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Chair

Mr. Massimo Pacetti

Standing Committee on Finance

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● (0935)

[*English*]

The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)): Good morning, everybody. Thank you for being here. We're just five minutes behind schedule. That's not so bad.

I want to make the witnesses aware that we're going to allow you a five-minute opening statement. I'd like to respect the five-minute time limit, because the members are going to want to ask questions, and we're on a time restriction. The meeting is going to have to last an hour and a half, because we have another panel coming afterward. Is that okay with everybody?

I have a list of the groups that are here. I have the Canadian Bankers Association first, with Mr. Protti.

[*Translation*]

Mr. Raymond Protti (President and Chief Executive Officer, Canadian Bankers Association): Thank you, Mr. Chairman, and members of the Committee, for giving us this opportunity to participate again in your pre-budget consultation process. The CBA welcomes the opportunity to provide our input into the Committee's pre-budget deliberations.

My comments here today underscore the themes outlined in our written submission which, we believe, support continued economic prosperity and a superior quality of life for all Canadians.

[*English*]

It is critical to invest in important public services such as health care, infrastructure renewal, and national defence; it is absolutely vital to continue to pay down the national debt so as not to burden future generations with it; and it remains an important priority of all Canadian businesses and households to have their tax burden reduced.

Last year, the six largest Canadian banks paid $9.5 billion in taxes to all levels of government in Canada, more than half of which was paid to the federal government. That's more than any other industry in Canada. To put the $9.5 billion in tax revenues in perspective, it's enough to finance by itself the child tax credit or National Defence operating expenditures.

While recognizing the need for investment in critical public services, we believe the best way to build upon Canada's recent economic success is to do more of the same: reduce taxes and pay down the debt. These two things, paying down debt and making taxes competitive, will provide the necessary foundation for a strong and prosperous economy and in turn the necessary revenue to fund government programs.

Specifically with respect to corporate income taxes, since the 2000 budget the government has reduced substantially the nation's general corporate income tax rate, from 28% to 21%, and combined with the different provincial CIT rates, Canada is now among the most competitive countries in the world on this score.

As these rates have come down, the tax base has grown stronger, and so government revenues have grown higher. The economy has proven resilient and has thrived.

This power of tax reductions to stimulate an economy, strengthen a tax base, inspire entrepreneurs, foster productivity and growth, and empower citizens is resonating all around the world. From Finland to Japan, and from France to Poland, governments of all political stripes are reducing the corporate income tax rate in part to achieve the fiscal and economic strength that Canada has realized over recent years.

Canada's banks see the benefits of reductions in corporate tax rates firsthand, because we have relationships with the smallest businesses and the largest. We see the new jobs, the new expertise, the new technology, the innovation, and the optimism. Canada has been at the forefront of these corporate income tax reductions, and we have been at the forefront of benefiting from them.

We recommend that you give strong consideration to further lowering CIT rates. We are a nation of entrepreneurs and job creators, and lower CIT rates will mean a stronger economy and a stronger tax base as new businesses emerge and existing businesses grow. This stronger tax base will ensure that the revenue sources government and citizens require are assured for years to come.

The second specific tax issue I want to address is the large corporations capital tax. Notwithstanding Canada's relatively low CIT rates, we still find the effective tax rates Canadian businesses pay continue to be uncompetitive with the United States.

The C.D. Howe Institute's recent study on taxing investments shows that the effective corporate tax rate on capital for large corporations is 50% higher in Canada than in the U.S. It's 31.8% here, and in the U.S. it's 20.1%.

Capital taxes are almost a uniquely Canadian phenomenon that undermines the nation's innovative and productive capacity. From the standpoint of financial institutions, capital taxes are particularly punitive, since our members are compelled by regulation to hold high levels of capital to support the safety and soundness of the financial system and are then taxed for doing so.

The Department of Finance's own study, released earlier this month, showed that from the standpoint of economic growth few tax cuts are as beneficial as capital tax cuts. Compared, say, with reductions in consumption taxes or personal income taxes, capital tax cuts provide a substantially greater economic stimulus.

We strongly supported the government's announcement in the 2003 budget to eliminate the federal capital tax over a five-year period. We believe that serves as an important example to provincial governments who, after all, collect the vast majority of capital taxes paid in Canada.

Given the undeniable benefits of the elimination of the capital tax and the fiscal flexibility the government currently enjoys, we encourage the government to accelerate the schedule to eliminate the federal capital tax.

Those are my initial comments, Mr. Chairman. Thank you very much.

● (0940)

[*Translation*]

The Chair: Our next group is the Canadian Association of Mutual Insurance Companies.

Mr. Lafrenière.

[*English*]

Mr. Normand Lafrenière (President, Canadian Association of Mutual Insurance Companies): Thank you.

The Canadian Association of Mutual Insurance Companies is pleased to appear before this committee to share its views on the questions you asked in preparation for the federal budget. CAMIC represents the large majority of property and casualty mutual insurers in Canada, and as most Canadian-owned property and casualty insurance companies are mutuals, CAMIC represents the majority of Canadian-owned property and casualty insurers in this country.

In 2003, our member companies had approximately four million policy holders, employed in excess of 10,000 managers, employees, and agents, and underwrote $4.1 billion in premiums, which was 11.7% of the Canadian market.

Mutual insurance companies are owned by their policy holders, and most of them operate under the "one member, one vote" principle. As owners, the policy holders elect the board of directors of their company. Mutual insurers are renowned for their strong balance sheets and their community involvement. Most Canadian mutual insurers are based in small communities.

Mutual insurers are associations of people whose purpose it is to supply insurance products. Surpluses, if any, are returned to the policy holders in one form or another. Similarly, governments are also associations of people. Surpluses, if any, should be returned to the people they serve; however, this is currently not happening at the federal level. The federal government raises money for which it has no use under the responsibilities obtained under the current Canadian constitution.

[*Translation*]

Because of this surplus money being raised, the federal debt has been reduced in recent years to a point where our debt-to-GDP ratio now compares favourably to other G-7 countries. Because of debt reduction in conjunction with economic growth, the cost of servicing the debt on a per-dollar of revenue basis has diminished significantly in recent years. Debt servicing costs have dropped from 30¢ per dollar in the early 1990s to 23¢ for every dollar of revenue now.

While eliminating the deficit and paying down the debt were certainly necessary, we now have to recognize that in the last seven years, the provinces have not had access to the money they needed to fulfill their responsibilities, while the federal government has been generating surpluses. It seems somewhat peculiar that in order to meet their responsibilities, provincial governments and their creations—municipal governments—now have to go to Ottawa and beg for the funds they need.

We believe it is more appropriate for these levels of government to raise their revenue directly from the population they serve and that they be accountable to that population, and that population only, for all the money they spend.

[*English*]

The general population deserves and expects all levels of government to spend responsibly. In this respect, CAMIC applauds the multi-year reallocation exercise announced in the 2004 federal budget. While the general population does not ask for tax reductions, it is our belief that it is not ready to pay higher taxes either.

The solution to the federal imbalance, therefore, seems to be for the federal government to give the provincial and municipal governments the tax room they need by vacating an equivalent tax room. The tax room, and any subsequent additional tax room that should be vacated, should be flexible and be equivalent to the surplus generated the previous year by the federal government less the $3-billion contingency fund, which should continue to be allocated to the payment of the national debt.

In turn, the federal government expenditure growth should be limited to the level of inflation and population growth. While we acknowledge that the positive economic cycle may one day come to an end, it is our view that the systematic overtaxation of the last seven years, in conjunction with the provincial and municipal governments' systematic deficits, makes the status quo unsustainable.

About a week ago we saw the parents of autistic children from British Columbia asking the court to force the provincial government to provide health care services to their children. While the Supreme Court could not force the B.C. government to provide the service, it was widely recognized that fairness required that the government provide it. The government, it seems, cannot afford fairness. Providing fairness, in our view, should not be an option.

● (0945)

[*Translation*]

At the municipal level, Canada is facing a deficit in the infrastructure system. Water and sewer systems must be renewed at a given rate in order to keep them operational. According to the municipalities, this rate of renewal has not been respected for so many years that we now risk many costly breakdowns.

Clearly, the responsibilities given to the provinces under the Canadian Constitution—health care, education, social and municipal services, etc.—are proving very expensive to meet. We are nevertheless a caring society and, to the limit of our abilities, we should attempt to meet them. Similarly, the responsibilities transferred to municipalities by provincial governments are enormous and not commensurate with their taxation abilities.

[*English*]

The insurance industry also needs tax changes to operate more effectively and more fairly. Foreign-owned property and casualty insurance companies doing business in Canada often benefit from taxation provisions in other countries that allow them to set aside, free from income tax, reserves to meet their obligations in cases of catastrophe, which occur every 25, 50, or 100 years. For its part, the Canadian system considers as profit in any given year sums of money received but not reserved for the payment of a specific claim. To establish a level playing field with their foreign competitors, many Canadian-based companies have resorted to establishing what is called offshore companies. Through these offshore companies they can obtain equal income tax advantages to those enjoyed by many foreign insurers doing business in Canada.

For their part, mutual insurers do not resort to the offshore companies concept, and find themselves in a tax disadvantage with both many of their foreign-based and many of their Canadian-based competitors.

The solution lies in allowing the establishment of catastrophe reserves in Canada, free from income tax, similar to the catastrophe reserves concept implemented in many European countries and in Japan. This is a self-financing proposal, as the investment income generated by these reserves would be taxable.

Thank you, Mr. Chairman.

The Chair: Merci.

Now we'll go to one of the most important associations, I would think—that's because I'm a CGA, by the way—the Certified General Accountants Association of Canada.

Mr. Colby.

Mr. Everett Colby (Chair, FCGA, Certified General Accountants Association of Canada): Thank you, Mr. Chair.

Thank you for your welcome this morning and for the opportunity to appear before the committee. We are honoured that the Standing Committee on Finance is interested in the views of the Certified General Accountants Association of Canada.

Mr. Chair, I'd like to start with some very brief remarks about the role we think the federal government should play in Canada's economy. You've received copies of our brief as well as my remarks. They're available in both official languages.

CGA Canada believes that the federal government's primary role in governing the financial affairs of Canada is to get the fundamentals right—to ensure spending, tax, and regulatory structures do not diminish Canada's ability to compete; to promote economic policies that maintain low inflation and stabilize interest rates; to support research and promote its commercialization; to provide modern physical and social infrastructure; and to dismantle barriers to allow Canadian goods and services to reach across provincial and foreign markets.

In our opinion, the federal government has in recent years made considerable progress in these areas. We are particularly pleased with the establishment of the cabinet committee on expenditure review chaired by Minister McCallum. The committee has set out an ambitious agenda to review programs and assess them against such important criteria as public interest, value for money, efficiency, and affordability. This is how we manage our affairs and how we would expect the government to manage the affairs of the nation. Likewise, we support efforts to strengthen financial management, oversight, transparency and accountability by re-establishing the office of the Comptroller General, appointing professionally accredited comptrollers, bolstering internal audit functions on a government-wide basis, and introducing corporate governance rules for crown corporations.

Mr. Chair, our brief contains detailed recommendations in a number of areas covering four essential economic and fiscal fundamentals—continued commitment to fiscal prudence and expenditure control, competitive federal tax policy, efficient and smart regulation, and effective interprovincial and international trade policy. Our brief contains a number of recommendations, but my comments today will focus specifically on tax reduction.

As committee members know, the five-year tax reduction plan has come to completion. The time has come to build on the changes instituted in the 2000 budget and the 2000 budget update. We would like to make the following proposals. We believe that if implemented these proposals will contribute to conferring a competitive edge on all classes of Canadian taxpayers relative to U.S. counterparts. CGA Canada proposes that consideration be given to increasing the taxable income threshold by 25%. Upper rates could be further reduced and upper brackets further expanded. Adjusting personal income tax rates in brackets would increase efficiency and enhance incentives, compliance, and other economically consequential factors.

Our second proposal addresses the growing consensus that Canada must shift its personal tax base from an income base to a consumption base. One method of implementing this shift involves establishing a regulated regime of tax-prepaid savings plans that could be used to supplement existing savings vehicles such as RPPs and RRSPs.

Practically speaking, by introducing tax-prepaid savings plans, the federal government would prepare Canada to address the future financial responsibilities of an aging population, decrease tax avoidance among high-income earners, and more importantly, preserve tax progressiveness, while promoting savings among those facing increasing marginal tax rates. All these benefits would suggest to me that the advantages of tax prepaid savings plans fit with Canada's overall tax and fiscal policy objectives.

Canada possesses less clout than our southern big brother in attracting and retaining investment capital. Yet one comparative advantage we do possess is a decidedly rosier fiscal outlook, giving the government greater leeway to use the tax system to generate economic advantages. Because business taxes, among other types of tax, produce disproportionate economic effects relative to revenue, further attention to lowering Canada's tax burden should primarily focus on further reducing corporate tax rates. Implementing already scheduled cuts to corporate tax rates will lower our rates below those of the U.S., but Canadian tax treatment of depreciation and a general absence of capital taxes in the U.S. still disadvantage Canadian investments. Indeed, even at reduced values, Canadian corporate tax rates will exceed EU and OECD averages, unfavourably impacting Canada's ability to compete on transfer pricing, debt shifting, and choice of business location. High effective tax rates on capital, moreover, impede capital investment and job-creating foreign direct investment, and harm productivity.

Canada ought to investigate exploiting corporate tax advantages to become a preferred gateway for business and international expansion in the North American market. Gains in investment, innovation, output, productivity, diversification, and jobs are probable, while fiscal costs and risk to government remain relatively low.

● (0950)

In conclusion, Mr. Chair, CGA Canada recommends the following: reform personal income taxes and corporate income taxes, and introduce tax prepaid savings.

We thank you for your time. We would be happy to address any questions the committee might have on these or other recommendations contained in our brief.

The Chair: Thank you.

The Canadian Co-operative Association, Mr. Sitaram.

Mr. Dave Sitaram (President, Canadian Co-operative Association): Thank you, Mr. Chair.

Good morning. My name is Dave Sitaram. I am president of the board of directors, Canadian Co-operative Association.

I am pleased to be here this morning and I am joined by Jean-Yves Lord, CCA exective director.

The Canadian Co-operative Association is a national, not-for-profit co-operative owned by its members. The members come from many sectors of the economy and include groups such as federated co-operatives, Co-op Atlantic, eight provincial credit unions central, including my own Credit Union Central of Ontario, the Co-operators Group, and the Co-operative Housing Federation of Canada.

Co-operatives are owned and controlled by the people they serve. While all of us value financial performance, the ultimate focus of the co-operatives and credit unions is the social and economic empowerment of people and communities.

In the time we have this morning we would like to highlight a number of issues that are of concern to the co-operative sector as a while. I would like to pass the microphone to Jean-Yves.

● (0955)

Mr. Jean-Yves Lord (Executive Director, Canadian Co-operative Association): Monsieur le président, we have four recommendations to put before you touching on the following areas: agricultural trade, co-operative development, social economy, and official development assistance.

In co-operative development, a current partnership between the federal government's Co-operatives Secretariat and the co-op sector is allowing Canadians to use the co-operative form of enterprise to respond to contemporary issues and challenges all over Canada. This partnership is known as the co-operative development initiative, CDI, and includes two components: research and innovation, and advisory services.

Advisory services is managed by the co-op sector and is valued at $5 million over five years, with an additional 20% contribution from the sector. Unfortunately, the resources allocated to CDI, in particular those resources supporting the advisory services component, are not nearly enough to respond to the needs expressed by communities looking for co-operative solutions to locally defined economic and social issues. The amount of $1 million a year for advisory services in ten provinces and three territories in both official languages is not enough. It does not go far enough.

