



CANADIAN FINANCE & LEASING ASSOCIATION
ASSOCIATION CANADIENNE DE FINANCEMENT ET DE LOCATION

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House of Commons Standing Committee on Finance
Room 673, 180 Wellington Street
Wellington Building
House of Commons
Ottawa, ON K1A 0A6

***“Partners in Productivity” ~ «Partenaires en productivité»
Enabling Canadians to work smarter***

Dear Sirs,

The Canadian Finance & Leasing Association (CFLA) thanks the Committee for this opportunity to submit its recommendations as part of the pre-budget consultations.

Who is CFLA? The CFLA represents the asset-based financing, equipment and vehicle leasing industry in Canada. A list of the over 250 company members of the association is attached to this submission.

The 2004 *Annual Survey of Asset-Based Financing & Leasing in Canada* reported that the asset-based financing industry's portfolio of assets (owned and managed) was estimated to be worth **\$116.7 billion in 2003**. After the traditional lenders (banks and credit unions), the members of the asset-based financing industry are the largest providers of debt financing in this country. About 60% of the industry's customers are estimated to be small and medium-sized businesses.

Statistics Canada has estimated that Canadian business intends to invest \$84.5 billion in machinery and equipment in 2004. Between 20% and 25% of annual new business investment in machinery, equipment and commercial vehicles is financed by this industry.

What is Asset-based Financing? Asset-based financing is the financing of equipment, vehicles and related assets by way of specific asset-based priority financing, that is, the financing of particular equipment and vehicles and related items or services, primarily by way of lease, but also by secured loan or conditional sales contract.

The specific assets financed secure the borrower's unconditional obligation to make payments over the term of the agreement. In this way, users of equipment and vehicles can use the value of the asset as security to finance its acquisition. This form of financing relies on cash-flow-based credit analysis. Because the financing company retains legal ownership of the asset until the end of the lease or financing term, it allows a business or person to qualify on generated cash flow rather than on a net worth lending formula basis as typically offered by traditional lenders.

The services of the asset-based financing industry are complementary to traditional banking and other financial lending in providing incremental capital to increase the pool of available credit in Canada and provide a vital competitive alternative in the financial services sector.

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Productivity growth and raising living standards for all Canadians

If public policy debates in the 1990s were dominated by the debt and deficit, policy makers are talking increasingly of the coming decade being overshadowed by the challenges of productivity and economic growth in Canada.

Demographic trends are changing Canada's economic landscape. With an aging population, an increased demand for publicly-funded services is inevitable. With a smaller proportion of the overall population in the workforce, there will be fewer taxpayers.

How do we square this circle? The essential choices for government are clear: cut services, increase taxes or grow the economy. If cutting services and increasing taxes are unpalatable for governments, growing the economy is the positive solution. As the federal Department of Finance pointed out in the budget earlier this year:

In recent years Canada has been successful in raising living standards through both employment and productivity growth. However, looking ahead 10 years, it will be increasingly difficult to continue to improve living standards through increased employment, because of shrinking of the working-age population. Aging population will also lead to greater pressures on pensions and health care expenditures. To lessen this burden, one of the critical tasks facing Canada over the rest of this decade is to increase productivity growth so that living standards continue to rise.¹

The challenge of enhancing Canadian productivity to raise living standards has become more acute in recent months with the rapid rise in value of the Canadian dollar *vis-à-vis* the currency of our most important trading partner.

It is our recommendation that a primary way to cope with the combined challenges of enhancing productivity and a rising dollar is for Canadian business to become more competitive through increased investment in capital equipment.

Improvements in living standards will increasingly rely on gains in labour productivity

In its 1999 report *Productivity with a Purpose: Improve the Standard of Living of Canadians*, the House Finance Committee observed:

Investment is also a key word because it is through investment that productivity is ultimately enhanced. Whether it be private investment in machinery and equipment, private investment in research and development, public investment in infrastructure, public investment in education, or individual investment in human capital formation, it is the creation of some form of capital that is the key to enhancing productivity in the future.

