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● (1530)

[*English*]

The Chair (Mr. Rob Merrifield (Yellowhead, CPC)): I call the meeting to order pursuant to Standing Order 108(2), a study on the structure of Canada's federal revenue-raising system.

We have with us the battle of the universities today: the University of Sherbrooke, Queen's, and the University of Toronto. David Duff from the University of Toronto is stuck in traffic and will be along shortly, so we'll start with the two presenters we have.

Thank you very much for coming.

We'll start with the University of Sherbrooke and Luc Godbout. It's good to have you with us. I understand you have a PowerPoint presentation. We're looking forward to that.

The floor is yours. Take it away.

[*Translation*]

Professor Luc Godbout (Professor of Fiscal Policy, Director, Taxation and Public Finance Chair, University of Sherbrooke): I want to thank the Standing Committee on Finance for its invitation to discuss Canadian taxation and international comparisons. I will raise some of the topics outlined in the committee's news release, as well as those found in the notice of motion tabled by Mr. Dysktra.

Obviously, in a span of 10 minutes, we will not have time to make all of the comparisons possible; I will make a few observations about the Canadian tax system and its current state. In keeping with the mandate of the committee, I will also talk about tax mechanisms that can be created in light of the current economic scenario in the second half of my presentation.

The most recent year for which it is possible to compare Canadian tax revenue, as a percentage of GDP, with that of other G7 countries, is 2005. At the time, Canada stood below the average. Taking into consideration tax amendments made by federal and provincial governments in 2006, 2007 and 2008, it can be said that Canadian taxation will be further reduced. We compare favourably to other G7 countries. However, as regards income tax taken in isolation as a percentage of GDP, our performance is less sterling: income tax in Canada is the highest among all G7 countries. Obviously, we include taxes collected by both federal and provincial orders of government.

Income tax as a percentage of GDP is not only high, but rather heavy for earners whose income is rather modest. There are three factors which explain this situation. For a low-income earner, income taxes rise taking into account social premiums, such as the Quebec pension plan, the Canada Pension Plan and the Employment Insurance Plan, whereas state benefits such as the Canada Child Tax Benefit are reduced.

Take for example a single or two-parent family seeking to raise its income by $5,000, from $35,000 to $40,000, a rather modest amount for 2008. Under federal and provincial taxation, once social and tax deductions are made on the combined income, the family takes home only 25% of the $5,000 in additional income.Therefore, the implicit tax rate in this case is 75%. Obviously, there's not a great incentive to work more.

In Canada, the weight of consumption taxes as a percentage of GDP is the lowest among G7 countries. We established an index to compare our standing to that of other countries. We took the weight of consumption taxes divided by the weight of income taxes. A ratio higher than one means that consumption taxes are higher than income taxes; inversely, a ratio lower than one indicates that income taxes are higher than consumption taxes. Canada sets itself apart with a significantly lower ratio than the average of G7 countries. In fact, with the exception of the United States, Canada has the lowest ratio.

All of these factors argue in favour of an increase in consumption taxes which would result in a decrease of income taxes having no impact on total tax revenue. Some claim that the exact opposite occurred with the recent cut in the GST, that went from 7 to 6%, then 6 to 5%. These claims are correct.

Companies are taxed on their profits, payroll, and capital. Canada finds itself below the average of G7 countries in terms of weight as a percentage of GDP. Taking into consideration the effect on government revenue of the government's plan to reduce taxes, effectively bringing the rate down from 22.12% in 2007, to 15% by 2012, this indicator in terms of percentage of GDP will continue to drop. Therefore, Canada will find itself in an enviable position in the eyes of G7 countries.

● (1535)

Let us turn now to taxation and how it can be used as a tool that takes into consideration the changing economic situation. What do I mean by "changing economic situation"? I mean that in Canada, economic growth for last year, this year and next year is different according to whether you are in Quebec, Ontario or the rest of Canada. This can be explained by the crisis that hit the manufacturing sector, and between January 2005 and January 2008, 280,000 jobs in Canada were lost. In fact, 92% of these jobs were lost in Quebec and in Ontario. This means that economic growth in these provinces is markedly different, and clearly weaker depending on whether you are in Ontario, Quebec, or the rest of Canada.

If the government is to intervene, the problem that the Canadian economy faces must be clearly identified. To do so, we must assess three elements: productivity per hour worked, growth of this productivity per hour worked, and the level of investment in production equipment.

If we start with productivity per hour worked, Canada stands below the average of G7 countries. Each hour worked in Canada produces less output than the average of G7 countries. We are less productive than our American neighbours. This is the first observation.

Another element concerns the growth of this productivity, and how it has changed over the years. Between 2001 and 2006, the average annual growth rate of productivity for Canada placed this country second-last, just before Italy, of all the G7 countries. This means that the productivity gap between Canada and other countries is widening. To understand growth and productivity, and the determinants of growth and productivity, three factors must be considered: technological progress, human capital, and physical capital. Physical capital can be quantified by an average rate of investment in production equipment for all G7 countries between 2001 and 2005. This rate is a percentage of GDP. Of all G7 countries, investment in production equipment in Canada is the lowest, which explains which factors we need to emphasize if we are to increase productivity. These last three slides are rather eloquent on the situation.

Let us now turn to choices that governments can make, and what has been done recently to help the industrial sector. It has been noted that the industrial sector is experiencing a crisis. In January, assistance was given to traditional sectors. This slide shows the percentage of jobs lost between January 2005 and January 2008, as spread across Quebec, Ontario and Alberta. Conversely, you have here an illustration of the percentage of assistance given last January broken down on a pro rata basis. Ontario suffered 57% of job losses, and received 36% of the assistance targeted to traditional sectors. As for Quebec, this province lost 34% of jobs between January 2005 and January 2008, and received 22% of the assistance. Alberta suffered only 2% of job losses between 2005 and 2008, and received 10% from the same envelope. If we are to convert these amounts into dollars per job lost, then Alberta received approximately nine times more than Quebec and Ontario, on a per capita basis. Seen in this light, it can be said that apportioning assistance on a per capita basis to help the industrial sector is an insufficient measure.

Other measures were implemented to spur economic growth and stimulate certain economic activities. There were corporate tax cuts. I don't know if it's worth bringing up again, but earlier I talked to you about cutting taxes on profits. There was also the accelerated capital cost allowance. I will not focus on these points, but we can certainly discuss them if you wish. Rather, I want to talk about what would be helpful if we want to help companies invest.

● (1540)

We saw a rapid rise in the Canadian dollar—I think you're in a good position to know that—and this harmed our exports. However, this rapid increase in the value of the Canadian dollar had a positive effect as well because businesses have been able to acquire imported equipment at a better price. Therefore, these economic circumstances have to be used in order to help businesses modernize. How? One way would be to use last year's surplus for the purposes of helping businesses. Thus, over the next 12 months, we could tell them that for every dollar of investment a certain percentage will be given back to them. I illustrated this using 20¢ for every investment dollar but it could be done another way. Therefore direct action would have to be taken given the low level of investments over the past few years.

Regardless, it should be pointed out that we're moving in the right direction. Reducing corporate income tax means that in 2012 there will be an attractive corporate tax rate, however, we could have moved faster by directly helping businesses to invest between now and then.

In conclusion—I know that I do not have much time left—Canada's tax system compares favourably internationally even though income tax measured as a percentage of GDP was higher than in all the G7 countries. Furthermore, in some income tax cases, the implicit income tax rate results in 75% of additional income earned by some families being confiscated, and there is an under-utilization of consumption taxes in this country compared to other G7 countries.

The tax system could also be used to help the manufacturing sector get through the current crisis. The tax system could also be used to counter slow productivity growth. There has been a lack of investment in production equipment and businesses could be told that they will receive assistance if they make short-term investments.

Even if this does not take place—although I believe it should—the Canadian tax environment for businesses and investments will be an attractive one in 2012, based on the information we have now.

● (1545)

[*English*]

The Chair: Thank you very much. It was very informative and I'm sure it stimulated lots of questions.