We are calling on the government to recognize the specific socio-economic role that co-operatives play in Canadian society. We ask for a commitment in the next budget to work with us to provide adequate federal funding to foster its growth and development where the need exists.

On agricultural trade, the BSE situation is disastrous to more than agricultural co-operatives. Credit unions for which agricultural lending represents a significant portion of their portfolio and retail co-operatives that supply inputs to the agricultural sector are also affected.

We concur with many that having the U.S. border reopened will be the quickest way to resolve the problem. To that end, we urge the government to allocate additional financial and human resources to reopen the border as soon as possible. We also recommend that these efforts be focused on ensuring that all restrictions related to trade in live products be based on scientific data only.

Also, current government measures meant to facilitate an increase in domestic slaughter capacity do not adequately meet the needs of producers interested in forming co-operative slaughter houses. We have three areas of concern: the lack of funding to help farmers develop new co-operatives to meet these needs, the use of the loan loss reserve fund instead of the loan guarantee, and inadequate short-term compensation for beef farmers.

We also urge the government to continue to work with the agricultural community to develop long-term policies including sustainable support programs for producers.

On the social economy, co-operatives have always been an integral part of the social economy. In fact, most have started as social economic projects. We urge the government to ensure that the co-operative sector is well represented in the regional round tables set up by the regional development agencies to establish priorities for the social economy initiative.

On official development assistance, through CCA, co-operatives and credit unions in Canada are active partners in Canada's international development work. They are strong supporters of the dynamic development role for Canada and contribute over $600,000 in cash annually.

CCA recommends that the government refocus on the long-stated goal of having 0.7% of GDP going toward development assistance and encourages the government to accelerate its pursuit toward that goal.

We also ask that money designated to official development assistance be targeted to poverty reduction.

[*Translation*]

Thank you, Mr. Chairman. I'd be pleased to answer any questions you may have.

[*English*]

The Chair: That's the best presentation so far—under the five-minute limit. Thank you.

VenGrowth, the next group. Mr. Heller.

Mr. Jay Heller (General Partner, VenGrowth): Mr. Chairman, committee members, my name is Jay Heller and I'm with VenGrowth Capital Partners. VenGrowth is pleased to be participating once again in your pre-budget consultations.

VenGrowth is one of Canada's largest venture capital firms, managing both retail and institutional assets. Since we began operations in 1982, we've invested over $900 million in more than 150 companies. Typically these are small and medium-sized enterprises, usually in the technology sector, with significant potential for job growth and economic development.

Today we would like to scan for you the venture capital environment in Canada and focus on one change to the Income Tax Act that we believe could do much to encourage entrepreneurial activity in Canada.

Emerging entrepreneurial companies often have difficulty raising capital from the traditional sources that are available to larger firms, because they have no history of earnings or cash flow and because they lack bankable assets, such as equipment, inventory, and receivables. These companies need venture capital investors who are willing to take an equity stake and are prepared to be patient, often serving as a mentor to management in the expectation that the company will grow and prosper.

Venture capital has a proven track record in this country. Businesses financed with venture capital in Canada have generated employment growth that is 20 times faster than the economy as a whole and eight times faster than the country's 100 largest companies. Venture-backed firms also significantly outperform the economy as a whole in terms of sales, exports, and spending on research and development.

However, these businesses face a unique challenge in Canada, in that there is a significant under-supply of venture capital. This is due primarily to the reluctance of Canadian institutional investors, such as pension funds, to put their assets into venture capital. The Department of Finance has estimated, for example, that during the period between 2000 and 2002 venture capital per capita investment in Canada was 50% of the comparable level in the United States.

To remedy this situation, the Government of Canada, to its credit, has done two things. First, the government has provided direct support through public agencies such as the Business Development Bank and Farm Credit Canada. Second, since the 1980s the government has provided indirect support for fundraising for venture capital through the labour-sponsored venture capital program in which shareholders receive federal tax credits. Since 2002, direct government support has accounted for over 11% of Canada's supply of venture capital, while by indirect method through labour-sponsored funds has resulted in about 28% of Canada's supply.

Recent budgets have introduced a number of tax measures to facilitate venture capital, but we believe there is a further measure that the government should consider that could make a substantial difference. For several years the federal credit for labour-sponsored venture capital has been fixed at 15% of the amount invested to a maximum of $750 per year. This effectively caps the commitment by each individual investor at $5,000. We would like to see that amount tripled to $2,250, while keeping the 15% rate. This would encourage individuals to invest up to $15,000 per year in labour-sponsored venture capital funds.

The reasons for this proposed change are as follows. First, labour-sponsored funds are a very efficient way of leveraging government investment, because the pool of capital grows by $1 for every 15¢ invested by the federal government.

Second, by effectively raising the amount of the investment to up to $15,000, the opportunity will attract the attention of a new generation of investors, primarily higher net worth investors advised by brokers for whom the $5,000 cap is too small to interest them currently.

Third, studies show that whatever tax revenues are forgone by the government would be recovered in less than three years as a result of the economic activity generated by companies that benefit from the venture capital investments.

In conclusion, Mr. Chairman, there is another change we would like to see brought to the tax act that would allow venture capital firms to make sub-debt investments. I don't want to take more time than we're allotted to explain this now, but we encourage all members, particularly those interested in helping traditional economic sectors outside major cities, to consult our written submission for that particular recommendation.

VenGrowth thanks you for your attention and looks forward to answering any questions you may have about encouraging entrepreneurship in Canada. Thank you.

● (1000)

The Chair: Thank you. You were also under the time limit. Good job. I appreciate it.

The Tax Executives Institute. Mr. Penney.

Mr. David Penney (General Director, Taxes and Customs, General Motors of Canada Limited, Tax Executives Institute, Inc.): Mr. Chairman, members, good morning. I'm pleased to testify on behalf of the Tax Executives Institute in my capacity as TEI's vice-president for Canadian affairs.

The Tax Executives Institute is the pre-eminent association of business tax professionals. Its 5,400 members work for 2,800 of the largest companies in Canada, the United States, Europe, and Asia, with representatives from a broad cross-section of businesses. Our Canadian members contend daily with the provisions of the income and excise tax acts, with chapters in Montreal, Toronto, Calgary, and Vancouver making up approximately 10% of TEI's membership. Although my comments today reflect the views of the institute as a whole, those views are guided by TEI's Canadian members.

TEI has several recommendations for tax policy and administrative changes that we believe will foster economic growth and job creation and diminish the cost of tax compliance and administration.

First, in October 2003 the Department of Finance released draft amendments to section 3.1 of the Income Tax Act to clarify that income means net income and that net income excludes capital gains and losses. In addition, the legislation would add a new statutory reasonable expectation of profit, or REOP, test to replace the common law test governing deductibility of expenses.

Although the department's goals are clear and supportable in principle, the REOP test and other aspects of the proposed legislation are broader than necessary to achieve the department's goals. Consequently, the draft legislation poses a risk of confusing taxpayers and Canada Revenue auditors alike. The interaction of the REOP test with a source rule would impose an expensive and time-consuming burden on large commercial enterprises to trace expenditures to particular sources. But many of the overhead expenses incurred to comply with legal requirements or to provide management oversight may not be traceable to a source and thus may not be deductible.

In addition, the cumulative profit prong of the REOP test ignores how business decisions are made. In deciding whether to make an outlay, the key factor is determining whether the expenditure increases cash inflows or minimizes cash outflows. A cumulative profit is desired, but it does not drive the decision to make a payment or an investment. The requirement of an annual evaluation of the prospect of a cumulative profit potentially penalizes entrepreneurial activity as well as the misfortune of poor business results. Further, CRA auditors might be tempted to second-guess taxpayers' decision-making. The disallowance of a business loss under any of the foregoing circumstances would be at odds with the taxpayers' expectations under the act.

We understand that the Department of Finance is considering TEI's comments, as well as those of other organizations. We urge the standing committee to recommend that the statutory REOP test be abandoned.

Next, we note that the Auditor General's December 2002 report made several observations about the taxation of foreign source income and foreign affiliates. In response, the Department of Finance confirmed that the existing foreign affiliate regime accurately reflects the policy intention of Parliament and provides for the taxation of all income that is intended to be subject to Canadian income tax.

TEI agrees with the Department of Finance. The current foreign affiliate rules balance competing policy goals, foremost among them the objective of promoting the international competitiveness of Canadian businesses. The Department of Finance and CRA continually monitor taxpayers' compliance and propose amendments as needed. Hence, we see no reason to adopt recommendations that might undermine core national policies embodied in the current foreign affiliate regime.

Because TEI supports targeted legislation to remedy specific abuses, we are concerned about the overly broad proposed legislation in respect of foreign investment entities and non-resident trusts. Fundamentally, the draft legislation remains unworkable. We recommend that it be withdrawn, because it would burden compliant taxpayers who are not transferring assets abroad in order to circumvent tax rules. It is confusing, complex, co-extensive with yet inconsistent with the foreign affiliate regime in section 17 and will interfere with many legitimate commercial transactions. It would require information that is unavailable generally or is likely unavailable to a Canadian taxpayer where it is a minority investor and lacks control of the entity. Lastly, it would require a commitment of government audit resources that would be out of proportion with the policy goals served.

TEI has consulted with the Department of Finance on this legislation and shall continue to work to craft more targeted provisions. In the event the proposed legislation moves forward, a delayed effective date is essential. Taxpayers need time to digest and understand this mind-numbing legislation and where possible to modify company information systems to capture and report the required information. If the legislation is not withdrawn, the coming into force date should be no earlier than taxation years beginning after 2004.

● (1005)

The final matter we wish to address is the reduction of withholding taxes on cross-border payments between the United States and Canada. Withholding taxes constitutes unnecessary friction on cross-border transactions, especially where economies are highly integrated and dependent on cross-border flow of goods, services, technology, and know-how. Since the United States is Canada's principal trading partner, as well as a key source of investment capital for Canadian enterprise, the full benefits of the North American Free Trade Agreement will be realized only by removing withholding taxes.

As important, the United States recently renegotiated treaties with several of its major trading partners and provided a nil withholding rate on many cross-border payments. To ensure that Canadians can secure similar benefits and compete effectively for increased capital investments, exports, and jobs, we urge the standing committee to recommend that the Department of Finance negotiate with the U.S. to eliminate withholding taxes on all dividends and interest for payments to both related and unrelated parties.

In conclusion, TEI commends the standing committee for holding pre-budget consultations again this year. On behalf of TEI, thank you for the opportunity to participate.

My colleague Mr. Rasmussen and I will be pleased to respond to any questions you may have.

The Chair: Thank you.

Now we go to the Credit Union Central of Canada, Mr. Smit.

● (1010)

Mr. Jack Smit (Chairperson, Board of Directors, Credit Union Central of Canada): Thank you.

Good morning, Mr. Chair and committee members. I want to thank you for this opportunity to come before the committee today to discuss our recommendations for the next federal budget.

My name is Jack Smit, and I'm the chairperson of the board of directors for Credit Union Central of Canada. With me today is Mr. Wayne Nygren, president and CEO of Credit Union Central of British Columbia and chair of Credit Union Central's legislative affairs policy committee.

Canadian Central operates as the national trade association and finance facility for our shareholders, provincial Credit Union Centrals, and, through them, the 572 affiliated credit unions across Canada. Our credit unions employ more than 21,000 Canadians, serving our 4.6 million members. At the end of the second quarter of this year, our credit unions held close to $75 billion in assets.

Although primarily known for serving the consumer market, credit unions are a rapidly growing presence in the small and medium-sized enterprise lending market. Credit unions' participation in the SME market in Canada equals approximately $18 billion.

Credit unions are committed to Canada's communities, and this is evident in our efforts to purchase bank branches in communities where commercial banks have decided to leave. Since the year 2000, credit unions have purchased 72 bank branches.

The credit union system is a significant lender in both the agriculture and agrifood sectors in Canada, thus the BSE crisis has been an issue of concern to credit unions. In response to the crisis, credit unions have taken measures to help support cattle producers through holding fundraisers, implementing interest-only repayments, loan extensions, not realizing on security, assisting producer groups, and making representations to different levels of government.

The credit union system welcomes the government's recent September 10 announcement of a strategy to reposition Canada's livestock industry in the wake of the BSE crisis. We note that the government is focusing on longer-term issues such as those aimed at expanding slaughter facilities in Canada and diversifying Canada's export markets. This shift of long-term orientation is to be commended.

We believe that, in the context of the BSE crisis and emerging problems in the hog sector, the government can do more. To that end, we have three recommendations to consider: that the federal government should dedicate further funding to work with Canadian farm producers and processors in order to diversify export markets for Canadian agricultural goods; that the federal government should dedicate further resources to expand domestic slaughter and processing capacity in both the cattle and hog sectors; and both the BSE crisis and the U.S. tariff on hogs point to the need to improve international and continental trade dispute mechanisms, and further resources should be dedicated to achieve this end.

Let me now draw your attention to an issue our members have with Competition Bureau policy in Canada. In recent years, the government has reduced the tax burden borne by businesses in Canada, and credit unions appreciate the government's sensitivity to the need for tax reductions on business. However, as the government increasingly employs user fees to collect revenues, greater attention should be paid to ensure that they're fair, efficient, and do not work to reduce innovation and competition.

In this regard, credit unions have indicated that fees paid to the Competition Bureau to review mergers should be commensurate with the complexity of the mergers under consideration. Canadian Central submits for consideration two alternative approaches that would increase the fairness of the bureau's fees. The first is to replace the current $50,000 merger review charge with a lower-based fee combined with a sliding-scale fee. This could be based on assets and/or revenue of the merger partners, or based on a billable hours approach. The second would adjust the merger notification thresholds. Financial institutions accumulate assets in a different manner from those of commercial organizations. Applying the $400 million notification threshold to financial institutions requires transactions with limited competitive implications to be subject to the bureau's review. The competitive implications of any such transactions are very limited, however, given that the $400-million credit union has assets of less than 1% of the assets of the Royal Bank of Canada.

To conclude our remarks, we also recommend that the government take steps to reduce the negative impact that Canada Revenue Agency's priority over secure lenders is having on lending to small business. This issue is of concern to our members, since they frequently find that the security they take when making a loan is often being superceded by the government's priority claims. The issue is quite complex. For further background, we'd refer you to the detailed submission.

I want to thank the committee members for their time today. Mr. Nygren and I will be happy to answer questions you may have.

The Chair: Thank you.

I just want to remind members that the first round is seven minutes.

Mr. Solberg, then Monsieur Loubier.

Mr. Monte Solberg (Medicine Hat, CPC): Thank you very much, Mr. Chairman, and thank you to all of our witnesses for their presentations today.

I have a lot of questions, but let me just start by asking a question of Mr. Protti. Others can then respond to this as well.

In your presentation you talked about cutting corporate income tax rates, and you made mention of the fact that our rates are actually lower than those in a number of countries now, and certainly those in the U.S. We've also had people appear before us who have pointed out that the effective tax rates in Canada are still very high. In fact, they're some of the highest in the industrialized world, because we languish when it comes to depreciation and that kind of thing. In your industry, how big an issue is that? Do you struggle with that? Are depreciation rates competitive, or would just a straight cut to tax rates be the way to address these things?

● (1015)

Mr. Raymond Protti: Thank you very much for the question.

You're quite right. In a longer study that we tabled with the committee, we make some reference to some really effective work that has been done by the C.D. Howe Institute on the issue of effective rates. That study indicates quite clearly that when you look at it on that basis, there's still work to be done in Canada, both at the federal and provincial levels for sure.