Improved productivity is something that is largely achieved within the private sector. It is up to the business sector and individual Canadians to enhance productivity. They do so by investing in plant and equipment and new technologies, by engaging in research and development, by being innovative, by taking risks, and by investing in their own human capital on an ongoing basis.²

Just two days ago, the Ontario Task Force on Competitiveness, Productivity and Economic Progress released its Third Annual Report "*Realizing our prosperity potential*". In its report last year,

1 Federal Budget Plan 2004. Annex 7, *The Importance of Productivity Growth to the Long-Term Well-Being of Canadians*, at page 290, March 23, 2004

2 *Productivity with a Purpose: Improving the Standard of Living of Canadians*, Twentieth Report of the House of Commons Standing Committee on Finance, June 1999

“... the Task Force concluded that more investment is an important element in raising productivity. This year’s report sets out areas where that investment is required. For businesses, it means larger investments in machinery, equipment and software; for governments, it means striking the right balance between spending on current consumption, such as health care and social services and investing for future prosperity, such as infrastructure and education; for individuals, it means investing more in themselves, such as in higher educational achievement.”³

Asset-based financing, investment and economic growth. CFLA has commissioned original independent research from the respected Centre for Spatial Economics (C₄SE) to determine the link between productivity, economic growth, the standard of living of Canadians and asset-based financing. Research over the last two decades has demonstrated the importance of financial services in supporting economic growth. None of these studies have, however, explicitly examined the role of asset-based financing as part of the financial services sector.

We attach a copy of the [Executive Summary of the 100-page C₄SE study](#) as part of this submission.

Key Findings of the C₄SE study

- **Investment drives productivity** – economic research states that machinery and equipment investment directly contributes to labour productivity gains by increasing the amount of productive capital available for workers to use. Research also suggests that machinery and equipment investment is either directly the agent of technological change, or else an important facilitator in the diffusion of new technology.
- **Productivity raises living standards** – in order to boost living standards either labour productivity needs to rise, or people need to work harder, or more people need to become employed, or more people of working age need to enter society relative to total population. Canadian living standard gains rely primarily on labour productivity growth.
- **Financial system development promotes investment** – research conducted by the OECD⁴ supports the notion that financial system development promotes capital spending and that countries with weaker financial systems are unable to effectively channel domestic or global savings towards new investment opportunities.
- **Asset-based financing adds significantly to the financial system** – the analysis in this report finds that asset-based financing was responsible for a 2.3% increase in Canada’s living standards over the decade 1992 to 2002 (or about 8% of the total increase in Canada’s living standards over that decade). Asset-based financing makes a significant positive contribution to increasing national living standards.

Policy Implications identified in the C₄SE study

- **Financial innovation** – financial choice and innovation need to be encouraged in order to maintain a healthy and growing financial system. A dynamic financial system is one of the key factors in promoting investment, raising productivity and, therefore, improving our standard of living.
- **Tax policy** – government policy in Canada does not encourage investment in machinery and equipment to the degree that the economic research suggests would be optimal.

³ The Ontario Task Force on Competitiveness, Productivity and Economic Progress, media release, November 24, 2004 <http://www.competeprosper.ca/public/release241104.html>

⁴ The Organisation for Economic Co-operation and Development (OECD) is an international economic research institute with 30 member countries, including Canada.

Therefore, a strategy of improving the economic climate for machinery and equipment investment should pay significant dividends in terms of stronger economic growth, higher productivity and living standards for Canadians for many years to come. This could be done in a horizontally equitable manner by encouraging all forms of investment spending because of the potential complementary nature of machinery and non-machinery investment in boosting economic growth and productivity.

CFLA Tax Policy Recommendations. Based on this groundbreaking study, it is clear that investment in machinery and equipment (including vehicles) directly and significantly enhances productivity. The C₄SE study confirms the link from enhanced productivity to raising living standards of Canadians.

Following his review of the C₄SE study, Dr. Jack Mintz⁵ has stated that

“this unique study overwhelmingly demonstrates the importance of asset-based financing to Canada’s economic growth by supporting greater product financial choice and innovation. The industry contributes a disproportionate share to higher living standards ... that has been experienced during the decade, 1992-2002.

