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ECONOMIC ACTION PLAN 2013 BILL, NO. 2

Third Reading of Bill C-4

Speech by:

The Honourable Diane Bellemare

Thursday, December 12, 2013

THE SENATE

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[*Translation*]

ECONOMIC ACTION PLAN 2013 BILL, NO. 2

THIRD READING

Hon. Diane Bellemare: I was asked to be quick, so I will begin with my conclusion.

Honourable senators, I wish to reaffirm my confidence in the Minister of Finance, because, so far, he has managed to keep Canada's economy on track.

However, as a senator from Quebec, I cannot ignore the reasons behind the broad consensus among Quebec's business community that the tax credit for labour-sponsored funds should be maintained.

Everyone knows that productivity growth is a real problem for Canada. At present, Canadian productivity is consistently weaker than that of the United States, and this problem must be addressed. Investment is very important to productivity. There is a connection to be made between the budget and improving investment and productivity.

It is in name of neutrality — Senator Buth talked about this principle during the debate on Bill C-4 — and efficiency that the federal government plans to eliminate the 15 per cent tax credit granted to people who invest in labour-sponsored funds. Eliminating this tax credit will save the federal government a total of $355 million over five years, and a large proportion of that money will come from middle-class investors in Quebec who will no longer be able to claim that credit.

Labour-sponsored funds exist in many provinces, but they are most common in Quebec. These funds are part of what are known as "retail funds." There are three retail funds in Quebec: the FTQ's Fonds de solidarité, created in 1983; the Fondaction, created in 1996 and — this is what Senator Maltais spoke about — Capital régional et coopératif Desjardins, which is not affected by Bill C-4 and currently benefits from a tax credit of 50 per cent from the Government of Quebec, although it is a 15 per cent tax credit in the case of the FTQ and a 25 per cent tax credit in the case of the CSN.

Quebec's two labour-sponsored funds are governed by provincial laws that require them to invest at least 60 per cent of their assets in Quebec businesses.

The decision to eliminate the labour-sponsored funds tax credit has been strongly criticized, not only by the unions but also by business people in Quebec and across Canada. Many of them believe that doing away with this tax credit will have a negative impact on investment in Canada and thus on productivity enhancement.

At first glance, one might wonder why labour-sponsored funds should benefit from such a tax credit when other private investment funds do not. With that in mind and based on a study conducted by the OECD in 2006, the government decided to eliminate this tax credit and to allocate the funds recovered in the future to private venture capital funds.

At second glance, however, it seems that the advantages of this tax credit outweigh the disadvantages. That is the argument presented in many submissions that were made to the Minister of Finance during the online public consultation held from May 23 to July 23, 2013, on the phasing-out of this tax credit.

Réseau Capital, the only private equity association that brings together all stakeholders involved in the Quebec investment chain, had this to say, and I quote:

> Approximately 40 submissions, including our own, were made by key stakeholders in the business community in order to stress the importance of maintaining the federal tax credit for labour-sponsored funds, as well as of the direct contribution that these funds make to the development and growth of our local businesses.

A study conducted by Gilles Duruflé, an independent expert who has produced a number of empirical analyses on venture capital funds and who was quoted in many submissions, shows that Quebec's retail funds generate significant leverage with regard to investment in Quebec and Canadian business. From 2004 to 2012, retail funds committed $758 million to private funds, which led to co-investments within Canada and leverage of $1,783,000 in these same funds. As Mr. Duruflé and other experts point out, labour-sponsored funds often provide an initial investment in specialized funds, which attract additional investments through leveraging.

That is why Réseau Capital is asking the Minister of Finance to continue discussions with the labour-sponsored funds in order to find a way to keep the tax credit given to shareholders of labour-sponsored funds. Réseau Capital has even committed to participating.

Peter van der Velden, President of Canada's Venture Capital & Private Equity Association, gave compelling testimony before the National Finance Committee in support of retail funds, particularly labour-sponsored funds. He said he was concerned about the elimination of the tax credit for people who invest in these funds. He supports the government's efforts to develop venture capital in Canada, but like Réseau Capital, he would like labour-sponsored funds to be included in the government's strategy.

