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Mr. Rob Merrifield

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● (1530)

[*English*]

The Chair (Mr. Rob Merrifield (Yellowhead, CPC)): I would like to call the meeting to order.

Mr. Jon Kesselman, professor of the public policy program at Simon Fraser University, is appearing by video conference today.

Can you hear us, Mr. Kesselman?

Professor Jon Kesselman (Professor, Public Policy Program, Simon Fraser University): Yes, I can.

Mr. Rob Merrifield: Perfect, and we can hear you.

This is the beginning of our study on the structure of Canada's federal revenue-raising system. It's great that you're here to kick it off, and we're looking forward to your presentation and to the many presenters who hopefully will be coming before committee as we proceed through this study. We expect it will be very fruitful for the people of Canada as we do this on their behalf.

We have two presenters, Mr. Kesselman and Mr. Jim Davies, from the University of Western Ontario. We will start with Mr. Kesselman.

The floor is yours, and we are prepared to hear what you have to say to us.

Prof. Jon Kesselman: Thank you very much.

I appreciate the opportunity to appear today to share my research findings and thoughts on the broad issues of taxation policy in Canada. My presentation will be based largely on my 2004 study for the Institute for Research on Public Policy, titled “Tax Design for a Northern Tiger”. I think the study was distributed to committee members in advance, with an executive summary in both official languages—

The Chair: I'll just stop you there. For the committee's information, it was not translated into both official languages. Members will get it. It has been sent for translation. We have the summary, and it has been translated. But the entire report has not yet been. That's just to let you know what we have.

Please continue.

Prof. Jon Kesselman: Okay. Translating the entire study will be a major work project for someone.

At any rate, the major message I hope you take away from the study and my presentation is that an economically efficient and socially equitable tax system hinges on its overall structure and design, not its overall level.

Other countries have applied taxes at much higher levels than Canada while still attaining very good levels of productivity growth and enviable standards of social programs. The key to achieving an efficient and growth-oriented tax system, whatever the desired overall level of taxes and size of government, is to shift the taxable base further toward consumption and labour income, and away from capital and investment income.

In the four years preceding my 2004 study, Canadian governments at both the federal and provincial levels made significant progress in pushing the tax system in the desired direction, and further constructive changes have been made in the four years since then. Some examples include large reductions in corporate income tax rates, reduction and elimination of corporate capital taxes, expanded allowances for depreciation of business investment, reduction in personal tax rates, reduced tax rates on capital gains, the rise in contribution limits for pension plans and RRSPs, and, most recently, the introduction of tax-free savings accounts. All of these measures move the tax system further toward consumption-based levies, and away from income- and capital-based levies.

But there remains room for further improvements in the tax system at all jurisdictional levels in Canada. I will briefly describe what I believe to be the eight most important areas for future tax reforms.

First, I begin by noting an item that applies at the provincial and municipal levels, the disproportionately high rates of property tax applied to business and industrial properties relative to residential properties across most of Canada. This discourages productive business investment, and it sends the wrong signals to provincial and municipal actors about what voters are willing to pay for additional local services. That, of course, is because most voters are homeowners rather than business owners.

Reforms to restrict the differential rates between business-industrial and residential property tax rates could easily be implemented through provincial legislation—though, undoubtedly, issues of public acceptance would arise.

Second, at the combined federal and provincial levels, the most urgent tax reform is to achieve a harmonization of indirect consumption taxes for the five provinces that still utilize a retail-level tax. In those provinces, nearly 40% of the total sales tax revenues are paid by business inputs rather than final consumers, inhibiting business investment and the efficient allocation of resources.

The federal government missed an opportunity to achieve this goal when it reduced GST rates without any linkage to provincial sales tax harmonization. To get the provinces on board with this change—especially Ontario and B.C.—the federal authorities will have to provide greater fiscal compensation than they have offered to date, and greater flexibility to the provinces as to the taxable base of the harmonized tax.

Third, at the federal level, one of the more important tax changes would be to raise the annual dollar limit for contributions to tax-deferred savings plans, like registered pension plans and RRSPs. The introduction of the tax-free savings accounts is helpful for individuals in efficiently arranging their lifetime savings on a consumption tax basis, particularly for lower and moderate income households. But Canada lags other countries, such as the U.S. and the U.K., in its limits on tax-recognized savings for higher earners. The current annual limit of $20,000 should be substantially increased, say to $30,000. This change would also make the Canadian tax system more competitive with other countries in attracting and retaining highly skilled technical and managerial talent.

● (1535)

Fourth, also at both the federal and provincial levels, the upper-bracket personal tax rates bite at incomes that are low, relative to where they bite in some competing countries. The top federal marginal tax rate of 29% kicks in at just over $123,000 of taxable income. This could be raised substantially—for example, to $180,000. The provincial personal tax schedules mostly hit their top marginal rates at taxable incomes below $100,000, with three provinces reaching their top rates in the $60,000 range. While the federal top tax rate is not excessive internationally, some of the provincial rate schedules are more steeply progressive than they should or need be.

These changes, as well as stretching out some of the intermediate tax brackets and reducing their rates, will be helpful in improving incentives for individuals and in attracting and retaining the most productive workers for our economy.

Fifth, while on the topic of direct personal tax, which is still called an income tax but in reality is closer to a consumption-based tax, another aspect warrants change. The major tax reforms of 1987 converted a number of items that had previously been deductible in computing taxable income into non-refundable credits. However, a few of those items are more properly allowed as tax deductions because they define the taxpayer's ability to pay tax. Thus, they should not be credited at a common rate independent of the individual's marginal tax rate. Three items in particular should be restored to tax deductible items: employee contributions for Quebec and Canada pension plans, employee contributions for employment insurance, and medical expenses.

Sixth, another aspect of the personal tax also deserves careful thought and reform. Unlike most other countries' tax systems, Canada seeks to attribute taxable income on assets transferred between spouses to the donor for tax purposes. This leads to highly complex attribution rules and equally complex manoeuvres by taxpayers to skirt the rules.

Based on my analysis and a study on income splitting published also by the IRPP, but just last month, I recommend that Canada follow the British practice of allowing full splitting of investment incomes between spouses when there is a bona fide transfer of assets. In conjunction with that change, I would also recommend that Canada simplify its complex and cumbersome rules for deductibility of investment interest expenses by allowing them up to the filer's taxable investment income, following U.S. practice.

Seventh, the payroll taxes, or so-called premiums, for the employment insurance program are levied at uniform rates on employers and employees, independent of the risk of unemployment in particular industries and firms. This structure leads to highly inefficient cross-industry and cross-firm subsidies as well as to disincentives for individual employers to stabilize their employment levels. A remedy to this problem is to differentiate the premium rates —at least those applied to employers—to reflect the differential rates of layoffs and employment stability. This system of so-called experience rating has been applied to good effect in many of the provincial workers' compensation programs as well as in the U.S. states' unemployment insurance programs.

