REPORT OF
DIRECTORS OF INDUSTRIAL INCENTIVES
REGARDING THE ONGOING REVIEW OF
THE REGIONAL DEVELOPMENT
INCENTIVES PROGRAM

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A. Background and Purpose of Report

As part of their ongoing management responsibilities, the Director General of Industrial Incentives and the Directors of Industrial Incentives in Ottawa and the Regions review from time to time the operation of the regional development incentives program in relation to the pursuit of departmental objectives. Such a review was recently carried out.

Accordingly, this report is intended to provide for consideration of management, at the Assistant Deputy Minister level in Ottawa and the Regions, some views and specific recommendations regarding improvements that could be made to the Department's regional development incentives program.

B. Methodology of the Review

After two initial meetings in 1975, the Directors established terms of reference for four working groups which examined during 1976 various facets of the incentives program's operations.

One group (Group A) examined the objectives and goals of a program of incentives to industry for the different regions of Canada.

Two groups (Groups B and C) examined the types of individual incentives or sets of incentives that could be employed to achieve those objectives, with Group B consider-ing the appropriateness of grant and related type incentives while Group C reviewed the value of profitability, cost and reinvestment incentives.

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The fourth group (Group D) examined various mechanisms for enhancing the use of an incentives program by entrepreneurs and other interested parties.

Members of the groups were drawn from different disciplines and different offices within the Department. Although activities of the four groups were coordinated, there was no obligation upon group members to reflect the opinions of their own departmental organizations or to achieve unanimity of view in all respects; neither was it possible to examine all proposals in maximum depth within the time period prescribed.

The Directors of Incentives examined the reports of the four working groups. They accepted some, but not all of the conclusions of the four working groups and they themselves did not reach unanimous agreement on all recommendations. However this, the Directors' report, is an expression of their opinions and it presents the major arguments for and against the adoption of the many ideas which were advanced during the review for improving the operation of the incentives program.

C. Overview

Since its creation seven years ago, DREE has striven to identify and improve the development of economic and social opportunities in the various regions of Canada and to reduce regional imbalances in employment and income levels. It is now clearer than ever that the whole issue of regional disparities is a very complex one that requires the application of a range of policy instruments and the efforts of more than one level of government, as well as the full involvement of the private sector. It is equally clear that an incentives to industry program is a key and essential element of any regional development strategies. The nature or content of a program that can best perform this elemental role is less clear.

It can be argued that, ideally, programs such as RDIA and the various IT&C industrial incentives programs should be elements of a cohesive national industrial policy designed to address simultaneously national, regional and socio-economic concerns. Though commendable as a goal, a national industrial policy that would at the same time be national, regional, and industry oriented in scope, would be very difficult to design and implement. What is feasible, however, is the implementation of a general industrial strategy framework against which specific policies and programs designed to achieve well defined goals (e.g. change the industrial structure in a given region or provide better quality employment opportunities) could be checked for consistency. DREE has a definite responsibility to contribute to the formulation of such an industrial strategy or strategies for the federal government and to shape its own program or programs of incentives to industry accordingly. Needless to say, provincial views and priorities as well as the anticipated impact of activity under GDAs must also be taken into account in any such consideration.

Irrespective of whether it is for regional development or for industrial development, any governmental strategy designed to achieve specific objectives must recognize and state clearly the essential contribution to be made by the private sector. This contribution can be to policy development or program implementation or both. Previous and current regional development industrial programs have vacillated on the role to be played by the private sector in identifying and developing initiatives that will contribute to the economic growth of disadvantaged regions. In

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addition the private sector's potential has not been optimally tapped by the presentation of a set of mechanisms and tools which are at once attention-catching and attention-sustaining. DREE must recognize these needs in reshaping the RDIA program.

D. General Considerations

Canada is in fierce international competition for industry. Experience in Canada and elsewhere suggests that regional development policies must be long term in nature and must be integrated into regional strategies. Insofar as incentives to industry are concerned, in large measure they need to be simply constructed and easily administered, well publicized and relatively free from periodic change in geographic coverage as well as in program provisions and incentives rates.

