FEI CANADA 2010 PRE-BUDGET SUBMISSION

AUGUST 14, 2009

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August 14, 2009

Mr. James Rajotte, MP Edmonton-Leduc
Chair, Standing Committee on Finance
House of Commons
Ottawa, Canada
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EXECUTIVE SUMMARY

FEI Canada provides the following three recommendations related to the House of Commons Standing Committee on Finance (FINA) 2010 pre-budget consultation:

1. Monitor government spending and encourage spending restraint in light of the increasing deficit,
2. Stimulate economic growth and employment, and
3. Increase access to capital and cash flow,

all of which are vital to reducing the recession's negative impact, will lead to economic stability in the near term, and will enhance the efficiency of the Canadian economy.

Dear Mr. Rajotte,

INTRODUCTION

The Tax Policy Sub-Committee (Committee) of the Issues and Policy Advisory Committee of Financial Executives International Canada (FEI Canada) is pleased to respond to the House of Commons Standing Committee on Finance (FINA) invitation to present a submission to FINA's 2009 fall pre-budget consultation. As an organization representing more than 2,000 senior Canadian financial executives, FEI Canada is acutely aware of the need to develop economic and taxation policies which encourage savings and investment; foster innovation, productivity and initiative; and enhance the economic and social well-being of Canadians by eliminating unnecessary barriers to economic growth.

Canada has many natural attributes but, in a competitive world beset by economic turmoil, we must foster a business environment that encourages investment and capital accumulation to ensure the growth of the economy and opportunities for future generations. We compete head-to-head with productive capacity in the U.S., particularly given NAFTA. Thus, we must ensure that our taxation regime is also competitive with the U.S.

In today's global economy, competitiveness is critical to the long-term prosperity of, and in certain cases, the survival of, Canadian businesses. Competitiveness implies production with the most efficient use of resources, notably capital and labour; consistent with the desired degree of product quality, access to the capital required to invest in modern machinery and equipment, increased productivity, and enhanced training and education. Increased labour productivity is dependent on the development of a highly educated and trained workforce. Up-to-date in-house training is especially critical to the development of technical and IT employees. Competitiveness requires access to current research and the ability to capitalize on innovative product development. Competitiveness also requires the accumulation of critical masses of labour and investment capital, and dictates that corporations accumulate, and retain, sufficient cash flow to expand and modernize their physical manufacturing structures. As demographics change, Canada faces a severe labour shortage. We must attract and retain the brightest and best talent with the know-how required to increase productivity and competitiveness. Competitiveness must further be achieved, not only on domestic fronts, but on international fronts as well.

Although the Bank of Canada has suggested a tentative economic turnaround, and some suggest Canada is the envy of other countries with respect to economic and financial security, individual Canadians are concerned with the reality or threat of unemployment and the decline in value of their pension and savings portfolios. Offshore competition has placed Canadian manufacturers at a competitive disadvantage, resulting in plant closures and job losses. The worldwide financial crisis has created a credit crunch and contributed to sharply declining corporate profitability or the threat of bankruptcy. Nevertheless, the Committee recognizes the government's capable stewardship of the Canadian economy and financial markets as we move through these difficult times.

As representatives of a cross-section of leading large, medium and small Canadian corporate entities, our members are keenly aware of the need for caution and prudence in troubled times. Similar to managing an individual corporation during an economic downturn, government policy-makers must make strategically sound decisions. Canada must apply solutions to the current global economic crisis appropriate to the relatively stable condition of the Canadian economy and not simply mirror actions of other more severely impacted countries. Planned expenditures must pay off in the short term. The budget must be re-balanced before major new non-recovery initiatives are contemplated. Recovery initiatives should stimulate investment and spending, slow down the rate of bankruptcy and job loss, and foster economic growth.

The following sections outline three issues of concern to our members and flow from the above comments. The Committee believes that implementation of our recommendations will contribute to the achievement of our shared objective, i.e., to "ensure prosperity and a sustainable future for Canada".

I – MONITOR FEDERAL SPENDING AND ENCOURAGE SPENDING RESTRAINT

Federal government spending indirectly affects the revenue system as government must raise the revenues required to pay for its expenditures and service the national debt. Federal program spending has increased back to its 1997-1998 level as a percentage of GDP, and budgetary expenses are at their highest level ever. These trends are not conducive to responsible management of federal fiscal resources, although increased spending is justified where necessary improvements are made to Canada's economic and social infrastructure. FEI Canada is encouraged by the government's pre-recession initiatives which were projected to reduce the federal debt-to-GDP ratio; the Expenditure Management System, which is expected to maintain federal spending in line with economic growth; and legislation which placed formal limits on programs cost-shared with the provinces. These control measures must continue. It is critical that spending be monitored so that the government can continue to provide the health and retirement benefits Canadians have become used to, which, due to the aging population, will consume an increasingly greater percentage of government spending in future years.