On another note, the Standing Senate Committee on National Finance heard some economists' criticisms of labour-sponsored funds. Finn Poschmann, Vice President of the C. D. Howe Institute, and Jack Mintz, a professor at the University of Calgary, reiterated the OECD's arguments, which are more academic than empirical. Opponents of the labour-sponsored fund tax credit say that the returns on these funds are low, that they crowd out private funds and that their governance model is lacking.

In one study, independent expert Gilles Duruflé reviewed the various criticisms made by opponents of retail funds.

I would like to quote a key passage from what he said:

[*English*]

> Many of them [these critics] are now outdated and, when repeated in the latest studies, do not take into account the important changes in retail funds' more recent investment strategies. Other claims are not supported by evidence. Overall, the mentioned studies demonstrate a poor understanding of (i) the reasons for the Canadian [venture capital] industry's poor performance until recently and (ii) the specificity of Quebec retail funds and their contribution to the renewal of the private sector Canadian [venture capital] industry.

[*Translation*]

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As for retail funds crowding out other funds, Deloitte conducted a study on retail funds that was tabled in the Standing Senate Committee on National Finance by Fondaction. I would like to quote from the executive summary of that study:

> In Ontario, the phasing-out of the labour-sponsored funds tax credit (announced in 2005) contributed to their decline. That decline was accompanied by a significant reduction in venture capital financing in Ontario. The gap left by the labour-sponsored funds was not filled by other players.

I would like to point out that the Conseil du patronat du Québec, the Board of Trade of Metropolitan Montreal, the Association des manufacturiers du Québec as well as the authors of the Deloitte and IREC study used certain characteristics of labour-sponsored funds to demonstrate that there are important benefits to the funds.

First, the funds do not simply exist for maximum returns; they are also designed to create and maintain jobs in regions that need them.

Second, unlike private venture capital funds, these retail funds offer patient capital to businesses that typically have a hard time securing funding from traditional financial institutions.

Third, these funds combine the retirement savings goals of individuals with economic development goals. These funds are riskier than institutional pension funds; therefore, the additional tax support is justified.

Fourth, they play a counter-cyclical role during recessions and support businesses when traditional financial institutions are cautious.

Fifth, they invest in the regions and provide support to local businesses, which traditional funds do not.

Sixth, the labour networks allow the labour-sponsored funds to achieve a critical mass of small investors. The average annual income of the individuals who contribute to these funds is $48,000.

Last, but not least, they play an undeniable role in improving the financial knowledge of their contributors, which, according to management negotiators, has improved the negotiating process for private-sector collective agreements.

For all these reasons, the Conseil du patronat, the Board of Trade of Metropolitan Montreal, Réseau Capital, Canada's Venture Capital & Private Equity Association, and many other groups and experts in the field find the decision to abolish these tax credits premature and unfounded. The benefits and advantages of these credits far outweigh the disadvantages.

Some will say that the witnesses at the Charbonneau commission raised very legitimate questions about the governance of the Fonds de solidarité. There has been a turnover in management, which seems to be taking appropriate measures to address the problem. That is reassuring. As far as Fondaction is concerned, no allegations were made against it at the Charbonneau commission or anywhere else.

I hope, honourable senators, that meetings will be held between the venture capital funds stakeholders, including the labour-sponsored funds and the Department of Finance, in order to come up with an amicable solution by March 2015.

In closing, I would like to mention that the World Bank's latest report indicated the need for a paradigm shift in policy development by government decision-makers. According to the Bank, to ensure sustainable prosperity, policies have to make employment the top priority, and that is what our government wants to do. However, to ensure sustainable prosperity, we must focus on employment before added value or traditional growth. Growth and added value always stem from employment, but the converse is not always true. That is the spirit of the labour-sponsored funds.

Therefore, I will close by saying that I will be voting for this budget because it is a good budget nonetheless. However, I did want to point out that there is a consensus among Quebecers that they would like the government to consult them and try to ensure that abolishing this credit will not have a negative impact on the total amount of venture capital invested in Canada. Thank you.