Toward this end recommendations are advanced in this report for establishing regional needs and priorities, clarifying the objectives and goals of the program as well as the assumptions underlying these objectives and goals, identifying the constraints under which the program operates, and estimating the costs of effecting changes. Recommendations are also made for short term changes to the program which include modifying the emphasis on new facilities over expansions, encouraging local entrepreneurship over ownership of similar activities by other Canadians and foreigners, and increasing departmental commitment to the program by financial and other means.

E. Types of Incentives

In keeping with the overview of the total program it is concluded that outright grants continue to represent the major appeal to most private entrepreneurs with repayable grants and loan guarantees being useful tools for more limited and specialized purposes.

Other incentives instruments could be used either to complement the provision of outright grants or to serve as an alternative in selected situations. Indeed, one of the working groups and a number of officers in the Department believe that the profitability incentive would be a very influential means of attracting certain major firms and undertakings to designated regions where they could have a significant economic impact. The Directors, on the other hand, are strongly of the view that the attractiveness of such an incentive is almost entirely negated by certain administrative and other considerations.

F. Industrial Development

The case is strong for a substantially enhanced departmental role in industrial search, industrial development, promotion and related activities. Specific recommendations are advanced for restructuring the development organization in the department to better reflect its proposed new role.

G. Recommendations

The recommendations which follow are intended to improve the operations of the regional development incentives program, and they have been framed within the context described primarily in section C above.

To summarize that context again, a regional development incentives program is a key tool available to policy makers for realizing regional potentials and reducing regional imbalances, should not be inconsistent with an overall federal industrial strategy, should recognize the validity of the GDA approach in identifying principal regional and provincial needs and priorities, and should recognize the need to involve the private sector in a meaningful way in regional economic policy formulation and in bringing economic opportunities to fruition through appropriate program provisions and other inducements.

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(a) Canada has need of a strong and influential incentives program in order to stay competitive with other countries for industrial investment and should allocate a significant portion of its budget for this purpose.

(b) DREE should aspire to create an increasing number of jobs of more significance in strengthening regional economies than in the past and while further study is required to determine a more specific magnitude of costs and jobs, on the basis of 1976 dollars a budget in the order of $160 million per annum should be provided initially based on 16,000 direct jobs annually at a cost of $10,000 per job.

(c) To meet the most generally accepted objectives of the incentives program, incentives should continue to be provided in the form of grants and loan guarantees; out-right grants should be the basic inducement available to industry with repayable grants and loan guarantees available to meet particular circumstances; loan and particularly special interest subsidies may be of value in certain situations but they are not regarded as preferred incentives tools.

(d) To meet certain higher priority objectives, inducements could be made available in the form of profitability, cost and reinvestment incentives, however, these are not recommended.

(e) Priorities should be better established between and within regions for purposes of program coverage (i.e. designation) and budget allocation. These priorities should be based on both the need and opportunity to grow (established with reference to unemployment rates, levels of income, real participation or attained levels of economic diversification, geographic location, linkages and available infrastructure).

(f) Priorities should be set for encouraging new industrial development in the various regions and sub-regions of Canada, since different levels of industrial activity carry with them different types and levels of economic impact.

(g) The objectives and goals of the program, as well as the underlying criteria or premises on which the objectives and goals are based, should be made widely known in order to ensure public awareness and understanding of the program's role within the federal government's industrial and regional development strategies. Particular attention should be addressed to widely held misconceptions about the program.

(h) DREE should undertake an aggressive and selective marketing program designed to induce industries to locate, expand and modernize their operations in the designated regions.

(i) This program should consist of three main elements:

- industrial research and analysis whose purpose would be to identify for entrepreneurs opportunities for development in designated regions;
- advertising and promotion of the program on both a general and a selective basis;
- industrial search and related activities such as information-gathering, the purpose of which would be to identify, locate, contact and attract desirable industrial prospects to designated regions.