The one thing we have to remember is that although we have made some significant progress in this country—and I very much want to acknowledge that—no other countries are standing still. It's an important issue for the finance committee, and certainly for the government, to always keep its eye on what in fact is happening elsewhere outside of the country. When you look at it on an effective tax rate basis, there's still clearly an awful lot of work to be done.

It's an issue that's obviously of interest to the banking industry, but it's an issue that's of interest to everybody who's involved in business. When we do suggest strongly that you look at further reductions, it's an issue of further reductions that would benefit the entire business community, small, medium, and large, in the country.

Mr. Shaughnessy, do want to add anything?

Mr. Kelly Shaughnessy (Vice-President, Banking Operations, Canadian Bankers Association): When we are recommending a reduction in corporate income tax rates, we're recommending also that the federal government accelerate the large corporations tax schedule reductions. Most of the capital taxes in this country are imposed by the provinces now, but I think there's an important leadership role for the federal government to show in accelerating the scheduled reductions.

We also believe that by having a competitive tax environment in this country, it will provide this government and all governments with a tax base on which they can finance those expenditure programs that are so critical to them. I believe that if we want a sustained tax base to finance the needs of this country, such as health care, such as education, such as infrastructure, it is vitally important to have a competitive tax environment, because capital today is far more mobile today than it was even ten years ago. We are competing for capital on a global basis, we're competing for capital on a continental basis, and we look forward to this government taking a leadership role in reducing the tax burden on all business in Canada and providing Canada with a tax base with which it can sustain those programs that are so important to it.

Mr. Monte Solberg: I want to ask a question of you, Mr. Colby. You mentioned a tax-prepaid savings plan. We already have RRSPs. Why do you want to go that route? What's wrong with RRSPs?

Mr. Everett Colby: Thank you for your question.

We didn't necessarily say there is a lot that is wrong with them, but what we need to do is enhance the ability of Canadians to save. Right now, with the way RRSPs are structured under the Income Tax Act, many low- and middle-income earners are actually penalized when looking at withdrawing from their RRSPs, which creates a tax disincentive for them.

The U.S. introduced Roth IRA several years ago. These tax-prepaid savings would be similar to that. From the government's point of view, revenues would be seen at the end when people are consuming with that money, as opposed to providing any kind of impact on revenues now by allowing a deduction. They wouldn't be deductible. It's a more efficient plan, and hopefully it would prompt low- and middle-income earners to save more.

If I may, I'd also just take a moment on your previous question about the corporate tax rates. I'm not sure if you were here on the committee at the time, but in our budget submission either two or three years ago, we included a study that was done for the United Nations that shows the economic cost of taxation. For every dollar of corporate tax that is exacted, there's an economic cost of about $1.57. So the economic cost to corporate taxes, even if we don't just focus on the rates, is much more punitive than any other levels of taxation.

● (1020)

Mr. Monte Solberg: I don't know how much time I have, Mr. Heller, but I wanted to ask you a question about labour-sponsored funds in general.

There have been some criticisms in the past of your funds. I remember a number of years ago the concern was that the funds weren't actually getting this capital into some of these start-ups and sometimes were sitting on this money. You're asking for a tripling of the tax break on this now. Are we certain that this money is going to where it needs to go?

Mr. Jay Heller: Yes, we are certain. The issue you allude to was a concern in the mid-nineties. When the program was first beginning, some funds raised a lot more money than they were able to deploy in an orderly timeframe. That hasn't been an issue at all in the industry since 1996 or 1997. If you look at the rate of deployment, it has been pretty good. Those funds that have been unable to deploy their capital quickly enough are restricted in how much money they can raise. The legislation self-corrects the problem, so that hasn't been an issue any more at all.

The tripling we asked for is not exactly a tripling of the outlay by the government. In percentage terms, it would be the same. We're just asking for individual investors who can afford to do more and are disinclined to invest only $5,000, to be able to step up to the plate and invest more. It would help us run our businesses more efficiently if we could raise money in bigger chunks from smaller numbers of people.

The Chair: Thank you.

Monsieur Loubier, and then Mr. McKay.

[*Translation*]

Mr. Yvan Loubier (Saint-Hyacinthe—Bagot, BQ): Thank you, Mr. Chairman. My question is addressed to Mr. Protti.

Mr. Protti, you know that I have a great deal of respect for you; we have known each other for years. But I can't help but make a connection between what you said this morning in the presentation and an article that appears in the *Journal de Montréal* today, which talks about the practices of the big Canadian banks in tax havens—something we have in fact been questioning you about since 1994, without ever getting any answers. You said this morning that the five major Canadian banks realize 67 per cent of their profits here in Canada, but pay 89 per cent of their taxes in Canada. But if we look at those figures in reverse, what they mean is that you realize 33 per cent of your profits offshore and yet pay only 11 per cent of all your taxes offshore.

The five major banks have 73 subsidiaries in countries considered to be tax havens. However, in Barbados, the worst tax haven of all, where some of their practices are rather dubious, the five major Canadian banks have 16 subsidiaries. This analytical piece, which is drawn from a study conducted by a professor at the University of Quebec, Mr. Léopold Lauzon, states that in the last four years alone, your practices, which are legal but illegitimate, and even immoral, have meant that the Canadian Treasury has been deprived of close to $6 billion in revenues.

I should say that an example was set at the highest levels, because Mr. Martin, who was Minister of Finance and is now Prime Minister, always refused while he was Minister of Finance to review tax treaties—that's the reason for this—with tax havens such as Barbados. We specifically asked him to do away with that treaty, which had even been criticized by the OECD.

So what do you say in answer to that article about the fact that you engage in practices which, I repeat, are legal, but unacceptable, illegitimate and immoral, in my opinion, since in so doing, you deprive the Treasury of several billion dollars per year, billions that have to be compensated for by other taxpayers, either businesses or individuals, who have to pay instead of you?

Mr. Raymond Protti: Thank you for your question, Mr. Loubier. I did not see the article in the *Journal de Montréal* this morning. I obviously will read it immediately following this meeting and I promise to give you a detailed answer. But it's difficult for me to respond to an article I haven't even seen.

Mr. Yvan Loubier: Fine. Then I guess I'll talk to you about what you do know.

Since 1994, we have had regular meetings with the Canadian Bankers Association. And, since 1994, I have been making the same request of your predecessor—I believe you have been in your current position since 1998 or 1999—and I did in fact make this request of you when you came on board. At the time—in 1994—there were, I believe, some 54 subsidiaries of major Canadian banks located in countries considered to be tax havens, such as Barbados—which is, rightly so, the preferred country, given that the maximum tax rate applicable to business profits is 2.5 per cent.

So, what this article says and what we have noted in the past is that the major Canadian banks and their subsidiaries are involved in completely legal operations in tax havens. These transactions, which I believe you refer to as swaps, in your jargon, mean that the parent companies of Canadian banks show losses, while these subsidiaries operating in countries considered to be tax havens show profits from these transactions. And because those profits are taxed at a maximum rate of only 2.5 per cent and because there is a tax treaty between Canada and Barbados, when those profits are repatriated to the parent companies of those major Canadian banks, they are not subject to a second tax on business profits. So, when I look at your figures—and these are your own figures—and here you say you've realized 33 per cent of your profits offshore, given that you have 73 subsidiaries operating in tax havens, and that you pay 11 per cent of all your taxes in places other than Canada. Once again, these practices are perfectly legal, but I want to put the same question to you that I have been asking for a number of years.

First of all, do you recognize that these swaps are taking place? Secondly, even if they are legal, do you recognize that there is a need to clean up these tax treaties, because even though these practices are profitable for you, they very much hinder the ability of both the federal government and the provincial governments to maintain the integrity of the tax base in Canada, and because it is hardly appropriate for people to be asking for business tax cuts, given this immoral tax evasion which you are engaging in?

● (1025)

Mr. Raymond Protti: I'd like to make one comment and then ask my colleague, Mr. Shaughnessy, to respond as well.

We are working with a regulatory system which is obviously very narrow. Everything that a bank does is absolutely legal. There is oversight by the government, through the Superintendent of Financial Institutions, which looks very closely at all these matters.

I would like to ask Mr. Shaughnessy to answer your specific question.

Mr. Kelly Shaughnessy: If you don't mind, I'd like to answer in English.

[*English*]

I think a couple of items are very important also in considering this question. Canadian banks operate on a global basis. In a number of these countries where Canadian banks are operating, especially in the Caribbean, we are actually providing banking services to the residents of these countries. Canadian and British banks have a long history of providing core banking services to residents in the Caribbean countries.

I think it's also important to keep in mind that Canadian banks have global operations, and in a far greater extent, to some of these countries that are being referred to as tax havens. Those operations frequently are funded outside of Canada. The domestic assets and the domestic liabilities of Canadian banks tend to reside in Canada.

I think you'll also find, and I don't have these numbers here today, Mr. Loubier, but with your permission I'll provide them to the clerk—

[*Translation*]

Mr. Yvan Loubier: Mr. Shaughnessy, I would like to make one clarification. You say that you provide banking services to the residents of these countries. And yet you have 16 bank subsidiaries operating in Barbados to serve 278 000 inhabitants. Don't you find it rather strange that there would be 16 subsidiaries for only 278 000 residents?

I put this question to Mr. Martin many times when he was Minister of Finance. He found it perfectly normal to maintain a system like that, which had been denounced by the OECD. He would make exactly the same arguments as you are, adding that we live in a competitive, global world. At one point, he had actually admitted that his subsidiaries in Barbados benefited from very low tax rates on profits, but said that in the transportation sector, that was the way things worked. He said that if we didn't take advantage of tax treaties and preferential tax rates, which are illegitimate practices even though they may be legal, we just wouldn't survive.

What I'm speaking out against is the fact that the Minister of Finance, who owned a shipping company and was benefiting from this system, also had the power to maintain these regulations, which are now benefiting you. It isn't illegal, but it is both illegitimate and immoral.

● (1030)

The Chair: Please be brief.

[*English*]

Mr. Kelly Shaughnessy: I can only speak to the banking industry. As I said, I will provide to the clerk the effective rates of taxation of the Canadian banks for Canadian earnings. I cannot speak to the proprietary funding arrangements each of the banks has for their offshore operations, but I would point out that Canadian banks operate on a global basis. They operate in very large capital markets such as New York, they operate in very large capital markets such as London, and they need to fund their operations there.

They fund their domestic operations principally from Canada. As we pointed out in our submission, the large six banks alone pay more domestic taxes in this country than any other industry in this country.

The Chair: Thank you.

Mr. McKay.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Mr. Chair, and thank you, witnesses.

Now for a touch of reality. How long do you think the banks and other industries would last if they didn't compete in the same tax environment as their competition?

Mr. Raymond Protti: I think it's a question that can be answered in respect to not just the banking industry but all of the corporate community. It's quite clear that the level of taxation, the extent of taxation, is an important factor in locational decision-making, but it's clearly not the only one. The quality of the workforce that you work with is obviously an equally important if not more important factor. But if we don't have, Mr. McKay, on a consistent basis, really competitive rates of taxation for small, medium, and large-sized businesses in this country, then of course we're going to see some locational changes.

Hon. John McKay: Essentially, you basically wind up Canada's international companies fairly quickly if in fact they don't compete in the same tax environment.

Mr. Raymond Protti: Yes. If you look at what in a sense has happened particularly with large-scale companies, or what I'd call the so-called national champions, then the track record over the last eight to ten years across all sectors is not encouraging. We've lost some really effective national players, on a national scale and on a global scale, to consolidation in their various sectors. They've tended to go and move.

So I think it's enormously important.for parliamentarians and the government to pay an awful lot of attention to the effective rates of taxation.

Hon. John McKay: Thank you.

I wanted to ask a question of the tax executives, and that has to do with your desire to move the withholding tax rate to nil, particularly with our largest competitor, the United States. The real question for the department is how do you stop tax leakage? I'd be interested in your response on that.

I'm sorry, my question was directed to the tax executives. After a while you all blur. Which ones are the tax executives?

Mr. David Penney: Tax executives, here.

So how would we prevent tax leakage...?

Hon. John McKay: Essentially, you have a withholding tax for the simple reason that...and it's set at 15%, because the anticipation is that the non-resident may not be as enthusiastic about paying Canadian taxes. So if in fact you set your rate at nil, and there's no withholding tax, how is the Government of Canada going to generate a tax based on income earned in Canada?

Mr. David Penney: An excellent study done by C.D. Howe in 2001 went through a complete analysis of what the impact would be if in fact the withholding taxes were eliminated on dividends and interest. When Canadians invest in the U.S. and receive funds, the U. S. government withholds from those as well. So there's a reciprocal tax going both ways. It probably would be a net cost to Canada, but the analysis done by Dr. Mintz came to the conclusion that although there would probably be a net loss to Canada of about $1.8 billion—I think those were his numbers—there would be an additional $28 billion of investment in Canada, which would translate into $7.5 billion a year in income.

Clearly, if you stop collecting tax there would be less tax going into the government's revenues directly from that particular tax, but the theory is that with respect to that tax, as well as income taxes, taxes are a drag on the economy. So the flip side is that there would be much more direct investment in Canada, and an increase in jobs and economic activity.

● (1035)

Hon. John McKay: I've never fundamentally understood why that withholding tax is a drag on the economy. A withholding tax is just a prepaid tax, much like the rest of us have deductions from our salary cheques. That ultimately is a credit to the tax that's paid by the foreign resident. So I don't understand the drag argument.

Mr. David Penney: Theoretically, you're correct. One government gets credit, the other government gets credit, you're even. As a matter of practice, though, it often doesn't work that way. When U.S. companies invest in Canada or make loans in Canada, they often effectively gross up the interest rate to recover the withholding tax, because they don't assume they will be able to in fact get a credit for that withholding tax on the other side. It basically increases the cost of capital in Canada.

I think there's some empirical study on that. Certainly within my organization, the Tax Executives Institute, there is fairly widespread anecdotal evidence that in fact you do pay extra when you deal with—

Hon. John McKay: Why would they assume that they wouldn't get credit? Are they just lousy accountants, or does the American government not recognize it?

Mr. David Penney: In the American tax system—and my colleague here may be able to chip in—you don't necessarily, on a contemporaneous basis, get credit for the withholding taxes or other taxes that you pay in another country. A lot of American companies are carrying huge unutilized tax credit positions. Although it's in the system, they don't necessarily realize on it on a current basis.

Hon. John McKay: Okay.

I have one more question. How much time do I have?

The Chair: You have a minute, but two more people had also wanted to reply.

Mr. Everett Colby: Mr. McKay, to answer your question on why that would be a drag, it's not so much about the credit being received on one side or the other. Dividends are moneys paid on tax-paid money already. The company has already earned it. It has paid tax to Canada. Now it wants to pay a dividend to the U.S., and vice versa.

The withholding tax is an extra tax, on top of the corporate taxes already paid, that is not recovered from Canada. In effect, it creates a higher effective tax rate on those earnings, which is a disincentive to investing the money there.

The Chair: Thank you, Mr. McKay.

Ms. Wasylycia-Leis.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): Thank you very much, Mr. Chairperson.

Thank you to all of you for being here today and for posing quite differing views. That gives a chance for some debate, and so I'd like to do that.

First, I want to say to Mr. Shaughnessy, who talked about banks paying some of the higher levels of taxation in this country, it's also a fact that bank profits are way up. We've just had the report today about the TD bank, and its profits have more than doubled, to $2.3 billion. That followed similar high-profit levels with the Bank of Montreal on Tuesday. So I think we have to put it all in perspective when looking at this issue. First, what is the right fiscal policy for this country? Second, what kind of tax advantages should there be for financial institutions in the country today?

