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GREATER CHARLOTTETOWN AREA
CHAMBER OF COMMERCE

SUPPORTING ECONOMIC GROWTH THROUGH A COMPETITIVE BUSINESS ENVIRONMENT

Province of Prince Edward Island Pre-Budget Submission
January 2018

SUPPORTING ECONOMIC GROWTH THROUGH A COMPETITIVE BUSINESS ENVIRONMENT

INTRODUCTION

The Greater Charlottetown Chamber of Commerce is pleased to be able to share its views on how we can continue to strengthen the PEI advantage and push for continued economic growth and prosperity in our province.

The Chamber reflects a diverse network of small, medium and large businesses in almost every industry sector and business profession. We are advocates for businesses in the Greater Charlottetown area, but we also take a broader view as to how we can strengthen all communities on Prince Edward Island, as everyone benefits when all regions of our province are strong.

Working together, the Chamber believes government and the private sector can find ways to address the social and economic challenges we face so that everyone has an opportunity to succeed.

After years of running deficits we are finally seeing the light at the end of the tunnel. The Chamber is pleased that the provincial government has found its way to a return to balanced budgets and are encouraged that this presents Islanders with an opportunity to find new ways to grow and diversify our economy.

It is no secret that there has been considerable attention paid to the manner in which corporations of all sizes are taxed over the past six months, both federally and provincially. We believe the return to balanced budgets provides us with an important opportunity to re-examine Prince Edward Island's tax regime and explore ways to make it more attractive to investment, which we believe will allow us to

continue to recruit and retain companies, entrepreneurs and residents.

POSITIVE ECONOMIC CLIMATE

There are many reasons to be optimistic about the future of Prince Edward Island from an economic perspective. PEI is expected to lead Atlantic Canada in economic growth again this year. This is strengthened by the fact that immigration continues to boost our population which is increasing overall household spending and driving residential construction.

Prince Edward Island Economic Outlook	2016	2017F	2018F
GDP Growth (% change)*	2.4	2.4	1.9
Employment Growth (% change)	-2.3	2.8	0.7
Unemployment Rate (%)	10.8	9.8	9.6
Retail Sales (% change)	7.7	7.0	5.5
Inflation (CPI, % change)	1.2	1.8	1.9

*For 2016, preliminary estimate of industry GDP at basic prices

Table 1 – Prince Edward Island Economic Outlook
 (Source: Atlantic Provinces Economic Council. (2017). Atlantic Canada Economic Outlook 2018: Diverging Prospects. [Online].)

While other provinces in the region have been struggling with their population numbers, Statistics Canada reports that Prince Edward Island has seen its annual population growth rate hit 1.7 per cent. This is 0.5 per cent higher than the national rate and the second consecutive year the province has exceeded it. A significant factor in this accelerated growth is international migration which saw the province hit a new all-time high. At a rate of 15.0 per thousand, the province doubled the national rate of 7.5 per thousand.¹

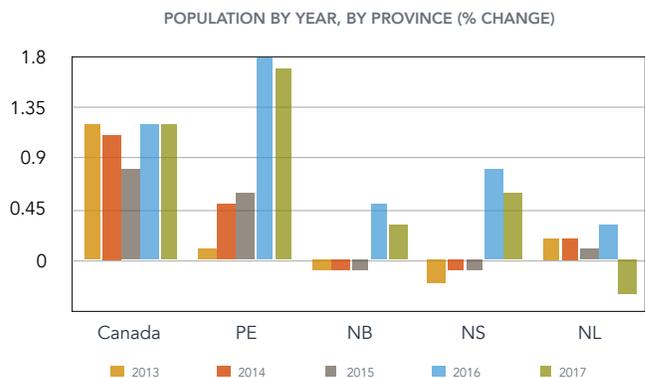


Figure 1 - Population by year, by province (% change)
 (Source: Statistics Canada)

Other positive news from a population perspective is that the provincial median age has been reduced slightly to 43.5, the first decrease since 1967.

One of the benefits of this rapid increase to our population is the need to build more housing. Prince Edward Island had the highest growth in residential investment in Canada through the second quarter of 2017 with an increase of 25.3 per cent, most of which can be attributed to new housing starts.

Another positive indicator is employment with the year over year job rate increasing 3.9 per cent through the end of December 2017. That represents an increase in approximately 2,800 jobs, with all of the gains in full-time work.

With more people in the province, and more people working, the provincial economy has seen an increase in retail sales. In December 2017, Statistics Canada released retail sales data for October and its numbers showed that retail trade on Prince Edward Island rose 7.2 per cent in October 2017 when compared to one year earlier and exceeding the national average of 6.7 per cent. This was second only to New Brunswick in Atlantic Canada.