And eighth and final on my list, which is certainly not an exhaustive list, is an item that appeared in a limited form in my 2004 paper, which was increased excise taxes on transport fuels, mainly gasoline. Given changes since then in our thinking about environmental issues and climate change, we should pursue higher taxes not only on gasoline but on a wide range of carbon-dioxide-emitting fuels and activities. The revenues from these levies, which could become very large over time, should be recycled in the economy through reductions in other taxes, such as some of the reforms that I've suggested here. Sensibly pursued, such environmental levies will yield the so-called double dividend; that is, reduced climate and environmental degradation along with a more efficient economy through reduction of distorting taxes.

● (1540)

You might note one item that was not on my list of tax reform priorities—tax-free rollovers of capital gains as promised by the current government in the last election. I would cite several reasons for not including that on a list of priorities.

The TFSAs and expanded access to tax-deferred savings that I've recommended provide tax-free treatment for capital gains and also for interest and dividend incomes. So unlike a capital gains rollover, they do not distort portfolio holdings.

Tax-free rollovers of past-accrued gains provide an inefficient windfall for past behaviour rather than incentives for future savings behaviour. Tax-free rollovers would provide large tax savings highly concentrated in the very top income classes. Tax-free rollovers are technically more difficult to implement and enforce than the existing tax-deferred saving schemes and the forthcoming TFSAs. And finally, Canada's effective tax rates on capital gains are already competitive with those in the United States, especially for short-term gains, where the U.S. applies full tax rates. So I commend the government in choosing not to pursue that particular item of its campaign platform.

To conclude, Canada at both the federal and provincial levels has made major strides since 2000 to improve our tax system, but additional steps are needed. These changes will move our revenue system further toward an economically efficient consumption base. Regardless of whether one seeks larger government or smaller government, it is important that revenues be collected using an efficient, smart design.

I have outlined briefly what I believe to be the top priorities and I'll be glad to answer any questions that members of your committee might have.

● (1545)

The Chair: Thank you.

We'll now move to Jim Davies, professor of economics, University of Western Ontario.

Professor Jim Davies (Professor, Economics Department, University of Western Ontario) Thanks very much.

Like John, I'm very pleased to be here. I think it's very important work that your committee is embarking on, and I wish you well in this enterprise.

My goal today is just to talk about some important areas in the federal tax system that I think still require attention. My comments will reflect my particular interests, which are mostly in the personal income tax area. I'm by no means presenting something exhaustive or comprehensive. It's not possible to do that; the tax system is too huge a thing.

When I started to think about this, I thought it would be useful to cast my mind back, and I'm going to invite you to cast your minds back as well, 10 years to 1998 and think about what's happened since then. A lot of good things have happened, in addition to some problems continuing. I think it's important to remember that Canada has a pretty good tax system, and it's the result of a lot of people thinking about it very seriously and trying to improve it over time, just as this committee is trying to do at the moment. We shouldn't have any notion that there are horrendous, terrible problems in the Canadian tax system that need to be fixed up.

At any rate, here's my little list of things that were wrong 10 years ago.

The first thing is the top tax rate, as John has pointed out, kicked in at too low a threshold. That problem has been quite significantly addressed. I think the $123,000 threshold for 2008 is still a bit low. I was talking to an Australian economist yesterday, and their top rate kicks in at $150,000, so I think we could move further there.

We used to have surtaxes in the PIT, and we don't have them any more. The last surtaxes and the corporate income tax were removed this year. These are good things because those raised the top marginal rates quite a bit.

Ten years ago we only had partial indexation of the personal income tax, which is a bad thing. It increases tax rates every year. We've had full indexation since the year 2000, so that's a big improvement.

Again, the RRSP contribution limit was too low. Ten years ago it was only $13,500; now it's $20,000. We should keep going up, but we've made some progress.

We didn't have a tax-free savings account. Actually, by the way, a better term for this, and it's a term that John has used in his previous work, and others have used, is tax prepaid savings account, because you've paid tax on that money you're saving; you're just not going to get nailed with a second tax in the future. This is something economists have called for, for a long time, in the theory of a consumption tax approach. You should have both the RRSP-type vehicle and you should have the TFSA-type vehicle. It's not some strange thing that came from nowhere; it's been thought about for a long time. I also think the contribution limit should go up, and I hope it will rise more than it's slated to do as we go forward.

Personal income tax progressivity was too strong ten years ago, partly because the top rate kicked in at such a low tax level. But that does have some interesting impacts. One thing I've worked on in my research is the impact of that progressivity on the incentive for people to invest in human capital. So people are thinking about taking graduate programs at university, becoming doctors, lawyers, engineers, whatever, and they ought to think about the material as well as the moral rewards to doing that. Those are reduced the more you enter into high tax brackets after you graduate. This is the impact of progressivity, and it's now been well established that it really does reduce the rate of return to investing in human capital. If people are thinking along these lines, it reduces that incentive.

That's something where the situation has improved quite a bit, and this is something that I don't think people expected. Raising the threshold for the top marginal tax rate has an impact, and there are a lot of other initiatives that have been pursued over the last 10 years to increase the assistance through the tax system for students.

Back in 1998, my research with Kirk Collins at Western indicated that for a median person taking a bachelor's degree in Canada, the effective tax rate on that investment was 15%. A neutral tax system would have an effective tax rate of 0%. Our 2006 results indicate that for this median person this rate is now down to 1%. So it's gone down from 15% to 1% as a result of various changes in the tax system. That is an important victory.

● (1550)

The child tax benefit in 1998.... Due to the clawback, if your net income was above about $70,000, there was no tax recognition for having children, which is a violation of horizontal equity. So, as John pointed out in a paper in 1994, if you had an income of $100,000 and three kids, you paid the same tax as somebody else with an income of $100,000 and no kids. The tax system was effectively treating the kids as if they were a fancy boat. This has been addressed with recent initiatives like the universal child care benefit and the tax credit for kids that was introduced in 2007.

There's a problem a lot of people talk about, about high effective marginal tax rates for low-income people. It's a very difficult problem. It's been addressed to some extent through the working income tax benefit. Federal capital taxes are gone, and it's a very good thing. The corporate tax rate has come down. It was 28% ten years ago and this year it's going to be 19.5%. So there's real progress there.

Lack of harmonization of the GST and provincial sales taxes is still with us. There's a problem with the GST that there are relatively high compliance costs. This is partly or perhaps largely due to the complexity that comes from having multiple rates and different treatment for different kinds of goods. In principle, as an economist, that's a problem that I would like to see addressed in the future, even if it's probably not very high on the agenda for non-economic reasons.

Okay. So that's my little checklist from ten years ago. Now, we could also talk about what's changed. Have problems arisen that we didn't have then? I have a little list of those. There have been some improvements in other areas that I just haven't had a chance to talk about.