(j) At the provincial, regional and headquarters levels, the development function should be more closely aligned organizationally with the incentives function in order (a) to pursue broad industrial development functions more effectively, (b) to undertake market oriented activities as a complement to RDIA program promotion and to industrial subagreement initiatives, and (c) to coordinate its marketing efforts with those of other federal agencies and provincial and community development organizations.

(k) Many specific improvements should be made to the present program, including the following:

- local entrepreneurs should be favoured over other Canadian or foreign entrepreneurs on similar activities;
- the statutory dollar limitations which have applied to grant levels since 1969 should be increased;
- project analysis should recognize more fully provincial priorities as well as other elements of industrial development strategy such as industrial selectivity, available infrastructure, and manpower training and mobility;
- areas of discretionary authority should be increased or strengthened for better and quicker decision making on such matters as an applicant's need for an incentive;
- the negative impact of the loss of capital cost allowances on grant payments should be removed in order to make the grant more effective and to provide the public with truer costing.

H. Conclusion

This review of the ongoing operation of the regional development incentives program has served to clarify many of its strengths and weaknesses. It has also brought forward many ideas as to how the program, as a key instrument of departmental policy for realizing regional potentials and reducing regional imbalances, can be improved. It is hoped that, following the distillation of the ideas and views summarized in this report and expressed in detail in the reports of the four working groups, immediate steps will be taken to effect desirable changes because, while many changes can be made promptly, others will require a lead time of up to two years to become effective. As an aid to consideration, the attached Appendices have been prepared to categorize the major recommendations emerging from the review into suggested time frames for implementation.

APPENDIX A

RECOMMENDATIONS FOR IMMEDIATE IMPLEMENTATION REQUIRING NO AMENDMENT TO THE ACT OR REGULATIONS

1. Reinforce and publicize various aspects of the program

The regional development incentives program is highly visible and the subject of much critical comment; some of the criticism is negative, or negatively portrayed by the Press (e.g. Dudley), and much is positive but inadequately publicized (e.g. Economic Council). Because the program is such an integral and valuable tool of regional development policy, its critics should be answered publicly and the program's strengths and limitations should be acknowledged and made known.

In particular, it is recommended that the Department reinforce and publicize to the maximum extent possible,

(a) the objectives and various goals established for the program;

(b) the assumptions underlying those objectives and goals; and

(c) the limits and constraints imposed on the achievement of the stated objectives and goals.

2. Maintain outright grants as the mainstay of the program

There are many types of industrial incentives which could be used to meet high priority objectives of the Department. For example, incentives whose amount varies directly with the profitability of the firm could have particular value for larger undertakings with significant economic benefit. Incentives based on operating as well as capital costs could be made available for selective use with a smaller number of projects. In other countries incentives are used to encourage firms to establish capital reserves which will be used for subsequent reinvestment in designated regions. The combining of these incentives with the more conventional grants could be of special value.

These types of incentives also have many disadvantages. The provision of incentives to firms, based on their profits, is often regarded unfavourably by the public and the profits of multicorporation organizations are often difficult to allocate to specific firms or divisions of firms. DREE is seen to provide "front end" money and not ongoing assistance. Administrative difficulties would be significant in determining accurately profits, costs, etc. For limited use, these new types of incentives are not seen as a highly desirable improvement to the present program.

It is recommended that (a) new types of incentives not be introduced under RDIA at the present time, (b) outright grants, repayable incentives as well as loan guarantees continue to be made available, and (c) of the latter types of incentives, outright grants should remain as the mainstay of the program.

3. Effect a number of administrative improvements

A number of administrative improvements could be made to the program. However, many of these have important policy implications which merit consideration for adoption on a national basis and/or which could lead to inconsistency and criticism of the Department if implemented in only one or two regions.