With regard to the fiscal balance, the Committee is cognizant of Canada's precarious economic and financial position as the 2010 budget evolves. Fiscal surpluses are only a memory; deficits are now the order of the day. Government must, however, avoid starting down the slippery slope to a permanent structural deficit. Not spending Canada into an unnecessarily large deficit position is a prudent and pragmatic strategy for managing the public purse. We continue to believe that deficit spending must be approached as a temporary measure with a view to short-term recovery so as not to burden future generations with today's over spending.

The fundamental questions are: Who will pay for the current spending and when will payment occur?

A three-year budget horizon, clearly indicating the government's framework for once again achieving a balanced budget position by fiscal 2012 is an effective planning tool. To the extent possible, initiatives should be revenue neutral over the short to medium-term, or the legislated period of the initiative, to limit the negative impact on the deficit. Furthermore, there should be no changes to the previously announced income tax rate reduction schedule, as these are vital to Canadian corporations (especially small and medium sized corporations) as they struggle to remain in operation and maintain their employment base.

FEI Canada recommends that FINA urge the government to:

(i) monitor federal spending and encourage spending restraint where possible, and

(ii) ensure that the reports of the Parliamentary Budget Officer continue to be publicly disseminated, as transparency, accountability and credibility are essential in a parliamentary democracy.

II – STIMULATE ECONOMIC GROWTH AND EMPLOYMENT - SECURING ECONOMIC RECOVERY

Policy initiatives designed to ensure a rapid economic recovery should be prudent and incremental in nature, appropriate to Canada's relatively stable economic and financial situation, and benefit all Canadian taxpayers, businesses and citizens. The focus should be on short to medium-term policies designed to alleviate the immediate negative impact of job losses or declining profits and cash flow. Budget measures intended to provide a major economic stimulus should be subjected to credible analysis of the true state of our economy and be based on empirical evidence rather than public outcry. Furthermore, they should be readily measurable by policy analysts and should not unduly add to the complexity of the tax system or the compliance burden of taxpayers. Reduced compliance costs will improve business productivity and reduce uncertainty, thus improving Canada's competitiveness and assisting in increased production and wealth creation. Wherever possible, the approval processes for accessing government programs should continue to be streamlined and, without compromising the integrity of the program, result in relatively quick decisions.

Economic recovery will be secured by investment policies. However, new major capital expenditure commitments must not be rushed into. Although infrastructure enhancements are urgently required in many regions of Canada, and over time will contribute to economic growth, many of the benefits will not be realized for many years, whereas the related expenditures will be over the short to medium term. The Committee views the focus on infrastructure spending positively while cautioning the government against reactionary spending directed to select industries. Furthermore, Canada must support the growth of a knowledge-based economy by facilitating investment to restructure the economy and provide employment for future generations. Infrastructure spending, therefore, should be focused on strategically placed investments which will create short-term benefits. They should be prudent and fiscally responsible, as has been the government's past practice. Examples of such beneficial targeted spending would be investments in technology incubators and public-private partnerships which foster the commercialization of ideas developed by university researchers.

Government is also urged to put more effort toward encouraging the creation of Canadian corporate champions of research and development and continuing education and training, and to more publicly support corporations which are recognized worldwide for their creative and innovative approaches to employee skills development.

Tax incentives are most effective when targeted directly at the desired outcome.

Business responds to incentives which benefit operations. Selective and carefully designed tax credits (e.g. the small business deduction) have achieved their intended results. Prior FEI Canada pre-budget submissions have recommended an employee education and training credit to encourage businesses to increase spending in this vitally necessary area; a "learning account" into which a portion of Employment Insurance contributions could be placed for use by employers in declining sectors; a broadening of the definition of what is currently deductible as qualifying education and training; and introduction of a deduction or refundable tax credit for personally acquired qualified education and training. Alternatively, displaced employees could be provided with a subsidy to undertake re-training. The effectiveness of these initiatives should be monitored to ensure positive net benefits are realized. These promising measures (which parallel similar provisions in other countries) support the government's commitment to hasten economic recovery. Such policies also help to achieve the more important overall objective – that of improving the economic and social well-being of individual Canadians as we compete on the global stage.

FEI Canada recommends that FINA urge the government to:

(i) closely monitor previously announced economic recovery initiatives to ensure they are meeting stated goals,

(ii) reallocate funds to enrich federal investments in infrastructure which will lead to economic growth (transportation, research and development, and post-secondary education are three examples of sectors which would benefit from enhanced infrastructure spending), and

(iii) include in Budget 2010 the specific recovery measures noted above.

