

Pre-Budget Submission to the House of Commons Standing Committee on Finance

August 2011

Executive Summary

The Canadian Chamber of Commerce welcomes the opportunity to participate in pre-budget consultations and to share our views on the questions posed by the House of Commons Standing Committee on Finance: How do we achieve a sustained economic recovery; create quality, sustainable jobs; ensure relatively low rates of taxation; and achieve a balanced budget?

We note that these objectives are interlinked and, therefore, public policies must be implemented consistently with due regard to possible trade-offs and complementarities.

With the Finance Committee's questions in mind, the Canadian Chamber of Commerce calls on the federal government to:

1. Pursue policies consistent with the principles of price stability, fiscal prudence, trade openness and structural reform.
2. Implement a reinvigorated national innovation strategy focused on research, training and retraining, education and the transformation of ideas into marketable products and services.
3. Rein in program spending and improve efficiencies in government activities to eliminate deficits and regain the fiscal flexibility to tackle areas that are crucial to Canada's long-term competitiveness, including reducing high marginal personal income tax rates.

Achieving sustained economic growth

The decades-long experience of OECD countries has shown that the economic policies that provide the strongest foundation for sustained economic growth are based on four principles: inflation control, fiscal prudence, trade openness and structural reform. A sound financial system is the anchor.

- **Inflation control:** When inflation is low, stable and predictable, consumers and businesses have the confidence to plan for the future because they know that the purchasing power of their money will not steadily erode year after year. Low inflation also means lower nominal and real interest rates. This enables households to spend and businesses to finance their day-to-day operations and invest in productivity-enhancing machinery and equipment. The Canadian Chamber believes the Bank of Canada's inflation-targeting framework has served Canada well, and should be retained.
- **Fiscal prudence:** Big deficits and mounting debt drive up interest rates and drain national savings. They corrode economic activity. Maintaining a focus on balanced budgets and debt reduction will provide the government with the fiscal flexibility to

keep taxes low to foster long-term growth, and the wherewithal to deal with the gale force of an aging population.

- Trade openness: Openness to trade and integration into global markets is a potent stimulant for higher and sustained growth. Competition fosters efficiency and fuels innovation, raises productivity and leads to better paying jobs. Ensuring the dynamism of Canadian businesses and Canada's economy requires an ambitious, comprehensive and forward-looking strategy focused on boosting our country's trade and investment ties with other nations.
- Structural reform: Addressing long-standing structural impediments to productivity and economic growth must remain a crucial cornerstone of the government's agenda. This includes breaking down all internal barriers to trade and mobility, removing work disincentives in the income-support system (like Employment Insurance), eliminating burdensome regulatory procedures and minimizing tax administration and compliance costs. Policymakers should always be looking for ways to enhance the flexibility of our economy and improve its performance. This is particularly important for a relatively small and open economy such as ours.
- A sound financial system: Canada is in a fortunate position that its financial system is mature, sophisticated and well-managed, underpinned by strong prudential regulation and supervision. "The financial system makes an important contribution to the welfare of all Canadians, since the ability of households and firms to hold and transfer financial assets with confidence is one of the fundamental building blocks of our economy. A stable financial system contributes to broader economic growth and rising living standards."¹

Creating quality, sustainable jobs

Developing countries are aggressively competing with industrialized nations, including Canada, to gain an edge in the race for global market share, technological innovation, foreign investment and high value-added activities in global supply chains. China has solidified its role as a manufacturing superpower and is the regional hub for foreign outsourced production. Many developing countries are the spokes supplying China with parts and components, raw materials and energy products. China, India, Malaysia, Thailand and Vietnam are rapidly expanding their innovative capacity. They have a critical mass of researchers, scientists and engineers. Their commitment to research and development will make these countries global leaders in product and process innovation. Canada is at risk of being swept aside as more aggressive nations power ahead.

To create quality, sustainable jobs Canada must embrace a culture of innovation. Innovation is "new or better ways of doing valued things. Innovation is not limited to products but includes improved processes like the assembly line, and new business models like web-based commerce. . . . Radical innovations like the steam engine and the

¹ Bank of Canada. "Financial System Review." June 2011.

transistor create entirely new markets. Much more prevalent is incremental innovation in established markets in which goods and services are continuously improved.”²

Across every industry, innovation plays a critical role in an organization’s success. Innovation has led to new jobs in high-tech and advanced manufacturing sectors like aerospace, nanotechnology, life sciences, and alternative energy. It has also resulted in more jobs in support-related fields, for example in installing broadband networks and building advanced infrastructure.

To foster innovation, the government must focus on:

- Building the most skilled, educated and entrepreneurial workforce in the world.
- Significantly improving our ability to move research breakthroughs out of the laboratory to the marketplace.
- Championing a strong intellectual property rights regime.
- Improving the administrative management of the Scientific Research and Experimental Development (SR&ED) program to ensure SR&ED investment tax credits are being delivered in a predictable, timely and cost-effective manner to make it easier for businesses of all sizes to invest in research and development.