It seems to me that the banks are in a fairly healthy position, but at the same time, have generally abandoned the area of community economic development. As Mr. Protti knows well, in an area like Winnipeg north the big banks have left and totally deserted a fairly low-income community. We know from the Credit Union Central that they're picking up the bulk of the initiatives at the community level and in fact, next to the Royal Bank, are the biggest lenders to small and medium enterprises.

My first question is to the Co-operative Association and the Credit Union Central. What kind of tax advantages should there be in this budget that will help you do your job in respect of community economic development and social economy, and what kind of overall fiscal policy do we need to make the kind of vision you have a reality in this country?

Then I want to ask the banker' association why they've shown so little interest in the broader social economy issues and focused totally on tax reductions and debt repayment, as opposed to acknowledging anything in respect of community, quality of life, social programs that sustain the profitability of the banks and other corporations.

Maybe we could have a debate going. Maybe you two could start, the banks could follow, and then maybe Mr. Colby could jump in.

● (1040)

Mr. Wayne Nygren (Chair, Legislative Affairs Committee, Credit Union Central of Canada): Let me start with this. Thanks for the question.

In Winnipeg, for example, back in 1998 there were 162 branches of banks, there are now 104, so that's dropped phenomenally; the credit union system was 53, and we're up to 56. There's still a need in that area.

It's a cost issue for us in many respects. Rural Canada is certainly populated by credit unions. One of the things we're looking at with this budget is the cost to some of the smaller communities that have credit unions. These credit unions are certainly not there for profit. They're effectively breaking even, and sometimes it makes it very difficult for us to cover costs. We want to keep those credit unions open. The return on equity is not there, but they're certainly a service to the community.

So one of the things we're looking at from this budget is trying to merge those smaller credit unions with larger credit unions. It costs us $50,000 just to look at that, because of the Competition Bureau. So we would like that fee looked at. It is not a money-making issue for a larger credit union to merge with a smaller credit union, because of those costs. The $50,000 cost is to be seen over and above the fact that that smaller credit unions in these communities, especially some in north Winnipeg, are not profitable already. They're just struggling, and the regulators are after us to keep our capital and liquidity up to a certain level. So there are some of the costs of doing business with credit unions for us. It would help us if the budget would look at those, especially the merger cost, this $50,000 fee. We're looking at this across the country.

Ms. Judy Wasylycia-Leis: Okay.

Do you want to jump in on this big question?

Mr. Jean-Yves Lord: Thank you for the question. I think there are three areas where we can definitely make a difference.

I think it's important to invest more in the social economy, to have patient money available. It takes time to get small enterprises going at that particular level of community. Also, it takes time to support the putting into place of a co-operative, although we have shown that double the number of co-operatives are still in existence after five years of being in business compared to small private enterprise. So it takes a little more to get them going, but they stay there, and they continue to contribute to communities way into the future.

Fortunately, we will have an opportunity to talk about the agricultural sector, next week, I believe, but there is definitely an area there for special consideration, that is, possible deferment of taxes, so that co-operatives can capitalize themselves better, because at that point we're definitely not on the same level as corporate Canada

Ms. Judy Wasylycia-Leis: Thank you.

Now I want to hear from the bankers association. You don't say anything in your paper about investing in programs that actually create life in our communities and augment the economy, which will in turn bring down the debt.

Mr. Raymond Protti: We actually do. I'll make three comments.

First, it's clearly a choice parliamentarians are facing, tax reduction, debt reduction, investment in critical infrastructure, health care, national defence, early childhood learning, a national child care program. I very much acknowledge that, and I said in my opening comments that investments—

Ms. Judy Wasylycia-Leis: I have to apologize. I wasn't here for your opening comments.

Mr. Raymond Protti: That's fine. That is point one.

Second, as to your comments on community economic development, I have offered the chair a briefing, and I'm hopeful that at some point the finance committee will have sufficient time on its agenda that I could come in and talk in much broader terms about the nature of the banking industry in this country. I've prepared a great deal material on it. Much of it is, in fact, focused on the community economic development story. More than half the lending that goes to the small and medium-sized companies in the country comes out of the banking community. There is no sector in the country that's as active and involved in charitable contributions. There's no sector that has as many of its employees across the country actively participating.

● (1045)

Ms. Judy Wasylycia-Leis: Okay.

Mr. Raymond Protti: If I can just finish, there's a tremendous story to be told. It is encapsulated in the public accountability statements that every bank produces. It's the only sector that produces these statements, and what I'll do is come with a collection of the analyses.

I have one other comment on bank profits. Yes, profits are up. There are smiles everywhere in the Department of Finance and every finance treasury across the country. Why? Because the ones who profit enormously from profitability are provincial and federal governments. The others who profit enormously are just about every Canadian in the country, because these are the most widely held institutions. There are 17 million people who contributed to the Canada Pension Plan, and 23% of the Canadian equity holdings of the CPP are in Canadian bank stocks.

The Chair: Thank you.

Mr. Penson.

Mr. Charlie Penson (Peace River, CPC): Thank you, Mr. Chair.

I thought it would be interesting this morning to ask our panel members for their thoughts on the Canadian dollar and what effect the rapid appreciation of the dollar might have on the Canadian economy, at what level that may start to hurt our exports, particularly in the resource sector, but in manufacturing as well, and if there is a breaking point, considering how quickly this has moved. Further to that, people may not want to comment on monetary policy, but the rumours are that the Bank of Canada is going to move the interest rates up again a quarter of one per cent. It seems to me that may just fuel the dollar even more and further exacerbate the problem.

I would start with Mr. Protti, if you would be interested in commenting on this.

Mr. Raymond Protti: I'm just going to make one quick comment, because you're touching on an area in which I really have very little expertise. I did begin, along with Mr. Newton, my career at the Bank of Canada. I was in the forecasting business when I was there. Quite frankly, I did a horrible job at it, so I wouldn't even begin to guess to what value the marketplace will eventually see the dollar going. I think the real issue here is how much the pace will change. It's accelerating faster, I think, than anybody anticipated. I think that's the real issue, because if it accelerates too fast , there will clearly be significant adjustment problems in some sectors.

However, Mr. Newton may have a comment, as a graduate of the Bank of Canada.

Mr. Charlie Penson: Yes, that may be so, but just before we get to that, Mr. Protti, I want to explore this a little further. Surely, the banks have run some models on where our industries are competitive and at what point the dollar starts to become a problem. Do you have nothing you can share with us on what breaking point we may reach?

Mr. Raymond Protti: Yes, we do. I don't have it personally, but I will get you some analysis. Each of the banks has a chief economist actively involved in examining issues of monetary and fiscal policy, and I'll make sure I put together a package of analysis on precisely that issue for you.

Mr. Wayne Nygren: I think it's a double-barrelled issue. First, for the consumer I think it probably is a positive, because of the imports we have. I'm from British Columbia, and the export industry has certainly been very difficult. So I think it depends. When it hit the mid-70s, I think it was an issue for our export industries, especially the lumber and mining industries. Generally, for the consumer I think it will be a positive, but for business it will be different. I think you have to balance what the effect will be on the whole economic environment of the country.

Mr. Charlie Penson: But wouldn't it also give our businesses and manufacturers a chance to upgrade their capacity in terms of investment in equipment? A lot of the equipment we use comes from outside of Canada, and that's been one of the difficulties in the past. The amount of investment in these sectors has not been great enough to allow them to upgrade equipment so they can be competitive—incorporate new innovations and new technologies. Isn't this a timely opportunity for them to do just that?

● (1050)

Mr. Wayne Nygren: Overall it will be positive in many respects, and I think you're right that it will help. It will create extra ability for manufacturers to upgrade their facilities, the fixed assets.

On the other hand—and I don't know what the numbers are—the export industry in certain parts of the country is certainly struggling with this. The film industry is certainly struggling with this. With the dollar the way it is at 84¢ plus, I'm not sure what the numbers really work out to on the overall value to the Canadian economy, but generally I think it's a positive aspect for most of the country.

Mr. Charlie Penson: But I'm a little surprised that especially the bankers aren't on this a little bit harder. We have a huge export industry—agriculture, forestry, and mining. If the dollar rises so quickly they can't be competitive.... Just as a case in point, I know canola farmers are telling us that last year they were getting $8.50 and now they're getting $6, and it's largely the exchange rate difference. At some point it has to have an effect on the economy if it rises too quickly.

I'm not getting much feedback here, and I'm surprised.

Mr. Raymond Protti: As I said, I will provide you with a lot more analysis than I'm carrying around inside my head, Mr. Penson. But clearly you've put your finger on the critical issue, and that's the rate at which the value of the dollar is changing. Abrupt or rapid changes in one direction or another do create and can create, in some circumstances, some difficult challenges for a whole variety of sectors, including agriculture.

I did a stint as Deputy Minister of Agriculture and Agri-Food, so I have some feeling for that sector, and I understand when you talk about the challenges facing canola producers. The rate of change, though, is in a sense determined in the marketplace; that's the critical thing.

The Chair: Thank you, Mr. Protti.

Mr. Charlie Penson: But my point is, the Bank of Canada also affects that—

The Chair: Sorry, I have to rip it up.

Mr. Hubbard, Monsieur Côté, and Ms. Minna.

Mr. Charles Hubbard (Miramichi, Lib.): Thanks, Mr. Chair.

We seem to be zeroing in on the bankers this morning, but I'd like to look at a bit of this from the reverse. We find that a lot of financial institutions—or at least we call them that—are involved in practices where the head office is outside Canada. We talk about leasing and a lot of the plastic money that some of us use every day...and a tremendous attempt to come to our markets with programs through which the financial benefit, shall we say, from those services is outside our country.

Is there anything you might recommend to our committee? Maybe it doesn't affect you, but if it does, or if we're not treating it respectfully, do you have any points to make about money being administered outside Canada with Canadian taxpayers or Canadian citizens being involved? Maybe in terms of our so-called tax policies and systems, we're not looking at those in a proper fashion.

I see Mr. Colby is keen on that, along with Mr. Lafrenière. So very briefly—I only have five minutes.

Mr. Colby.

Mr. Everett Colby: Thank you.

If you make the tax system easier to comply with, more companies will comply with it and you'll see more capital invested here. So things like depreciation rates have a far greater impact on that corporate investment than the dollar, in terms of investing in equipment.

Lowering corporate tax rates, and getting rid of capital taxes—you'll see more of it here than you will in Barbados or anywhere else.

Mr. Charles Hubbard: Mr. Lafrenière.

Mr. Normand Lafrenière: In the insurance industry, we see the potential to go outside the country to save money for the big events—the catastrophes I was talking about. In order to match what the foreign companies have in terms of benefits in hiding money, getting money, or keeping money outside of Canada to pay for those big events, Canadian companies want to do the same thing. This is when they set up offshore companies. They don't have a choice, because they want to be competitive.

In our case, we don't do that—the mutuals—but we see our competitors doing just that, setting up offshore companies in order to hide the money for income tax, pending the large catastrophes that occur every 25, 50, or 100 years. We have a solution there, and hopefully you'll take a look at it.

● (1055)

Mr. Charles Hubbard: Mr. Shaughnessy.

Mr. Kelly Shaughnessy: When it comes to foreign banks providing financial services to Canadians in Canada, in general those services are being provided by Canadian-based subsidiaries of these companies, or Canadian branches of foreign banks. So they would be subject to the tax laws and all the other regulatory requirements of Canada.

But there's one item that the gentleman from the Tax Executives Institute brought up that I'd like to draw to your attention. We did not address it, for the sake of time, in Mr. Protti's opening comments, but it is in our submission. That is withholding tax. We believe there is a need for far greater liquidity in the capital markets in Canada. Specifically, we believe there's a need for greater liquidity in the secondary loan market here.

We fully endorse the position taken by the Tax Executives Institute on the elimination of withholding taxes on a bilateral basis between Canada and the States. We believe that will bring additional liquidity and competition to the capital markets here in Canada.

Mr. Charles Hubbard: So we can assume there's no disadvantage to our own banking institutions in terms of the services that are provided outside the country. Is that correct?

Mr. Kelly Shaughnessy: As I said, on the banking services that are provided for Canadians—and I do believe you made reference in your comments to things such as leasing and cards—the issuance of credit cards to Canadians in Canada is being done by Canadian-based subsidiaries of the foreign banks, so they'd be subject to the laws of Canada. I may be wrong, but I do not know of any foreign bank operating in this country that is not regulated by our prudential regulator within the laws of Canada. There is one, and I mentioned the name earlier. Wells Fargo did have initiatives to lend to small and medium-sized businesses, but I frankly don't know to what extent that has occurred.

Mr. Charles Hubbard: I thought so.

The Chair: Mr. Smit.

Mr. Jack Smit: Certainly, as you know, the banks are increasing their international operations. We don't know what the policy will be on bank mergers, if in fact the government sees that there's some level of approval for bank mergers.

Credit unions are community-based organizations. We are located in Canada and don't have international operations. We certainly welcome the opportunity to expand into that area. We have actually created a committee at Canadian Central to look at how we can help with that process in acquiring bank branches and setting up more support systems for small and medium-sized businesses, in addition to what we have already, and extending our ATM network. So we have a number of initiatives that we feel we can take to be a real alternative to the banks and the more international operations of the banks, and have more of a community focus.

The Chair: Thank you.

Mr. Heller, quickly please.

Mr. Jay Heller: Mr. Hubbard, in the venture capital area, we take the opposite view. The more foreign money we can get to help build the pool of venture capital in this country the better, because we need money, wherever it comes from. I'm saying that as an executive with a Canadian venture capital firm. We don't mind the competition. We want the competition, because developing companies in this country need the biggest pool of capital possible. So withholding taxes, tax treaties, all the things that inhibit American pension funds from helping Canadian companies commercialize their technology—anything we can do to reduce those would be helpful to the economy and to Canadians.

The Chair: Thank you, Mr. Hubbard.

Monsieur Côté, and then Ms. Minna.

If I can ask the witnesses to hang on for an extra five or ten minutes, I have two members left. Is that okay with everybody? Thank you. I appreciate it.

[*Translation*]

Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ): Thank you, Mr. Chairman.

Mr. Protti, I'm sure you won't be surprised to hear that I want to talk a little more about tax treaties. That is the real issue here. In the Bloc québécois, we are not against tax treaties. They do have a role to play, but only if tax rates are comparable.

Let's take the tax treaty between Canada and the United States, for example. In that case, we're talking about tax rates that are indeed comparable: around 40 per cent. In the case of Barbados, specifically, we're talking about a maximum tax rate of 2.5 per cent or 1.5 per cent. So, the rates are nowhere near being comparable.

Do you not see this kind of tax treaty as being immoral from a taxation standpoint, in that it really fosters tax evasion? I can understand that back then, when he was making changes the last time around, the current Prime Minister, who was Minister of Finance then, forgot to withdraw our tax treaty with Barbados. I can understand, even now, why he hesitates to withdraw that tax treaty, which benefits the companies now owned by his sons.

Once again, out of concern for greater tax equity, do you not think the Prime Minister would be well-advised to abolish this treaty, that fosters tax evasion and that is highly debatable, even though it may be legal?

● (1100)

[*English*]

Mr. Kelly Shaughnessy: As I said earlier, certainly from the point of view of the Canadian banks, you have to separate their domestic and their international operations. Their domestic operations pay enormous amounts of taxes. They pay more taxes than any other industry in this country. I am satisfied, and I hope the committee is satisfied, that they're paying their fair share of taxes compared to other industries in this country.

