

Fiscal Policy

The overriding focus for the federal government in the coming year should be to restore Canada's economic health and enhance Canada's long-term competitiveness. With this in mind, the following key priorities with respect to fiscal policy should contribute to achieving this goal.

Debt Management

In light of the recession and substantial expenditures to stimulate the economy, the federal government projected in the September 2009 Update of Economic and Fiscal Projections the accumulated deficit will increase by \$170 billion over the 2008-09 to 2014-15.

We need to be mindful that there is a price to be paid when a deficit is incurred. Canadian will have to pay it back in the future - both principal and interest - making it harder to cover program costs (like health care and education) and meet the needs of an aging population. If deficits persist over a long period of time, Canadians and Canadian businesses will face a higher tax burden, and our competitiveness will be threatened. Rebalancing the federal books is, therefore, crucial.

The Government faces a number of challenges in rebalancing its books. First, budgetary revenues may not grow as fast as the government is projecting (i.e. about 6.6 percent per year over the 2009-10 to 2014-15 period) to get us back into a surplus position by 2016. Second, debt changes will be increasingly exposed to interest-rate risk. Although interest rates on debt currently sit at historically low levels, governments worldwide will have to fund their fiscal stimulus packages by issuing new bonds and treasury bills. The increase in the global supply of new issues of government debt will escalate putting upward pressure on interest rates.

Ultimately, the ability of the Government to rapidly eliminate the deficit and reduce overall exposure to interest rate movements rests in limiting program spending growth to historically low levels.

Once balanced budgets are achieved, surpluses should be put towards quickly eliminating the deficit accumulated over the Government's five-year projection period.

Program Spending

The financial crisis and recession necessitated that Budget 2009 focus on measures to promote recovery and keep the country on course towards meeting its longer-term economic goals. Finance Minister Jim Flaherty unveiled a stimulus package totaling about \$40 billion in measures over the next two years. About three-quarters of this is earmarked for new spending, with infrastructure topping the list.

To balance the books by 2015-16, program spending will need to grow, on average, by less than 3.0 percent per year starting in 2011. The major challenge for the Government will be to constrain growth in program spending to this level. It does not have a very good record. For example, program spending at the federal level rose 7.5 percent in fiscal 2006-07 and 6.0 percent in 2007-08.

The Canadian Chamber has always suggested that growth in program spending should never outstrip growth in the economy (nominal GDP). This would enable the Government to eliminate deficits and drive down the debt burden faster, and have some room for tax relief.

The Government said it will “continue to carefully manage spending” and “focus spending measures in two years” to stimulate the economy during the downturn. To control spending, the Government is “taking action to ensure the Equalization program grows in line with the economy” and is limiting growth in federal public sector compensation.

Going forward, the Canadian Chamber strongly urges the Government to continue its strategic review process that is managed by the Treasury Board Secretariat. On a four-year cycle, departments will review their direct program spending and the operating costs of their major statutory programs (the Government has about 90 departments and agencies delivering about 2,500 individual programs) to assess how and whether these programs are: effective and efficient; meet the priorities of Canadians; and are aligned with federal responsibilities. Through the strategic review process, departments will also determine whether there are any lower priority/lower performing programs for possible reallocation of funding to higher priority/higher performing programs within the department or government.

Taxation Policy

In Budget 2009, the Government adopted many of the Canadian Chamber's proposals, including reducing the tax burden facing low- and modest-income Canadians; providing incentives for new business investment in machinery and equipment; and continuing the previously-announced corporate tax reductions.

Personal Income Taxes

A number of permanent and welcomed measures were introduced in Budget 2009. The basic personal amount was increased to \$10,320 from \$9,600; the top of the two lowest personal income tax brackets was raised; the level at which the National Child Benefit supplement for low-income families and the Canada Child Tax Benefit are phased out was lifted; the Working Income Tax Benefit was doubled; and the Age Credit amount was increased providing further tax relief to seniors.

Despite these improvements, many low- and middle-income Canadian families with children pay higher effective marginal tax rates on their labour earnings than individuals at the top of the income spectrum because many of the public transfers these families receive (including child tax benefits, the GST and provincial sales tax credits, provincial property tax credits, student financial assistance and social welfare) end up being clawed back as income rises. Punitive marginal tax rates send a strong negative message about the merits of working, upgrading one's skills and pursuing higher education. Fiscal conditions permitting, the Government should put a plan in place to reduce high marginal personal income tax rates for low- and middle-income Canadians.

Tax relief is also warranted at the top end of the income spectrum. The Canadian Chamber recommends that the federal government raise the threshold at which the top federal marginal personal income tax rate kicks in to \$200,000 from the current \$126,264

to help attract and retain high-tech skilled workers, upper management, entrepreneurs and professionals, many of whom are quite mobile. As a result, the marginal personal income tax rate on income between \$126,264 and \$200,000 would fall from 29% to 26%.

Business Taxation

There were a number of positive developments with respect to business taxation in the January 27, 2009 federal budget. Budget 2009 provided a temporary 100 percent capital cost allowance rate for computers acquired after January 27, 2009 and before February 1, 2011; extended the temporary 50 percent straight-line accelerated CCA rate to investment in manufacturing or processing machinery and equipment undertaken in 2010 and 2011; repealed the interest deductibility constraints in section 18.2 of the Income Tax Act; permanently eliminated tariffs on a range of machinery and equipment; and extended for one year the temporary 15 percent mineral exploration tax credit to help companies raise capital for mining exploration. For Canada's small business sector, Budget 2009 increases the amount of small business income eligible for the reduced federal tax rate of 11 percent to \$500,000 from the current limit of \$400,000 as of January 1, 2009.

Going forward, there are a number of measures the Government can take to enhance the tax competitiveness of Canadian business. It should maintain the previously announced corporate income tax reductions on which Canadian businesses have been basing their planning; continue to review and make improvements to CCA rates; redouble efforts to persuade the provinces that currently levy retail sales taxes to harmonize these taxes with the federal GST; and continue to reduce administration and compliance costs for businesses.

Recommendations

That the federal government:

Re: Debt Management

1. Avoid structural deficits which result in ever increasing debt levels and higher interest charges making it harder to cover program costs, such as health care.
2. Once balanced budgets are achieved, dedicate surpluses towards quickly eliminating the debt.
3. Ensure that the federal debt-to-GDP target falls to below 35 percent by 2015.

Re: Program Spending

4. Starting in fiscal 2010, Adopt a smart spending bandwidth approach to government spending by targeting increases within a range delimited by population and inflation growth and real GDP and inflation growth .
5. Continue to review all direct program spending and operating costs on a four-year cycle to determine where the payoffs are the greatest, identify areas where spending can be reduced or eliminated, and evaluate whether activities or spending should property remain at the federal level or should be undertaken by the provinces/territories.

Re: Tax Policy

6. Continue to reduce high marginal personal income tax rates for low- and middle-income individuals.
7. Raise the threshold at which the top marginal personal income tax rate kicks in to \$200,000.
8. Maintain the previously-announced corporate tax reductions on which Canadian businesses have been basing their planning.
9. Continue to review and make improvements to Capital Cost Allowance rates.
10. Work with the provinces (Saskatchewan, Manitoba and Prince Edward Island) to harmonize provincial retail sales taxes tax with the GST.
11. Reduce administration costs to manage and maintain the tax system and reduce costs of complying with tax laws and regulations.