Now I'm going to talk about some problems that have arisen more recently. I wouldn't like you to think that I just think it's problems that have come onstream. On these problems that have arisen, the new ones, the introduction of the credit for interest on student loans was unnecessary. In the tax system, the main approach, the way the costs of getting educated are recognized is through immediate expensing. If you have immediate expensing of capital expenses, you don't need interest deductions later. Quantitatively it's not a huge issue, but in terms of a precedent for how we treat interest deductability or credits, I wasn't too happy about that.

Tax mix.... Most economists across the country have been disappointed that the GST rates were reduced rather than having PST rate reductions. We're certainly in favour of rate reductions, but we are more concerned about the impact of PIT, personal income tax, and also about corporate income tax on incentives to save and invest.

It appears, and I think it's probably true, that there's been a bit of an increase in the use of special purpose tax credits to achieve social objectives. This is not something I would rule out entirely. I'm thinking of the public transit tax credit, the children's fitness tax credit, for example. If we want to change people's incentives and if we're convinced that through the tax system is really the best way to do it, then we should do it. We need to be on our guard about trying to do too many things through the tax system. It makes the tax system more complex, but it also reduces the revenue. So you have to keep the rates up, in general, to pay for these additional credits.

The final thing I would touch on is carbon tax. Like many people now, I'm in favour of carbon taxes. There's this benefit that you certainly don't want to use as some kind of revenue grab. If it's introduced in a revenue-neutral way, then you can reduce other taxes that are distorting things like labour supply and saving and investment. So there could be economic payoffs from introducing these taxes if we feel we need to reduce our emissions.

So that's more or less all I had on that.

● (1555)

The Chair: I want to thank you both.

We'll now move to questioning and answering. We will start with Mr. McKay. You have the floor for seven minutes.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you both for your presentations. They were very thoughtful and very useful, and a good lead for our study.

I'll start with Professor Kesselman.

A consumption tax seems to be regarded by most economists as the last tax that you would reduce. What is difficult to explain in the public is why you would reduce any other tax first, before you'd reduce a consumption tax. As I understand it, it has something to do with a multiplier effect, the benefit of tax moneys floating in the system, and the productivity enhancements that are gained by reducing corporate taxes or reducing personal income taxes rather than consumption taxes.

I wonder if you could, first of all, for the purposes of the committee, explain the multiplier effect. If I have time after that, there are a couple of other questions I want to go with.

Prof. Jon Kesselman: The common popular understanding of a consumption tax is associated with sales-type taxes—provincial sales taxes and the federal sales tax, which is the GST. This differs from an economist's notion of a consumption-based tax, which is much broader than that. A consumption-based tax in economic terms is one that does not distort investment and savings choices—in other words, people's choices about how to consume over their lifetime and how to allocate their savings to various forms of investment.

Viewed in that light, our personal income tax in Canada is actually very close to being a consumption-based tax. Why is that? Well, for most people the allowable contributions through your pension plan and through RRSPs are like consumption-based taxes, because you can deduct from your taxable “income” the amount that you save. What is left is consumption. And when you withdraw it, it gets added to, again, your taxable “income”. You withdraw from those funds only when you want to consume.

So that's one reason. Another is that the personal income tax does not tax savings in the form of owner-occupied housing, or principal residences. Capital gains on such homes are tax-free. Still another reason is that even for non-registered savings—in other words, savings not in an RRSP or a pension plan—when you realize capital gains on them they're taxed at a very preferential rate, at only half of the individual's normal rate.

The personal income tax in Canada, like that of some other countries, is called an income tax but it actually is much closer to a consumption-based tax for the great majority of the population. Only the top maybe 2% or 3% of the population is actually constrained by the $20,000 limit on annual contributions to these tax-deferred plans. Therefore, only—

Hon. John McKay: You don't regard the GST as a consumption tax then. That's a curious analysis.

Prof. Jon Kesselman: Yes, the GST is also a consumption-based tax. A lot of the uproar—including from a number of my fellow and sister economists—that cutting the GST was bad because it's a consumption tax and consumption taxes are good, so we should cut income taxes, was overlooking the fact that the personal side, not the corporate side but the personal income tax side, is very much consumption-based at progressive rates. The GST, of course, is consumption-based at a flat rate, which works out to be a regressive pattern.

So one could certainly argue that cutting the GST was no better and no worse than cutting the PIT, the personal income tax, but was actually better than cutting the personal income tax in terms of its distribution over various income classes. In other words, cutting a regressive tax, like the GST, would be a progressive move.

● (1600)

Hon. John McKay: Sorry, Professor, I have only a few minutes left.

Professor Davies, do you agree with Professor Kesselman's analysis that personal income tax is in fact a consumption tax, as opposed to any other...?

Prof. Jim Davies: Clearly it is for the great majority of people, but what I would throw in is that the top percentage of people, for whom it's not truly a consumption tax, are very important in economic terms. Savings rates rise very steeply with income towards the top of the income distribution. So the people who are very active in the markets, who are saving a very high fraction of their income, who have a lot of income to save—they are beyond the contribution limits.

Hon. John McKay: So is it your position, both of you, that it's a matter of indifference to you which tax is cut, whether it's a GST or a PIT?

Prof. Jim Davies: No. But I think you're picking up the nuance that there's a slight difference of opinion between us, right?

Hon. John McKay: I am, yes. And I'm a little confused, frankly.

Prof. Jim Davies: Yes, well, I guess not all economists think exactly the same, although we do have large areas of agreement.

I think the reason that the majority of economists reacted by saying that it would have been better to have PIT and CIT cuts is that they're thinking about the impact of the top marginal rates on the people who are not operating in a consumption tax system within the PIT. Then, of course, we go to the corporate income tax, and clearly this is not a consumption tax.

Hon. John McKay: If I understand your position, you would prefer a personal income tax cut over a GST cut because the people at the top end are the ones you would really like to retain in the economy.

Prof. Jim Davies: Well, I'd like to give them the right incentives for saving and investment.

The Chair: Thank you very much.

We'll now move to Mr. Laforest.

[*Translation*]

Mr. Jean-Yves Laforest (Saint-Maurice—Champlain, BQ): Thank you, Mr. Chair.

Mr. Kesselman, perhaps I am mistaken, but it seems to me that you did not deal with the question of tax evasion in your presentation. The system as we know it allows a number of companies to evade taxes. Are the consequences of this significant? How do you see the system? Should evasion not be completely eliminated? There must be some way to do it. I would like your opinion on that. Then I will have more questions for you.

[*English*]

Prof. Jon Kesselman: I'll be glad to give you my thoughts.

We do not have very precise measures on the extent, nature, and structure of evasion. From very indirect types of methods, we know it is substantial. Estimates range between 10% and 15%, and some are a bit higher, on the total potential revenue lost due to evasion of various forms. There are certainly grey areas of compliance, where companies that operate in Canada and in other countries can shift their financing to the countries where they get the higher tax deduction, and shift their revenues through so-called transfer pricing into the jurisdictions that have the lower tax rates. That is not a simple issue for Canada or any country to address.

