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House of Commons Standing Committee on Finance Pre-Budget Consultations in Advance of the 2018 Budget
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Executive Summary

The Investment Industry Association of Canada (IIAC) welcomes the opportunity to participate in the House of Commons Finance Committee's pre-budget consultations and provide our recommendations on behalf of our 130 member firms in Canada's securities industry. Our members are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services for individual investors, and securities trading and underwriting in public and private markets for governments and corporations.

The themes chosen for this year's consultations—productivity and competitiveness—are not new, but remain top of mind of many Canadian business leaders. The topics are interlinked—productivity growth is closely linked to growth in the standard of living, and to business competitiveness.

Chronic poor productivity growth in Canada is damaging our international competitiveness. A strategic and visionary policy approach is required to create a distinctive Canadian advantage.

With this in mind, the IIAC calls on the federal government to:

1. Chart a credible path back toward balance. Rising debt and interest burdens constrain budgetary flexibility, reducing the government's capability to bolster our long-term competitiveness. The federal government must provide a credible plan on how it will balance the books.

2. Leverage the private sector for infrastructure investment: State-of-the-art transportation, telecommunications, and energy networks are central to Canada's prosperity and global competitiveness. Mechanisms to link public and private capital and expertise are needed to ensure a more broadly based and powerful national infrastructure program.

3. Provide incentives for investment in growing Canadian businesses: Implementing a broadly based, market-driven tax incentive will enable small and mid-sized successful businesses to grow, innovate and create jobs in Canada.

4. Further encourage tax-assisted retirement savings: With life expectancy steadily increasing and real returns on investments expected to remain low, many Canadians face a significant risk of outliving their

savings. Additionally, a rapidly aging population and slower growth in the labour force will exert significant pressure on strapped government coffers as demand for publicly funded programs, like health care, rises significantly. It is critical that the government make improvements to tax-assisted retirement savings programs to encourage Canadians to save more for their retirement and for future out-of-pocket health care costs.

Charting a credible path back toward balance

The government was elected on a pledge to run deficits for two years and then bring the books back into balance over the next two years. Now, the government's view appears to be that deficits don't matter, as long as the debt-to-GDP ratio remains stable. The fact is, the level of GDP is out of the government's control. As the Parliamentary Budget Officer notes, a one percent decrease in real GDP over the next five years would result in a deterioration in the budget deficit of roughly $4 billion a year. Debt levels would rise, increasing public debt interest expenses. Moreover, any upward movement in interest rates would exacerbate the deficit and debt burden. By the government's own estimates, federal public debt charges are projected to consume $33.3 billion in fiscal 2021-2022—money that could otherwise be invested in productivity-enhancing measures.

Fiscal discipline is also the cornerstone of business, consumer and investor confidence, and critical to robust private sector investment spending and overall economic growth. Today's deficits are tomorrow's taxes. The federal government must present Canadians with a credible plan and clear timeline for balancing the budget.

Leveraging the private sector for infrastructure investment

A Senate Committee report titled "Smarter Planning, Smarter Spending: Achieving Infrastructure Success" found that of the $13.6 billion in infrastructure spending planned for 2016-2017 and 2017-2018, only $806 million worth of projects (or 6%) have actually commenced. It is clear many projects are not "shovel ready", taking time to move from the drawing boards to commencement. The Fraser Institute concluded that only a small fraction of Ottawa's nearly $100 billion in planned infrastructure spending over the next decade, just 11 cents of every dollar are earmarked for transportation and trade projects that can improve productivity and boost long-term economic growth. Government needs to manage infrastructure spending carefully to mitigate the risk that the spending (and the growing deficits and debt burden) will fail to unleash productivity and translate into significant economic growth.

The federal government should develop a complementary strategy to harness the available capital and expertise of the private sector, based on a "P3" financing model. It could tap into the large pool of available private capital, thereby reducing the need to rely so heavily on the public purse for these projects. It could also rely on private sector mechanisms to allocate capital to the right projects.

There are many mid- and large-sized infrastructure projects in Canada in need of capital; there is also private sector institutional and retail investment capital available in Canada which could be invested in these projects. To fully capitalize on this, the government should: (1) to provide "catalytic capital" to help enhance the economic viability of these large projects; and (2) to ensure projects are structured to balance a healthy return to private sector investors with the needs of the public and the "social return" to Canadians in the form of increased productivity. If the government can fully leverage public and private resources, the success of infrastructure projects will be enhanced, in terms of the number of projects that can be completed, and developing projects that are more efficiently built and operated.