The report makes a good case for improving the climate for investment as a means of improving Canada’s standard of living. Canada’s investment performance is lagging and needs to be improved in order to achieve greater labour productivity and adoption of new innovations. Tax policy is critical to capital investment decisions as the report points out. Several tax policy actions have good payoffs to the economy including the elimination of provincial capital taxes, increased capital cost allowances for investments and the removal of provincial sales taxes on business capital spending.

The C₄SE study concludes:

“Given the importance of machinery and equipment investment to productivity and economic growth combined with the fact that this type of investment tends to be the most mobile factor of production over the long run and considering the evidence that the world economy is undergoing a significant technological transformation, it is not hard to reach the conclusion that governments should encourage this type of investment.

Government policy in Canada, however, is not encouraging investment in machinery and equipment to the degree that the economic research suggests would be best for the economy. ... A strategy of improving the economic climate for machinery and equipment investment should pay significant dividends in terms of stronger economic growth, higher productivity and living standards for Canadians for many years to come.

The analysis conducted in this report illustrates the economic impact of various tax policy options available to Canadian governments. ... The more attractive options are to reduce, and ideally to eliminate, corporate capital taxes and to raise capital cost allowances. Both policy options yield significant economic benefits with minimal short term fiscal cost.”

“There is a degree of urgency to the need to construct an appropriate policy environment because evidence suggests the world economy is undergoing a significant technological transformation. The economic landscape has changed, and thus new policy regimes more consistent with the New Economy must be employed in order to ensure our potential productivity gains are translated into actual gains.”

While there remains an important preoccupation with the effects of the rising value of the Canadian dollar *vis-à-vis* our U.S. trading partner for export reasons, the other side of that coin

⁵ Dr. Jack M. Mintz is President and Chief Executive Officer, C.D. Howe Institute. He is also the Deloitte & Touche LLP Professor of Taxation, Joseph L. Rotman School of Management, and co-director of the International Tax Program, Institute of International Business, both at the University of Toronto.

contains an advantage. Most new and innovative machinery and equipment are offered for sale in U.S. dollars. For the first time in a decade or more, the rising value of the Canadian dollar makes the acquisition of machinery and equipment much more affordable for Canadian firms.

CFLA recommends that the government target tax policy to encourage investment in machinery and equipment (including vehicles):

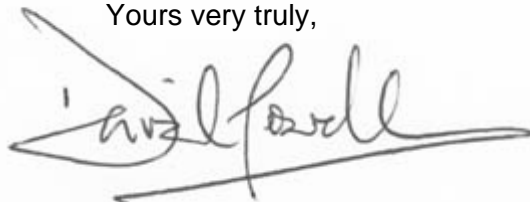
- (1) by accelerating the schedule for eliminating the Large Corporation Tax; and**
- (2) by raising capital cost allowance rates and permitting faster depreciation.**

It is important to note that although the 2003 federal budget moved to raise the capital threshold at which the federal capital tax applies from \$10 million to \$50 million effective 2004, such that SMEs under the \$50 million threshold no longer had to pay the tax, this provision failed to eliminate the capital tax cost on leasing transactions. As lessors own the assets leased until such time as the customer purchases them at lease end, the lessor is assessed capital tax which must be added to the customer's leasing costs. When it is estimated that 60% of the industry's customer base is SMEs, the burden of capital tax remains as a cost disincentive to investment.

Again, thank you for this opportunity to participate in the pre-budget consultations.

Should you have any questions, please do not hesitate to contact the undersigned.

Yours very truly,

A handwritten signature in black ink, appearing to read 'David Powell', with a long horizontal flourish extending to the right.

David Powell
President & Chief Executive Officer

Attachments

- (1) Executive Summary of *Asset-based financing, investment and economic growth*, Centre for Spatial Economics (C₄SE), November 2004
- (2) List of CFLA Members

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The Hon. David Emerson, M.P., P.C., Minister of Industry
Patrick T Byrne, Consultation Officer, Consultations and Media Relations, Finance Canada