We'll next yield the floor to Queen's University. We have Robin Boadway, associate director. It's good to have you here. Please give us your presentation.

Mr. Robin Boadway (Associate Director, John Deutsch Institute, Queen's University): Thanks very much for the opportunity to speak to you about a very important issue.

I would like to take the opportunity to touch on some basic principles of taxation, rather than the specific details of the current system, because I think the time is ripe for some fundamental rethinking about basic taxation in Canada. The nature of the international economy has changed since this issue was last visited, and there have been some major reform initiatives elsewhere in the world.

VAT has been adopted in a vast majority of countries, with the notable exception of the U.S., and accounts for a significant proportion of revenues raised in most.

There have been some major reforms of the personal tax system in many countries, including such things as the dual income tax in western Europe and flat tax systems in some transitional economies.

Some important tax reform studies have been completed or are under way elsewhere, such as the President's commission on tax reform in the U.S., the so-called Mirrlees review in the U.K., and the comprehensive documents on tax reform recently put out by the OECD. Some of these call for some new thinking in the area of personal and business taxation especially, and we should heed them.

The basic objectives of a good tax system are widely accepted. The ideal is to raise revenues fairly, efficiently, and with the least administrative cost to both the taxpayers and the taxing authority. Achieving these objectives in a decentralized federation is a major challenge. In my view, the following priorities are particularly important and necessarily involve some provincial contrivance.

First of all, with respect to sales taxation, by international standards the GST is a very good tax. It's broad-based, well administered, and accompanied by an effective refundable tax credit to achieve fairness. This structure should be protected.

However, there is much work to be done. The federal tax rate is now relatively low, so the share of revenues raised is small compared with that in many countries.

Harmonization with the provinces is a high-priority issue, as I'm sure you've heard before, and a very difficult one in a federation. In my view, the only sensible, workable reform is to adopt an HST type of scheme for Canada as a whole, which amounts to a national GST accompanied by provincial revenue-sharing. This is the system that's used in Australia very effectively, and also in Germany and other countries.

The alternative of allowing provinces to run their own harmonized sales taxes is administratively too cumbersome and has too few benefits. A harmonized GST obviously requires provincial agreement, and that can best be facilitated by federal leadership and the federal government having a significant stake in the outcome. This goal is made more difficult by reductions in the federal GST rate.

The Séguin report recommendation to turn over the sales tax completely to the provinces made little sense for the rest of Canada, in my view. It would, of course, be difficult to replace the Quebec sales tax in Quebec with a harmonized federal sales tax. The best option is therefore to allow the QST to coexist alongside a harmonized GST elsewhere in Canada, rather than trying to replicate the QST elsewhere.

With respect to individual income taxation, we have had a series of piecemeal reforms over the years, some of which go in the right direction, others of which do not. I think it's time to ask the basic question: what kind of personal tax system do we want? Some considerations are the following.

I would not favour a move to a full consumption-based personal tax system. Unlike most other countries, ours does not have an inheritance tax, and that alone means that we need some taxation of asset income.

An option that has attracted a lot of attention is the dual income tax system used in the Scandinavian countries and increasingly taking shape in other European countries—and incidentally, recommended by the President's commission on tax reform in the U.S. This system imposes a progressive rate structure on labour income and a flat tax on personal capital income at the rate corresponding to the lowest tax bracket. The system reduces administrative costs significantly and can be made virtually as fair as our current system.

The main fairness issue with the current system concerns those at the bottom end of the income distribution. The single most important thing that could improve fairness for them and that would remove inconsistencies in the existing tax system would be to make all tax credits refundable, and not just those for the GST and children.

The temptation to use the tax system, whether the income tax or the GST, to achieve social objectives should generally be resisted unless clear and persuasive objectives are at stake. This compromises the simplicity, efficiency, and fairness of the tax system. Examples that one could think of would be to offer tax breaks to homeowners, to induce people to change their spending patterns, to subsidize books, and so on. On the other hand, a clear and persuasive objective that might warrant special treatment and that is kept constitutionally mandated is equality of opportunity. This might justify special measures to ensure that children have equal opportunities and access to education, whether in early childhood or in post-secondary institutions.

● (1550)

Payroll taxation. Payroll taxes are nominally earmarked to social insurance programs, but there is no real connection between taxes paid and benefits received. This is as it should be, given that the programs are social insurance programs. However, it does imply that the contributions are really more like taxes than payments for future transfers. As such, they're highly regressive, even compared with the GST. I would favour relaxing the limits to contributions to correct this, making them more like proportional taxes, with correspondingly lower rates.

Business taxation. There's been much focus on tax rates and far too little on structural aspects of the business tax system, which in my view are the most important. At the outset one must ask, what is the main purpose of the corporate income tax? Traditionally we have thought of the corporate tax basically as a withholding tax against both retained earnings of domestic shareholders and foreign owners. This was the view of the Carter report many, many years ago. However, the tax also plays an important role as a device for collecting rents, particularly in the resource sector, and this orientation had been the focus in tax reports in other countries, especially in Europe. With that in mind, some important issues are as follows.

As documented by the Mintz report, the federal corporate tax system has long favoured the resource sector at the expense especially of services, such as by excessive deductions. This should be corrected, both on the grounds of economic efficiency and on the grounds of the federal government maintaining some access to resource rents. There are various models of efficient rent-collecting taxes—cashflow taxes, allowance for corporate equity taxes, which was recommended by the European Union and is likely to be recommended by the Mirrlees review.

More generally, the use of the federal corporate tax system as a means for the federal government to obtain a share of resource rents is an important one, especially given the federal constitutional commitment to equalization. Traditionally the federal government has obtained a significant share of resource revenues through the income tax system. The tendency to reduce federal corporate tax rates is problematic in this regard. This too reinforces thinking of the corporate taxes, at least partly, as a rent-collecting device and designing it accordingly.

A closely related issue to this is that there is no good rationale, in my view, for the deductibility of royalties from the federal tax. It's largely a transfer of resource revenues from the federal government to resource-producing provinces.

The corporate tax discriminates against small, growing firms and highly risky ones, precisely those that are major sources of productivity growth and employment generation. One measure that would be very helpful here, that would help compensate for financial difficulties faced by new firms, would be to allow for full refundability of tax losses.

On the issue of vertical balance, the federal government collects more in tax revenues than it needs for its own spending, transferring the difference to the provinces. This is as it should be. Federal-provincial transfers play a critical role in our federation, and their size needs to be protected. At the same time, federal dominance in taxation is necessary for maintaining an effective and harmonized tax system. Income tax harmonization through the tax collection agreements relies on the federal government being dominant. In sales tax harmonization, which as I mentioned most reasonably would involve a national sales tax with revenue sharing, would be difficult without a significant federal presence in the GST.

The final category is environmental taxes. Most economists would agree that environmental taxes should be an important part of the program for addressing environmental pollution. Such taxes yield an important double dividend: they provide free revenues to the government as well as correcting the problem of pollution. To exploit that, I would just make two points. The first is that a carbon tax should be contemplated, and if so, if it's used to maintain the competitiveness of Canadian industries, it should also be imposed on the carbon content of imports as well as on domestic-source carbon use.

● (1555)

Finally, revenues from a carbon tax should ideally go into general revenues rather than being earmarked for environmental subsidies. For example, abatement technologies or subsidies to reduce pollution should not be financed by revenues from environmental taxes.

That's it.

The Chair: That's all? That sounds easy.

Let's move on to the University of Toronto. We have David Duff, Associate Professor, Faculty of Law. The floor is yours, please.

Professor David Duff (Associate Professor, Faculty of Law, University of Toronto): Thank you, Mr. Chair.

Thanks to the committee for inviting me to speak with you today and actually, more generally, for conducting a comprehensive study of tax issues in Canada. I think it's a good moment for this in Canada. It's necessary to do these things on a regular basis. The world changes. We need to rethink our tax system on a regular basis.

As members of the committee are undoubtedly aware, tax policy has important implications for the quality of life that Canadians enjoy, both because of its effects on the efficiency and competitiveness of the Canadian economy, but also because of its impact on the distribution of economic resources in Canada.