Providing incentives for investment in growing Canadian businesses

In an effort to augment the sources of equity capital available to growing small and mid-sized businesses, the government launched the $500 million Canadian Business Growth Fund (to grow over time to as much as $1.0 billion), backed by the large banks and insurance companies. Individual fund investments will typically range from $3 million to $20 million. The Fund is modelled on the success of the UK Business Growth Fund, financed by five UK banking groups (Barclays, HSBC, Lloyds, RBS, and Standard Chartered). The UK Business Growth Fund makes equity investment in private and AIM-listed companies—initially, between £2 and £10 million.

The more effective financing vehicle—generating far more equity capital for small business and in terms of identifying successful investment opportunities—would be a Canadian version of the UK Enterprise Investment Scheme (EIS). The EIS Program provides a 30% personal tax credit for EIS-eligible share purchases, an exemption from capital gains tax for EIS shares held more than three years, and a rollover provision exempting capital gains taxes on the sale of an asset, if the proceeds are reinvested in EIS shares. For businesses to qualify for the EIS relief, they must have gross assets of less than £15 million and no more than 250 full-time employees.

The EIS has funded more than 26,000 small businesses in the UK, providing overall equity capital of £16 billion (£6 in the last four years, more than 10 times the amount undertaken by the UK Business Growth Fund). Further, the EIS Program is dominated by small-sized investments, with 80% of the investors making a claim for tax relief for investments less than £50,000. This means the program is popular among individual investors.

Investments in EIS-qualifying shares of small business have a solid track record of success because the investor's own capital is at stake—unlike the professional fund manager. Many investors are knowledgeable and acquainted with the EIS-qualifying investments, as many of the businesses are local.

The EIS Association estimates the tax expenditures of the Program are more than offset by the revenues generated from corporate taxes, taxes paid on salaries to employees, and VAT paid by EIS-financed companies.

Addressing the retirement savings gap

It is critical that the government make improvements to tax-assisted retirement savings programs to encourage Canadians to save more for their retirement and to help Canadians meet future out-of-pocket health care costs (e.g. drugs, home care, long-term care, dental and vision), which could potentially be financially devastating in retirement. As an example, the cost to live in a private nursing home in Ontario can range from $20,000 to $30,000 per year, according to Senioropolis Inc. A 2014 BMO Wealth Institute survey indicated that Canadians expect to spend an average of $5,391 a year on out-of-pocket medical costs after the age of 65. Of those surveyed, 45% made regular or occasional contribution to an RRSP, often through employer-sponsored plans; 24% made regular or occasional contributions to a TFSA; and 18% made contributions to another retirement fund.

The federal and provincial governments have made modest enhancements to the CPP to provide incremental improvement in the retirement income of Canadians. These CPP modifications will help working-age Canadians the most, but will not address the savings challenges faced by specific groups, such as younger Canadians who need strong employer-based savings plans (such as Group RRSPs) to supplement the CPP, or Canadians close to retirement who would benefit from being able to save in these plans later in life, and by having more flexibility to manage those savings.

The government should consider options to strengthen existing tax-assisted savings vehicles to ensure that all Canadians have access to adequate income replacement upon retirement.

First, the IIAC recommends that the government relieve employers' and employees' contributions to Group RRSPs from payroll tax, which will lead to higher savings for individuals using these plans. According to Benefits Canada, there are approximately 10,400 companies that sponsor Group RRSPs for two million employees, with more than $76 billion under management. Group RRSPs face tax disadvantages versus Defined Contribution Pension Plans and Pooled Registered Pension Plans. This tax unfairness disenfranchises the many Canadians that rely on Group RRSPs for saving for their retirement. For example, employer contributions to a Group RRSP are treated as earnings and, hence, payroll taxes like CPP and EI are deducted from those contributions. This uneven treatment is justified on the spurious grounds that Group RRSPs are not really a pension plan as funds can be withdrawn before formal retirement.

Second, the IIAC recommends the age of eligibility for contributing to RRSPs be extended beyond age 71, and that the rules mandating minimum yearly drawdowns from RRIFs and similar accounts be eliminated to provide seniors with more flexibility and longer income tax deferral.

Finally, the government should gradually increase the Tax-Free Savings Account (TFSA) contribution limit back up to $10,000. TFSAs are a very popular saving vehicle for Canadians. They appeal to just about everyone. Low- and modest-income Canadians like TFSAs because withdrawals and investment returns earned in the account do not affect their eligibility for federal tax credits and benefits. Seniors make use of TFSAs because they can no longer contribute to an RRSP after December 31st of the year they turn 71 years of age. Younger Canadians use TFSAs to fund their first home purchase or post-secondary education. Additionally, the TFSAs have proven to be an important source of capital for small business – i.e. a proportion of TFSA savings have been invested in the speculative shares of small business.