On your question of whether we can fully eliminate tax evasion, we certainly cannot. No country has been able to do that. No country can fully eliminate it. If you think of small businesses that operate partly in cash and in the underground economy, the best we can do is have our tax enforcement people out there trying to nab a few of them. We cannot nab all of them.

It is a real problem, and the relevant aspect of it is to ask how evasion interacts with our design of the tax system and questions about personal income tax rates: how do we withhold those taxes? Empirical studies have found that the GST has increased the incidence of evasion, because in part it has given small-business people the incentive—

● (1605)

[*Translation*]

Mr. Jean-Yves Laforest: Thank you. Given that my time is limited, I will move to another question that I will put to Mr. Davis.

In Canada, we calculate the individual incomes of each person in a family whereas in other countries, in France specifically, tax is calculated using family income. Would that kind of approach not be of interest for Canada? In fact, our tax system is so complex that families are often penalized. They have difficulty following it and do not understand their place in the system, especially when it comes to taxing their income.

[*English*]

Prof. Jim Davies: That's an interesting question. Most countries tax husbands and wives independently. In addition to the example of the French system, there's the U.S. system, where most husbands and wives are taxed jointly. For example, when teaching I find that a lot of people are aware that's how it's done in the U.S., and the question arises of whether we should we think of taxing the family unit rather than the individual.

Actually, I had an experience with this back in 1992. I presented a paper at a conference arguing that we should think of doing this, or at least figure out how much inequity we're introducing by taxing people separately rather than as families. There was a very strong negative reaction from people at the conference. There was a very strong feeling, not just from people at the conference, but also from others I spoke to back in the early nineties, that the independence of husbands and wives was too important and too fundamental or central to our outlook at the moment to think of aggregating their income and taxing them as a unit. So I've been discouraged about such initiatives.

[*Translation*]

Mr. Jean-Yves Laforest: Let me stop you there. You talked about women being independent of men. That is exactly what is behind my question.

Does our system really allow men and women to be equal? In the great majority of cases, the man has a higher income. Deductions usually go to the higher income in a family when they could go to the lower income, the woman's. So the woman often loses deductions. She does not benefit from them herself. Contrary to what you are saying, it is not clear that the present system encourages men and women to be independent.

[*English*]

Prof. Jim Davies: Yes, I think you're making a good point. It's a complicated issue, because there are downsides as well as upsides.

If you tax a husband and wife together and one of the partners has been out of the labour force and is thinking about perhaps taking a job, their effective marginal tax rate is the marginal tax rate of the family. If the primary earner is earning $70,000 or $80,000, that is a high marginal tax rate; whereas in our system, when the secondary earner thinks of going into the labour force, the first $10,000 approximately is at a zero tax rate. Actually, that's not quite right, but they enter independently, so they enter at the bottom of the tax schedule and there is more incentive for them to enter the labour force, as they're taxed more generously.

Another point to make is that as tax structures are flattened, this becomes a less serious issue. Now, if you actually move to a flat tax, the issue would largely go away. So I would hope that we would continue to flatten the tax structure in the future, and maybe then it won't be so important.

These are good points that you're raising, ones that are well worth examining, I think.

● (1610)

The Chair: Thank you very much.

We'll now move to Mr. Menzies, for seven minutes.

Mr. Ted Menzies (Macleod, CPC): Thank you. We will bear in mind that we only have seven minutes, which I'm going to share with my colleague, Mr. Del Mastro.

Thank you to both of you. Your presentations have certainly stimulated a lot of questions, so we'll try to keep this very tight.

You both raised the issue of the top rate being too low. We've raised the lowest rate and taken a lot of people off the tax rolls completely. I'd like an answer from both of you on whether we should consider reducing the number of tax brackets. Is this the direction we should be going in? Would it be a positive move? Great Britain has moved toward that. Should we be considering this to make it fairer?

Prof. Jim Davies: I don't think the number of tax brackets is that crucial, because if we wanted to flatten our structure—which I certainly advocate—we could reduce our 29% rate and our 26% rate.

It's probably a good thing that the bottom rate went down over the years from 17% to 15%, but we still have this 29% top rate. This top rate I would like to see come down—and that will flatten the structure.

Sometimes, in order to achieve flattening, you have to add a bracket. So when we added the middle-income bracket from about $70,000 to $120,000, it actually helped to flatten the structure, because there's a 26% rate there instead of the 29% rate.

So I think there are different ways you can approach this; you don't necessarily have to reduce the number of brackets.

Prof. Jon Kesselman: I would concur with Jim that the number of brackets in itself is not a crucial concern for policy. As I said in my presentation, I think that the threshold for the top rate should be higher, but I do not necessarily think that the top rate of 29% is excessive in terms of either incentives or in comparison with other countries.

I think some issues of high marginal tax rates on upper earners really come out of the provinces—Ontario in particular, with its rate schedule and surtaxes labelled as, whatever, a health care tax. The provinces are the places to look for flattening of rate schedules. The progressivity in the federal rate schedule is appropriate. If you want progressivity in a tax system, as many people do, it should be at the federal level much more than at the provincial level.

The Chair: Mr. Del Mastro.

Mr. Dean Del Mastro (Peterborough, CPC): Yes, thank you.

Thank you both for your presentations today. I thought they were well thought out and very comprehensive.

First of all, Mr. Kesselman, you talked about the need to transition retail sales taxes into value-added taxes. I wrote a paper on that very recently. One of the things I agree with you on—and maybe you could touch a little upon this—is you specifically said the way taxes are applied is much more important than the rate. Could you expand on that a little—why where a tax and how a tax is collected is more important than what the rate may be?

Prof. Jon Kesselman: The design or structure of a tax affects the kinds of incentives and inefficiencies imposed upon the economy. Some taxes are simply much more inefficient. Let's say most taxes are inefficient, but some are much more inefficient than others, which leads to, I'd say, almost a consensus among tax economists that taxes on capital and investment income and business income are more distorting to the economy than taxes on consumption or labour income, which leads to the preference for consumption-based types of taxes, whether they're done through sales-type taxes, indirect taxes, or through direct personal taxes like what we call our personal income tax.

The evidence for this is cross-national. The countries with some of the highest tax overall burdens in the world are those of Scandinavia, the Nordic countries, the Netherlands. They're still able to perform very well as economies, but they do it through sensible tax structure.

Now, this does not mean that you or I have to favour a very high tax level. That's a matter of choice. But it's saying that whatever level of taxes we want, whether we want big or smaller government, we should pursue a structure that promotes growth and economic efficiency, and that pushing the tax system even further toward consumption-based and labour-income-based is the way to do it.

● (1615)

Mr. Dean Del Mastro: Can I ask you very briefly, because I have one other question I want to get to, whether it's your view that there should be very few instances when products or services may be excluded from value-added taxes? Should it be very uniform in how it's applied? Is that preferable?

Prof. Jon Kesselman: As an economist, I think it's preferable that what should be in there are groceries, everything, but you as political experts know that this is not an easy road to follow. Some countries —look at New Zealand and Australia—have in the past decade brought in GSTs of their own with broader bases than Canada, but it is politically tricky and difficult to gain public acceptance for an even more broadly based type of GST.