In my comments today I'd like to address two sets of issues, considering first the goals or objectives of the tax system, especially at the federal level in Canada, and second, some of the implications of these goals for the kinds of taxes that the federal government should collect and the specific design of these taxes.

First of all, I'll consider the goals of taxation. The preamble, of course, to the mandate of the committee rightly identifies as an important goal "to collect sufficient revenue to provide required services in the least costly manner". Other things being equal, of course, a tax system should be as efficient as possible, so as not to distort market behaviour in an inefficient manner; it should be as simple as possible, so as not to consume resources unnecessarily in administration and compliance; and of course, it should be as competitive as possible, so as to encourage economic activity in Canada and not to encourage the relocation of economic activities to other jurisdictions.

That said, we also know that a tax system must be fair and must be perceived to be fair. It's important to remember that one of the most efficient and least costly kinds of taxes to collect is a poll tax. It would impose the same amount of tax on each individual, regardless of their economic behaviour. It's also instructive to note that the attempt to introduce such a tax in the United Kingdom led directly to the downfall of Margaret Thatcher. As a result, tax scholars typically suggest that a tax system should seek to collect revenues in a manner that is fair or equitable as well as efficient, simple, and competitive.

In addition to revenue raising, moreover, a tax system has two other important goals, which tax scholars generally refer to as the so-called "allocation function" and the so-called "distribution function". Consistent with the allocation function, certain taxes should be designed not only to raise revenue to finance public goods and services, but also to correct for market prices where these do not reflect the true social costs to produce a given good or service. A classic example of a corrective or so-called Pigouvian tax—this is how economists refer to it—along these lines is an environmental tax such as a carbon tax, which would correct for market transactions that do not currently take into account the environmental costs from carbon emissions. Although such a tax would inevitably raise revenues—and these revenues, of course, could be used to reduce other taxes or public debt or to finance public goods and services—the primary purpose of a carbon tax, or an environmental tax, is not actually to raise revenue, but rather to correct for the market failure that results from not putting a price on the environmental harm.

In addition to the allocation function, taxes can also be used, and are used, to redistribute economic resources, moderating inequalities in economic outcomes that result from market transactions as well as from transfers of property from one generation to the next. Although some tax scholars suggest that this distribution function is best accomplished on the expenditure side after raising revenues in the most efficient manner, others, myself included, contend that distributive fairness is best accomplished not only by a so-called "end state approach" that looks at the ultimate result and redistributes towards those who might be most needy, but also through a process-based approach that defines individual entitlements to income, as well as gifts and inheritances, in terms of after-tax amounts that moderate extreme inequalities that might otherwise prevail.

What implications then do these three goals—efficient, simple, and competitive revenue collection; market correction; and redistribution—have for the design of the tax system, particularly at the federal level?

Beginning with revenue collection, of course, experience demonstrates that one of the most efficient, simple, and competitive kinds of taxes that most countries do impose, and can impose, for revenue collection is a value-added tax like the GST. These taxes are levied by almost all developed countries around the world, generally to a larger extent than Canada, with the exception, of course, of the United States. They are effective taxes for raising revenues. They have very few implications for competitiveness if, as in Canada, they're imposed on a destination basis rather than an origin basis, so that you tax imports and you strip away the tax on exports.

● (1600)

As such, I think it's unfortunate that the federal government chose to lower the rate of GST while initially increasing, and then subsequently leaving untouched, personal income tax rates, particularly of course since the leverage from the reduction in federal rates could have been used more effectively to encourage provinces that have yet to harmonize their retail sales taxes with the GST.

I think there are lots of good arguments that the provinces should abandon their retail sales taxes where they exist. There's this full story of cascading effects on businesses that purchase business inputs and don't get the credit that the GST would provide. And something has to be done to encourage the provinces that haven't harmonized to harmonize. It's now much more difficult, unfortunately, to do that.

Turning to the allocation function of the tax system, I endorse the arguments, first of all, that Professor Boadway made, but also those that I notice Professors Kesselman and Davies made earlier to a session of the committee, that Canada should introduce a carbon tax in order to put a price on carbon emissions. Now, such a tax can raise competitiveness concerns. That's one of the biggest concerns about introducing a carbon tax. On the other hand, it's quite likely that the U.S. is going to be moving in this direction in the near term.

Furthermore, there are ways to try to design a carbon tax that would take into account the competitiveness concerns, generally by imposing the tax on a destination basis like the GST, imposing a tariff on imports based on the carbon content, and unfortunately—but I think this is probably necessary, it's a short-term step—trying to strip away the carbon tax on exports. Otherwise, of course, you simply encourage the flight of those industries to countries that don't levy the carbon tax themselves. So you could try to levy a carbon tax on a destination basis, like the GST, and address a lot of the competitiveness concerns.

Finally, with respect to the distribution function, I believe this is best accomplished by moderately progressive income taxes, like the current federal income tax, that moderate the results of market returns and, I believe, by a progressive gift and inheritance tax that would moderate the inequalities in wealth and the opportunities that wealth generates resulting from the transfer of wealth from one generation to the next.

Although the federal government currently levies the progressive income tax at rates that are not significantly out of line with comparator jurisdictions like the U.S., which will probably be increasing income tax rates after the next presidential election, it does not tax the transfer of wealth from one generation to the next. It hasn't done so since 1972, except to the extent that it taxes capital gains through a deemed realization at death. My view is that that's not an adequate substitute for a comprehensive gift and inheritance tax.

As well, I believe a number of changes over the last several years have caused the federal income tax to increasingly take the form of what scholars call a personal consumption tax, through increases to the capital gains exemption, reduction in the capital gains inclusion rate, increases in RRSP contribution limits, and now the introduction of tax-free savings plans. This kind of personal consumption tax effectively exempts income from savings from tax.

Economists often tout the alleged efficiency of personal consumption taxes over personal income taxes, but I believe the sufficiency case is seriously overstated. Experience suggests that, for the most part, savings are responsive to changes in income levels rather than changes in the return from savings. In fact, you see that in evidence about who contributes to RRSPs. Lots of low-income people with potential contribution room don't contribute to RRSPs, simply because they don't have the ability to contribute. I think the movement in this direction doesn't necessarily increase savings, but rather shifts savings from a taxed form to an untaxed form.

And I think that's going to be the case with tax-free savings plans, which by the way creates an amazing intergenerational transfer of wealth issue. You start transferring $5,000 a year to kids once they turn the age of 18, and if you contribute for 10 years to your kid—a colleague of mine did some numbers with standard rates of return—by the time they're 65 they could have $1.5 million that is not subject to tax. That's just through the rate of return on the tax-free savings plans.

So the conclusion on this, then, is that the shift toward a personal consumption tax not only is not necessarily required by efficiency considerations, but has significant implications for the fairness and redistributive function of the tax system, and I think it is a disappointing direction that we've headed in.

● (1605)

The Chair: Thank you very much.

We'll now open it up to questions and answers.

We'll start with Mr. McCallum. You have seven minutes.

Hon. John McCallum (Markham—Unionville, Lib.): Thank you all for being here.

[*Translation*]

Thank you all for being here.

[*English*]

I don't want to use up much of my time, but I think I heard each of you say—correct me if I'm wrong—explicitly or implicitly, that you don't think the reduction in GST from 7% to 5 is a good idea. Do any of you think it is a good idea?

Monsieur Godbout.

[*Translation*]

Prof. Luc Godbout: Are you asking me whether the GST is a positive or negative measure?

Hon. John McCallum: I would like to know if it is a negative one.

[*English*]

Prof. David Duff: I would say that if it had been accomplished by harmonizing with the provinces, then it would have been a decent policy trade-off.

Hon. John McCallum: Okay, but it wasn't.

[*Translation*]

Mr. Godbout, I would just like to clarify a point. You mentioned assistance in dollars per job lost in the manufacturing sector. Is the fact that Alberta receives $20,000 and the other provinces $2,000 due to per capita distribution?