There are many positive trends happening from an economic perspective, which gives us reason to be hopeful for the future, though we cannot become complacent or rest on our laurels. Good businesses regularly scan the competitive environment to see what others are doing that may impact their operations and make adjustments to ensure that they continue to grow and prosper.

COMPETITIVENESS OF THE TAX SYSTEM

The global economic system is based on the principle of competition. Private sector businesses are constantly looking for ways to differentiate themselves from others who offer similar products and/or services. They need to stand out and convince prospective customers that what they are offering is

superior. Successful businesses are often the ones that take advantage of these unique selling features to expand their markets and hopefully, their profits.

When it comes to recruiting businesses, Canadian provinces are no different and have long worked to identify and highlight why their jurisdiction is the best choice for businesses to operate. They use similar tactics when trying to recruit doctors, entrepreneurs, and others who have choices as to where they wish to establish their businesses.

Naturally, a variety of factors go into a business making the decision on where to locate. Market access, labour costs, availability of an educated workforce, cost to access markets, tax rates, real estate prices, energy costs, and overall quality of life to name a few. PEI has an advantage in some of these and other categories, but the Chamber believes there is an opportunity to focus on how PEI can become more attractive from a cost perspective.

The province is heading into what the Chamber hopes is a new, long-term era of balanced budgets. With that, we believe the time is right to reexamine what it is that makes PEI an advantageous choice for business. We suggest the first area of focus be the competitiveness of our tax system. More specifically, how we can recalibrate the system to help us recruit and retain businesses and newcomers to Prince Edward Island over our primary competitors. We need only look to the success of the bioscience and aerospace sectors to see how a competitive advantage can facilitate growth and expand an industry. These are examples of emerging industries who have benefited from tax holidays, providing evidence that when you use tax incentives you can realize positive economic growth.

Strategic planning is an ongoing exercise for most organizations as they look for how to adapt their businesses for long-term success. There is an opportunity for Prince Edward Island to adopt a similar approach as it searches for ways to continuously improve the competitiveness of the Island advantage. We believe that the provincial

government should adopt an approach that takes a long-term view of taxation. A comprehensive review of the competitiveness of our tax system is long overdue for both corporations and individuals. This review should be done in an open and transparent manner encouraging Islanders to participate and share their views.

In an effort to maximize our long-term competitiveness, we need to take an across the board look at the overall costs of doing business in the province. This includes a detailed examination of personal and corporate income tax rates, property taxes, as well as the various fees that businesses incur for routine government permits and applications. On the pages that follow, we present to you recommendations that can be taken immediately to help improve the competitive advantage of operating a business on Prince Edward Island.

Corporate Income Tax Rates

According to the 2017-2018 budgetary estimates published by the Government of Prince Edward Island the province expects to derive approximately \$60 million in revenue from corporate taxes, which is roughly 5 per cent of the total Own Source Revenue. Not an insignificant number, but in the context of a \$1 billion budget, there are some other numbers with more significance.



Figure 2 - General Corporation Tax Rates by province (Source: Government of Canada)

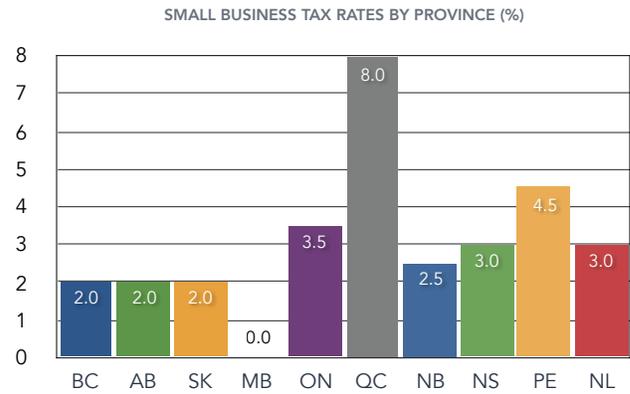


Figure 3 - Small Business Tax Rates by province (Source: Government of Canada)

As demonstrated in Figures 2 and 3, Prince Edward Island currently has the highest corporate tax rates in Canada, with a general corporate rate of 16 per cent, and a small business rate of 4.5 per cent. If we take a step back and look through a marketing lens, it is clear PEI is not as competitive as other provinces from a tax perspective. Unless this changes, other provinces can always claim that they have a better tax regime than PEI, and while it is not the only factor that companies look at when making location decisions, it is certainly a distinguishing factor.