III - INCREASE ACCESS TO CAPITAL AND CASH FLOW

(a) Increased Access to Capital

Capital formation is a critical component of economic development and growth. Without significant infusions of new capital, economic development is hampered, critically-needed maintenance and renewal is delayed, productivity is impaired, and employment levels are lower than is optimal. Unfortunately, Canadian capital pools are, and always have been, insufficient to satisfy the constant need for new investment capital. Consequently, Canada has historically relied on foreign investors to provide the capital not available from Canadian sources.

Given the globalization of economic activity and capital formation, where international investors can place investments anywhere in the world relatively quickly and easily, government must provide additional incentives to lure mobile capital to invest in Canada, an imperative the government recognized in concluding the 2007 Protocol to the Canada-U.S. tax treaty with respect to cross-border interest payments. Removing withholding on interest and dividends paid to all non-Canadian entities would greatly facilitate the acquisition of cost-effective capital.

All Canadian corporations require capital obtainable on reasonable terms to maintain current operations, expand capacity and markets (especially global markets), conduct research and development initiatives, and in certain cases, survive. In addition to shareholder equity capital, corporations' access debt capital provided by financial institutions, venture capitalists, equipment suppliers, government sponsored agencies, and, in the case of smaller corporations, loans from individuals. Critical to the growth of the economy is the ability of entrepreneurs to access capital for start-up businesses. An important category of potential entrepreneurs is the large number of displaced employees resulting from the current recession. In certain situations, private-public partnerships expand the capital pool.

As the financial crisis has evolved, access to capital has decreased. A recent FEI Canada survey indicated that 46% of respondents report a significant decrease in working capital financing, and 52% a significant decline in long-term financing, post December 2008. Furthermore, respondents report a more onerous process for obtaining credit and an increased cost of capital. These concerns are especially acute for small and medium sized businesses.

Well-designed tax and other government policies can efficiently expand the overall capital pool, streamline the debt approval process, decrease the after-tax cost of financing, and result in an increased flow of capital to otherwise worthy, but risky, businesses. The Committee believes government policy should focus on increasing the capital pool available to venture capital funded businesses, entrepreneurial activity and start-ups, as properly financed profitable operations of this nature provide a significant potential for economic growth and increased employment. Tax policies which assist displaced workers start a new business (e.g., an averaging for tax purposes of their termination payment over two or three years if it is reinvested in a new start-up), enhanced investment tax credits for research and development (an effective source of collateral), and a tax holiday for new entrepreneurs subsequent to the loss of employment, would provide additional capital to assist individuals who wish to create new businesses.

To support the economy as Canada moves out of recession, government should (i) strive to create a National Securities Regulator, (ii) encourage initial funding of Canadian technological companies, especially those engaged in innovative research and development, and (iii) work with government sponsored lending agencies to increase existing loan limits to large and small businesses, streamline the application process, and create new types of loans which tailor interest rates, repayment terms and collateral requirements to the needs of recession plagued corporations, especially for firms which focus on innovative processes and technologies and green investments.

(b) Enhancing Cash Flow

Corporate cash flow is critical to meeting current operating needs. A particularly onerous concern for corporations with defined-benefit pension plans is the requirement to fund these plans over a five-year period. Liquidity could be improved if this requirement was extended to fifteen years.

Many Canadians now must consider working beyond their expected retirement date as the current financial crisis has significantly diminished the value of their pension plans or reduced the value of their investment portfolios set aside for retirement. Extending the mandatory date for cutting off contributions to the CPP for those not yet eligible for the maximum pension payments, contributing to RRSPs, and converting RRSPs and RRIFs to the age of 75; increasing RRSP contribution limit to 25% of earned income; and electively extending the deadline for RRSP contributions to the age of 73 will add flexibility to the employment opportunities of older workers and will greatly enhance their retirement planning.

FEI Canada recommends that FINA urge the government to:

(i) review all government funding programs, tax policies related to debt financing, and the lending practices of financial institutions and other providers of finance, with a view to increasing the availability of capital, streamlining the application/approval process, and ensuring that debt contract terms are appropriate to businesses recovering from, or being started in, a financial crisis, and

(ii) include the above cash flow enhancements in Budget 2010.

CONCLUSION

FEI Canada believes that Canada is in a unique position to provide the temporary stimulus that our economy needs in 2009, while keeping in mind the long-term stability of government finance that has been demonstrated to provide the basis for our nation's long-term economic benefit. We urge FINA to consider the long-term implications of all of its recommendations to government as we have attempted to outline in this brief.

We thank FINA for the opportunity to present FEI Canada's recommendations on the 2010 budget. We look forward to continuing to work with FINA and the government to ensure that Canada maintains the highest levels of competitiveness and economic growth from which all Canadians will benefit.

Respectfully submitted,

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