Prof. Luc Godbout: There are two phenomena involved. Alberta did not suffer many job losses in the manufacturing sector and it receives assistance on a pro rata basis, when it accounts for 10% of the Canadian population.

Hon. John McCallum: Are you saying then that the funds should have been allocated based on job losses? Is that correct?

Prof. Luc Godbout: It would have been preferable to use a method other than distribution based on population on a pro rata basis.

[*English*]

Hon. John McCallum: Thank you.

Now, on the carbon tax, neither Mr. Boadway nor Mr. Duff suggested that it should be tax neutral, whereas in B.C.'s model, for every dollar of carbon tax they collect, I believe they are committed to giving back $1 in lower taxes of one kind or another.

Do neither of you think that tax revenue neutrality is a good idea?

Prof. Robin Boadway: Not in principle, no.

Well, when I said you should use the carbon tax for double dividend purposes, rather than to subsidize environmental projects, that could be interpreted as saying that you should use the double dividend revenue to reduce other taxes. That's consistent, but it's not necessary that you actually implement it in a revenue-neutral fashion, except for political reasons, perhaps.

My point was simply that if you have a carbon tax, it should go into general revenues, and you should go from there. If that entails reducing other taxes, so be it.

Prof. David Duff: I don't think this is a matter of principle; I think it becomes a matter of practical politics.

Carbon taxes are good. To get them in place, whatever it takes.... If that means reducing other taxes so that the carbon taxes are revenue neutral, that's pragmatic politics. If it means devoting the revenues to environmental causes, people tend to see that connection. Although the theorists say there's no necessary connection between the revenues you raise from a carbon tax and the expenditures you should devote to the environment, if the public perceives that and is prepared to support the tax more on that basis, then I think it makes sense.

Hon. John McCallum: Thank you.

Do all of you agree with the idea that we should apply the carbon tax to imports, and exempt exports from the carbon tax?

Prof. Robin Boadway: Yes, for the same reason as Mr. Duff mentioned.

Prof. David Duff: Yes, I think you have to.

It's unfortunate to exempt the exports, but I think that unless you do that, you're just creating an incentive for industries to flee to the non-carbon tax jurisdiction over the short term. Obviously, the goal in the long term is to get more countries on board and to expand the scope of the regime.

Hon. John McCallum: When you say that the carbon content of imports should be taxed, it could mean just the fossil fuels directly, or it could mean this much broader idea that Jeff Rubin came up with —in his case, directed at China, I believe—where you tax the carbon content in a much more general way. That concerns me a little bit in terms of protectionism.

But I wonder if you've seen that argument and how you would respond to it.

That includes Mr. Godbout.

Prof. Robin Boadway: I think the argument for imposing a tax on the carbon content of imports arises if other countries are not imposing the same carbon tax. If the whole world got together and harmonized their carbon tax systems, then you would choose on a worldwide basis to do it either on a destination basis or a source basis. But given that you're doing it unilaterally, the reason for imposing a tax on the carbon content of imports is precisely to keep an even playing field for your industries with respect to other countries.

● (1610)

Prof. David Duff: It's true that the potential for protectionist uses of that carbon tax or tariff could be a problem, particularly when you're imposing a tax on the embedded carbon content—and it's often hard to trace exactly what that is.

There is a precedent for this in the U.S., I think, with the import tax they imposed on ozone-depleting substances, when they had a tax on ozone-depleting substances to help phase out those substances. I haven't looked at all of the trade law on this, but I think it satisfied World Trade Organization standards. It was based on a set of presumptions about the embedded ozone in products. So to be comprehensive, you'd have to have some kind of a tax that would have presumptions about the embedded carbon content in various products.

Hon. John McCallum: Right.

Okay, I have one last question, and this is on one of the relatively few things on which we agree with the Conservatives, which is the desirability of a lower corporate tax rate.

The way I framed it, or our party framed it, is that Canada used to have a competitive advantage from the weak dollar. We've lost that, and so I see having a corporate tax rate 10 points lower than the one in the U.S. as an important substitute in the medium term to attract jobs and industry to Canada rather than to the U.S.

This is my last question. Would anyone would like to react to this notion?

[*Translation*]

Prof. Luc Godbout: That is certainly a good plan but it is spread out until 2012. Currently the industrial sector is not making a profit. A lower corporate tax rate is therefore not particularly helpful right now, and the same applies to the new accelerated capital cost allowance. If businesses are operating at a loss, providing greater capital cost allowances or a lower tax rate will achieve nothing in the short term. However, lower tax rates on investment in 2012, Mr. Mintz's TEMI, is definitely a good idea.

Could we have done something more in the meantime? That is the question that I put in my opening statement.

[*English*]

The Chair: Thank you very much.

Monsieur Crête.

[*Translation*]

Mr. Paul Crête (Montmagny—L'Islet—Kamouraska—Rivière-du-Loup, BQ): Thank you for your presentations

Mr. Godbout, you talked about the last two GST reductions in terms of industrial strategic choices. If I understand correctly, if that money had been channeled into assistance for productivity, regardless of the method used, the impact on job losses in the manufacturing sector would have been quite rapid and very different from the impact we are all aware of.

Prof. Luc Godbout: We're talking about two different things. A GST reduction could have been used, as my colleagues pointed out, for the purposes of harmonization with provincial taxes, but it shouldn't be forgotten that four provinces have already harmonized their taxes. Quebec in particular has done this with no assistance and at its own cost. With respect to lowering rates, it has often been pointed out that the money could have been used to decrease income tax, which would have been more effective. There were other ways to help the manufacturing sector. For example, this year's federal surplus could have been used to act directly. The proof is that a billion dollars has already been used to assist traditional sectors. The distribution should be questioned rather than the method of helping the sector.

Mr. Paul Crête: You said that it would have been more effective to reduce personal income tax rather than the GST. Can you explain why?

Prof. Luc Godbout: When you reduce the GST, you reduce the cost of a consumer product, whether that product comes from Canada or abroad. When you reduce income tax, you reduce the cost of labour. When you reduce income tax, you give people an incentive to work in Canada rather than abroad. Reducing income tax has a greater effect on Canadian economic growth, whereas reducing consumption taxes has an effect on Canadian economic growth but also on production abroad.

Mr. Paul Crête: So if I use an exaggeration, we have to an extent subsidized jobs in China, in a manner of speaking.

Prof. Luc Godbout: Indirectly. The cost of goods was reduced, whether they were produced here or abroad.

Mr. Paul Crête: In the light of the most recent budget, what type of measures would you like to see? Is it still possible to create a temporary modernization fund such as the one you suggest given the numbers that suggest there will not be a surplus?

● (1615)

Prof. Luc Godbout: I think that an analysis of the numbers shows that last year, which ended on March 31, 2008, was the last year of large surpluses. I have not undertaken a comprehensive analysis, but the simple fact that $3 billion was taken out of the reserve shows that surpluses will be much more modest, at least over the next two years. If there were going to be a modernization fund it would have to draw on the surplus of the year ending March 31, 2008.

I am not a legal expert. Can this fund still be created with this surplus, given that the year is not yet over and that financial statements will not be signed before September? I do not know and I leave that debate up to the legal experts. Perhaps it is possible.

Mr. Paul Crête: That is a question I myself have been wondering about these days. I wonder if the Conservatives could still change their mind.

Let us say that it is not possible and that the $10 billion were gone by the 31st of March last. Given the current situation, what will happen to jobs in the manufacturing sector because this type of action wasn't taken?

Prof. Luc Godbout: That is a really difficult question to answer. What I can readily say is that if we cannot use it, the $10.2 billion amount will go to pay down the debt, which is not a bad thing to do.

As well, action has been taken so that in 2012 our investment tax rates will be among the lowest of all G7 countries. But could we not have tried to do things faster, given the crisis in the industrial sector and the statistics I referred to showing that Canadian businesses are facing investment problems? I said that we needed to take specific action in the short term. But close your eyes, we are headed in the right direction, even without such action.