Given the relatively small amount of revenue the province derives from corporate income taxes, there is an opportunity to make our province more competitive, specifically when we are faced with aggressive competition from our neighbouring provinces.

So, what is the economic impact of a small business tax reduction?

Figure 4 shows provincial Corporate Income Tax Revenue by fiscal year end from 2008 thru 2017. The Chamber would like to be able to break this down into revenue that comes in under the small business rate versus the general corporation rate, however the Government of Prince Edward Island does not make public this detailed level of breakdown. The Chamber has made multiple requests to the Department of Finance for a detailed breakdown of general corporate and small business tax revenue; however this request has not yet been fulfilled.

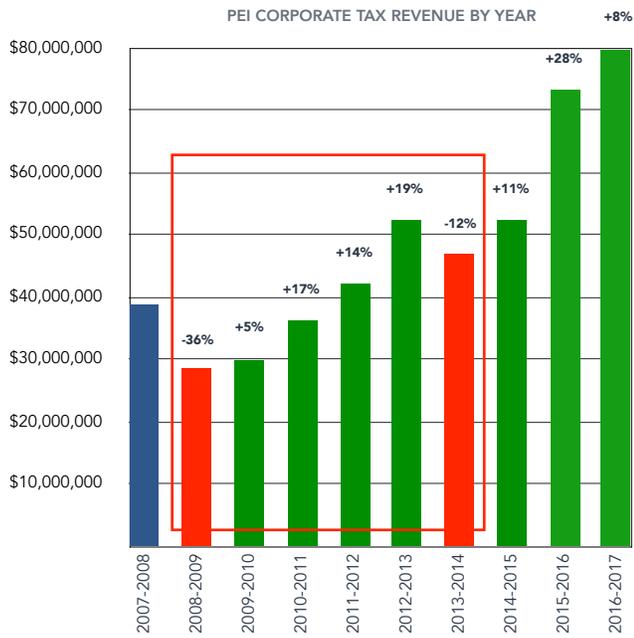


Figure 4 - Prince Edward Island Corporate Tax Revenue by Year
(Source: Public Accounts of the province of Prince Edward Island)

Based on information contained in Table 2, we know that the provincial government reduced the small business rate from 3.2 per cent to one per cent at the beginning of the 2009-2010 fiscal year. It stayed at that rate until the beginning of the 2013-2014 fiscal year when it was increased to the current rate of 4.5 per cent.

PEI Corporate Tax Rates by Fiscal Year			
Fiscal Year Start	Small Business Rate	General Rate	Business Limit
April 1, 2007	4.3%	16%	\$400,000
April 1, 2008	3.2%	16%	\$500,000
April 1, 2009	1%	16%	\$500,000
April 1, 2010	1%	16%	\$500,000
April 1, 2011	1%	16%	\$500,000
April 1, 2012	1%	16%	\$500,000
April 1, 2013	4.5%	16%	\$500,000
April 1, 2014	4.5%	16%	\$500,000
April 1, 2015	4.5%	16%	\$500,000
April 1, 2016	4.5%	16%	\$500,000
April 1, 2017	4.5%	16%	\$500,000

Table 2 – Prince Edward Island Corporate Tax Rates by Year
(Source: Government of Canada)

We acknowledge the correlation between increasing small business tax and an increase in provincial revenue. With that said, there is no correlation between a decrease in provincial income tax and the loss of provincial revenue. In fact, as the section highlighted in red in Figure 4 indicates we have seen provincial revenue growth. One of the primary reasons for the low number in fiscal 2008-2009 was the recession that hit the entire country. Following that year, the government lowered the small business tax to one per cent, and year over year growth in corporate income tax revenues was five per cent. In the three years that followed, corporate income tax revenues continued to rise, with increases of 17, 14 and 19 per cent respectively.

At the beginning of Fiscal 2013-2014, the provincial government increased the small business tax rate from one per cent to 4.5 per cent, and at the end of that year, revenues from corporate income taxes dropped 12 per cent. Much of the losses were made up the following year, and then significant growth (28 per cent) occurred in 2015-2016, when we first started seeing population spikes, employment growth and stronger tourism numbers. The numbers were still a strong eight per cent higher in 2016-2017, but a far cry from the consistent double-digit growth that took place when small business tax rates were at one per cent.

It is important to recognize that a reduction in the corporate income tax rate does not decrease the long-term overall tax revenues of the province. Even if it were the case that revenue was lost with the tax reduction, when corporate tax rates are reduced, the personal tax rates for residents of PEI on dividends from those corporations are increased by a reduction of the dividend tax credit. While in the company, the lower tax rate encourages entrepreneurs to grow their businesses, and this grows the economy of PEI. When the money is removed for personal purposes, the government receives their additional tax revenue by taxation of dividends.

