



Business Council *of*  
British Columbia

**Submission  
in Advance of the  
2008 Federal Budget**

February 11, 2008



## Business Council of British Columbia

The Business Council of British Columbia is pleased to provide our views on the 2008 federal budget. Established in 1966, the Business Council is an association representing approximately 220 large and medium-sized enterprises engaged in business in British Columbia. Our members are drawn from all major sectors of the provincial economy, including forest products, mining, manufacturing, transportation, agri-food, telecommunications, information technology, financial services, energy, utilities, tourism, retail, construction, biotechnology and life sciences, engineering, healthcare, education and the professions. Taken together, the corporate members and the associations affiliated with the Business Council are responsible for one-quarter of all jobs in British Columbia.

In what follows, we first briefly discuss the economic context for the upcoming budget and then highlight a number of priorities that we believe should guide the government's fiscal and tax policy decisions in 2008 and beyond.

### **1. Economic Context**

The Canadian economy performed well in 2007, despite weak exports and the competitive pressures stemming from a further almost 20% rise in the Canadian dollar against the US dollar.<sup>1</sup> Offsetting a decline in net exports<sup>2</sup> was significant growth in all of the components of domestic demand – consumer spending, government outlays, residential construction, and business investment. Current estimates suggest the national economy grew by 2.6% after inflation last year.

Buoyant job and housing markets have had a positive impact on consumer confidence and spending patterns. Payroll employment increased by 350,000 in 2007 (+2.3%), with the

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<sup>1</sup> The Canadian dollar rose from \$0.85 US in January 2007 to end the year roughly at parity.

<sup>2</sup> Defined as exports minus imports.



biggest gains coming in construction, business services, and the public sector. In contrast, employment declined in the manufacturing sector (which represents 17% of GDP). Indeed, Canadian manufacturing has fallen into recession, owing to the strong Canadian dollar, diminishing US demand for Canadian-produced products, and stiff competition from low-cost suppliers based in China and other emerging markets.

Housing construction remained strong in 2007, with the number of housing starts reaching 227,000 (compared to an average of 204,000 over the 2000-2006 period). Non-residential construction also rose, driven by increased government investment in infrastructure, major energy projects, and healthy office and commercial construction activity. Business investment in machinery and equipment also increased again in 2007 as Canadian firms took advantage of lower import costs (thanks to the high Canadian dollar) to purchase new equipment and technology needed to improve productivity.

As noted above, a deteriorating trade picture detracted from overall economic growth in 2007. Canada's trade surplus fell to \$55 billion last year. Very large trade surpluses on energy and industrial raw materials increasingly are being offset by growing deficits in most other trade categories.

Entering 2008, the economy received a boost from a reduction in the GST rate, lower personal income and business taxes, and higher public sector spending. These factors should help to offset continued softness in the trade sector, the deep slump in the Canadian forest products industry, and recession-like conditions for manufacturing as a whole. At this point the biggest uncertainty in the Canadian outlook is the extent of the economic downturn in the United States. As evidence mounts that the US is falling into recession, forecasters have revised down their projections for Canadian growth in 2008. According to a range of recent published forecasts, Canada's economy is unlikely to expand by much more than 2% (after inflation) this year, the smallest advance in five years. Job growth should decelerate to 1.5%, versus 2.3% in 2007. A further drop in net exports is also expected, as Canada's exports to the US take a hit.



The past two years have seen a modest acceleration in inflationary pressures as the labour market tightened, unemployment declined, and higher oil prices began to affect business costs and the prices of some consumer goods. However, inflation in Canada is expected to ease in 2008 in the face of slower economic growth. In this climate, interest rates are poised to move lower – as was confirmed when the Bank of Canada trimmed its key overnight rate from 4.25% to 4.0% on January 22. Further modest reductions in interest rates are likely over the balance of 2008.

Turning to the Canadian dollar, by early February, it was trading near US\$0.99, down from its peak of US\$1.10 in November 2007. Most forecasters expect the dollar to trade within a fairly narrow range (US\$0.95 to US\$1.03) over the course of 2008. It is important to note that an exchange rate at this level will continue to exert downward pressure on net exports and thus dampen overall Canadian economic growth.