For example, the replacement of an existing facility is now classified administratively as a new facility rather than as a modernization/expansion. This leads, in size A and B cases, to the application of the standard formula based on costs and wages (e.g. 25% ACC plus 15% AWS) rather than on costs alone (e.g. 20%). The result in many cases is a very generous incentive. To classify the replacement of a facility now as a modernization/expansion is reasonable and feasible but it would be a departure from historical practice.

Similarly, initial inspection procedures could be simplified, particularly for the small cases where the incentive is based on the standard formula. This could result in audit observations about the legitimacy of some costs for grant calculation and payment purposes but would reduce manpower requirements and payment delays.

It is recommended that the aforementioned two administrative improvements be approved in principle for adoption and that other similar improvements be identified and referred to the Management Board for policy consideration.

4. Initiate detailed review of selected incentive tools

There is a spectrum of incentive tools applied in various countries for inducing industries to locate in disadvantaged or designated regions. Some of these tools have been examined as part of this review in modest depth. Further investigation into these and other incentive tools is considered warranted so that Canada can remain competitive with other countries in attracting industry to its designated regions.

It is recommended that, with a view toward possible future program modification, study should be undertaken of the value as an incentive of such tools as (a) an investment reserve system, (b) the provision of venture capital, and (c) equity participation.

APPENDIX B

RECOMMENDATIONS FOR EARLY IMPLEMENTATION REQUIRING MORE SIGNIFICANT POLICY CHANGES BUT NO AMENDMENT TO THE ACT OR REGULATIONS

1. Regions and sub-regions should be ranked in terms of priority

The fact of regional imbalances in Canada is the raison d'être for DREE, for regional development policies and for the incentive program. Differences between regions have already been recognized under the incentives program, for example, through designation of some provinces and not others as well as by application of different standard formulae in different regions. These differences are seen to support the principle of ranking not only regions but sub-regions for priority assistance under the incentives program. This ranking, which would be based on both economic need and economic opportunity, could take into account the influence on assistance available to each region of such factors as (a) extent of designation, (b) amount of standard formula, (c) types of incentives to be applied (d) overall budget, and (e) industries to be assisted. The major disadvantage of establishing extensive priorities is the potential for criticism. In addition, RDIA is currently a responsive program rather than one intended to steer the course of industrial development significantly.

Nevertheless, it is recommended that (a) regions and sub-regions should be ranked in terms of priority and, (b) priorities for desirable types of jobs (e.g. skilled, high technology) be established, and (c) targets be set for administrative purposes in terms of number of jobs to be created or dollars to be spent.

2. An aggressive and selective marketing program be undertaken

The arguments in favour of a market oriented development activity in support of the incentives program itself are well-known: there is international and domestic competition for industry; incentives programs are standard inducement; activity under RDIA has been at a low ebb; the industrial development process is known to stimulate investment; provincial industrial development activity has been scattered; and foreign promotion has been low key at best. For DREE to enter extensively into this field could result in costly duplication of services and be considered an intrusion into a field of provincial jurisdiction.

Nevertheless, it is recommended that (a) DREE assist the provinces with industrial marketing and promotion; (b) it actively and aggressively market and promote RDIA through a planned program of industrial sector and opportunity analysis, industrial search and analysis, as well as advertising and promotion, and (c) at the provincial, regional and headquarters' levels, the development function be more closely aligned organizationally with the incentives function in order to pursue more effectively both the pursuit of broad industrial development objectives and the administration of these specific development activities.

APPENDIX C

RECOMMENDATIONS FOR IMPLEMENTATION
WITHIN ONE OR TWO YEARS DEPENDING UPON
WHETHER AMENDMENTS TO THE REGULATIONS, THE ACT
OR SOME OTHER LEGISLATION IS INVOLVED

1. Calculate grants on the basis of capital costs only

One of the most time consuming and difficult aspects of administering the incentives program is determining with precision the number of jobs on which an incentive should be based and paid. The problem is further compounded by the distinction between eligible direct jobs, ineligible direct jobs, and indirect jobs, whereas the Act refers only to jobs created directly in the operation. Any simplification of job terminology would require numerous amendments to the Act and the Regulations since both make extensive use of words relating to jobs. It is also recognized that one of the main objectives of the program is job creation and that information on jobs created must be gathered for reporting and evaluation purposes.

