INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Pre-Budget Consultations

House of Commons Standing Committee on Finance

Opening Remarks

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Good morning.

I appreciate this opportunity to appear before the House of Commons Standing Committee on Finance, and offer insights and policy recommendations in connection with your pre-budget consultations. The Investment Industry Association of Canada represents approximately 200 member firms, which employ over 40,000 Canadians from coast to coast. Our member firms have a key role in domestic capital markets advising individual and institutional clients on savings and investment decisions, trading securities, and issuing and distributing newly offered securities to finance capital formation and government spending requirements.

At the G-20 Summit held in Toronto, Canada agreed upon a framework to strengthen financial systems against risk and "create strong, sustainable and balanced global growth". Along with the other G-20 nations, Canada has committed to a fiscal plan that will, at a minimum, halve its deficit by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016.

Canada's Economy

Economic growth has faltered after a solid rebound in 2009, and continued confidence in sustained strong growth has weakened. The Bank of Canada's October report shows that the country's economy grew by only 2% in the second quarter this year, at a slower pace than previously estimated. The economy is now expected to grow 3.0% in 2010, 2.3% in 2011 and 2.6% in 2012.

Capital spending collapsed last year, down 33% in the resource sector and 11% for the corporate sector as a whole. However, following a sharp decline and delayed recovery, the rebound in business investment (especially in equipment and machinery) gained momentum in the second quarter of 2010. The Bank of Canada's Business Outlook Survey for Fall 2010 shows that firms across all sectors and regions expect to increase their investments in equipment and machinery over the next 12 months. Yet, access to equity capital in finance markets has been uneven reflecting volatile share prices and trading patterns in secondary equity markets. The changing conditions for raising equity capital, particularly for non-resource companies, have complicated the capital formation process for businesses. Financings for small companies last year and through this year were roughly 50% below the levels before the stock market crash in late 2008.

The IIAC commends the federal government for providing sufficient stimulus to mitigate the economic slowdown and improve business credit conditions, and for retaining a competitive corporate tax regime. Despite these positive steps, the rapid build-up in public debt by federal and provincial governments has dampened business confidence and raised concerns about eventual tax increases and continued slow growth.

The focus of fiscal policy in the Government's 2011 Budget should be expenditure restraint, committed to the plan charted in last year's Budget, to bring the deficit into near-balance by 2014. Sound fiscal management through measured expenditure reduction will strengthen public finances and build business confidence in Canada.

Encouraging Investment in Canadian Businesses

The time is right to implement targeted, specific tax incentives to provide a catalyst to create sustained economic growth in Canada. Small and mid-sized companies heavily dependent on external capital will benefit from capital gains tax relief. The uncertain economic climate and volatile market conditions have made it difficult for these companies to attract capital, increasing the value of a tax incentive to channel capital into productive investment opportunities. Canadian households are currently holding excessive cash in their portfolios – a sizeable cache of funds that could be used to invest in promising new businesses and grow the economy.

The IIAC recommends the federal government lower the effective tax rate on capital gains on publicly listed companies by lowering the current 50% inclusion rate. A reduced capital gains inclusion rate will lower the cost of capital for Canadian businesses and improve the availability of capital, particularly for small enterprise.

Furthermore, evidence suggests a reduction in the inclusion rate on capital gains may not have a significant impact on government tax revenue. For example, if the inclusion rate is reduced by one-quarter to 37.5% from the current 50%, the tax loss would be about $1.5 billion, a small percentage of overall tax revenue. Moreover, this loss would be mitigated by increased tax revenue from the unlocking of unrealized capital gains in response to lower tax rates.

Encouraging Canadians to Invest in the Future

The IIAC supports the efforts of the Canada's Task Force on Financial Literacy and its mandate to provide recommendations for a national strategy, and commends the federal government for initiating this project. It will be important for the federal government to identify and coordinate the many financial and investment literacy programs that already exist in Canada. The securities industry can play and important role in the financial literacy effort, identifying materials already developed and promoting awareness and access to these materials by the investing public through the media and the internet.

The federal government should increase the allowable contribution limits for RRSPs and TFSAs to promote increased retirement savings for middle income Canadians and, at the same time, provide greater fairness in the treatment of pension savings between Canadians with private sector arrangements (typically defined contribution plans) and those Canadians with defined benefit plans. The evidence suggests the well publicized retirement savings shortfall may be restricted primarily to middle income Canadians employed in the private sector.

This argues for targeted relief by buttressing existing tax-assisted retirement savings arrangements by raising allowable contribution limits for RRSPs rather than implementing comprehensive structural solutions. The IIAC has recommended retroactive or “lifetime” contribution limits to the popular TFSAs as a cost-effective approach to help Canadians save for their retirement. The IIAC has also recommended greater flexibility in the minimum withdrawal thresholds in RRIF accounts to assist Canadians.

Conclusion

Robust capital formation by Canadian business is the key to better economic growth and job creation in the country. A faster pace of business spending will also enable a smooth transition from government stimulus spending as the trajectory of deficit financing declines over the next few years. While our capital markets have recovered from the financial crisis in 2008 and are well functioning, a cost-effective incentive in terms of a lower effective capital gains tax rate would provide a catalyst to stimulate risk-taking and improve access to equity capital for Canadian companies, especially job-creating small and mid-sized companies dependent on external capital for expansion.