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

Statement Before the Conservative Members of the Finance Committee

Pre-Budget Remarks

Ian C.W. Russell
President and CEO
Investment Industry Association of Canada

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The crisis in global markets in the past six months has been the most severe since the Financial Panic of 1917. The international dimensions of this crisis reflect the expansion and integration of global financial markets that has taken place in recent years. The sudden and steep collapse in equity prices in global equity markets caught market participants by surprise and left them in a state of shock. Timely, coordinated and extensive intervention by the G20 countries has averted the real possibility of a meltdown in global financial markets.

We have now moved to the second stage of financial crisis where massive deleveraging, the flight to increased saving in low risk assets, and deepening gloom about the economic outlook has caused a significant pullback in consumer and investment spending.

The immediate challenge for fiscal and monetary policy has been to contain the financial crisis and mitigate the adverse consequences on employment and economic growth. The Caucus should be aware that many foreign investors have recognized and admired the positive steps taken by the federal government and Bank of Canada to deal with the enveloping financial crisis in Canada. The federal government has taken several independent measures, including insuring interbank deposits, buying mortgage pools from banks, and backstopping the Montreal Accord to bring finality to the ABCP crisis. The Bank of Canada has pumped substantial liquidity into credit markets -- more than $36 billion in short-term liquidity exchanged for less liquid assets, to unclog congealed credit markets and promote the flow of credit across the yield curve to finance the real economy.

The focus of fiscal policy, articulated in the upcoming federal budget, should be to continue efforts to counteract the contraction effects of the financial crisis and bolster economic growth. We anticipate the most serious economic consequences for Canada will occur this year.

Budget policy measures should achieve following objectives:

a) To provide a temporary but effective Keynesian stimulus to offset the fall off in private sector spending. These expenditures should be focused, timely in implementation and coordinated with provincial measures.

   Infrastructure spending will be a key expenditure component. The federal government should identify projects that yield long term productive gains for the economy and, once projects are selected, find ways to reduce inevitable planning and approval lags. Government will also be asked for financial support from ailing businesses. The criteria for targeted spending should be linked to the impact of these companies on the economy and, importantly, their long-term viability.

b) To provide selected tax relief. Tax measures should include (i) confirming and, if possible, accelerating planned corporate tax rate reductions to assist large and small companies cope with reduced cash flows and earnings, and (ii) lowering the capital gains tax rate, as well as extending tax benefits applying to Canadian controlled private to small Canadian public companies.

Our tax recommendations, such as lower capital gains tax rates, will improve after-tax returns and have a positive impact on investor psychology -- changing the mindset of investors and businesses, to reverse the retrenchment in financial and capital investment.

These tax measures will repair the savings-investment process in Canada. They will encourage risk-taking by investors, whose appetite for risk has been devastated by the collapse in financial markets, and lower the cost of capital to encourage productive investment by business. It will make it easier for financial institutions to rebuild capital and enable non-financial companies to strengthen balance sheets and finance investments. For many small companies, access to external capital means the difference between proceeding with planned investment projects to unlock future cash flows, and abandoning them. If projects don't go forward, future profits cannot materialize, share prices will fall further and business activity will contract, with many companies facing the prospect of windup or acquisition at depressed share prices. This process has already begun, notably in the resource sector.

An ancillary benefit of these tax measures is that sustained, if modest, improving conditions in equity markets -- such as rising share prices, and increased trading and financing activity, will improve consumer and investor sentiment. Much of the uncertainty that has paralyzed spending by individual Canadians was triggered by the devastating downward spiral in equity prices.

There are several other measures that could provide further tax relief and improve financing prospects for small companies. The government could extend the flow-through share concept to non-resource companies. This measure would allow depreciation expenses, analogous to depletion allowances for resource companies, to flow from businesses to individual investors, improving after-tax returns. Flow-through shares have proven an effective incentive for mining and energy companies. Finally, government could extend the tax benefits that apply to Canadian-controlled private corporations to small Canadian public corporations, with eligibility determined by asset size and profitability. These small public companies, listed on the TMX Venture and TMX stock exchanges, would benefit from a lower federal corporate rate (11% versus 19%), tax credits for R&D spending and the $750,000 capital gains tax exemption for original owners to divest common shares.

The Budget should also consider some administrative changes to assist Canadians rebuild their retirement savings. The recent stock market collapse makes a strong case for extending the mandatory RRSP conversion age from 71 to 75. Second, individuals should be permitted greater flexibility in respect of mandatory annual withdrawals from RRIFs.

All these measures would not be a significant drain on government revenues. Indeed, it is likely that lower capital gains tax rates will stimulate the shift of capital to more productive enterprise and result in higher revenues. The important point is that tax policy can play a complementary role to expenditure policy in arresting the contraction of economic activity and set the stage for recovery. The recommended tax measures will have a significant influence altering investor and business sentiment, critical to restoring risk investment in the economy, and contributing to more robust capital markets and improved growth and employment.