Mr. Dean Del Mastro: Thank you.

I'd like to ask you both your opinion on a flat tax replacing the current marginal system, and whether you think it would be better, or what have you, than the current system.

Prof. Jon Kesselman: Okay, I'll try to do that quickly.

I do not feel a flat tax is appropriate for Canada at the federal level. Alberta has a flat tax. I think it is acceptable at the provincial level because of interprovincial mobility of labour. At the federal level, if we want any progressivity in our overall tax system, given the regressivity of indirect sales taxes, property taxes—all the others —we need significant progressivity in the rate schedule of our federal direct tax.

Mr. Dean Del Mastro: Go ahead, Mr. Davies.

Prof. Jim Davies: That's another area in which we differ.

I think a flat tax is a progressive tax as well, because there always is a basic exemption of a certain amount. If you look at Alberta, it's fairly healthy. Normally in flat-tax proposals what people put forward is an increase in the amount of basic income that's exempt, so that the proposals normally deliver a benefit to low-income people. They also deliver a benefit to very high-income people— that's inescapable—but if you arrange it so that there's sufficient benefit to the low-income people, then many observers who look at it will say that on distributional grounds it may improve things.

Another point to keep in mind is that the marginal tax structure doesn't just come from the personal income tax system. It also comes from the CPP, EI contributions, and clawbacks. When you add them all together and look at the effective structure of marginal tax rates, actually the marginal tax rates are at the highest for some of the lowest-income people. Beyond that it's a bit jagged if you add the whole thing up, but the marginal tax rate on average is about constant as you go up, because the very high-income people are not making EI and CPP contributions, for example, on their marginal income, and the two things just cancel out.

Some people think one could rationalize this whole system and simplify things by having one constant marginal tax rate for everybody. This would be a very radical reform. It would require a wholesale rethinking of the whole system, but I think if people are thinking about flat-tax ideas, they ought to think in those terms.

The Chair: Thank you very much.

We'll now move to Mr. Pacetti.

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.): Thank you to the witnesses for appearing.

Part of the reason that we came up with this study was not to try to see how the government is going to spend the money, but rather how it's going to raise the money to spend later on. I don't know if that's English.

It could be any government, but if we use this government as an example, they've been doing different things. Just in the last two years, they've cut consumption taxes—GST—but they've also cut personal taxes and corporate taxes. For argument's sake, let's say the government needs *x* number of dollars. If we use a number of $200 billion or $300 billion or whatever, what is the best approach? Would it be to have a consistent approach and just reduce one type of tax, whether it be corporate, consumption, or personal, or is it best to do a bit of sprinkling everywhere? That would be the first question for both Mr. Kesselman and Mr. Davies.

Mr. Kesselman, would you comment?

● (1620)

Prof. Jon Kesselman: We can look back at what's been done, or we could ask going forward. Now, going forward, I don't think there's much room in the federal accounts to do significant further cutting in the next year or two, but let's think hypothetically: if there were room to cut taxes, where should they be cut? Should they be spread out, or should they be concentrated anywhere? I believe the move started under the previous governments, which is continuing and being pushed further by the current government, is that to cut corporate tax rates is generally desirable, but whether heading toward a 15% federal corporate rate goes a bit further than we need to is certainly open to debate. I believe—

Mr. Massimo Pacetti: I'm sorry, Mr. Kesselman, but we have limited time.

If we decided that corporate tax was the way to go, what would be the result? What's the next step? What will happen if we cut corporate taxes? Will it stimulate the economy? What will it do?

Prof. Jon Kesselman: In general, it should be helpful to business investment. It should also be helpful in some offsetting ways to federal revenues, as corporations will tend to shift more of their revenues into Canada, and they'll tend to shift out of Canada to claim as costs such things as interest financing. They'll shift to other jurisdictions where they operate that have higher rates.

Mr. Massimo Pacetti: Do we have examples of places where that's had positive results? Would Ireland be one?

Prof. Jon Kesselman: Yes, Ireland is the so-called poster boy of the corporate tax cuts.

Mr. Massimo Pacetti: What would the Scandinavian countries do? Are their corporate rates low?

Prof. Jon Kesselman: The Scandinavian countries have cut corporate rates, and at the personal level they have cut to kind of a flat rate on investment-type incomes, while retaining progressive rates on individuals' labour earnings. I think that is another way to pursue the general goal that I was espousing earlier.

Mr. Massimo Pacetti: So they have a combination in which the corporate taxes are lower but the personal income tax rates are higher?

Prof. Jon Kesselman: That is personal income tax as it applies to labour-type earnings—wages, salaries, and self-employment earnings—but on investment incomes of individuals, like interest dividends and capital gains, they have pursued a lower rate and kind of a flat rate. The U.S. has also gone that way a bit.

Mr. Massimo Pacetti: Mr. Davies, would you agree with that?

Prof. Jim Davies: Yes, I agree with everything Professor Kesselman has said.

I would also point out that some of these initiatives that both he and I were suggesting on the personal income tax side—increasing contribution limits for RRSPs or for TFSAs—of course would also have a revenue cost, and that could be part of a package of tax reductions if there was room for tax reductions.

Mr. Massimo Pacetti: Okay, so having said that, what would happen if the government just concentrated, for example, on deductions and said we'll leave the rates as they are, but we'll increase RRSPs, and we'll increase the fitness deduction, transit deduction, all kinds of deductions? Is that a policy that is going to help the economy and raise revenues, or is that just revenue-neutral, or is that just trying to change the residents' behaviour to try to adapt to where you want them to go?

Mr. Kesselman.

Prof. Jon Kesselman: May I defer on that one?

● (1625)

Mr. Massimo Pacetti: Yes, sure.

Mr. Davies.

Prof. Jim Davies: In the short run, increasing credits and deductions is going to reduce revenue, so I think you have to do that very carefully. I was flagging that. I had some concerns about proliferating tax credits or whatever. There has to be a really good reason for them, right?

So, yes, in the short run, it can be revenue reduction. On the other hand—

Mr. Massimo Pacetti: So unless you're doing it for behaviour, you wouldn't do it to generate revenue?

The Chair: Actually, you both could defer, because the time has gone.

Monsieur Laforest.

[*Translation*]

Mr. Jean-Yves Laforest: My question goes to both witnesses.

If you put yourself in an ordinary citizen's shoes, do you not find that, generally speaking, the tax system is complex? Could it not be improved, simplified or changed so that people can find their way around it more easily? A good number of measures target businesses and investments, but have we looked at the way in which ordinary citizens, workers and their families, perceive the tax system in Canada? In my opinion, people find it very complicated. Could we not simplify it without reducing national revenue as a consequence? Each of you can have a turn answering.

[*English*]

Prof. Jim Davies: I think that's a really good point.

Prof. Jon Kesselman: Shall I take a first crack here?