Against this economic backdrop, the Business Council recommends that the government use a cautious forecast in developing the 2008 budget. With the US on the verge of recession, the global economy slowing, and large parts of Canada's manufacturing sector suffering from the high dollar as well as softening external demand, the outlook for the Canadian economy in 2008 is subdued at best.

## **2. Federal Spending and Debt Management**

Within the OECD, Canada has an excellent fiscal record. The past decade has seen a string of federal budget surpluses and a steadily declining debt/GDP ratio. Continuing on this path will put the country in a strong position to manage the fiscal pressures that are sure to intensify as the large post-war baby-boom generation gradually moves into retirement.

In this regard, we believe it is important that the federal government continue to practice prudent fiscal management. The October 2007 Economic Statement forecasts a sizable \$11.6 billion surplus for 2007-08, with smaller surpluses projected for the following two



years. The Statement also predicts a further drop in the federal debt/GDP ratio from 32.3% in 2006-07 to approximately 27% by 2009-10. With the government committed to using end-of-year surpluses to reduce debt, it is possible that the debt/GDP ratio will fall even faster than assumed in the Economic Statement.

That said, a weakening economy and the large tax cuts announced in the October 2007 Economic Statement suggest the government has little room for new spending initiatives or further tax cuts in the upcoming budget. Federal program outlays are on course to reach \$198 billion this year, up by \$10 billion from the previous year and approximately 35% higher than five years ago. Although some provincial governments and interest groups are calling for bigger spending increases, the Business Council believes the government should strive to achieve the spending targets outlined in the October Economic Statement. We also recommend an ongoing program of spending review, both to ensure that existing programs are meeting their objectives and to provide a basis for reallocating expenditures from lower to higher priority areas.

### **3. Tax Policy Choices**

Taken together, the 2007 federal budget and the October Economic Statement delivered substantial tax reductions that will lend support to the economy at a time when growth is likely to be weaker. In particular, the 2007 budget included several key tax measures:

- A 50% depreciation allowance for manufacturers on new machinery and equipment purchased before 2009. This is providing assistance to the struggling factory sector and is expected to stimulate investment in machinery, equipment and technologies.
- New, more generous capital cost allowance (CCA) rates for buildings used for manufacturing/processing, other non-residential buildings, computer equipment; and natural gas distribution lines. The budget also included accelerated CCA for investment in equipment used for “clean energy” generation.
- Major changes to the way in which Canadian companies that do business abroad are taxed. The budget eliminated withholding tax on interest paid between persons in



Canada and the US under the Canada-US tax treaty – a welcome step that should improve Canadian companies' access to global capital markets. However, the decision to disallow the deduction of interest on borrowed money that Canadian firms use to invest in foreign affiliates has attracted strong criticism from business organizations. This measure threatens to undercut the ability of Canadian companies to develop a stronger global presence; it will also lead to a more complex and costly tax reporting and compliance regime. The Business Council is encouraged that the government has established an Advisory Panel on Canada's System of International Taxation, which has a mandate to review the fairness and competitiveness of Canada's international taxation rules.

- The 2007 budget also contained tax measures for individuals and families, including a new, non-refundable \$2,000 tax credit for each child under the age of 18; higher contribution limits for Registered Education Savings Plans; and elimination of the so called marriage penalty by raising the tax credit for low-income spouses to the same level as the basic personal amount. In addition, taxpayers will now be able to contribute to RRSPs and registered pension plans up to age 71 (compared to age 69 before), and workers nearing retirement can continue accruing pension benefits for work performed with the same employer after retirement. Budget 2007 also increased the age credit by \$1,000 per year, allowed pension income splitting, introduced a new Working Income Tax Benefit of up to \$500 for individuals (\$1,000 for families), and raised the \$500,000 lifetime capital gains exemption for small business owners and farmers to \$750,000.