It is our opinion that lowering our tax rates to be competitive will encourage more businesses to locate in PEI and for existing businesses to reinvest more of

their profits into business expansion. Both of these will spur economic growth in PEI, generating more tax revenues based on such economic activity, and ultimately, the Province will receive the tax revenues when business owners take the money for personal purposes. The lower tax rate would at worst be a deferral, and at best, will generate additional revenues from immediate economic spinoffs.

Based on this analysis, we believe that cutting the small business tax rate would show support for our small business community without negatively affecting government revenue sources... in fact it can help improve them.

Recommendation 1: The Chamber recommends the Government of Prince Edward Island reduce the small business tax rate to 2.5 per cent in fiscal 2018-2019 and bring it down to 2.0 per cent the following year, which would give us the lowest rate in Atlantic Canada.

CARBON PRICING

In 2015 the Government of Canada signed onto the Paris Agreement with an aim of strengthening the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius.

In an effort to meet this international obligation, the federal government announced that all provinces would need to put a price on carbon by 2018, and if a province failed to do so, the federal government would impose one. Should a province's proposed carbon pricing regime fail to meet the national benchmark, the federal government would also implement measures to close the gap.

In a previous submission to the provincial government the Chamber recognized that the provincial government must move on climate change given it is clearly a current reality, rather than a future problem. While the province has yet to announce how it will respond, we believe that any mechanism must be done through a continued consultative process.

The Chamber has encouraged the province to conduct a comprehensive cost-benefit analysis of the proposed actions. Any program needs to consider the finite financial resources of businesses and individuals, and we caution against the development of an abundance of small programs which have the potential to create an increased administrative burden with limited gains in emissions reductions.

We must also clearly understand the objectives of any carbon policy being introduced by the provincial government. Is it to ensure there is a price on emissions, to reduce emissions or raise revenue for the provincial government?

British Columbia's carbon pricing model initially established the province as a global leader in climate policy, with little impact to its economic competitiveness. There remains work to be done to maintain that model's effectiveness in emissions reduction, but the Chamber feels that it provides a good starting point. In the interest going further to assist businesses and the public to decrease their overall consumption, the Chamber suggests a hybrid system that offsets some personal and business tax and also introduces a select few proven, cost-effective government mitigation programs.

Recommendation 2: The Chamber strongly recommends that the provincial government adopt a carbon tax system that offsets business and personal taxes with funds collected through carbon taxation. Furthermore, government should clearly state their objectives in adopting the carbon policy, be it to ensure a price on emissions, to reduce emissions or raise revenue for the provincial government.

Recommendation 3: The Chamber strongly encourages the province to conduct a comprehensive cost-benefit analysis of government programming intended to support the reduction of carbon emissions. Again, in consideration of finite financial resources, the Chamber would caution against the development of an abundance of small programs which have the potential to create an increased administrative burden with limited gains in emissions reductions.

MINIMUM WAGE

The Chamber has long felt that the process concerning changes to the minimum wage on Prince Edward Island lacked predictability, transparency and fairness. We believe that when minimum wage hikes fail to meet these criteria, businesses are unable to budget for increased labour costs and have to find new ways to make up for unforeseen expenditures. As seen recently in other Canadian jurisdictions, a poorly managed, non-collaborative process can often have unintended consequences.



Figure 5 - Minimum Hourly Wage Rates as of January 1, 2018
Source: Retail Council of Canada

The Chamber was pleased that the provincial government accepted our recommendation of a minimum of six months' notice for any changes to the minimum wage. With that said, opportunities remain to improve the predictability and fairness of the minimum wage process for both employers and employees.

As demonstrated in in Figure 5, Prince Edward Island currently has the highest minimum wage in Atlantic Canada and is just slightly lower than British Columbia's, though PEI will pass BC when the next scheduled increase (\$11.55) goes into effect on April 1st, 2018. It is important to note that the Chamber supports a living wage for employees, but we would also like to see government pursue some additional measures that could help improve fairness for both employees and employers.