The Chair: We'll have Mr. Davies first, and then we'll go to Mr. Kesselman.

Go ahead.

Prof. Jim Davies: I think that's a really good point. Often things we introduce to try to achieve greater fairness or pursue goals that seem to be attractive add to the complexity.

If you think about the situation with children, we have the Canadian child tax benefit, child expense deductions, the universal child care benefit, and a Canada child tax credit. You could think of cleaning this up.

The working income tax benefit was introduced to try to reduce disincentives for working people, which are coming from the tax system in clawbacks and so on. These things do. You get a situation in which I think ordinary people, rather than doing some calculation and figuring out what their tax burden would be or how much their taxes would go up if they worked some more and so on, figure these things out in a more informal way. They kind of look around at their friends and relatives and they can tell that so-and-so went and got a full-time job but they don't seem to be any better off.

It is very complicated, and I appreciate that.

The Chair: Mr. Kesselman

Prof. Jon Kesselman: I quite agree with your observation on public concern and the complexity of personal tax. The GST itself is very complex. The question is what we do about it. We can't deal with it in generalities. We have to look at specific areas and ask the questions: What is the complexity achieving? Is it achieving something important in terms of any of the many dimensions of equity or efficiency? If it is not, then we have to look very carefully at the design of those provisions and at how to redraft the legislation. But again, we cannot do that in generalities. We'd have to take any of several hundred areas where there is complexity and deal with them in the concrete.

The Chair: Thank you very much.

Mr. Wallace, you have five minutes.

Mr. Mike Wallace (Burlington, CPC): Thank you, Mr. Chairman, and thank you, professors, for joining us today.

I have just a couple of questions. As you know, you live in academia, and we live in politics. Raising the amount of money you can make before the top rate kicks in might be a little bit difficult politically. I actually made that argument with my colleagues on this side of the table for this last budget. If we do it for the one rate, should we not be moving the income levels up for all the other marginal rates that exist? That's my first question.

Second, based on the models you've been working on, does that still generate enough revenue to run the government?

Does anybody want to answer?

● (1630)

Prof. Jon Kesselman: I'll be glad to try.

In my presentation I mentioned the threshold for the top rate, but I also mentioned stretching out the threshold levels for the other brackets. I think that would have to be part of the package, yes. Any politically astute budget that raised one would have to deal with the others as well, not only for political reasons, but because it would also move many taxpayers who are not currently in the top bracket into lower brackets, without explicitly cutting the rates on the various brackets.

On revenue, yes, there would be revenue costs. The most expensive threshold to raise is the bottom threshold, because all taxpayers bear that. We have been raising that bottom bracket beyond inflation in the last budget or two. It becomes less costly as you move thresholds for higher brackets, per dollar of move in the bracket. Yes, there would be significant budgetary impact. Finance people and your committee have the models to crank out the numbers for any conceivable change you might wish to explore.

Prof. Jim Davies: I don't have anything to add to that. I agree.

Mr. Mike Wallace: My next question is something that, as a member, I hear on occasion from people, and I just want your opinion. As you know, and Garth knows this, with his new book, your own home is tax-free, in a sense. It's an investment; you don't pay tax on anything. Across the border, it's a capital gain for them and whatever happens with that, but they are able to deduct the mortgage interest. Would both of you like to comment on whether that's an approach we should be looking at here, or do you prefer the approach we have here in Canada today?

Prof. Jim Davies: I'll have a crack at that.

I think we should stay with our own approach, and I believe that very strongly. The way housing is treated at the moment is very good in terms of a consumption-tax approach. The argument is that even if you look at this from the income tax viewpoint, there's not only the capital gains but also the imputed rent. So the return to the homeowner is the imputed rent on the house plus capital gains. We're not taxing those things, so we shouldn't be deducting the mortgage interest costs. That's a good way of looking at it.

Prof. Jon Kesselman: I would fully agree with Mr. Davies.

With regard to the United States, in fact they do not take the full capital gain. They have a large exemption on capital gains—I don't recall, it's maybe $300,000—in addition to the deductibility of mortgage interest. They have gone overboard in giving fiscal incentives and stimulus for home ownership, and along with, of course, all the financing debacles of the last couple of years, that's part of the reason for the overinvestment and the bubble in the housing market in the U.S. We're seeing the downside of that now—not mainly tax, but their tax treatment has certainly encouraged this overinvestment in housing. It's simply an inefficient allocation of an economy's resources when people are buying a lot more home than they would under a more neutral system.

The Chair: Thank you very much.

Mr. McCallum, you have the floor for five minutes.

Hon. John McCallum (Markham—Unionville, Lib.): I'll share my time with Mr. Turner.

As a former practitioner of economics, I welcome both of you.

I might just mention to Mr. Wallace that one way of raising the threshold at the highest income tax is that you reduce every income tax rate and at the same time raise the threshold, which is exactly what we did in 2005 in the fiscal debate that was defeated.

I'd like to ask a general question. I had to be out of the room for a little while, and it might have been raised, but I haven't heard much talk about a general trade-off between efficiency and equity or progressivity. It would seem to me that a flat tax, while progressive for the reasons given, is a whole lot less progressive than the current system.

For example, I think Jon Kesselman's point number seven said a deduction is better than a credit but a reduction is also more regressive than a credit. I'd like to ask each of you how, in general, you balance the classic question of fairness versus efficiency in making these recommendations.

● (1635)

The Chair: Who would like to start?

Prof. Jon Kesselman: I'll be glad to start.

The Chair: Mr. Kesselman, then we'll go to Mr. Davies quickly.

Prof. Jon Kesselman: That balance or trade-off is not one that can be made as a social scientist or an economist. That obviously involves personal values, or from the political side of the table, it involves constituencies, but—

Hon. John McCallum: Let me interrupt you there, if I may. I know that, but it means since we are the politicians, when we hear these presentations it would be nice for you as social scientists to tell us, if we're gaining something in efficiency, how much we are losing in progressivity.

Prof. Jon Kesselman: I will briefly address that. I will differ from Mr. Davies on the flat tax. I think it involves a large compromise in vertical equity. Most studies of the flat tax find that, yes, it would be a large tax relief for the very high income, it could be designed to avoid any tax increase on the very low income, but it would be a shift of tax burden onto a fairly broad range of middle income. In my values, I don't particularly think that's good. Politicians would have to make their own judgments.

Yes, many of the other kinds of proposals both of us have made today do have equity dimensions, both horizontal—that is, across people with the same ability to pay tax—and across income classes.

This will be my last bit on it. For example, my recommendation that we revert to deductibility for employee contributions for the social insurance plans and for medical expenses would be less progressive than the system now, but would try to restore an appropriate measure of horizontal equity—in other words, assessing people's relative ability to pay tax. Someone might have very high medical expenses, which are not part of their ordinary consumption; therefore they should not be part of their taxable base. They should be deductible.

The Chair: Mr. Davies.

