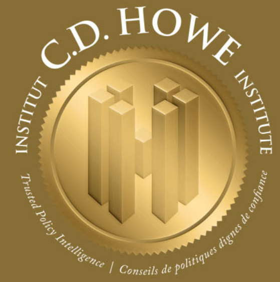
Intelligence MEMOS



From: William B.P. Robson

To: Retirement Savers and Fund Managers

Date: November 13, 2023

Re: **Retirement Savers Should Face No Offshore Investment Limits**

Is the federal government thinking of limiting the foreign assets Canadians can own through their pension plans and RRSPs? Rumours to that effect are spreading among Canada's pension plans and investors.

The rumours are plausible. As a recent C.D. Howe Institute **report** documents, business investment in this country has been so weak that capital per worker has actually been falling. That deadens productivity growth, which causes living standards to stagnate. A government that puts populist intervention ahead of principled economic policies, as this one often does, might want to force Canadian savers to invest more in Canadian assets.

How might it do so? Pension funds and other institutional investors have a fiduciary obligation to their members and clients: strive for the best balance of return and risk they can find, which is what they have been doing. Ottawa could impose industrial-policy-style mandates on funds it controls, but imposing such a mandate on other major pension plans and RRSP savers would be hard. The most straightforward tool would be a tax penalty on their foreign investments.

We have a precedent: the foreign property rule that existed from 1971 until 2005. It imposed a punitive tax – 1 percent per month – on foreign property that exceeded a given proportion of a plan's assets. The limit for pension plans and RRSPs was just 10 percent from 1971 to 1990. It then rose in equal steps to 20 percent in 1994. In 2000-2001, it rose in equal steps to 30 percent and in 2005 it disappeared altogether.

The initial **imposition** of the foreign property rule reflected the policy climate of the early 1970s, of which there are echoes today. Interventionism was in vogue and keeping saving at home so Canadian businesses, governments and even households could access cheaper capital seemed only reasonable. Also in vogue was the idea that deferring income tax on retirement saving by taxing withdrawals from pension plans and RRSPs but not contributions into them was Ottawa's gift to savers, and that restricting those savers to Canadian assets was therefore a justifiable quid pro quo.

The later liberalization and eventual abolition of the rule reflected changes in ideas and circumstances. Some previously unfunded pension plans, such as Ontario Teachers, the Canada Pension Plan and several federal employee plans, started pre-funding their benefits and accumulating assets. They became influential advocates for letting fund managers seek better returns for their members. **Evidence** mounted that the foreign limit hurt savers without benefiting borrowers. When the rule was still in place, many big players used derivatives and ownership structures to get around it, raising concerns about fairness for RRSP savers and smaller investors who generally could not do the same. Views of the tax system also changed, with double taxation of saving increasingly (and appropriately) seen as a bad idea, and deferral of tax on contributions to pension plans and RRSPs being a good way to avoid it.

Tellingly, the liberalization and ultimate abolition of the rule triggered **no discernible outflow** of saving or decline in Canadian investment. The exchange rate did not fall and the cost of capital did not rise. What did happen after the rule disappeared is that the gap in investment per worker between Canada and the United States and other OECD countries narrowed. No surprise there: Some critics had argued that by showing that interventionist Canada could not keep savings at home with good policies alone, the rule might, in fact, lower the value of the Canadian dollar and raise the cost of capital.

Today's advocates for new restrictions on foreign investment point to how much Canadian fund managers – notably the "Maple Eight" – hold abroad. But those investors, who have a global reputation for effective stewardship of member money, are seeking good returns for the risks they take. Among the most attractive investments for them are infrastructure, such as airports and ports, toll roads and bridges, water utilities, and companies that generate and distribute electricity. They would like to own similar assets in Canada, with returns linked to Canadian incomes and paid in Canadian dollars. But here such assets are typically owned by governments, and our record of attracting private investment without political headaches (think Highway 407 in Ontario) or operational glitches (think Montreal's REM) is poor.

Mandates or penalties to force Canadians to keep their money in Canada rather than seek better and less risky returns abroad are a perverse reaction to feeble investment, poor productivity and stagnating living standards. The list of more promising responses is long – how about coherent environmental regulation, development of Canada's energy and other natural resources, less unproductive government spending and borrowing, and no more capricious tax changes to hurt unpopular businesses and buy votes in politically sensitive regions? All more sensible than a return to the 1970s.

We need principled economic policies. We do not need foreign property limits – yet another populist intervention that would mark Canada as an unattractive place for Canadians, or anyone else, to invest.

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