It is therefore recommended that the Act and the Regulations be amended to calculate grants on the basis of capital costs only, with information on jobs created being gathered for reporting and calculation purposes. Failing that, a secondary and significantly less desirable recommendation is to confine the definition and calculation on jobs to those now known as direct jobs.

2. Refrain from the introduction of bridge financing

Although it is often stated that applicants are unable to obtain financing for their projects until DREE makes its first payment following the commencement of commercial production, there is little if any evidence to support these statements. Furthermore, any need for bridge financing would occur mostly with small investors who can be assisted by a number of lending institutions including FBDB. Certainly from an administrative point of view, DREE's problems are eased by having other agencies assume the risk until an entrepreneur is in commercial production.

It is recommended that bridge financing not be introduced under the incentives program but that efforts be made to make the letter of offer a stronger commitment by the Department so that lenders are less chary about advancing funds to the entrepreneur on the basis of the offer.

3. Include certain presently ineligible costs

There are several examples where incentives support for currently ineligible costs seems to be warranted. The barrier exists in the definition of costs found in section 2 of the Act.

For example, it should be within the Department's authority to consider as eligible the capitalized costs of rental expenses incurred during the first two or three years of a plant's operation in circumstances where it is more economical and of greater benefit to a community for the entrepreneur to rent idle factory space than to construct a new facility. Another example would be to make certain breaking-in costs eligible if capitalized.

It is recommended that these and other technical matters of this type be identified for appropriate amendment to the Act.

4. Give more discretion as to when an incentive is needed to achieve program objectives and goals

The Department is often precluded from providing incentives to deserving cases due to strictly technical or legal reasons.

One example is section 9 (4) of the Act which prohibits modernization assistance to firms which had already received RDIA grants. Although this prohibition is valid in many instances, it should be possible to permit exceptions such as unexpected and premature technological obsolescence, severe economic deterioration, an appropriate lengthy time lapse since previous assistance (say 7 to 8 years), staged modernizations, and modernizations made necessary as a result of government policy (e.g. tariff concessions). This problem could be overcome by adding the words "without the prior approval of the Minister" at the end of section 9 (4) or by changing the word "facility" to "asset".

Another example is found in section 7(1) (a) of the Act which presently permits the Minister to approve incentive support only if he can establish that the support is "needed". The Minister should have the discretion to provide an incentive if he considers it "appropriate" but is unable to establish need.

Still another example is section 9 (1) (b) where the applicant becomes ineligible for incentive support if he has made a prior commitment to his project irrespective of the size or other circumstance related to that commitment. Some discretion should be left to the Minister to determine the substantive nature of the commitment.

It is recommended that the Act be amended to accommodate these changes and others which may be identified on further examination.

5. Include selected industries as eligible operations

It can be argued that the addition of selected industries, including those in the primary and tertiary sectors, to the presently eligible secondary manufacturing and processing operations would make the program more useful as an instrument of regional development policy. However, significant job creation remains based primarily on manufacturing operations. If social and other economic goals are to be achieved, then other instruments and programs, such as those for smaller businesses under GDA subagreements with the provinces, are seen to be better vehicles for meeting those goals. Indeed, it is considered that the minima under the RDIA program are already too low in the sense that incentives support is available for projects which will create an insignificant number of jobs and minimal economic impact.

It is recommended that the incentives program not be expanded to include additional industries and that the minima eligibility limits be raised as soon as alternative departmental programs can be put in place.