In its October 2007 Economic Statement, the government unveiled an ambitious package of tax cuts amounting to some \$60 billion over five years. The key measures announced in the Statement were: a one-point drop in the GST rate, a plan to bring the basic federal corporate income rate down to 15% by 2012 (compared to 22.1% in 2007), an increase in the “basic amount” that Canadians can earn before paying federal income tax, a reduction in the lowest personal tax rate from 15.5% to 15%, and lower Employment Insurance premiums. Taken together, these measures should provide an additional boost to the economy in 2008



and, more importantly, should substantially improve the competitiveness of Canada's business tax regime over the next several years.

Although the government is not in a position to implement further significant tax cuts in the short-term, the Business Council recommends that it focus on the following priority areas over the fiscal planning period:

- Implement the proposed reductions in corporate income tax.
- Review and, where warranted, modify current capital cost allowance rates to bring them into closer alignment with the economic life of the underlying assets and to close/narrow significant CCA gaps with the United States.
- Extend the 50% depreciation allowance for manufacturers on new machinery and equipment for at least one additional year (to 2010).
- Following the completion of the work of the Advisory Panel on Canada's System of International Taxation, take steps to ensure that Canada's tax laws do not discourage Canadian-based companies from becoming more active as global investors.

As fiscal circumstances permit, we also recommend that the government continue to raise the tax-free amount individuals can earn; lift the threshold for the highest federal personal income rate to \$150,000; and improve the tax treatment of Research and Development by broadening eligibility for tax incentives geared to business spending on innovative activity.

Finally, the Business Council has recently reviewed a proposal on the Streetohome funding model for homelessness developed by the City of Vancouver and we recommend that the federal government support this initiative. Aimed at attracting private funds to help tackle the increasingly visible problem of homelessness, the proposal builds on the government's previous decision to permit the donation of publicly traded shares without incurring capital gains tax. It would enable communities across the country to tailor solutions to their individual situations, bringing in the leadership and funding of local philanthropic investors. The proposal also includes a foundation, focused on homelessness, that would



receive the benefit of donated partnership units. We believe this proposal can be effective in building community capacity and leadership to specifically address homelessness.

#### **4. Other Priorities**

We wish to highlight three other areas where timely action by the federal government is necessary to create a stronger and more competitive Canadian economy.

The first is *regulatory coordination and streamlining*. On an ongoing basis, governments all across Canada should be looking to eliminate outdated regulations, develop more efficient regulatory and approval processes, reduce compliance costs, and strengthen coordination and cooperation with other levels of government. At the federal level, it is especially critical that proposed new regulatory frameworks to limit industrial emissions of greenhouse gases and air pollutants are implemented in a way that minimizes incremental regulatory costs and ensures effective coordination with provincial governments that share jurisdiction in this area.

Second, more must be done to *attract qualified immigrants* to Canada. Last year, the government took steps to expand temporary foreign worker programs, particularly in Western Canada where unemployment rates have plummeted to exceptionally low levels. Looking ahead, the government should build on this success by streamlining and allocating more resources to immigration processing to reduce backlogs and delays; working with the provinces and regulatory authorities to develop foreign credential recognition systems; and taking further action to make it easier for foreign students graduating from Canadian post-secondary institutions to stay in Canada.

Third, Canada's prosperity is closely tied to the ability of our companies to do business in and with the United States. In this regard, like many other business organizations we are troubled by the apparent "thickening" of the Canada-US border and the difficulty of resolving border- and security-related issues with the American authorities. While there are no quick or easy solutions on this file, we urge the federal government to work with US



authorities to minimize disruptions to commerce and travel associated with the implementation of the Western Hemisphere Travel Initiative and to pursue opportunities to expand participation in the NEXUS and FAST programs. Continued investments to improve the efficiency and increase the capacity of border crossings and other border infrastructure are also essential.

The government's 2006 Advantage Canada plan outlined a bold policy agenda to strengthen the foundations of the country's prosperity. The Business Council agrees with the policy directions identified in Advantage Canada, and we applaud the government for the progress it has made to date on a number of the priorities outlined in the plan. We are hopeful that the Advantage Canada vision will continue to inform the government's policy choices in the 2008 budget and beyond.

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The Business Council appreciates the opportunity to provide our advice and recommendations on the 2008 federal budget.