Mr. Paul Crête: Is it possible that, through the sole use of generalized tax cuts up until 2012, a great number of businesses will want to benefit from that tax environment? At the same time, a huge number of corporations will have been bruised and battered and will not have been able to make it through the difficult times.

Prof. Luc Godbout: That's possible. The rate cuts on investments, especially those reducing taxes on profits, are geared towards profitable businesses. Take away the profits and the plan holds little interest. Companies may well get battered between now and then, given that economic growth will be rather weak over the next two years, particularly in Quebec and Ontario, two provinces with industrial problems.

Mr. Paul Crête: Could current losses have such a negative impact that, even if positive fiscal measures are adopted overall, there could be a major shift in the manufacturing sector preventing it from reaping any benefits?

Prof. Luc Godbout: I cannot answer that, but perhaps my colleagues can. We will be well positioned in 2012, although some businesses will have closed their doors by then.

Mr. Paul Crête: You gave the example of an income that would go from $35,000 to $40,000, a $5,000 increase. Of that amount, only $1,200 would not be clawed back. What measures would you suggest so that the incentive... Basically, you are confirming what we have heard from the public: it makes no sense to earn $5,000 more if you have to give it all back to the state. That is the consequence. What could be done to correct the situation?

Prof. Luc Godbout: First of all, the good news is that the problem has been identified and governments have tried to not make matters worse over the past few years. The federal government has implemented working income assistance. Quebec did the same thing two years earlier, with its working bonus. And yet, despite those measures, some people were worse off after receiving federal assistance because those measures were not fully harmonized. Governments have to talk with one another.

One of the problems is that two orders of government are taxing the same income at the same time. And then there are the payroll taxes collected by para-public agencies. Assistance programs have been implemented especially for people with low incomes, and these are positive initiatives. But when all these programs bear down on an additional dollar of income at the same time, in some instances, the government ends up clawing back 75¢ on that dollar. People are wrong not to work overtime and claim that they have no money left over, but in fact, they are not entirely wrong. In some cases, the problem is due in part to taxes but also to the effect of three distinct actions.

[*English*]

The Chair: Thank you very much.

We'll now move on to Mr. Del Mastro, I believe—or is it Mr. Wallace?

● (1620)

Mr. Mike Wallace (Burlington, CPC): That's fine.

Mr. Dean Del Mastro (Peterborough, CPC): Thank you, Mr. Chair. I appreciate that.

I want to go back to the carbon tax issue that was raised and discussed at some length when Mr. McCallum was asking questions around that. There was some discussion on taxing imports and tax-exempting exports. Bearing in mind that Canada is an exporting nation and not an importing nation, aren't we opening ourselves up to the real danger of countervails and damaging the Canadian economy under that kind of theory?

Prof. David Duff: I'm not an expert in trade law, but that's why I've mentioned this ozone-depleting substances tax that the U.S. introduced. They had a domestic tax on ozone-depleting substances and wanted to make sure their industries weren't at a competitive disadvantage to imports. That was considered to be acceptable under the GATT at the time, I think, not the World Trade Organization.

If it's acceptable, you're not subject to countervailing duties, right? It's legitimate under international trade law. So obviously you have to make sure that any arrangement satisfies international trade law, but there's a precedent out there for that.

Mr. Dean Del Mastro: Well, there's a stark contrast, though, in the comparison of our two nations, because the United States is a net importer, not a net exporter, so sometimes they can get away with some laws, and as the largest consuming nation on the planet and the number one economy, sometimes they can get away with things that we might not be able to get away with as an exporting nation. I think that's why the Prime Minister has been working towards a global consensus on the environment, something that would actually get things headed in the right direction. It might incorporate a carbon tax here in Canada and allow us to remain competitive, because ultimately we want our Canadian companies to be able to compete. We don't want to put undue penalities on them so that they're not competing.

But what you're speaking to is relevant, and I might get your opinion on this. There's a lot of opinion out there that many nations with a better record than Canada's on reducing greenhouse gas emissions have in fact just exported their emissions to emerging economies such as China. That's what you're getting at and trying to battle. Is that correct?

Prof. David Duff: People say that. People say Germany doesn't really produce any oil, so they've had an easier time satisfying the emission standards and they're importing from other countries that are burning coal or whatever. I think that's one of the rationales for trying to think of this as a destination-based tax rather an origin-based tax, which is the way we've generally thought of carbon taxes. I'd agree with that.

I don't want to slam Germany, though.

Mr. Dean Del Mastro: Right, and I understand that—

Prof. David Duff: They have done a good job on wind power and a variety of other things.

Mr. Dean Del Mastro: Good.

I understand the premise that you're coming from. In some ways I support it; in other ways I'm really afraid of it, because an exporting nation is always afraid of being countervailed on its production.

I was also really struck by your suggestion of taxing inheritance. I try to draw personal examples into this. My grandfather, a poor immigrant who came here with literally nothing and worked for 50 years, passed on a small inheritance to his family. He paid every form of tax that there could be possibly be throughout that entire time. He passes on to his family the inheritance that he has left over, whatever he has saved, and you're proposing that it should be taxed.

Prof. David Duff: No, I'm not.

Mr. Dean Del Mastro: Okay.

Prof. David Duff: The key is that you said “small inheritance”. That's the key, right? The key thing is that these taxes should only apply to very substantial estates that are transferred from one generation to the next.

In fact, I was speaking a couple of weeks ago in connection with a debate in the U.S. right now about a gift and estate tax they have that is repealed in one year but comes back into existence in 2011. When I was speaking to the folks in the U.S., I was saying that I'm a big believer in the value of building up a business, an enterprise, or a family farm and transferring it from one generation to the next. That's part of the American dream and part of the Canadian dream. But at a certain point that value comes up against another set of values, which is the value of a degree of equality of opportunity and concerns about dynastic inheritances, and that balance is what I think needs to be accommodated in a tax with a very high threshold.

Mr. Dean Del Mastro: I wanted to go back to the HST, and I'd be happy to entertain comments from both.

We had testimony provided last week—testimony I happen to agree with—that it's not even how much tax you collect sometimes, but how you're applying the taxes. You talked about Ontario and provinces that don't currently have a value-added tax moving to a harmonized sales tax. There's no reason Ontario has to necessarily take a hit in moving to an HST. What we're really talking about is changing where we're applying the taxes to create a more competitive tax scheme overall.

Wouldn't you agree with that? Isn't that the incentive for Ontario, or provinces like Ontario, to move to a VAT—that it's more competitive overall?

● (1625)

Prof. Robin Boadway: It's clearly in Ontario's interest to move to the VAT to eliminate the inefficiencies associated with the fact that the current retail sales tax in Ontario taxes business inputs substantially. The question is how to do that.

There are two options you could pursue. One is to have Ontario do it unilaterally by adopting a Quebec-type system, a QST-type system—well, there are three ways of doing it. One is to harmonize the retail sales tax to the GST at the retail sales level just by including services, but you'd run into the same problem there as you would with the existing tax. Another possibility is having Ontario adopt the QST; then you'd have three separate provincial GST systems, which starts to become unwieldy for businesses dealing in many provinces. The only workable option, it seems to me, is for Ontario to harmonize with the federal GST by effectively joining the HST.

Mr. Dean Del Mastro: Did you have any comment?

Prof. David Duff: I agree, and I think it can probably be revenue neutral and certainly advantageous.

Mr. Dean Del Mastro: Mr. Godbout, did you have any input on that? I know that you talked about productivity. Certainly this is pretty key to improving on that—

[*Translation*]

Prof. Luc Godbout: Clearly, Ontario and the other Canadian provinces that have yet to do so would gain from harmonizing their retail sales taxes and turning them into value-added sales taxes. From a Quebecker's point of view, I wonder whether Ontario and the other provinces should be compensated, as was the case for the Maritime provinces. As the model student, Quebec was the first to take the initiative, but did not receive any compensation.

Aside from that, Ontario and all Canadian provinces should adopt that measure. I am not sure whether that harmonization has to be full and complete or whether the same approach should be adopted. I am not as categorical as Mr. Boadway, but I think that the tax should at least be harmonized and based on the value added.