The operations of the Canadian banks in other countries are a reflection of their global operations, not necessarily a reflection of their domestic operations. They operate within the laws of those countries where they have operations and they operate within the laws of Canada. As Mr. Protti pointed out, not only do the banks monitor their compliance with the laws of Canada and other jurisdictions very carefully, OSFI, our prudential regulator, has in place a very robust regime to ensure that all financial institutions that are regulated in Canada by OSFI are in total compliance with the laws of this country and other countries within which they operate.

Mr. Everett Colby: With all due respect, I think you are missing the point of the tax treaty in focusing on Barbados. A company operating in Barbados is going to pay that tax rate whether there's a treaty with the country or not. All a treaty does is remove barriers to cross-border investment by avoiding double taxation. It doesn't change the fact that if a bank is going to operate a subsidiary there, it's only going to pay 2%.

[*Translation*]

Mr. Guy Côté: I'm going to have to interrupt you. The purpose of a tax treaty is indeed to avoid double taxation. But it seems to me that a tax treaty only makes sense when you are talking about comparable rates of taxation. However, in the specific case of Barbados, the rates are nowhere near being comparable. All you have to do is look at the number of subsidiaries that have been set up in Barbados in recent years to realize that the tax incentive is very significant.

[*English*]

Mr. Everett Colby: I don't believe the only reason Barbados is being used is as a tax incentive. Quite frankly, rates in Ireland are approaching the same effective rates as they are in Barbados, and nobody is accusing Ireland of being an abusive tax shelter.

One of the main reasons Barbados is used is because it is a gateway to South American and Central American markets, in part. The tax treaty between Barbados and Canada allows for Canada to tax more of those profits than just Barbados. That's because of the result that if a Canadian company is operating down there and doesn't operate in a permanent establishment, it's all taxable here and not just restricted to Barbados.

Unfortunately, due to the high types of tax rates that we pay here and the punitive types of tax rates, Canadian companies and individuals are going to seek out tax fairer jurisdictions. At least having a country with which we have a treaty that allows for cross-border enforcement, sharing of information, and so forth, actually helps make it a more efficient system for Canadians to use Barbados.

The Chair: Thank you.

Ms. Minna.

Hon. Maria Minna (Beaches—East York, Lib.): Thank you, Mr. Chairman. I'm going to go back to the banks as well, but from another perspective.

In this committee, we had quite a lot of discussions in the last several years with respect to investment of small and medium-sized businesses in the banks and the history we had during the recession. My question is, to what extent has investment in the banking system —if you have an analysis—increased with respect to investment in SMEs?

Given the American situation, if you look at their deficit and their trade deficit as well, it is quite serious. If their economy collapses— which I think there is a good chance of at some point—and that affects our economies, to what extent will the SMEs pay the price? Will it happen quickly, or do you have a policy in place this time where we don't dump the small and medium-sized businesses as fast as we can as the economy starts into a downturn, which is what happened last time and further accelerated the unemployment situation in our society? I just want to understand where we are now, because we had a discussion not too long ago about bank mergers and the criteria for bank mergers, and that's an area that is very important.

● (1105)

Mr. Raymond Protti: I happen to have next to me here a real expert on small-business banking. He used to run it for CIBC before he joined CBA, and he went through that whole history. But I'll make one comment.

We do have an awful lot of data and analysis about the banking business with the small and medium-sized community. I didn't bring it with me, but I will make it available to you so that you can see the trend analysis of what's going on.

Mr. Kelly Shaughnessy: Having lived through it with this committee and with the industry committee in the mid-nineties, I know exactly what the honourable member is talking about. It was a very difficult point in time for the country. In the province of Ontario, which you represent, I don't know if it was a recession; I think it was probably almost close to a depression for the small and medium-sized businesses. I believe, though, that there has been a fundamental change.

At that point in time, small and medium-sized businesses, and probably the country as a whole, were leveraged more than they are leveraged today. Today, I am seeing small and medium-sized businesses having access to multiple sources of capital—not only from the banks, but from the credit unions, from the cooperative movement, from leasing companies, and others. I also see small and medium-sized business people being far more prudent in the amount of debt they're taking on.

I don't know if there will be, Ms. Minna, but if there is a downturn in the economy, I hope and I believe the financial institutions, I believe small and medium-sized businesses, and I believe the economy in general—partially due to the fiscal condition of the country compared to what it was back then—are in a far better systemic position to deal with that than they were the last time. So I hope to goodness we will never face a period of time such as we did in the early to mid-nineties, and I firmly believe that we're in a position to avoid that this time around.

Hon. Maria Minna: I appreciate that response, Mr. Shaughnessy, but I must say that because we were being contacted and I was working with some of them, I know of at least a couple companies whose line of credit was very minimal during that period. It was not a very major line of credit, but it was important for this small company. They had always paid, never defaulted, but were cut off. And that's not because it had a huge debt, as you were suggesting; they were more careful and they did not. But the banks were not taking any chances.

What I'm asking is, what is the policy as we get into deep waters, if we do get into deep waters, in dealing with this situation? In some cases, there was absolutely no reason that I could see for the plug being pulled on those companies.

Mr. Raymond Protti: May I respond to that with a specific—

Hon. Maria Minna: I'm only raising this because I think the economy south of the border is not the greatest and that these things can happen very soon.

Mr. Raymond Protti: Let me respond to that by pointing to an example that was mentioned by the credit union representatives. Some of the most important small and medium-sized entrepreneurs we have in this country are in fact the farm community, the agricultural community, livestock producers who were very hard hit by the BSE crisis. In the banking industry, each of the banks has put in, over the last 18 months—because we're now through into month 19 or 20 of the cycle—very special client relationships with each one of those who are effected by the BSE crisis.

We've had excellent discussions with the agriculture committee and the Minister of Agriculture, who recognize the extraordinary effort the community has put in to manage their clients through this particular situation. I would suggest that we learned some painful lessons from the early 1990s, and the painful lessons we've learned have been reflected in the behaviour of the banking institutions in managing their clients through the BSE problems we've been facing.

Hon. Maria Minna: Thank you.

Is my time up?

The Chair: Yes, your time is up.

I think we can talk to the banking sector all day long, but unfortunately we're restricted to time.

Again, I want to thank the witnesses for appearing and for your patience.

The meeting is suspended for five minutes.

●

(Pause)

●

● (1120)

The Chair: Good morning. If we can begin, I just want to thank the witness groups and associations for appearing.

I'm not sure if you're aware of it, but what we like to do is give you five minutes for your opening remarks or opening statements. I'd appreciate it if you can keep them to five minutes because we have six groups. Please keep within that time limit so that the members will have time to ask questions.

I have a list of groups, and we'll go in the order I have here. First, I have the Registered Education Savings Plan Dealers Association of Canada, and Mr. Renaud.

Mr. Paul Renaud (Chairman, Registered Education Savings Plan Dealers Association of Canada): Thank you, Mr. Chairman.

Good morning, ladies and gentlemen. My name is Paul Renaud, and I'm here on behalf of the Registered Education Savings Plan—RESP—Dealers Association of Canada.

We have a presentation that hopefully is in front of you. I'd just like to make reference to it in my remarks.

Registered education savings plans have been available since 1960, and have been eligible for registration since 1974. The Canada education savings grant was introduced in 1998, and it's a 20% top-up per child up to a $400 per year maximum of $7,200. I'm sure you're quite familiar with that.

The industry at present has grown over the last five years from $2.5 billion on deposit to over $13 billion on deposit. The dealers association is the voice of the leading group of RESP dealers in Canada. We were established in 2000, and the company I work for, USC Education Savings Plans Inc., is one of the members of the association at this point in time. The association represents about 42% of that $13 billion in assets under administration by virtue of dollar amount, but about 52% of the number of agreements that are actually in place relative to the administration of those funds.

On page 6 of our presentation, you will find the objectives of the association, which are directed at providing easier access to post-secondary education; encouraging savings; lowering student debt and default; lowering the student dropout rate due to financial circumstances; increasing the number of families with RESPs; and providing an opportunity to retain students within their home province.

You will recall that in the 2004 budget the government introduced legislation to provide an enhanced top-up to the Canada education savings grant and also introduced the concept of the Canada learning bond, both of which are now before the House in Bill C-5. We have recently made a presentation to the committee that is reviewing that particular bill.

I would just like to direct your attention, in the few moments that I have, to a couple of particular slides within the presentation. I am now moving over to slide 11 within the presentation.

RESPs motivate families, in our view, and the statistics that we maintain indicate that. Over 80% of children with RESPs go on to post-secondary education; of those, over 90% graduate from some form of post-secondary education. You will see from the statistics that we've quoted that, overall, only 49% of Canadians graduate from some form of post-secondary education. So the initiative of establishing a savings program for helping to pay for the cost of post-secondary education is a significant indicium to getting families and their children into post-secondary education.

Over on page 13 of our presentation, I would like to direct you to the strategies of our association, which are to target low- to moderate-income Canadian families to invest in RESPs; to increase the number of families taking advantage of the Canada education savings grant; to motivate more parents to invest early; and to protect RESPs from bankruptcy requirements.

I would just like to finish off my comments by taking you quickly through the recommendations that we have for this committee. First of all, as I said earlier, there is a bill in front of the House that I'm sure you're all aware of, and we would certainly recommend the expeditious implementation of Bill C-5, with its enhanced Canada education savings grant and the new Canada learning bond.

Also, the second recommendation we have for the committee is to proceed with the Senate committee's recommendation from the fall of 2002 to exempt RESP proceeds from seizure by bankruptcy trustees. These are funds, of course, that are set aside for children and their post-secondary education, and they should not be considered as assets of a debtor in circumstances where they may have found themselves in financial difficulty.

● (1125)

Thirdly, we would like to suggest to the committee that a focus be placed upon the expedition of the issuance of social insurance numbers. A social insurance number is required as a piece of identification in order to open an RESP, and at times people are thwarted in their desire to open an RESP because their child does not have a social insurance number and it takes time. The Human Resources and Skills Development Canada initiatives to have social insurance numbers issued at birth should be a focus of the government pushing forward.

There is a recommendation here for some greater flexibility with the specific issues in the tax act relative to RESPs, and I'll leave that with you.

Lastly and perhaps most importantly, we urge the government to use its opportunities to cross-promote RESPs to target audiences such as recipients of federal family benefits programs—parents, grandparents, and students. It is our experience that families who have RESPs, regardless of their income level in society, are those whose children go on to post-secondary education. It changes the dynamic in the family when the family begins to save for their child's post-secondary education. The savings do not have to be great; the fact of the savings simply has to occur. And the initiatives we have proposed and the government has undertaken to date certainly hold true to that finding.

Mr. Chairman, those are my remarks. I'll look forward to the questions of the panel.

The Chair: Thank you.

I have a question on recommendation number two. The RESP proceeds are subject to bankruptcy. Does that mean the RESP proceeds belong to an adult and not to the child?

Mr. Paul Renaud: The bankruptcy legislation currently allows a trustee, on behalf of the debtor, the adult who is the subscriber and contributor to the plan, to access those funds and seize them for the purposes of paying the creditors.

The Chair: Okay.

The next group I have here is the Investment Dealers Association of Canada. Mr. Oliver.

Mr. Joe Oliver (President and Chief Executive Officer, Investment Dealers Association of Canada): Thank you, Mr. Chairman.

The IDA is a self-regulatory organization and representative of the Canadian securities industry. The association oversees about 208 investment firms and 25,000 licensed brokers. Our member firms employ more than 38,000 people throughout Canada and across the globe.

The IDA's mandate is to protect investors and enhance the efficiency and competitiveness of the Canadian capital markets. Efficient capital markets are crucial for economic growth, capital formation, job creation, and the achievement of a standard of living that makes Canada one of the most desirable places in the world to live and to do business. I've tabled a report titled *Resetting the Federal Policy Compass*, which provides our recommendations in detail.

Since lagging productivity growth is an increasing concern for Canadians, our focus is on policies that will enhance productivity and build competitiveness. Two factors have exacerbated the productivity problem. First is the 34% appreciation of the Canadian dollar from its low in February 2002 compared to the U.S. dollar. Our strengthening currency is squeezing Canadian operating margins in international markets.

Second, U.S. companies have benefited from lower U.S. corporate tax rates and the re-elected Bush administration has pledged to make these tax cuts permanent. Currently the effective tax rate in the United States is 20.1%, compared to a current rate here of 30.5%, declining to 28% in 2008. On the other hand, Canada is in a fortunate fiscal position, with projected surpluses for the next six fiscal years totalling almost $30 billion, starting with $5.9 billion this year. In other words, although we have a problem, we have the resources to deal with it.

Our budget submission identifies a number of tax recommendations to promote capital formation and to facilitate the competitive adjustment process for both large and small Canadian companies. I will confine my remarks to three of these recommendations, but I invite the committee to consider the full report we have tabled here today.

First, we recommend that the government reduce the tax rate on dividends by raising the dividend tax credit from its current level of 13% to 18%, which would lower the tax rate from 32% to 24%. Lower taxes on dividends will reduce the cost of capital for dividend-paying corporations and narrow the gap with the United States rates to 9% from 17%. The lower rate will encourage reinvestment by existing shareholders and enhance market participation generally.

Second, we recommend that the federal government lower the effective capital gains tax rate for investment in small public companies with assets of $50 million or less. This measure will remove an impediment to capital formation by small and medium-sized enterprises, SMEs, the engines of innovation and employment growth in our economy. The lower rate will increase the after-tax return in these shares, enhance share demand, and thereby broaden small companies' access to risk capital. Another version of this idea would be an exemption from capital gains tax up to $100,000 for investments in small public companies.

Third, we recommend that the government announce a multi-year plan of personal tax reductions. The fiscally prudent plan would allow Canadians to keep more of their earned income and provide an immediate boost to consumer and business confidence. Lower personal marginal tax rates would help small knowledge-based companies to attract and retain highly skilled professionals and would make it more likely that these companies will expand their operations within Canada. Specifically, we propose a 1% tax rate cut for all four income tax brackets and an increase in the threshold at which the top marginal rate begins from $114,000 currently to $150,000. These adjustments can be phased in over a four-year period so that the cost of the program remains within projected fiscal surpluses.

● (1130)

Mr. Chairman, I would be pleased to respond to questions about these and other measures designed to enhance capital formation and competitiveness, so important to Canadians' economic well-being.

The Chair: Thank you.

From the Multi-Employer Benefit Plan Council of Canada, we have Monsieur Landry.

Mr. Peter Landry: Good morning.

The Multi-Employer Benefit Plan Council of Canada represents the interests of Canadian multi-employer pension and benefit plans. In these plans are about 360 multi-employer pensions and 400 benefit plans, which have a membership of over one million individuals and their families.

The employees participating in the pension sections have about $2 billion in these plans. We are in industries as diverse as construction, retail, transportation, entertainment, garment, and textiles. The majority of our members are middle-income and low-income people.

These types of plans, in our view, should be encouraged with the continuation of tax incentives both to provide necessary health and dental benefits, which are not otherwise available under Canada's public health care system, and to promote retirement savings. Often our employees are highly mobile, working for several employers in a year. If it were not for the multi-employer plans they would be forced to switch plans as often as they do employment. Benefits would be haphazard if they existed at all.

The purpose of our submission is to talk about encouraging such plans and removing some disincentives that currently exist.

The first thing we want to talk about is the preservation of the EET approach to registered plans. MEBCO opposes any taxation of investment earnings or contributions to registered pension plans or RRSPs. Canada's approach should remain EET, meaning no tax on contributions, no tax on investment earnings, and tax on receipt of benefits and lump sum payments.