6. Increase the limits on amounts of incentives available

There are various dollar limits set forth in the Act whose effect has been eroded due to inflation. These include the $5,000 per job in the calculation of the incentive, the total maximum of $30,000 per job and the $6 million for the primary development incentive. Although cost increases would warrant an increase of at least 70% in each case, there appears to be no justification for any ceiling on the amount of incentive to be made available for expansion projects. The ceiling on secondary development incentives was removed from the Act in 1971 and experience since that time would suggest that the ceiling on expansion projects only serves to limit worthwhile cases where an incentive in excess of $6 million might prompt a needed economic stimulus.

Although the ACC limits of 20% for expansion and modernization projects and 25% for new facilities and new product expansions are not affected by inflation, consideration has been given to their value as an incentive. Experience would suggest that a 20% incentive would be sufficient to encourage volume expansions but 25% is not always sufficient to attract new industry.

It is therefore recommended that (a) the dollar limits on jobs be raised by 70%, (b) the $6 million dollar ceiling on primary incentives be removed, and (c) the amount of incentive available for new facilities and new product expansions be raised from 25% to 30%.

7. Remove the negative impact on incentive grants due to the loss in capital cost allowance privileges

Although the RDI Act makes the claim for incentives to be tax exempt, under section 20 (h)(6) of the Income Tax Act the amount of the RDIA grant must be deducted from the amount of depreciable assets. In other words, the entrepreneur's depreciable costs are reduced, his taxable profits increase, and he pays more tax. A further irritant is the fact that the portion of the incentive related to jobs is also deducted from the asset cost. In addition, firms appear to receive more government "assistance" than is the case; this also tends to distort the comparison of DREE's budget with those of other Departments.

The amount of additional tax the entrepreneur must pay depends on many factors, including the class of assets involved, the profitability of his operation in a given year or in relation to parent or subsidiary companies, and the tax rate involved. It is estimated, however, that the value of the RDIA grant is reduced in many cases by as much as 30% when these factors are taken into account. Using this figure, RDIA costs could theoretically be lowered with the reinstatement of capital cost allowance (CCA) privileges from an approximate annual level of $80 millions to $55 millions. If CCA privileges were reinstated for the Quebec and Atlantic regions, only, RDIA costs might be reduced to the order of $60 to %65 millions.

If RDIA costs were not reduced with the reinstatement of CCA privileges, then the reinstatement could be criticized for creating windfall profits. This criticism would be particularly pertinent to standard formula cases but less so in C size cases where an adjustment in the incentive award might be made to recognize the reinstatement of CCA privileges and still provide the entrepreneur with the amount "needed" to induce him to locate in a designated region. The criticism can, of course, be offset by noting the economic need to enhance the value of RDIA incentives in order to stimulate industrial investment, and by pointing out that the overall cost to the government would be lessened because of increased personal tax due to increased employment, reduced U.I.C. demands, and eventually higher corporate tax returns generated by new viable industry.

It is therefore recommended that the Income Tax Act be amended in order to reflect the true status and value of incentives authorized under RDIA.

APPENDIX D

Loan Guarantees

It has been suggested, inter alia, that the loan guarantee program has been severely constrained from fulfilling an effective role because it was grafted onto an incentives act in a marriage of convenience. To some extent, this view has some validity. Loan guarantees are not an industrial incentive in the orthodox sense, as they are really a financing mechanism and most often constitute an incentive to the lender rather than to the borrower. The latter, of course, benefits as the presence or absence of guaranteed financing can mean the difference between the project getting off the ground or not.

The linkage of guarantees with purely incentives legislation has meant that constraints and conditions forming a perhaps necessary feature of an incentives program have a tendency to dampen the flexibility of a financing medium. For example, while it makes a great deal of sense to use capital costs as one of the determinants of incentives support, this constraint ignores the total financing needs of a company such as working capital, which is frequently an important feature of a firm's requirements.