[*English*]

The Chair: Thank you very much.

We'll now move on to Mr. Martin. You have seven minutes.

Mr. Pat Martin (Winnipeg Centre, NDP): Thank you, Chair.

Thank you, guests and witnesses.

Mr. Boadway, in your remarks you reminded us that one of the purposes of corporate income tax—I think it's the way you put it—is to collect rent, almost, for the federal government to allow.... Or was that you, Mr. Godbout?

I see. Thank you for pointing that out. I think it was helpful.

My question is regarding the resource-based industries, where in recent years there has been an explosion of the flow-through types of businesses—the income trusts—especially in resource-based and then also in real estate. So the government took action to stop the income trusts. From a policy point of view, do you believe that was the right thing to do? Is that in keeping with one of the objectives you pointed out, that the government has to collect some revenue from the extraction of resources, especially in that sector?

Prof. Robin Boadway: The income trust set-up was essentially a vehicle for avoiding paying the corporate tax, to put it in the simplest possible terms.

Mr. Pat Martin: It was a flow-through to the unit holders.

Prof. Robin Boadway: You can say that if you adopt the classical view of the corporate tax as being simply a withholding tax against shareholders, and you have a 100% full method of integrating personal and corporate tax, then it wouldn't make any difference who paid the tax: the corporation or the individual. But we don't have that kind of tax, and I don't think we should. I think the corporate tax should, in part, be a vehicle for taxing what economists call the rents or the pure profits that are earned by industries, whether through ownership of resources, or monopoly profits, or whatever it might be.

We know perfectly well how to design such a system. We should think about moving our tax in that direction, because in addition to it preserving the ability to raise rents through the tax system, it also makes the tax more efficient when it comes to investment decisions.

Mr. Pat Martin: Does anybody else care to comment?

Mr. Godbout, you have a comment on income trusts.

[*Translation*]

Prof. Luc Godbout: We could not sustain two parallel systems where, on the one hand, some companies were exempt from tax because they chose to operate as a trust, and on the other, businesses had to pay taxes. Had the integration system worked properly, there would have been no problem, but that was not the case. Businesses changed vehicles simply to cut taxes, which is not a bad thing, but that is why amendments were made to the legislation.

● (1630)

[*English*]

Mr. Pat Martin: Looking at the helpful graphs that you brought in, Mr. Godbout, I was startled—shocked, if you will—to see the assistance per job lost in the province of Alberta versus the provinces of Quebec and Ontario. Did your research show which specific industries had job losses in the province of Alberta and where the subsidies would be going?

[*Translation*]

Prof. Luc Godbout: We simply looked at changes in the number of manufacturing jobs by province between January 2005 and January 2008. In Canada overall, 280,000 jobs were lost. Very few were lost in Alberta, but aid was distributed per capita within the traditional sectors, and amounted to about 10%. That case isn't unique, it shows a strong tendency on the part of the federal government. Increasingly, aid is distributed per capita.

Concerning the Canada Social Transfer, it has been shown that welfare has produced somewhat comparable results. The funding is given to provinces according to their demographic weight, regardless of how many welfare recipients they have. As such, Alberta receives more welfare money from the federal government than it pays out to its welfare recipients. Alberta receives slightly more than $9,000 per welfare recipient, whereas Newfoundland receives approximately $2,000. This shows that it makes no sense to inject funding into certain sectors according to provinces' demographic weight, without taking into account their needs.

[*English*]

Mr. Pat Martin: Yes, I agree.

In that same vein, it was only recently that they stopped allowing fines—like a business fine or a levy—and penalties to be tax deductible, but we still allow royalties to be tax deductible.

One of your presentations was critical of the idea that extraction royalties should be tax deductible in the province of Alberta, and that they would risk their political future, if you will, by having the temerity to raise the royalties of the oil and gas sector. If that's tax deductible at the federal end, how is the extraction company really paying more rent, to use your term?

Prof. Robin Boadway: I think the deductibility of royalties comes about by viewing royalties as a payment to the province for the right to use the resource.

Mr. Pat Martin: And why is that tax deductible, then? What do you think the reasoning is for that being a writeoff?

Prof. Robin Boadway: I was saying the contrary—that it shouldn't be a writeoff.

Mr. Pat Martin: Yes.

Prof. Robin Boadway: It was introduced as a substitute for the resource allowance, which was sort of an across-the-board allowance that all resource industries got. My point of view is that there's no economic reason for there to be a deduction of royalties in the oil and gas industry against the federal income tax. Basically all it does is transfer revenues from the federal government to the province while really having no other effect.

Mr. Pat Martin: That's an interesting point.

Mr. Duff, do you have any ideas on that?

Prof. David Duff: Well, I guess the counter-argument sometimes—and I haven't studied this in detail—would be that it's a cost of doing business, like any other cost of doing business. So it should be treated as a deduction. I see it has these federal-provincial implications.

Mr. Pat Martin: That was the reasoning regarding fines, though. We have a labour movement that objected, because if you get fined half a million dollars for killing a worker at work, it's not just a cost of doing business.

Prof. David Duff: I agree. I wrote about the fines and thought it was a terrible decision when the Supreme Court did that. But the rationale is different from that for a royalty. You're not killing anybody by....

Mr. Pat Martin: But you aren't supposed to be paying out of pocket, though. This is supposed to hurt somewhat. This is like paying rent. I don't know, I don't agree that it should be, but....

The last thing I'll say is that what the poll tax did for Maggie Thatcher the inheritance tax almost did for my leader in the last federal election, when we had the temerity to suggest a tiny little inheritance tax after your first $1 million of inheritance. Believe me, it is not a popular sell in this country. We know from experience.

The Chair: Thank you.

We'll now move to Mr. McKay.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you.

There seems to be a universality of opinion here that the GST cut was probably the worst of all tax policies, but that was...a loonie will get you a cup of coffee at Tim Hortons.

I just want to ask Professor Godbout a couple of questions with respect to consumption taxes anomalies.

The rationale for downing income tax and corporate tax is in upping consumption tax, largely in the area of productivity. Yet the United States has low consumption taxes, but it also has very high productivity.

In your other charts here you have France, which has high consumption taxes and, indeed, high productivity. Can you give me a comment as to the central core of your argument, which is that higher GST and downing your income tax leads to better productivity? Can you explain those anomalies?

● (1635)

[*Translation*]

Prof. Luc Godbout: I did not suggest increasing the GST to boost productivity. Productivity is not the only factor. There are also research and development, human capital and education. We talk about production per hour worked, and in that regard, investing in machinery is a significant factor. In fact, I was saying that we had to help businesses invest in machinery, but that is another topic.

Furthermore, as we have the highest income tax rates in relation to GDP, should we not reduce them to make up for lost revenues? I believe that one of the themes was whether it was possible to redesign the taxation mode without affecting revenues, i.e., by reducing income taxes while increasing consumption taxes. That is something that could have been done in the past few years.

[*English*]

Hon. John McKay: But it is anomalous, isn't it? Your argument is tax mix, and your tax mix, particularly in France's case, is high consumption, high income tax, high productivity. It doesn't seem to jive with the basic theory of tax mix.

[*Translation*]

Prof. Luc Godbout: The consumption tax in France is based on the value added. Consequently, it does not affect business productivity. Their exports are not burdened by that heavy consumption tax. The tax is imposed on the value added, as is the case with the federal GST. That is also the case in the Maritime provinces and Quebec. The tax is not reflected in the price of exported products. However, that is still the case in Ontario, where there is an indirect effect. In fact, the sales tax is applied to machinery and inputs, in particular, and thereby increases the price of exported products.

[*English*]

Hon. John McKay: Thank you.

Professor Duff, regarding this notion of putting on a carbon tax, anybody who lives in 2008 knows you have to price carbon somehow or other, and whether it's a tax or whether it's cap and trade, or whatever it is, there are all kinds of ideas out there.

I'm curious as to how you would see the application of the tax on a destination basis. That's not clear to me. Could you use an example of a product originating in China or India? Then if it comes to a Canadian consumer or industry, how would that tax apply and how would that affect our competitiveness?