While there's no imminent threat—at least we don't believe there is—to introduce any such unwarranted new taxation, MEBCO feels so strongly that the status quo must be maintained that we find it appropriate to reiterate our views each year in the pre-budget consultations.

Much has been said and written about the impending retirement of aging Canadians. Most expect to retire on income from both public and private sources, including employer-sponsored pension plans. As the responsibility to ensure adequate retirement income shifts to private sources, additional incentives will be necessary to encourage individuals and their employers to save for retirement.

MEBCO's position includes that there be no new disguised taxes, such as registration fees or other disbursements sent to government. It would also preclude any new limitations or restrictions on pension funds, such as the now-suspended federal budget proposals to limit pension fund investment in income trusts. Investment restrictions of this kind generally undermine the ability of pension funds to diversify their risk, imposing a greater cost and impediment to deliver retirement security benefits. These measures are unnecessary from a tax policy perspective, given that members are ultimately taxed on the benefits paid from these plans.

The second recommendation is we think that multi-benefit plans should be provided relief from solvency crises. We are concerned that the collapse of value of equity markets, the decline of long-term returns on high-quality fixed-income investments, and the increasing longevity of our members imperils the security of pension plans.

Single employers involved in pension plans can address the solvency deficiency by funding supplemental contributions. The additional-contribution solution is not readily available to multi-employer plans, so we recommend two things.

First, we suggest that multi-employer pension plans be permitted an action plan to address any solvency deficiency by providing a special payment over 15 years. Technically, this solution requires changes to the Pension Benefits Standards Act and similar provincial acts. We believe Canada can strongly encourage such solutions for federally regulated pensions, which would encourage similar action in the provinces, with the leadership of the Office of the Superintendent of Financial Institutions.

Second, at the present time employers are not permitted to remit contributions to a multi-employer plan that are not in respect to a specific member, and these result in a pension adjustment to the member. We recommend that the Income Tax Act regulations be modified so that those special payments not generate a pension adjustment for any individual member. In this way, there can be a solution over time to the current solvency crisis that does not involve reducing benefits to active and retired members. There's been some precedent in this with respect to Air Canada, and we also know of some provinces moving in this direction.

The third recommendation is for a goods and services tax rebate for multi-employer benefit plans. Unlike single-employer plans, neither multi-employer plans nor their contributing employers are able to claim income tax credits or input tax credits and rebates for GST paid for taxable supplies.

● (1135)

The single employer, of course, can as a commercial enterprise deduct these as a business expense. We are not allowed this, and we would ask the government to change this to allow a full GST rebate.

We don't think extending the GST rebate, as the government has recently extended it to municipalities, would be a real cost to the government, while it would provide substantial benefits to the health care system. We estimate it would cost between $7 million and $12 million for this adjustment, and we don't think that's significant.

The fourth thing we're asking is that there be no taxation on supplementary health, dental, and group life insurance benefits. We continue to oppose any taxation of group supplementary health benefits. Taxation discourages participation, thereby placing an additional burden on the public health care system. We support maintaining the current exemption for premiums and benefits and reintroducing the pre-1994 exemption on group term life insurance premiums.

One of the features of our employees is that they change employment over a long time. If these plans are not encouraged, they will be without coverage, which we think, because much of our care —dental, prescription drugs—is preventative, would lead to greater cost to the public health care system, since we're now dealing with diseases, which are covered.

We think the encouragement that currently exists is not strong enough. Many employees still do not have access to employer-sponsored plans because of employment status and the fact that administrative costs such as benefits are too onerous for small employers. Existing tax policy in many ways discourages the growth of multi-employer benefit plans. One example—and this involves more the provincial jurisdiction—is that Ontario and Quebec have an 8% and 9% retail sales tax on plans, which costs us $76 million per year.

The final comment I'll make—and I'll be very brief to sum up—is that we are very concerned with the escalating cost of health care to our members. This has increased significantly over the last number of years, to the point where now 30% of total health care costs are paid privately. We are particularly concerned with the cost of prescription drugs and what it is doing to the viability of our plans.

Thank you.

● (1140)

The Chair: Thank you.

I have just a quick question before I forget. You costed the GST relief, but I can't find it in your brief. Is it in there, in recommendation 3?

Mr. Peter Landry: You're going to ask me to find it in the brief?

The Chair: You can get back to me.

Mr. Peter Landry: Yes, it would be; it's in the brief. I just can't tell you what page right now.

The Chair: I couldn't see the number. I think you said it would be $12 million, didn't you?

Mr. Peter Landry: Yes, Mr. Chairman.

The Chair: Okay.

I want to get to the next group. From the Certified Management Accountants of Canada, we have Mr. Tinkler.

Mr. Michael Tinkler (Chairman of Audit Committee, Member of the Board of Directors, Certified Management Accountants of Canada): Good morning, Mr. Chairman and members of the committee.

My name is Michael Tinkler, and I am pleased to present the pre-budget submission of the Society of Management Accountants of Canada.

The society represents more than 35,000 management accountants and 10,000 CMA candidates. Our members range from private and public sector senior executives to individual auditors and consultants. Thus we feel a professional obligation to contribute our perspectives on public policy issues and provide professional advice on some key federal budget matters.

[*Translation*]

As members of Parliament, you know better than anyone that governing is all about making choices. We believe our presentation will be helpful in developing your recommendations to the Minister of Finance.

[*English*]

Our written submission's specific recommendations can be grouped into two broad themes. The first is the threat to our standard of living posed by Canada's lagging productivity growth. The second is the threat to our democratic institutions posed by Canada's inadequate comptrollership practices.

Allow me to first address the threat of lagging productivity growth. Our benchmark is the productivity growth of our neighbour, the United States, as our two economies are increasingly integrated and we enjoy the world's largest bilateral trading relationship. Most industries in Canada export to the U.S. and have operations in both countries; thus these businesses have a choice of investing in either country. Unless Canada bridges the growing gap in productivity growth with the U.S., we will experience a migration of financial and human capital to the U.S. Our standard of living is 14.5% lower than that of the U.S., and the gap is growing.

[*Translation*]

CMA Canada believes that in its next budget, the government should propose tax measures to stimulate investment in the economy in order to reverse that trend. We have the fiscal capacity to make these tax expenditures in order to stimulate investment, and the return for our fiscal framework will be an attractive one, given the increased tax revenues that will result.

[*English*]

● (1145)

Small and medium-sized businesses are the lifeblood of our economy and a major source of job creation. In order to encourage them to grow we recommend the threshold for the lower corporate tax rate be immediately increased to $500,000.

With two highly integrated economies, why does Canada have different rates of capital cost allowances and methods of calculation from those of the U.S.? The rates and methods of calculation should be harmonized.

We make a number of additional recommendations aimed at stimulating innovation and hence productivity in Canada. These include: increasing the lifetime capital gains exemption limits to $1 million to help stimulate economic growth and investment, preferred tax status for researchers, and a more tax friendly royalty regime to encourage Canadian R and D and its international commercialization.

[*Translation*]

We believe that these collective measures will help to increase the pace of innovation in Canada and fill the productivity gap with the United States.

[*English*]

To further enhance our productivity we believe it is important for the government to review its present commitment to debt reduction. While CMA Canada supports government efforts to reduce the debt, we feel the size of recent surpluses and the application of these surpluses to debt repayment requires a more advanced discussion than the one to date.

Private sector financial managers know that there is a healthy level of debt for every enterprise that balances the cost of servicing debt against the return on investment from the initiatives funded by that debt. If a company borrows money at 5% and invests it in assets that earn 8%, the 3% difference goes straight to the bottom line. Although returns in the public sector are harder to measure, investments in infrastructure, R and D, health care, and education can have significant pay-offs in economic growth. A 25% goal may not be the healthy level of debt that would maximize our future productivity as an economy. We recommend that the government undertake a more analytical approach to the subject of debt reduction, examine the costs and benefits, and engage Canadians in a more thorough dialogue on the options.

Our second issue of concern is comptrollership in government, something we at CMA Canada know a great deal about. Private sector accounting has recently experienced a tectonic shift brought on by the accounting scandals in the United States. Enron, WorldCom, and Adelphia have become synonymous with poor accounting practices and the need for private sector accounting reforms.

But financial management challenges are not endemic to the private sector alone. Governments can be impacted too, if systems and checks are inadequate to mitigate these risks. Preventing financial mismanagement in government is even more critical, since public resources are finite and wasted taxpayers' dollars must not be tolerated. In this regard, CMA Canada has been pleased with the government's numerous initiatives to improve its financial management regime.

[*Translation*]

Despite these initial positive steps, we are concerned that the government's efforts have been too focussed on auditing, more central oversight, and disciplinary measures for non-compliance, and not enough on other important aspects of modern comptrollership. If not moderated, such a culture could paralyze decision-making, and frustrate the aims of many high-quality government programs.

[*English*]

Mr. Chairman, CMA Canada strongly recommends that the Comptroller General make implementation of modern comptrollership practices his highest priority. We recommend that training policies and procedures as well as a revised code of ethics be updated to reflect this new focus. We also recommend that the management accountability framework that has evolved out of the modern comptrollership initiative continue to guide government operations.

Furthermore, we believe deputy ministers must accept greater responsibility for departmental financial management and be held to account if these standards are not met. Moreover, deputy ministers should be directed by the Clerk of the Privy Council to seek ways to harmonize the procurement of departmental necessities and share basic corporate services in an effort to introduce standardization across government and thereby reduce costs and benefit from economies of scale.

In closing, Mr. Chairman, we believe our recommendations will help contribute significantly to improving productivity rates in Canada and strengthening the public's confidence in government.

We thank you for providing us with an opportunity to appear before this committee, and we look forward to your report.

The Chair: Thank you.

[*Translation*]

Now we will hear from the Association of Canadian Pension Management.

Mr. Perkin.

[*English*]

Mr. Scott Perkin (President, Association of Canadian Pension Management): Thank you, Mr. Chair.

My name is Scott Perkin. I am the current president of the Association of Canadian Pension Management.

The ACPM represents Canada's private and public pension plan sponsors, administrators, and other stakeholders, and our current membership represents over 400 registered pension plans, providing coverage for some four million Canadians. In our written submission, the ACPM has briefly addressed some of the committee's consultation questions. In addition, we also have five recommendations that I would like to address today.

The first recommendation is to encourage greater financial self-sufficiency in retirement. The ACPM welcomed the modest but positive increases in pension and RRSP contribution limits announced in the 2003-04 federal budget. Like many others, however, we don't think these increases go far enough, nor do they address retirement saving disincentives for Canadians living on more modest incomes. We recommend capping the effective tax rate on total pension income at 50%—that's inclusive of OAS clawbacks. We also recommend progressively increasing pension and RRSP contribution limits to $27,000 in 2003 dollars, after which further increases should be indexed to inflation.

These two recommendations combined, in our view, will allow Canadians to adequately save for and enjoy their retirement income.

We acknowledge the submission that was made to this committee last week by the Retirement Income Coalition, of which the ACPM is a member, which reflects the significant competitive disadvantage Canadians face when compared to the U.S. and the U.K. when it comes to tax-assisted retirement savings. Encouraging greater self-reliance toward retirement savings also reduces future reliance on government income support programs.

Our second recommendation concerns tax-prepaid savings plans, which are addressed more fully in our written submission. The ACPM is not opposed to the concept of TPSPs, but only if they are introduced as a complement to increased pension and RRSP contribution limits, not as a substitute.

Our third recommendation concerns elimination of the 30% foreign property limit on pension and RRSP investments. We recommend that this limit be removed entirely for the following reasons. It costs Canadian pension plan members an estimated $1.5 billion to $3 billion per year in forgone income and increased administrative fees at a time when Canadians are worried about pension funding levels. If the foreign property limits are not changed, many large pension plans, including the Canada Pension Plan, could have difficulty meeting their investment targets and could end up as dominant shareholders in virtually all companies traded on the TSX. Another Bre-X or Nortel could have a devastating impact in such a circumstance.

Our fourth recommendation concerns reforming Canada's tax and pension legislation to promote and help secure workplace pension plans. The ACPM believes that the federal and provincial governments must create a legislative and regulatory environment that promotes workplace pension plans and reinforces pension plan security. In this regard, we recommend the following:

Amend the Income Tax Act to increase maximum allowable funding levels. In most defined benefit plans, the current tax rules disallow further contributions when the level of funding reaches 110% of liabilities. The last few years have shown us how quickly bad markets and low interest rates can erase a 10% actuarial surplus. Plan sponsors and administrators need more flexibility to manage the upside to protect against such downturns.

We further recommend amendments to the federal Pension Benefits Standards Act to eliminate the risk of compulsory surplus distribution from ongoing pension plans that would result from the recent decision of the Supreme Court of Canada in Monsanto. If Canadian pension plan rules are not reformed, a growing number of corporate plan sponsors, and potentially even some public sector employers, may decide to get out of defined benefit plans entirely. This process is already under way in the United States and the United Kingdom. These comments were echoed in a recent speech by Mr. Dodge, the Governor of the Bank of Canada, who said that the Monsanto decision "tells employers to get out as fast as they can of defined benefit plans and if you're stuck in one to run in a deficit position at all times."

● (1150)

Our fifth recommendation is to ensure that Canada's pension plans benefit from a level playing field—in other words, no restrictions on investment in business income trusts. The association commends the minister and the government for removing this proposal from the 2004 budget. We cannot support any measure that discriminates against pension plans, large and small, by restricting their investments in attractive Canadian assets. Otherwise we risk jeopardizing the funding security of retirement benefits for millions of Canadians.

In conclusion, unless the government takes some significant steps now, there won't be the tax base from which to properly fund the health care and income needs of tomorrow's pensioners, given changing demographics and the aging of the boomer generation. It is our respectful submission that the government must act now to relax or remove limits on what Canadians can save toward retirement, what benefits Canadians can draw from their pension plans, and what investments Canadians can make with their retirement savings to diversify risk and to achieve an affordable and dignified retirement.

Thank you.

● (1155)

The Chair: Thank you.

The next group I have here is l'Institut des fonds d'investissement du Canada, Mr. Hockin.

Mr. Thomas Hockin (President and CEO, Investment Funds Institute of Canada): Thank you, Mr. Chairman.

My name is Tom Hockin and I'm president of the Investment Funds Institute of Canada. I have with me Jamie Golombek, who is vice-president of tax with AIM Trimark and chairman of our tax committee.

The bulk of what I'm going to say in my limited time today was in my letter tabled with the clerk on September 14, 2004. I have one extra point I wanted to add to that.

I'd like to begin by saying I support the direction you've just heard from the IDA and from the ACPM on retirement savings, business income trusts, personal tax deductions, reduced dividends tax rate, capital gain tax rate for SMEs. It's very important for the mutual fund industry that we have good issuers to buy from and that Canada has healthy and a growing number of issuers.

The Investment Funds Institute of Canada is pleased to take part in this meeting. We were founded in 1962 and we're the association of the investment funds industry. Our membership is restricted to industry participants directly involved and our members include mutual fund managers who manage almost $500 billion on behalf of Canadian investors. The diversity of viewpoints represented by our membership and our ability to get input and consensus from this group has been a strength of IFIC over the years.

I want to speak directly to retirement savings. For many years IFIC has written to your committee and urged you to recommend that the Minister of Finance provide increased opportunities for Canadians in all income levels to save for their retirement. We recommended an immediate increase in the RRSP limit to $27,000, similar to the ACPM, and that that limit be indexed accordingly thereafter. In the 2003 budget we were pleased to see the Minister of Finance raise the limits to $18,000, to be indexed accordingly thereafter, but we again urge your committee to recommend a further increase in the contribution rate.