Finally, it is worth studying Germany – a country that has been able to maintain a powerful manufacturing sector in the light of competition from China and other emerging economies. It focuses on high-end manufacturing, producing products renowned worldwide for their quality. Thus, they are able command a premium price. Germany’s manufacturing sector has developed strong connections with universities, technical institutions and polytechnics that have helped manufacturers develop world leading processes and products. The country places a high emphasis on scientific education, technical education, apprenticeship programs, training and retraining.

Ensuring relatively low rates of taxation

Relatively low rates of taxation can be achieved by reining in government spending, broadening the income tax base and growing the economy.

Reining in government spending and improving the efficiency of government programs and operations are key to eliminating deficits and regaining the fiscal flexibility to tackle areas that are crucial to Canada’s long-term competitiveness, including reducing high marginal personal income tax rates (especially as they apply to individuals with modest incomes) that reduce the incentive to work, save and invest.

² The Council of Canadian Academies. “Innovation and Business Strategy: Why Canada Falls Short.” *Report of the Expert Panel on Business Innovation*. June 2009.

The federal government should also review the hundreds of exemptions, deductions, rebates, deferrals and credits that are part of the federal tax system to ensure they are cost effective and economically efficient. For example, some credits simply subsidize activities many recipients would have done anyway. Others may stimulate spending in certain areas prompting suppliers to raise prices and, therefore, negate the benefit of the tax credit. In many cases, the government is using tax preferences to achieve social objectives rather than funding the initiative through spending programs. The incentives show up as tax cuts when in fact they are spending increases. Ultimately, the myriad of tax preferences enormously complicate the tax structure, increase compliance costs and open up avenues for evasion and avoidance of tax. Broadening the income tax base (by scaling back or abolishing inefficient and ineffective targeted tax provisions) would facilitate lower tax rates so that everyone benefits.

Finally, putting our nation on track for strong, sustained growth and real job creation will result in more tax revenue, allowing reductions in tax rates.

Achieving a balanced budget

The Canadian Chamber has called on the federal government to balance its books by 2015 and to do so by limiting program spending growth to about 1.6 per cent per year, on average, through fiscal 2015-16. On the surface this may not appear draconian, but it would represent a dramatic shift since federal program spending increased around six per cent per year from fiscal 2000-01 to fiscal 2008-09. Savings can also be realized by improving the efficiency and effectiveness of government programs.

The Canadian Chamber recognizes that across-the-board slashing of government programs without underlying structural reforms will generate little in the way of sustained savings. Close scrutiny of government programs must be an ongoing process.

At the Canadian Chamber's 2010 Annual General Meeting, delegates passed a resolution calling on the federal government to regularly evaluate all its programs and activities by asking the following questions:

- Does the program or area of activity continue to serve the public interest?
- Is there a legitimate and necessary role for government in this program area or activity, or could the private/voluntary sectors play a greater role in whole or in part?
- Are Canadians getting value for their tax dollars?
- If the program or activity continues, how could its efficiency and effectiveness be improved? For example, can delivery costs be lowered through intelligent use of technology, public-private partnerships or third-party delivery?

- Is the federal government acting within its well-known constitutional responsibilities, or is the program a candidate for realignment with the provinces/territories?

The Canadian Chamber believes that increasing taxes on Canadian families and businesses is the wrong way to eliminate deficits. In a highly integrated global economy, the tax base is constantly on the move. Skilled workers, businesses, jobs and capital move easily across national borders, seeking the best economic opportunities. They are drawn to low-cost, low-tax environments. It is crucial that we do not undermine the progress that has been achieved to-date with respect to corporate and personal income tax reductions.

In Conclusion

Population aging presents a significant challenge to the continued improvement of living standards and to the sustainability of social programs in the decades to come. 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. To deal effectively with emerging demographic pressures, Canada must bolster its economic base. In other words, if we want a bigger-sized pie to divide among the elderly and non-elderly in the future, we must grow Canada's economy.

"The evidence is overwhelming that economic growth is strongly related to the openness and competitiveness of a country's markets and that competition is a key driver of innovation, productivity and prosperity."³ As such, Canada has much to gain by addressing long-standing structural impediments that stifle productivity, slow job creation and constrain economic growth.

Restraining the growth in federal spending is imperative to eliminate deficits and regain fiscal flexibility to deal with changing economic circumstances.

The Canadian Chamber of Commerce wishes the House of Commons Standing Committee on Finance every success as it conducts pre-budget consultations. We are anxious to assist in every way we can to build a stronger and more prosperous Canada.

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³ The Commissioner of Competition. "Submission to the Competition Policy Review Panel." January 11, 2008.