Prof. David Duff: I think this is where you'd have to have presumptions about the carbon content in the import that would have to be based on rough figures from wherever the origin of the product is, and what kind of energy sources they're using, and presumptions about the energy sources that are built into the products. I think the only way it could be done in any practicable way is with rough-and-ready calculations or rough-and-ready judgments. That's why there's a potential problem with protectionist implications of a tax based on that approach.

And you'd have to make sure it satisfies WTO standards. That trade stuff is something I haven't done. I know there's a precedent for it out there, using presumptions about what the...probably, I admit, in a more simple context than carbon. Carbon enters into everything, and that makes it a problem.

● (1640)

Hon. John McKay: Is my time up?

The Chair: Your time is gone.

Mr. Menzies, five minutes.

Mr. Ted Menzies (Macleod, CPC): Thank you all.

I'll share my time with Mr. Wallace, because he's just chomping at the bit to get some questions here.

On this chart on some choices for government, I find that 10% of the assistance went to Alberta. I find it terribly misleading and a little too easily confusing. I don't think it's helpful to pit province against province with something like this. I would suggest the low unemployment numbers in Alberta are probably pretty important in here. The only unemployed people we have in Alberta right now are the Liberals after the last election. We'll take that into account.

I'd like to pursue a number of things, but corporate investments by government.... Right now we're dealing with the issue of MDA, and we put a lot of taxpayers' dollars into this company. In the big picture, now we're all wondering if we're going to lose those dollars. So when you look at putting government money into supporting industries to make sure they're competitive and viable, how do we make sure those dollars don't then leave the country? Now we have a difficult decision ahead of us: how we protect the tax dollars that went into it. How do we protect a Canadian investment?

I look at the forest industry, which said we shouldn't give them money, that they should sort this out, that the government shouldn't distort the market further. Further to Mr. Del Mastro's comments, they said we shouldn't set them up for tariff intervention against their products.

So the government has a very difficult balancing act. How do we support them? We've suggested the tax cuts, the accelerated capital cost allowance, those sorts of things, helping the communities that help the people, putting money into the communities. But funnelling money into companies that don't have an anchor tied to them, that don't have to stay in Canada, that's what concerns me.

Perhaps all three of you could address that.

The Chair: Who would like to start? Not all at once.

Prof. Robin Boadway: I certainly wasn't one who recommended that the government should deal with the manufacturing problem by throwing money at it and using the tax system or the subsidy system to do so.

The problems we face with manufacturing are problems that are brought about by fundamental things that you can't touch with the tax system. If you want to think of it this way, we're facing the equivalent of a resource curse. Our activity is moving west and chasing resources; the exchange rate is rising because all of the revenues from resources are not being saved the way they are in Norway, for example; and one of the consequences is that the whole economy is tilting toward the west, which is fine for the west, but that's the source of the problem. I don't see how responding to it by subsidizing manufacturing....

It's not just manufacturing, by the way. Manufacturing is not the only industry that's facing problems in this part of the country.

The idea of using the tax system to try to address an issue that is fundamentally a macroeconomic imbalance issue would be precisely sending good money after bad, if you want to think of it in those terms. I wouldn't contemplate using the tax system to try to address the problems that manufacturing industries are facing because of the pull of resources to the west and the increase in the value of the Canadian dollar.

The Chair: Anybody else?

[*Translation*]

Prof. Luc Godbout: Perhaps I can add a few things.

Indeed, we do not want to keep companies artificially alive or throw money out the window, especially when we are dealing with taxpayers' money, which is our money. We cannot do the investing for companies. But if we give them a tax credit or help them with investment support measures, such as 20¢ on the dollar, they would still have to find the other 80¢. Companies have to make the decision to invest. If you reduce their investment costs, you make investing more interesting. It might the only way for companies to become productive and profitable in a sector which, today, is feeling a lot of pressure.

We do not want to invest for them, nor tell them what to do. We do not want to tax at a lower rate the profits of companies in a single sector, as was done in the 1970s, 1980s and 1990s, on the pretext that they are less profitable than companies in other sectors. Everyone has to pay the same rate. The rate could be applied across all sectors, regardless of the level of investment, but the process would be benchmarked and companies would be helped.

I said 20¢, but it could just as well be 10¢, 12¢ or 15¢; it's up to you to decide. Quebec introduced this type of credit in its most recent budget and it was adapted to the particular characteristics of each region. The rate varies between 5% and 40%, depending on the region. I don't think that in Canada we could vary the rate by region, but the least we could do is offer an interesting rate to signal to companies that we encourage investment and that we want to help them invest for a certain period of time.

● (1645)

[*English*]

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. Chairman.

I have a question for you, Mr. Godbout. In the chart on personal income tax rates, you provide a visual answer to the general question which was asked of you before coming here: how should Canadians be taxed and what is the current impact of our tax system on Quebeckers and Canadians?

You mentioned an income which would increase from $35,000 to $40,000. Would the same calculations apply to an income which went from $40,000 to $45,000, or does the change occur specifically between $35,000 and $40,000?

Prof. Luc Godbout: Those rates are relatively high and they are not good. I personally have to pay much lower rates because my income is much higher. When your family income is over $100,000, social programs are not relevant any more, because at that income level, no benefits are paid out. The Canadian Child Care Benefit is not universal. Income earners above a certain threshold do not receive it. In those cases, the combined federal and provincial tax rates do not exceed 48%.

If you still pay premiums for social programs because your income is still going up, such as for the Quebec pension plan, the Canada pension plan or employment insurance, you still have to pay federal and provincial income tax, which is normal. Further, you don't have the right to access non-universal social programs. The GST credit goes down as your income goes up. All these small reductions, taken together, affect those people who are subject to a high rate. When your income is above $80,000—I don't know the exact figure—the rate is much lower. So the income bracket which is really affected—

Mr. Jean-Yves Laforest: It's between $30,000 and $80,000.

Prof. Luc Godbout: It's between $25,000 and $60,000, I would say. For families with children, those earning between those two amounts really feel the crunch. For a person who is single, it's perhaps between $25,000 and $40,000. If your income is above that, the worst is over. But if you have children, it's harder for a longer period of time.

Mr. Jean-Yves Laforest: But the middle-class is often affected.

Prof. Luc Godbout: The middle-class if often affected, but it is not just the federal government's fault, nor is it just the provinces' fault. It is a combined effect, that starts from a good cause: setting up programs that are not universal in order to make low-income earners a priority. When they begin to earn more, it is as if we were knocking their feet out from under them. When both governments collect their share at the same time, there is not much left over.

Earlier, your colleague to the right asked me a question about how we could fix that. I will try to clarify my answer. If the two levels of government were to ensure that the implicit tax rates never exceeded the marginal rate paid by a high-income taxpayer, that problem would be solved. Personally, I conducted a more detailed study on the topic. Guidelines could be set, for example, to limit the maximum federal-provincial rate at 50%. For each additional dollar earned, governments should commit to never taking more than 50¢. However, implementing a measure like that is quite costly. Nevertheless, the issue will have to be dealt with sooner or later. It is not normal to—

Mr. Jean-Yves Laforest: To be fair?

Prof. Luc Godbout: To be fair. We tell a single parent to make a little effort and to earn $5,000 more, and then we take away $3,800. I think that is a problem.

Mr. Jean-Yves Laforest: In another graph, on page 7, it says that Canada is below average in terms of the proportion of revenue from taxes on consumption and income taxes.

I am going to ask you to do an exercise that is perhaps not feasible immediately, but it would be interesting if you could do it. The United Kingdom is almost at the index, with 0.94. My question is very hypothetical, but if Canada were to reach an index like that, would we see a major adjustment to the model on a page 5?

● (1650)

Prof. Luc Godbout: First of all, I must point out that the index is not nirvana. It is not a major target to reach. It is there only to rebalance things somewhat.

Mr. Jean-Yves Laforest: It is a comparison.