Our arguments are similar to what you've just heard. We're not competitive with other countries when it comes to this limit. The annual contribution limit in the U.K., for example, is three times our limit. As we've argued previously, RRSP limits provide Canadians with flexibility in saving for their retirement, and for the majority of Canadians large RRSP contributions can only occur later in life—I repeat, later in life. That's why you get a low take-up when people are younger but they can get serious about this somewhat later in life, after their kids have left and their mortgage is paid off. Higher limits would help them to catch up and make contributions that were deferred in earlier years by their economic circumstances.

The 2003 budget also advised that the minister and his officials were studying the concept of TPSPs as a “useful and appropriate mechanism to improve the tax treatment of savings and to provide additional savings opportunities for Canadians”. We are a strong supporter of this concept, as it would provide additional flexibility to Canadians in securing their retirement incomes at little to no revenue loss for the government and would provide a similar savings vehicle to that already available in the U.S. and the U.K. So we urge the committee to recommend to the minister that he move forward in his opening budget to establish TPSPs.

We would also like to attract your attention—and there's a handout I've brought with me—to the rules governing the RRIF payout schedule. You're all aware of what that schedule is. The rules were established when the average mortality rate was 72 years of age, and now it's 76. But what's really dramatic is the dispersion around that average that is producing in absolute numbers more and more 85- to 95-year-olds who incur heavy long-term care expenses at that age. The result is that many retirees will find their funds depleted before they die because of the mandatory RRIF payout schedule. Consequently, they'll have to rely on government assistance. This is an ironic and perverse outcome for governments, given that RRIFs are intended to provide income for life, thereby reducing the need for government subsidization.

The minimum withdrawal rates begin to exceed in the long-term risk-free rate of return as RRIF holders reach their mid-seventies and this substantially degrades their capital. For many people, RRIF and Canada Pension Plan benefits are their sole sources of income. Clearly, for them there will not be enough money to fund health concerns in old age. Most large medical and long-term expenses occur in the last few years of life, but the RRIF payout will leave them almost nothing for this when a person is in their middle to late eighties or into their nineties.

● (1200)

I would like to ask Jamie Golombek, who is chairman of our tax committee, to speak to the third issue, the deductibility of interest and other expenses.

The Chair: Quickly, please, because time is limited.

Ms. Jamie Golombek (Vice-President , Taxation and Estate Planning, Investment Funds Institute of Canada): I will only take two minutes. There are only two issues I want to talk about very quickly.

The draft legislation was introduced a little over a year ago concerning the deductibility of interest expense and other expenses. In a nutshell, this will introduce a new test of a “reasonable expectation of cumulative profit”. This would be devastating, not only to the mutual fund industry but to investing Canadians as a whole.

As a simple example, this new legislation would basically say that if you borrow to invest and you invest either in stocks or in equity funds and you don't get a rate of return higher than the rate that you are borrowing, excluding capital gains, then your interest will not be deductible. This is a major detriment to Canadians who are trying to save for retirement or save for any purpose and invest outside of a registered plan in which interest is typically deductible today but would probably not be deductible if this legislation goes forward.

We urge the committee and the minister, obviously, to either scrap the legislation as it currently stands, or amend it to instead put in the possibility of profit test as opposed to a “reasonable expectation of cumulative profit” test.

My last point really simply echoes comments that were made earlier concerning RESPs. As you know, the annual limit right now is $4,000 a year, with a maximum cumulative of $42,000. These numbers have not been changed in years, nor are they indexed to inflation. It's IFIC's recommendation that both these limits be increased. Given the fact that a cost of a four-year education program 18 years from now will exceed about $95,000, we would encourage the minister to consider increasing both the annual limit and the cumulative limit.

Thank you.

The Chair: Thank you.

I remind members these are seven-minute rounds. I have on my list Mr. Solberg, Mr. Loubier, Mr. Hubbard.

Mr. Monte Solberg: Thanks very much, Mr. Chair.

Last weekend I was in Berlin at the G-20 and one of the issues that came up was the issue of the coming demographic debt crunch. So much of what you've talked about today really addresses that or I guess would help us broaden our tax base so that down the road we can handle those kinds of things.

This is a very good panel. It's very timely and it's good to have you here. One of the questions I have, though.... There are a number of proposals here, and they are all tax expenditures, I suppose, in the short run. The one that is always one of my favourites is cutting capital gains taxes. Mr. Oliver, I think you spoke about that.

If I recall correctly, cutting capital gains would be somewhere around a $1.9 billion tax expenditure, but a lot of people also argue that really the net loss would be zero, or maybe even a gain. Do you have any numbers on that? Mr. Hockin is nodding his head. Does anybody want to comment on that and maybe talk about the economic activity we could generate if we were able to cut and maybe even move toward eliminating capital gains?

Mr. Joe Oliver: Mr. Solberg, what we've tried to do when we've costed these proposals is be exceedingly conservative. That is to say, we've looked at the direct tax loss that would result from the measures. Our recommendation with respect to the corporate income tax would be roughly $3 billion a year in its final year, to move in the direction that we're recommending, and considerably less for the special provision for small and medium-sized companies. That would be in the order of some $20 million a year. That does not take into account the additional growth that would result from these measures, the additional employment income tax and ultimately additional revenue from corporate taxes.

It's difficult to quantify, but if you look around the world the evidence is in, and it's overwhelming. The best example that people often cite is Ireland, which forever was sort of an economic basket case, charming but not doing particularly well. A major structural fiscal reform has transformed the country, and clearly the reduction in taxes did not, on a net basis, cost anything. To the contrary, they added to economic growth and government revenues.

● (1205)

Mr. Thomas Hockin: As a footnote to that, the computer simulations of the Bank of Canada, the Department of Finance, where I was, and the University of Toronto I'm told don't have a static model any more. When they see tax cuts, they don't assume that it's a zero-sum game. I don't have the answer to your question, but those simulations should confirm what you've said.

Mr. Monte Solberg: To add to that, of course, in the annual financial report that we had come out a month ago the department expressed surprise at the revenue growth that occurred, even after corporate tax rates, in this case, had been cut, but of course, the revenues jumped dramatically after the tax cuts. I think there's lots of evidence as to how this broadens the tax base and increases revenues.

Would anyone care to comment on the issue of the demographic crunch? It's a very serious problem, as you know. In the short run there are many good arguments to be made for cutting taxes and money going directly back into people's pockets and raising the standard of living, but obviously, in the long run one of the things we have to be worried about is how we handle this demographic crunch and the impact on health care and pensions. Does anyone want to comment on that?

Mr. Scott Perkin: That's a very good question, Mr. Solberg. I think the government made some important steps a few years ago to put the Canada Pension Plan on a much more solid footing. That was the start, but obviously not the end.

To give you a very graphic statistic, back in 1970 there were 10 active teachers in the province of Ontario to every retired teacher. That ratio today is less than 2:1, and it's forecast to be 1.5:1 by the year 2010. That's just the teaching population. I assume that can be compared to other populations as well. We think the government needs to take the steps now for the longer term to make sure that when we get there, we do have the funding dollars to cover things like health care and the income needs of those retirees who, for whatever reason, have not been able to save properly for retirement.

The Chair: Mr. Hockin.

Mr. Thomas Hockin: The fastest-growing fund category in the last couple of years has been balanced and income funds, which indicates that you have an older demographic looking for some predictable yield. Regardless of what you think about the Bush tax cuts on dividends, that's how he's spoken to this demographic, because they were desperate for some yields, given that interest rates are so low. There's certainly a demand here for this kind of thing.

The Chair: Thank you.

Mr. Loubier.

[*Translation*]

Mr. Yvan Loubier: Thank you, Mr. Chairman.

Along the same lines, on page 7 of the French version of the brief submitted by the Investment Dealers Association of Canada, it states that even with major reductions in corporate tax rates in recent years, which make corporate tax rates in Canada quite a bit lower now than those in the United States, and even with the measures planned over the period from 2003 to 2008, under which capital taxes will go from 31.8 per cent, the rate in 2003, to 27.4 per cent in 2008, we will be unable to match the US record in terms of attracting private investment.

Am I to understand that cuts to capital taxes and corporate taxes are still not enough, and that we have to go even further than what has been done over the past two years?

● (1210)

[*English*]

Mr. Joe Oliver: The comparison between Canadian and U.S. rates has to take into account the effective tax rate on capital investment, which remains higher in Canada than in the United States. The effective tax rate, as we point out, takes into account the treatment of depreciation, inventory, financing, expenses, capital tax, and sales tax on capital input. The C.D. Howe Institute estimates that further reductions to 27.4% will still be higher than the 22% in the United States, which is the current rate, so that an unfavourable disparity continues to exist between Canada and the United States.

I don't know if that answers your question.

[*Translation*]

Mr. Yvan Loubier: Is the accelerated depreciation rate for certain types of capital equipment in the US similar to what we have here since the changes made about five years ago, if I'm not mistaken?

Mr. Joe Oliver: No. As I understand it, one of the problems is that the rate is higher in the US than it is in Canada.

Mr. Yvan Loubier: So, the problem is not the tax rate per se; it may be the accelerated depreciation rate. If we had a different rate, we could, with accelerated depreciation, resolve part of the problem in terms of overall taxation across the corporate sector and thus be in a position to respond to the productivity problems our businesses are experiencing at the present time?

Mr. Joe Oliver: That's the reason why we talk about the effective tax rate on capital investments. That rate continues to be higher in Canada than it is in the United States. So we need to do an overall calculation.

Mr. Yvan Loubier: Mr. Tinkler, you mentioned earlier that it would be appropriate to have not just the objective of a debt-to-GDP ratio of 25 per cent, but also a kind of social contract and to engage citizens in a debate on the purposes of debt reduction. I agree with you 150 per cent. People will always want to have discussions with the government about how to use the surpluses, considering they are higher and higher. Even the reserves are increasing more and more. We started out with a contingency reserve, and added a prudence reserve and pretty soon, as I was saying the other day to the Minister of Finance, we'll have a reserve for ministerial fear of the future. So, I agree with you.

Do you have some kind of policy in mind whereby on the basis of a perfectly democratic and transparent process, we could set goals to be met with respect to debt reduction, but also the use of surpluses for Canadians' other priorities?

Mr. Michael Tinkler: Exactly, Mr. Loubier. We see here a need for broader participation in such discussions. However, as a preamble to that discussion, the Minister of Finance and his officials need to carry out a more detailed and in-depth macroeconomic analysis—which would obviously be made public subsequently—as to the costs and benefits of different approaches.

If we're investing several billion dollars in the transportation or telecommunications infrastructure, what could we…

● (1215)

Mr. Yvan Loubier: You're talking about leveraging that investment.

Mr. Michael Tinkler: Yes, exactly.

Mr. Yvan Loubier: Along the same lines, I also agree with what you're saying about a cost-benefit analysis. Do you find it normal that the debt which costs us the least to manage, given the preferential rates charged the federal government, also be the debt we pay down most quickly, whereas provincial government debts—and it's important to remember there is only one taxpayer—are going up, except in Alberta, of course? Alberta will always be the exception that confirms the rule. So, other than Alberta, provincial debts are on the rise and are subject to much higher interest rates than the preferential rates the federal government pays. I imagine that in suggesting a cost-benefit analysis, you probably also have in mind this poor allocation of resources.

Mr. Michael Tinkler: Absolutely. If Canada were a private enterprise and the government were head office, and the provinces, the subsidiaries, there is no doubt that based on a fundamental principle of financial management, we would be reducing our most costly debts first. That principle also applies to personal finances. In terms of using the surpluses to help the provinces to pay down their debts, if memory serves me, the interest rate differential is almost 1 per cent.

It should also be mentioned that risk analysis is always performed in relation to the effect of debt. In the private sector, it's covering interest payments through revenues before interest and taxes. In the public sector, it could be a statistic such as the portion of the budget devoted to debt servicing. At one point, it was close to 35 or 40 per cent. Now it is only about 15 or 20 per cent. But 15 per cent would probably be a more normal level.

The Chair: Thank you, Mr. Tinkler.

[*English*]

Mr. Hubbard, and then Ms. Wasylycia-Leis.

Mr. Charles Hubbard: Thank you, Mr. Chair.

We're into some pretty heavy hitting here, but I want to go back to a very basic thing, and Mr. Landry might answer.

Under personal income tax applications we have two categories of workers you probably deal with, those who are disabled or hurt in the workplace, and you know, of course, how workmen's compensation benefits are applied in our tax system, and what we call long-term disability, which I suppose some of the people you work with are under. These are very different in respect of how we are treated for long-term disability, in the Income Tax Act and, more importantly, in the employment insurance legislation. They are very significant facts here. Mr. Landry, do you have any view on how your eventual clientele view WCB, as opposed to long-term disability benefits from a company you may be working with or for?

Mr. Peter Landry: I'm not sure I can answer your question with respect to WSIB workers' compensation plans. We do pay for long-term disability, and our point was that it's increasingly expensive for us to do so and we need to find a way of reducing our costs, so we welcome whatever the government can do to help us out with that. Because the truth of the matter is that if we're not paying for it..... A lot of the people who are in our plans are low-income and middle-income or they work for small and medium-sized companies. So I can't answer your question specifically, other than to say we need to find ways to make it affordable for us to offer separate coverage.

Mr. Charles Hubbard: So from your perspective, with the people you have insured, directly or indirectly, you don't receive many complaints about how the Income Tax Act treats long-term disability, or you're not aware?

Mr. Peter Landry: I'm not aware of that.

Mr. Charles Hubbard: You're not aware. I'm sort of surprised.

Mr. Tinkler, we have investment dealers and great investments made in pension funds; Mr. Perkin has referred to those. There are concerns in this country about pension funds. We look at the concerns of some of the steel industry. We have others concerned about how they are managed, some of the restrictions that may be placed upon them, some of the regulations under which they have to operate. You referred to a better system, being more transparent, so people would know where money was going and how it was being applied. Because some companies, apparently, can take pension fund money from here and apply it to their needs for operating capital and so forth. Would either you or Mr. Perkin have any recommendations to this committee on that situation?

● (1220)

Mr. Michael Tinkler: I'll just answer briefly to the best of my knowledge and defer to Mr. Perkin.

A number of our members, of course, are involved in pension fund management or are senior financial officers of those corporations you're referring to. The primary purpose of a pension fund is obviously to provide pension income to the beneficiaries at the end. And in the interest of greater transparency and greater financial responsibility with regard to those pension funds, we would be in favour of perhaps a tightening up of the regulations on how those funds can be used. I think what we saw in the recent Internet boom was that organizations were using those surpluses for other purposes, and they were subsequently in a rather serious position because of what they had done.

Mr. Scott Perkin: The only comment I would add is that our view is that whatever the rules are, they should be very clear and applied consistently and fairly. The Canadian Coalition of Good Governance, as you know, has been promoting governance on many fronts, including accountability and transparency, and that extends not only to the funding, but to the accounting of pension plans, and we would endorse that.

Mr. Charles Hubbard: Are there other comments?

Mr. Chair, I watched one night on TV a group from Pennsylvania, I believe it was, many of whom had worked their entire lives and paid into pension funds, and when their company went kaput, they were told, at 50 or 60 years of age, I'm sorry, fellows, but there is just no money left in the system for you, it's all gone. Could that happen in Canada with any of our pension funds? Really they're funded by deductions, benefits, the tax system, both by the employee and employer, but are there any concerns among you, as dealers and as people involved with pension management, that within Canada people could be hurt in the same way, and should we take initiatives to make sure this does not happen?