Prof. Jim Davies: I think, really, to answer your question about how much vertical equity you are giving up if you gain more efficiency, you need a good model that incorporates these things. We'd have to crunch some numbers, and clearly we don't have those numbers here today.

On the flat tax thing, I was making the point that you need to consider the marginal tax rates that are coming from other taxes in addition to the personal income tax. If we took the personal income tax and just replaced it with a flat tax and ignored what the other elements of the tax system were doing, we'd have a bad system, which I think is in agreement with what Professor Kesselman is saying.

On the deductions, I think there's a bit of a problem in Canada: we have too much of a tendency to leap to the vertical equity question and to overlook the horizontal equity question. When we switched all of the deductions over to non-refundable credits, that was a bit of a symptom of that.

For example, on the family stuff, it's more appropriate to have a deduction for dependents than it is to have a credit. The argument is that you should tax people according to their ability to pay, and kids cost something. Part of my income morally belongs to my kids, not to me, so that ought to be deducted from my taxable income.

Sometimes we should think about horizontal equity first and vertical equity second.

The Chair: Thank you.

Actually, all of his time has gone, but I'm going to give Mr. Turner five minutes, because we have a little extra time.

You have a full five minutes, Mr. Turner. Go ahead. Then we'll close it off with Mr. Del Mastro.

● (1640)

Hon. Garth Turner (Halton, Lib.): Thank you, Chair. What a sweetie.

An hon. member: Don't blow it, Garth.

Hon. Garth Turner: Yes, indeed.

Mr. Kesselman, a couple of years ago, when I was still delusionally a Conservative, we had a conversation one night, if you recall, about capital gains. We talked about the proposal that the Conservatives—Mr. Harper, as a campaigner—had brought forward about a capital gains rollover, and I asked you what your opinion was of that.

The government has not proceeded with the capital gains rollover to date. Do you think that's been a wise decision on their part? Can you articulate a little of what you see the costs involved would have been, in the program as proposed?

Prof. Jon Kesselman: I do recall a conversation, and in my opening presentation I stated that the “rollover of capital gains” proposal was not a good one. I even said that the government was wise not to proceed with it. I gave several reasons for it.

Just to recap them, it is a big tax windfall for disproportionately a very high-income group, a windfall in the sense that it's a reward for things that have happened in the past, not a use of tax revenues to provide incentive for future savings or future behaviour; it would have been a complex bit of legislation to draft and to enforce, which is perhaps one reason the government did not act on it earlier; and there are other, superior ways of shifting our personal tax system more toward an efficient, consumption-based system, which both Professor Davies and I have outlined here. These are things that previous governments and this government have done; that is, raising contribution limits to the RRSPs and registered pension plans, and the recent introduction of the tax-free savings account, which was under study by Finance Canada even before this government came in.

Hon. Garth Turner: Let me jump in there, because I see a bit of an inconsistency in some of the things you're arguing.

Certainly, arguing for larger deductions or contribution limits for RRSPs clearly favours higher-income earners. Today, I believe, 93% of all RRSP contributions go unmade; we have only 7% of contributions that are made. That seems to be a very blunt instrument of taxation policy that is not accomplishing, really, any goal right now. So I see an inconsistency there in your argument.

But I wanted to ask you as well about RESPs. We've had a big debate here in Parliament about whether RESP contributions should be tax-deductible or not. Can you give us an academic viewpoint on your position on this?

Perhaps, Professor Davies, you could chime in as well.

Prof. Jon Kesselman: Okay. I think the proposal that was brewing in Parliament to make contributions to RESPs tax-deductible was a bad one from the perspective of tax policy.

The reason is that the deductions would be tax-deductible, but typically the withdrawals from an RESP go into the hands of the student, are taxable in the hands of the student, and typically bear little or no tax. So there would be no tax going in and no tax coming out.

This is contrary to consumption tax principles. It is something that would have been very tilted toward high-income families in terms of what we know about how RESP contributions are done now. And they would have become even more relatively attractive to high-income earners if they were tax-deductible. So I think that was not a good way to proceed, and I'm glad the political process is not proceeding with that.

The Chair: Thank you very much.

Mr. Del Mastro.

Mr. Dean Del Mastro: Thank you, Mr. Chairman.

Mr. Kesselman, I have another question I wanted to get to, but I did want to talk a bit about the capital gains comment you made. I just want to ask you how you would suggest we put incentives in place so that stagnation of capital doesn't occur. Certainly one could argue that the current capital gains laws actually cause stagnation of capital. We have investors who stay in high-risk portfolios because they don't want to pull their money out, to be subject to tax, and that's not good for employment. It's not good for investment into new economies, into new business.

If we aren't going to contemplate changes to capital gains tax to do what you're saying, to assist people to avoid past decisions, how are we going to approach this stagnation of capital? How could we better approach it?

● (1645)

Prof. Jon Kesselman: First of all, for 95% to 98% of Canadians, they can do their savings through their pension plan, through their RRSP, and there is no penalty for selling appreciated assets in those. So this is mainly an issue for the top maybe 2% or 3% of taxpayers and a small number of other taxpayers who are unusually high savers for their income class.

You also have to keep in mind, I think, that the capital gains tax rate is half of the normal rate, so even if you're in the top bracket in a relatively high-tax province, you're paying 22%, 23%, or maybe 24% of the gain. These are not extremely high rates compared with what ordinary earners face. A person has to make their choice of whether to sell an asset or not, but even if they don't sell, on most of these we would be talking about appreciation on gains in common shares, equities. Capital is not stagnant. These are just reflecting the value of traded pieces of paper. They don't reflect the actual books and balances and cashflows of those corporations.

So I think the notion that capital is stagnant because of people being locked in due to capital gains tax is perhaps exaggerated—perhaps a phantom, even.

Mr. Dean Del Mastro: Really? Well, I'd point to the fact that I am approached by literally hundreds of seniors in my riding, and I know there are thousands across Ontario who own things like cottages. And they'd like to sell the cottage but they're going to pay a tax penalty to sell the cottage so they are holding on, waiting to see if anything will ever be done, because a lot of these cottages have gone up in value. It's not a bad thing that they would change hands, in fact, and that the seniors might reinvest into something that would more suit their current lifestyle.

I would point that out as an example of where we do see stagnation. They're still paying property taxes and they're paying expenses maybe they can't afford because they don't want to pay a tax on the sale.

So I think we do need to get our heads around it, and I'm not exactly sure what the solution is. I don't think we can rule it out of hand that it doesn't exist.

I do want to ask one more question and I'm going to run out of time if I don't. In government, I think, we're often guilty of forgetting that there is only one taxpayer. There are three levels of government but there is really only one taxpayer.

You talked a bit about property taxes. It doesn't matter if they're profitable or what have you: property taxes on businesses are very high. You talked about levelling property taxes between residential and corporate entities as being politically not popular.

On the increase we've seen recently on property taxes, are we seeing any evidence that this is actually discouraging investment in places in Canada—in Ontario, for example? Are these high property taxes affecting business decisions?