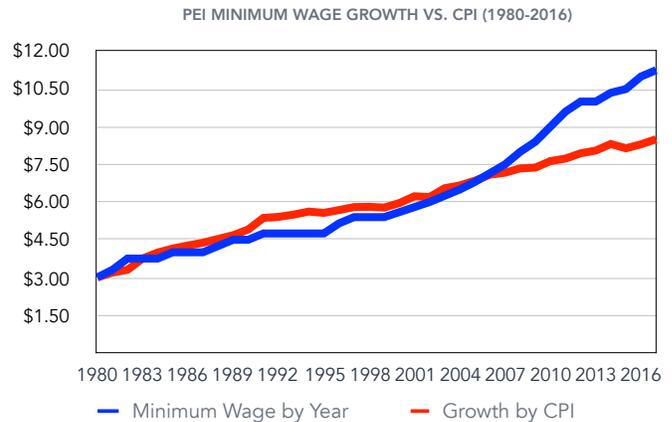


Figure 6 - PEI minimum wage growth vs. CPI
(Source: Statistics Canada)

As Figure 6 shows, in October 1982, mandated minimum wage increases fell behind the consumer price index (CPI). This remained the case until April 2006. After this time, minimum wage increases in the province mostly aligned with CPI until October 2008. Since October 2008, PEI's minimum wage has increased at a much higher rate than CPI. From then until now, the minimum wage has increased 41 per cent², while the CPI rose only 12 per cent³. This has put extra pressures on business owners whom, due to competition, must maintain low prices despite the rising costs of doing business.

The Chamber is encouraging government to consider other methods to improve the situation for employees. While the Chamber acknowledges that the government recently increased the Basic Personal Tax Exemption by 2 per cent, Figure 7 clearly demonstrates that the province continues to have the lowest exemption rate in Canada. It is also one of the only provinces that does not automatically increase the basic personal tax exemption at the rate of inflation.

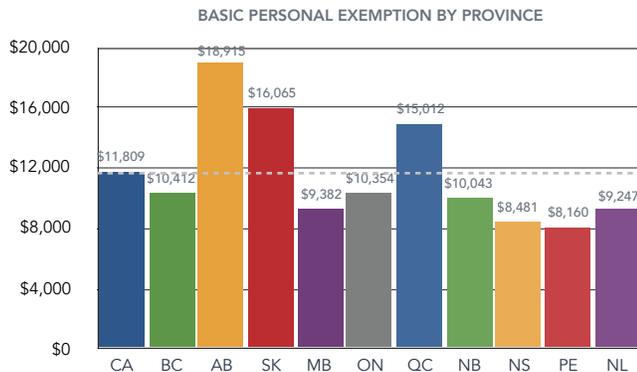


Figure 7: Basic Personal Exemption by Province
(Source: ADP Canada)

Recommendation 4: The Chamber recommends that the Government of Prince Edward Island tie future minimum wage increases to the previous year's Consumer Price Index (CPI), which is an indicator of changes in consumer prices for goods and services in the province.

Recommendation 5: The Chamber further recommends that the provincial government increase's PEI's basic personal tax exemption, which is the lowest in Canada to at least the Canadian average and ties future increases to the basic personal tax exemption to the rate of inflation.

CONCLUSION

The Chamber is proud to support a growing business community and is compelled to consider ways to not only maintain, but improve the existing economic climate. It is in this spirit that we challenge government to support improved competitiveness for Island businesses by adopting the following recommendations:

Recommendation 1: The Chamber recommends the Government of Prince Edward Island reduce the small business tax rate to 2.5 per cent in fiscal 2018-2019 and bring it down to 2.0 per cent the following year, which would give us the lowest rate in Atlantic Canada.

Recommendation 2: The Chamber strongly recommends that the provincial government adopt a carbon tax system that offsets business and personal taxes with funds collected through carbon taxation. Furthermore, government should clearly state their objectives in adopting the carbon policy, be it to ensure a price on emissions, to reduce emissions or raise revenue for the provincial government.

Recommendation 3: The Chamber strongly encourages the province to conduct a comprehensive cost-benefit analysis of government programming intended to support the reduction of carbon emissions. Again, in consideration of finite financial resources, the Chamber would caution against the development of an abundance of small programs which have the potential to create an increased administrative burden with limited gains in emissions reductions.

Recommendation 4: The Chamber recommends that the Government of Prince Edward Island tie future minimum wage increases to the previous year's Consumer Price Index (CPI), which is an indicator of changes in consumer prices for goods and services in the province.

Recommendation 5: The Chamber further recommends that the provincial government increase's PEI's basic personal tax exemption, which is the lowest in Canada to at least the Canadian average and ties future increases to the basic personal tax exemption to the rate of inflation.

On behalf of the members of the Greater Charlottetown Area Chamber of Commerce, we would like to thank you for this opportunity to share our views on how to strengthen our provincial economy.

ENDNOTES

- 1 Government of Prince Edward Island. (2017). Economic Update 2017. [Online].
- 2 https://www.princeedwardisland.ca/sites/default/files/publications/minimum_wage_history.pdf
- 3 <http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/ecpm150a-eng.htm>