Mr. Scott Perkin: We're very concerned, obviously. We've had Air Canada happen. We're now looking at Stelco in Ontario. As you know, we have a guarantee fund in Ontario. It's the only jurisdiction in the country that has one. We've got the regulators proposing various harmonization rules so the rules are consistent across the country.

The ACPM recently struck a task force to look at the funding issues surrounding pension plans, so that work is currently in progress. But we're very concerned that the rules are fair and applied consistently.

Mr. Charles Hubbard: Thank you, Mr. Chair.

Unless others have comments....

The Chair: Which department should be regulating that aspect of the pension? Finance?

Mr. Scott Perkin: Currently you've got regulators in every province, and at the federal level with OSFI. I think that's appropriate.

The Chair: Are there missing controls? Is that what I understand? I'm not clear on that.

Mr. Scott Perkin: One of the proposals that has been discussed—in fact it was on the news I think last week—is the whole issue around creditor protection for pension plans of insolvent companies. There's a question as to whether amendments might be made to, for example, the federal Bankruptcy Act to protect pension plans more appropriately when a company becomes insolvent. Then you have other issues as to whether banks will lend money to companies that have pension plans if they're not going to take preference over those plans in the event of insolvency. So there are issues like that.

There are issues of funding that all of the jurisdictions are now looking at. You've got some jurisdictions like New Brunswick, which has relaxed its funding rules in light of some of the things going on in that province. Then, of course, you've had rules put in place to deal with the Air Canada situation.

The Ontario government has been struggling for some time now with the Stelco situation, and we've yet to see what will happen as a result of that. It's an extremely important issue.

● (1225)

The Chair: It seems to be on a case-by-case basis.

Mr. Landry.

Mr. Peter Landry: Because of multi-employer plans, it's unlikely in our model that they're all going to go bankrupt at one time. That's why I made comments on the solvency crisis and having a little bit more flexibility, given it's unlikely that all the employers in the construction sector, for example, would go under. We do need the flexibility.

The Chair: I would ask the witnesses to hang on for about ten minutes more, if that's okay.

Ms. Wasylycia-Leis.

Ms. Judy Wasylycia-Leis: Thank you, Mr. Chairperson.

I don't want to spend time on the pension issue, but I do want to follow up quickly on that one point with Mr. Perkins. If banks will not lend because we have legislation requiring that workers get access to their rightful pensions, surely we should be doing something. Either the government should take over that responsibility, or we should force banks to do it.

There has to be some way, wouldn't you agree, to ensure that workers don't lose their life savings and are left destitute because a company goes bankrupt.

Mr. Scott Perkin: Absolutely. I think our current funding rules across the country represent somewhat of a patchwork. They are relatively consistent, but there are differences. Then again you've had, as the chair suggested, situations dealt with on a case-by-case basis like Air Canada.

I think it's important that whatever rules are there are clear and consistent, and make sure the security of benefits is protected. The issue that was on the CBC news obviously told part of the story. You could look at the Bankruptcy Act, and the tightening up of funding rules.

One of the proposals I referred to earlier was to allow plan sponsors in the good days to put more money away in the pension plans without the Income Tax Act restricting it, so when we have downturns, as we've witnessed in the last two years, not just with the stock markets but with a decrease in real interest rates, you've got enough money as a cushion there for the bad times.

Ms. Judy Wasylycia-Leis: Thanks for that answer. I'd love to spend more time on this, but I've got to get to the issue of RESPs. I'm quite shocked by the presentations today from a number of you suggesting that this program is such an important solution to the problem of creating equal opportunities for education. You will know—if you've been watching these proceedings—we met earlier this week with students, university professors, and all the organizations that are deeply involved in education. They basically condemned the Canada learning bond and the RESP system as not just a band-aid solution, but a solution that should be scrapped.

Mr. Hockin talked about tuitions rising to about $80,000 or $90,000 in 10 or 20 years. I can't believe you're going to propose a solution that will, if we're lucky, get someone in a low-income bracket up to 75% of one year of tuition fees, up to a maximum of $3,000. I just don't understand how you can promote these two programs as a solution to lack of equality in education—as a great equalizer—when it's not, and that you're not recommending other options when it's so important to look at education.

Mr. Oliver mentioned Ireland as having all these great fiscal policies to encourage business and encourage a good economic climate, but he didn't mention that Ireland gives universal access to all post-secondary students. They recognize the importance of having a solid program in place for education. None of the solutions you're presenting today touch this issue at all.

So I think Mr. Hockin, Mr. Oliver, and Mr. Renaud need to give some accountability for why they're pushing something that can only be good for high-income earners as a get-rich investment program.

Mr. Paul Renaud: Mr. Chair, I'll speak to that first, if that's okay.

The issues that have come forward as a result of the consultation that's going on with respect to Bill C-5, in our view, are promoted by individuals who are at the point where they have problems. Bill C-5 is more of a visionary type of step, dealing with one aspect of funding for post-secondary education. The groups that have presented to the committee to this point are in one segment of that post-secondary market. The post-secondary market deals not only with university and college, but also with all aspects of post-secondary education, from apprenticeship programs through additional learning, lifelong learning—any number of additional programs.

● (1230)

Ms. Judy Wasylycia-Leis: Give us the breakdown then by income group on access to RESPs, what you think will happen under the learning bond, and who's going to benefit.

Mr. Paul Renaud: The programs that are now being promoted are specifically targeted to low- and moderate-income Canadian families. The statistics we have indicate that once a family gets into a savings program, regardless of whether or not they're capable of saving a significant amount of money, it will assist families that have never been in any form of post-secondary education to break that cycle and move on to post-secondary education with their children.

Ms. Judy Wasylycia-Leis: Fair enough, except less than 19% of eligible families earning less than $30,000 a year have been able to make any RESP contributions. Are you saying the ability to put money aside is a motivational thing and has nothing to do with economic circumstances? Are you saying it's just the sheer lack of motivation and will to put money aside?

Mr. Paul Renaud: No. What we're promoting is the fact that the establishment of an RESP is what drives a family to change their cycle of circumstances. So the programs that are being established—

Ms. Judy Wasylycia-Leis: That's an awfully patronizing attitude. If you're really serious about motivating people, you would recommend today that the money be reallocated and put directly into universally accessible post-secondary education so low-income families can afford to send their kids to school. If I'm a low-income person and I invest in a learning bond for my kid now, 18 years from now I could eventually get up to $3,000 in 2004 dollars. How is that going to help me?

Mr. Paul Renaud: The Canada learning bond is a process that establishes an RESP and then makes available to the family the opportunity to invest. It gives them the awareness they need in order to establish and promote an RESP within their family unit. So the initiatives at the federal level, and the initiatives in Alberta with the Alberta centennial education savings plan, are all designed to create the awareness to start the process, and then to turn to the family and say—

Ms. Judy Wasylycia-Leis: I think we need more data from you. I think we need more information about this program. I don't believe it's working and I don't think it's the solution.

I think it was Mr. Oliver who promoted the idea of more corporate tax cuts, to the tune of $3 billion a year. Frankly, if it's a choice between $3 billion a year to finally create a quality child care program so people can contribute to our economy, versus another corporate tax break to the tune of $3 billion, are you saying you're going to pick the corporate tax breaks over families, women, and children in this country?

The Chair: Can you answer that quickly?

Mr. Joe Oliver: I didn't mention RESPs, that's the first point.

The point I do want to make is a very important one. Ireland is able to afford to give free education because it has lower income tax rates, lower capital gains tax rates, and lower corporate tax rates.

The Chair: Thank you.

Mr. Penson.

Mr. Charlie Penson: This is a very good debate and I'm glad we're having it, Mr. Chairman, because I want to address this very issue as well.

The alarm has been raised again here today about Canada's lagging productivity in relation to our major trading partner, the one that really counts with us, the United States. Many of us have been on these committees for quite a few years and have heard the same problem, and nothing seems to be improving. My concern is that we're sleepwalking our way to mediocrity in this country and we won't be able to afford the kinds of things Judy is talking about. She's right, it is a chicken-and-egg situation. I think we have to allow the kind of fiscal room for companies to make the investments they need in order to provide jobs that are going to provide a good standard of living for Canadians.

I see, Mr. Tinkler, you've talked about that where you've talked about investment. With the rising Canadian dollar that Mr. Oliver has talked about as well as, I think, Mr. Hockin, you'd think that Canadians would be out there buying machinery, equipment, updating their factories, and buying all the new information technology that's available to make that better. But that's not happening.

A few years ago we had a sea change in investment. We know that we've had a declining share of the direct foreign investment around the world in Canada, but Canadians have started to vote with their feet in terms of investment as well. A number of you have made that observation. I'm concerned. We have a lot of things that should be working to our advantage here. We have a lot of natural resources, we have a highly educated population. What is missing here? It seems to me that it's the kind of leadership needed from government on things like cutting corporate taxes to allow the kind of investment we need.

I invite a quick response from Mr. Tinkler and Mr. Oliver on those.

● (1235)

Mr. Michael Tinkler: On the impact of the rise in the Canadian dollar, it's one of those economic things that always has several sometimes contradictory impacts. One, of course, is a reduction perhaps in our competitiveness in terms of exporting. The other, I agree, perhaps it makes investments in Canada more attractive for Canadian investors, but it's been too short a time for that change, the relative rise of the Canadian dollar, to have been reflected in the Canadian economy. Perhaps we'll see that six months down the road to a greater extent.

Mr. Charlie Penson: Would you agree, Mr. Tinkler, that a lot of the machinery and equipment that factories would need to update would come from outside our country, and the rising Canadian dollar should be an incentive for them to do that? If they're ever going to, it should be now.

Mr. Michael Tinkler: Yes, but then they have to be able to sell the products those machines will generate, and the rising Canadian dollar makes that more difficult, perhaps. It's hard to say.

Mr. Charlie Penson: Mr. Oliver.

Mr. Joe Oliver: I think the rising Canadian dollar puts additional pressure on the productivity issue. The Governor of the Bank of Canada recently testified before the Standing Senate Committee on Banking, Trade and Commerce. He said that this issue is the most important macroeconomic issue facing Canada and that is how we improve our productivity over time.

Recent data published by Statistics Canada showed that annual labour productivity and growth in Canada between 2000 and 2003 averaged only 1.4%, compared to 3.8% in the U.S. Between 1989 and 2000 it was almost even, at a disadvantage of only 0.3%.

The gap is widening, and what we're talking about are the long-term opportunities—jobs for children, high-value jobs. Of course, as productive citizens, they will be paying taxes, hence more revenue. So it's what we call a virtuous circle.

Mr. Charlie Penson: Yes, I agree with you.

Isn't it a direct linkage that the Bank of Canada raising interest rates even one-quarter of a percent at a time would usually cause the Canadian dollar to strengthen further?

Mr. Joe Oliver: It would be a factor, and that's why people are wondering whether there will be further increases, given the strengthening of the dollar. I think monetary policy clearly has its effect, but the Bank of Canada is not attempting to set the exchange rate. It may smooth the effect a little, but it—

Mr. Charlie Penson: But it's a signal, isn't it?

Mr. Joe Oliver: It can be viewed as a signal, yes.

Mr. Charlie Penson: Okay.

The Chair: Thank you, Mr. Penson.

Mr. McKay will wrap it up.

Hon. John McKay: Thank you, Mr. Chair.

I apologize to the panel for missing your presentations, but it's a hazard of this business, where you can't be in two places at one time.

I want to talk about CMA's recommendation that has to do with removing any disincentives to invest in Canada. The current state of political dialogue in this country is rather immature. It's like "programs good, tax cuts bad", and it doesn't get much further than that. Tax cuts, depreciation schedules, CCA allowances, all of that frankly isn't designed to make a lot of rich guys richer, because the design is to try to make industry more competitive.

The issue from a government standpoint is twofold. One is to try to target the best possible use of the tax system to enhance productivity—and I'd like you to comment on that. The second I'd like you to comment on is the difference between the Canada and U. S. rates. We can live in la-la land here and think that what happens south of the border doesn't affect us. Well, you're dreaming in technicolor if you believe that. Given that there is an ideological drive by the neo-cons who presently inhabit the White House to force tax cuts above fairly well every other priority, from an industry standpoint what's going to be the best possible response on the part of the Government of Canada? Is it going to be in terms of thresholds? Is it going to be in terms of percentages? Is it going to be on capital cost allowances? Or do we get into tariffs and things of that nature, where we're actually handing out money and so on?

I'd be interested in your comments on both of those points.

● (1240)

Mr. Michael Tinkler: Thank you, Mr. McKay.

First of all, in terms of which tax measures are the most effective, I'm not really prepared to address that. Certainly with regard to your reference to what the Bush administration is doing, we're certainly not advocating the kinds of what we would consider to be less than responsible fiscal policies that are happening now in the United States. I think we're certainly not alone. Anyone who has been looking at the financial and business media for the last two weeks has seen an increasing level of alarm around the world at whether or not that can be sustainable and at the impact this could have on all of us.

Having said that, we would like to echo the fact that we totally agree with you that as much as we may not like this, we are very tied to that huge economy to the south. We can't afford to be very divergent, whether it's in terms of things like the dividend tax exemption or the treatment of capital gains. We have to adopt measures that continue to make Canada an attractive place to invest and that continue to give Canadian businesses the incentive to make productive investments that are going to generate future tax dollars.

Hon. John McKay: A capital gain is really hope money. You hope you make money and then you have to worry about a capital gain. On a day-to-day basis, most business folks are talking about sustainability, about "How am I going to keep my shareholders happy?" and "How am I going to keep my customers happy?" We have a bit of a complicated treatment with dividends, for instance, and the challenges down in the States...that their treatment of dividends is somewhat simpler, shall we say. Is that a point we should emphasize, simplifying the treatment of dividends?

Mr. Michael Tinkler: I think that's the case. As a small-business owner myself, I've recently been told by our financial adviser that there's no particular advantage for me to take dividend income as opposed to salary income. I happen to be a resident of the province of Quebec, and apparently the treatment there of dividend income is such that there's hardly any difference for a small-business owner in that regard. That's something that's important to small-business owners for their financial sustainability.

Again, I'm not a tax expert, but I understand your point that there are some things that have immediate tax benefits, that put dollars today into the hands of businesses, but at the same time, the capital gains tax, from a financial management point of view, is something that is taken into account when businesses make investment decisions. So certainly there is an impact, even though it's not a factor of cashflow today. It's something that has an impact on how businesses behave, and I think that can't be neglected either.

Hon. John McKay: Are there any other comments?

Mr. Hockin.

Mr. Thomas Hockin: As just a parenthetical comment, the way the world trade profile is going, for Canadian commodities, metals, mining products, oil and gas, all of this, there's high demand now because of the growth in China. I think accelerated depreciation speaks to making that industry more competitive. I would think, too, that would be true in the high-tech area.

I remember back in the 1990s when our dollar was up around 89¢. I didn't feel that our auto parts sector was using this opportunity with the high Canadian dollar to buy cheaper inputs from abroad to increase productivity.

Accelerated depreciation is a big part of what the Americans have done in the last two years, and I would encourage the Government of Canada and the Department of Finance to look at that—and I know they've done some things there—but look at it especially given the changing profile of our export sector.

● (1245)

Hon. John McKay: Okay.

Am I out of time?

The Chair: That's it. Thank you.

I want to thank the witnesses for their time. Thanks for being patient, and again, thank you for your presentations. Have a good day.

The meeting is adjourned.

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