Prof. Jon Kesselman: Certainly property taxes enter into the total tax burden on new investment, on capital. I can't speak to Ontario, but certainly there have been a number of studies showing that high property taxes do tend to divert businesses, at least within large metropolitan areas that have different taxing municipalities. They are probably not at the top of the list of where businesses choose to locate and expand across provinces or within or outside of Canada. More important are the costs of labour, the availability of skilled labour, land costs, rental costs. On a small list, perhaps property taxes would be around fifth or sixth on that list, and they are a concern.

● (1650)

Mr. Dean Del Mastro: Is that time?

The Chair: Your time has gone.

Mr. Dean Del Mastro: Thank you very much.

The Chair: We'll ask Mr. Pacetti to give his final quick question—we'll allow that—and then we'll move on to the other business of the committee.

Mr. Massimo Pacetti: Thank you, Mr. Chairman.

Again, similar to my previous questions in terms of keeping in mind that the government has to raise *x* number of dollars in revenues, how about all these other types of revenue-generating items the government has? For example, there's the airport tax, ancillary fees. Unemployment is also one of them. There's a surplus in the unemployment account. Are these items the government should be concentrating on as a revenue source, or should governments just focus on personal income tax, corporate taxes, and consumption taxes?

Prof. Jim Davies: Perhaps I could just say something very quickly about that. Some of these will be in the nature of user fees—airport taxes, for example. I think that is a good thing to pursue, but there's an appropriate level for these things.

Mr. Massimo Pacetti: What we see is that the government is addicted to these revenues, so they'll come out with an airport tax for security purposes and then all of a sudden they're generating profits and continue to sometimes even raise them when they don't actually need those moneys, but they go into the general fund. Is that the way they should do it? In the provinces, they levy a medicare tax for the health insurance, but there are also other moneys coming elsewhere. Should every service have a dedicated tax related to it?

Prof. Jim Davies: No. It depends a little on things like administrative costs and so on. In economists' language, we're in a second-best world and providing any government service for free is a little questionable. There could be an excuse for doing that, which is it may cost too much to collect these fees to really make it appropriate to do that. Of course, it's quite possible for these fees to be too high. Perhaps the ones you're citing should be reduced. I'm just reacting to say that, in general, there is broad recognition that user fees are an appropriate source of government finance, but they do have to be set carefully.

Prof. Jon Kesselman: I think there is reason for concern, as you suggest, that these kinds of fees are being used in excess. In particular, look at the employment insurance financing over the past, what, 10 or 12 years. Large amounts of excess revenues relative to the needs of that program are being used to finance other purposes. So airport fees and employment insurance premiums should be set to cover the costs of those programs. They should be cost recovery. That's their purpose. They should not be used as a general revenue source.

Mr. Massimo Pacetti: Just quickly, why not? It goes into general revenue and then goes back to be used for whatever government wants to do with it.

Prof. Jon Kesselman: I think there is a reason. We apply special types of financing to some programs that have a benefit very much attached to particular users where we think it is appropriate to charge for that rather than use general revenues. Typically, these are types of services that are not meant to redistribute income or do not have a general public benefit, so user fees for airline travellers are reflecting their private benefits, and it's proper that they should pay, but not that they should pay more than the actual costs they are imposing upon public authorities. It is the same with employment insurance. People are getting a coverage against the risk of unemployment—

Mr. Massimo Pacetti: So the government should decide which services it should bill and which it shouldn't? It's up to the government to do so?

Prof. Jon Kesselman: It's up to government, guided by economic, legal, and other analyses.

Mr. Massimo Pacetti: But as long as they don't over-tax for that particular service, you're okay with it in theory?

Prof. Jon Kesselman: For services where there is not some general public good or some highly important equity or redistributional component, yes.

● (1655)

The Chair: I have to cut him off, because he gets on a roll and he just doesn't stop.

We want to thank both of you, Mr. Davies and Mr. Kesselman. Thank you for being with us and introducing us to this subject. As the committee continues with this, we're going to find it more and more interesting.

With that, we'll suspend for a couple of minutes. Then we'll carry on with the business of the committee.

Thank you.

• (Pause)

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The Chair: We'll call the meeting back to order.

Just before we yield the floor to Mr. McCallum, I want to remind the committee that we have a Chinese delegation here at one o'clock on Wednesday. We are committed to sit down with this group. They will be here for one hour. I imagine we'll make it to question period, and we'll start at one o'clock.

Mr. McCallum, the floor is yours.

Hon. John McCallum: I have a short statement in light of developments that have happened since we last discussed this subject. Like most of you, I've been hearing from many of the over 1,700 retail investors who have been unable to liquidate their asset-backed commercial paper holdings since the market collapsed last August. I've been speaking to them, Mr. Purdy Crawford, and others about the restructuring plan that is currently under consideration.

I think it's desirable to encourage a private sector solution to this extraordinarily complex problem. But many of us also want to see that the special position of many of these smaller retail investors is recognized and appropriately dealt with in that process. Meetings with these investors are going on in Montreal and Toronto today, in Edmonton and Calgary tomorrow, and in Vancouver on Wednesday.

That brings me to what we are discussing today. I believe the results of these discussions over the next few days will have an important effect on who the members of this committee will want to hear from if we decide to proceed with hearings. Even if the special situation of the smaller retail investors can be resolved through this private sector process, I believe this committee will still want to get to the bottom of what went wrong from a regulatory perspective and what must be done to prevent a similar situation from recurring in the future. I believe there are some serious market oversight issues that need to be understood.

Mr. Crawford has confirmed to me that he will be happy to appear before this committee after the April 25 vote on the restructuring plan. We also need to hear from the federal and provincial regulatory authorities, the Superintendent of Financial Institutions, the various provincial securities commissions, investment dealers associations, rating agencies, and the ombudsman for the banking system. What went wrong? We need to understand how governments and regulators are responding to this failure in the U.S. and other jurisdictions.

If the retail investors are not satisfied by the results of discussions over the next few days, that's a different story. In that case, I feel our committee should hear from these investors directly as well as from the regulatory agencies that allowed this to happen under their watch.

So for these reasons, rather than bring my motion forward for a vote today, I would like to reschedule the vote on this motion for Wednesday of this week.

The Chair: So at present you're not bringing forward your notice of motion. You're tabling it to Wednesday?

Hon. John McCallum: Yes.

The Chair: We can put it on the agenda for Wednesday, unless there's a good reason not to. Fair enough: we'll leave it at that unless there's anyone who'd like debate it further.

Mr. Ted Menzies: I'd like to comment that I think it's prudent of Mr. McCallum to respect those individuals. I don't think anyone here intends this to be a witch-hunt. We won't be looking for culprits, but we want to make sure we provide those people who are impacted with the best opportunity.

Also, we want to make sure we don't negatively impact the outcome of the vote, so I would agree with Mr. McCallum.

The Chair: Seeing consensus, I will call this meeting adjourned until Wednesday.

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