canada must support more start-ups, attract more venture capital and provide more incentives to commercialize new technologies right here at home.
- Trade and regulatory harmonization: Canada must move quickly to ratify the Trans-Pacific Partnership and the Canada-Europe Trade Agreement. For many industries in the knowledge economy, regulations, ownership requirements and restrictions on data flows can be the most difficult barriers to success. This issue must be a global priority for the Canadian government and for the G20.

Fiscal Restraint

Considering global and local factors and the cumulative impact of policy decisions influencing business competitiveness in the coming years, chambers of commerce believe it is imperative that the government re-examine its fiscal priorities by focusing on long-term economic sustainability, enabling businesses to remain competitive and confidently plan for the future. One of the best ways to achieve this is to show leadership with fiscal restraint.

With this in mind the government needs to undertake an in-depth review of spending and revenue sources in order to identify the "transformational changes" necessary to return to balanced budgets.

In upcoming budgets, the federal government also needs to limit operational spending to a zero-per-cent increase over the previous year. The economy is in a downward spiral and we may not have seen the bottom, yet. As a result, our businesses are really hurting and the ripple effects are impacting all sectors of our economy. Now is the time to hold back on any new program spending and initiatives, so there are no additional increases to the already heavy burden on taxpayers. It's not the time to be increasing taxes on any segment of the economy, nor is it a time to increase long-term debt without a detailed plan to return to balance.

Delivering a Better Tax System

Canada also has much to gain by using the tax system optimally to promote employment, productivity and higher living standards. Reducing our heavy reliance on economically-damaging income and profit taxes, broadening the tax base, creating a more neutral business tax system and reducing compliance costs for taxpayers can significantly boost Canada's international competitiveness.

The following are long-standing principles of good tax policy:

- Tax Neutrality: Economic activities should bear similar tax treatment to encourage the best allocation and profitable use of resources in the economy.
- Tax Equity or Fairness: A tax system should distribute its burdens fairly. There are two dimensions to equity. The first facet is that people in similar economic circumstances should receive the same tax treatment (horizontal equity). The second aspect is based on the notion that the more an individual earns, the more income tax the individual should pay (vertical equity).
- Efficiency: The tax system should minimize adverse effects on taxpayer behavior that undermine the efficiency of the economy.
- Simplicity: The system should be simple, transparent and easy to understand and comply with.

- Minimize Compliance Costs: The *Income Tax Act* continues to become more complex and this frequently creates additional compliance burdens and therefore costs to many privately held companies. One example of this is the proposed amendments in the 2015 Federal Budget dealing with the ability to move funds within a corporate group on a tax-free basis. In order to still be able to do this, the proposed amendments would require Canadian businesses to maintain safe income calculations which would add significantly to the tax compliance burden. The amendment was meant to deal with an abuse of the *Income Tax Act*, but the proposals were far broader and would have created a significant compliance burden faced by Canadian businesses.

Strategic Infrastructure Investments

It's important that the government focus on strategic infrastructure that will improve access to markets for all Canadian products, allowing them to flow seamlessly within the country and to international customers. To that end, we recommend that the government develop a national / utility corridor plan that will serve to integrate all urban centres and regions in Canada and support a comprehensive transportation/utility system.

We further recommend that the Government implement this proactive plan by working with all orders of government to secure transportation/utility corridor rights of way throughout Canada with the potential for rapid transit, freight networks, telecommunications, regional municipal utilities, transmissions lines and pipelines.

The Government should also commit to the creation of a competitive regulatory framework which encourages investment, promotes regulatory alignment across jurisdictions, and does not introduce additional barriers that would compromise project viability. In addition, the accelerated capital cost program for oil sands projects need to be reinstated and extended to include investment in resource processing.

Recommendations

That the federal government:

1. Fiscal Restraint

    a. Undertake an in-depth review of spending and revenue sources in order to identify the "transformational changes" necessary to return to balanced budgets within three years.

    b. Achieve and maintain a debt-to-GDP ratio below 30 per cent with financial contributions to debt reduction as necessary to sustain that position.

    c. Confine program spending to core areas of federal responsibility and limit operational expenditures to zero percent increases. Maintain this no-growth policy until economic activity is generating sustained government revenues sufficient to support increased spending with overall rates of taxation and fee collection at levels similar to or lower than the existing regime.

    d. Continue to examine new ways to reduce costs, modernize how government works and ensure value for taxpayers' money, including in the areas of service delivery, corporate asset management, travel and administrative systems.

2. Tax Policy

    a. Ensure that Canada's tax system is as neutral, simple, efficient and fair as possible by immediately completing a comprehensive review of taxing statutes with the objective of identifying and ensuring the implementation of ways and means to simplify tax legislation, reduce the complexity of Canada's tax system and decrease compliance costs.

The review should include an examination of the hundreds of exemptions, deductions, rebates, deferrals and/or credits that are part of the federal tax system to determine which ones are inefficient or wasteful and can be eliminated.

b. Avoid unnecessary complications to tax legislation by rigorously reviewing any addition of special provisions and targeted tax benefits. A good example of this would be proposed amendments to the taxation of inter-corporate dividends and the additional compliance burden and cost this would have added to Canadian businesses with no increase in tax revenue.

c. Reduce Canada's heavy reliance on more damaging, high-cost sources of taxes, namely income and profit taxes, and rely more on consumption-based taxes, like the GST/HST in combination with a multiyear plan to reduce personal income tax rates with an immediate focus on reducing marginal tax rates.

3. Strategic Infrastructure Stimulus

a. Strategically develop the country by working with all orders of government to secure transportation / utility corridor rights of way throughout Canada with the potential for rapid transit, freight networks, telecommunications, transmissions lines and pipelines that will improve access to markets for all Canadian products, allowing them to flow seamlessly within the country and to international customers.

b. Increase funding for municipal projects through the Building Canada Fund and with provincial / territorial and municipal governments, promote the viability of P3 projects for infrastructure initiatives in urban centres across Canada.

c. Seize new economic opportunities in industries such as value added petrochemicals by reinstating the accelerated capital cost program for oil sands projects and extending the program to include resource processing investment like integrated upgraders, merchant upgraders, and petrochemical projects.