Similarly by the very nature of an incentive, it is logical to assume that once a company has reached commercial production the Department's intervention in influencing locational choice is no longer required. However, financing problems are ongoing. The situation frequently arises that the appropriate use of guarantee support after C.P. date might be validly considered to bring about financial reorganization in order to preserve the benefit intended when a grant was first authorized. Accordingly, then, the following are considered to be high priority amendments to the RDIA as they pertain to loan guarantees.

1. Extended loan guarantee assistance
Expansions and Modernizations

The restriction of assistance to new commercial facilities only, can create anomalies in the treatment of development opportunities. For example, under the current legislation the Department is able to assist an inexperienced entrepreneur in establishing, say, a new motel while perhaps a more disirable expansion of an existing motel in the area by experienced owners could not be helped to meet the same market opportunity. It would appear that the broadening of loan guarantee eligibility to include the modernization and expansion of commercial facilities would be a particularly useful and productive amendment as the problem has arisen on a fairly regular basis.

It is recommended that Section 13A (1) (b) of the Act be amended so as to include the establishment, expansion or modernization of a commercial facility.

2. Provide authority for loan guarantee assistance
after commercial production has been achieved

The ongoing nature of a company's requirements suggests that if loan guarantees are viewed as a financing as well as an incentive tool, some provision should be made to permit intervention on the basis of need. This need may arise outside the context of a subventable project. The flexibility of the loan guarantee program would be substantially enhanced if it had the ability (as does the General Adjustment Assistance Program) to provide post C.P. financing where it is clearly in the interest of orderly regional development. The same rationale could be applied for commercial facilities; however, it is not expected that the need would arise as frequently. It should be recognized that considerable discretion would have to be exercised in order to assure that such a capability would not merely be used for temporarily bailing out or postponing inevitable business failures.

It is recommended that an appropriate amendment to the RDIA be incorporated to permit the extension of loan guarantees after a company has achieved commercial production in the case of a manufacturing facility, and after establishment, in the case of a commercial facility.

3. Increase the Maximum Amount of Loan Guarantee Assistance available

This section constrains loan guarantee flexibility in two respects. Firstly, DREE can only offer limited help in assisting in the financing of a company's working capital requirements because the size of loan which can be considered for guarantee is based on fixed assets and capitalized expenses. This is considered to be quite restrictive in effectively fulfilling a role as a financing medium. It is suggested that using total capital employed as the eligibility base rather than total capital costs would introduce sufficient flexibility to enable the consideration of a company's working capital needs as a necessary part of financing requirements.

Secondly, the necessity of deducting the aggregate of any development incentive and other government support from the total capital costs in determining eligibility, limits flexibility considerably. It is recognized that for purely incentive grant purposes, this is a valid restricting measure, as it prevents the stacking of assistance from multi-level government sources. However, since the incentive properties of loan guarantees are directed more toward the lender than the applicant and since the commitment is a contingent one, the necessity for concern regarding incentives stacking in the loan guarantee context is comparatively unimportant. However, from a departmental point of view it would be preferable to continue to deduct any RDIA grant in the eligibility calculation.

It is recommended that section 13(4) of the Act be amended to establish the maximum guaranteeable loan as 80% of total capital employed minus the amount of any development incentive made pursuant to the RDIA.

4. Loan Guarantee fees be eliminated

The fees payable on DREE loan guarantees (currently 1% of the guaranteed portion) are an irritant to borrowers and detract from whatever incentives properties which loan guarantees have. The traditional rationale for the imposition of such a fee is that it has the effect of discouraging frivolous applications for guarantees and, as well, highlights the fact that Her Majesty's covenant should be regarded as a privilege of some meaning, not to be given lightly. Neither of these arguments is very convincing. The guaranteed loans legislations (Farm, Fisheries and Small Business) currently administered by Finance do not impose a guarantee fee. Equally, it is difficult to see how the absence of such a charge would encourage frivolous applications. Lenders are indifferent to the fee because they invariably pass it on to the borrower. It seems appropriate, therefore, that the requirement for a fee be dropped.

It is recommended that the reference to guarantee fees be removed from section 15(fa) of the Act.