Prof. Luc Godbout: It is a comparison. I have not done the calculations for Canada, but I did do them for Quebec, at both the federal and provincial level. To move closer to an index of one, there would perhaps need to be a three- or four-point increase in the sales tax. That would be the equivalent to a three- or four-point reduction in the income tax.

Mr. Jean-Yves Laforest: So to see an improvement, it would have been better to increase the GST by two points instead of reducing it by two points.

Prof. Luc Godbout: And it should go to reducing the income tax. I am not getting political. Someone was elected by promising to cut the GST. Once he was elected, he did that. We must congratulate him for having kept his promises, even if it was not the best thing to do and even if there was no consensus in that area.

[*English*]

The Chair: Okay, thank you very much.

Mr. Turner.

Hon. Garth Turner (Halton, Lib.): Thank you.

I'd like to get your opinion on a couple of changes to the tax code. A family tax return or having more of a French-type system—Mr. Duff, would you say that's a good progressive idea or not?

Prof. David Duff: I'm not a fan of that. I remain a fan of individual taxation, however, with the following exceptions. We have these attribution rules that I actually think don't respect individual taxation. Individual taxation treats individual ownership and entitlement to property and income seriously, and the attribution rules actually reject that. If you've actually transferred property to a lower-income spouse—I think you still need them for kids—the income is the spouse's income and it should be taxed in the spouse's hands. So I think the attribution rules for spouses are relative of an earlier era that we could do away with. It would make the system simpler.

I would actually encourage transfers of property between spouses. Now, that's only going to advantage high-income couples, and so lots of folks might reject it on that basis, but I think it takes individual taxation seriously.

The other thing that I think is not a bad idea is on the child care expense deduction. You're only able to get it if the child care is provided by someone other than a spouse or one of the parents. In fact, I think the dynamics of lots of child care arrangements are that it's a division of labour between spouses. It would be a reasonable thing to allow one spouse to income split with the other, up to the limits of the child care expense deduction, by paying the other spouse for the child care expense, which would do some income-splitting and actually allow the stay-at-home parent to earn income that could qualify for Canada Pension Plan, RSP contributions, etc.

Hon. Garth Turner: Thank you—none of which I asked you, but that was very good.

Mr. Boadway, I'd like to ask you about the capital gains tax rollover provision. As you may remember, in the 2006 election campaign there was some talk. The Conservative platform was to have a rollover of a six-month period of time. It hasn't transpired yet. Do you think it should?

Prof. Robin Boadway: You know, I can give you an economist's answer on the one hand, and on the other, there are pros and cons to doing this. The pro of doing it is that it doesn't induce people to lock their savings into a given asset; it allows them to freely change assets without penalty. The con is that we're taxing capital gains favourably already by allowing you to hold capital gains until you've realized them and, in the meantime, accumulate returns as they accrue.

On purely equity grounds, what we'd like to do is tax capital gains as they accrue rather than when you realize them. Given that we don't have that system, I can see the argument for allowing a rollover provision, but I'm not convinced that....

Hon. Garth Turner: Okay, I have another question here, and again, this is on a similar topic. It's on the tax-free savings plan. Right now, the government seems to indicate to us that the only contribution that will be accepted into a tax-free savings plan is cash. Should we be accepting contributions in kind? If we do accept contributions in kind, then are we, in effect, nullifying capital gains taxes?

● (1655)

Prof. Robin Boadway: I'm not sure I understand the question. What do you mean by contributions in kind? Are you talking about the new vehicle—

Hon. Garth Turner: It's the same as with an RRSP. You can make a contribution in kind—not cash, but a contribution in kind.

Prof. Robin Boadway: Do you mean another asset?

Hon. Garth Turner: You're allowed to contribute up to a certain limit based on the market value of an asset you already hold.

Prof. David Duff: It has an accrued gain on it already.

Hon. Garth Turner: Right.

We haven't had clarity from the Minister of Finance on this. We haven't really had clarity. This whole idea of a contribution in kind is quite significant, because as we go forward and develop this in 2009, this becomes a major point in tax planning.

Do you have ideas?

Prof. Robin Boadway: I must admit I haven't thought through the details of this.

The Chair: Go ahead, Monsieur Godbout.

[*Translation*]

Prof. Luc Godbout: I think I understand. The new tax-free savings account, the TFSA, does allow contributions in kind. However, there is a deemed disposition before the contribution in kind goes into the tax-free savings account. So there is a gain immediately before, as is currently the case with the registered retirement savings plans. Shares from a given company can be transferred to a TFSA. However, if there is a gain at the time of the transfer, that is taxable. From what I understand, you would like that not to be the case.

[*English*]

Hon. Garth Turner: That's the question, because now we're looking very carefully at whether contribution in kind.... Obviously this could be a major point of avoiding taxation for a lot of people who have maxed out their RRSPs and have high pension income. This becomes a real third leg of tax avoidance for people who are wealthy. Is that correct? It has all the earmarks of that. If we allow contributions in kind, it seems to exacerbate that.

I just wanted to get your point of view.

Prof. David Duff: It's an interesting point, at least as far as I understand it so far. The tax-free savings plans aren't in any way integrated with the limits that exist on RRSP contributions or registered pension plans. It's just an additional amount. So it really opens up an additional massive vehicle of tax-free savings for high-income people. At the very least, one would think that if one were to do it, one should integrate it. I'm not a fan of it to begin with, because the super returns that one can earn in one of these tax-free savings plans never get taxed. With an RRSP, at least in theory, the ordinary rate of return on capital is exempt from tax, but super returns are taxable. That's not the case with these.

The Chair: Thank you very much.

Mr. Wallace, you have five minutes.

Mr. Mike Wallace: Thank you, Mr. Chair.

We've been criticized, and we have discussed the GST cuts we've had over the last couple of years, but in 1993 part of the platform of the Liberal Party of Canada was to get rid of the GST completely. And they seem to forget that point. By the way, they promised that and never did it. Oh yes, we promised to do something and we did it. There's a complete difference there.

There was a reduction of a couple of points, but it would have been even worse if we had committed to Canadians that we were getting rid of the consumption tax, the GST, completely. Would you agree with that?

Prof. Robin Boadway: Yes, I think I said in my remarks that we shouldn't have reduced the GST. We should maintain the GST where it is, partly because it's a good tax on economic grounds, but also partly because it's going to make it more difficult to get harmonization with the provinces if the federal government reduces the GST and has less at stake.

Mr. Mike Wallace: I just wanted to make that point. Thank you very much.

The next question I have is more of a general question. You gentlemen and the previous people we had before us live in academia. My question is, in your modelling do you take into account the political ramifications or political acceptability of some of the changes you're recommending? Is that among the criteria of your examination at all, or is that left up to us and your modelling based on pure economic theory?

Prof. David Duff: First of all, I'm at a law faculty. I don't do any modelling; I talk. You may have noticed that.

As I responded to the question about carbon taxes, I think the practical implications of these things are important. You guys have to take them into account. When I write, I try to take them into account too. We'll have a conversation about gift and inheritance taxes at some point. I know that's a difficult tax to introduce, but I think it's a right one and that there are ways to introduce it.

• (1700)

Prof. Robin Boadway: I feel very strongly that I'm not paid to make political judgments and wouldn't be able to make them anyway. I'm paid to come up with what I think are the best forms of taxation, or policies more generally, from a normative and efficiency point of view.

If one starts compromising one's advice by what one thinks is politically feasible, we wouldn't, for example, have signed the free trade agreement with the U.S. and we wouldn't have a GST, among other things. I can honestly say that I don't think that's my job. I think it's your job.

Mr. Mike Wallace: Thank you.

Mr. Godbout, do you have anything?

[*Translation*]

Prof. Luc Godbout: You are the decision-makers, so the final decision is up to you. We make recommendations to the best of our knowledge. Theoretically, we have fewer constraints with respect to difficulties. We consider things in an ideal world, on occasion, but the fact remains that we put forth the best ways of doing things, beyond partisanship. Then you must also look beyond partisanship and take into account the difficulties involved in implementing certain measures.

[*English*]

Mr. Mike Wallace: Mr. Godbout, I have a question for you. I appreciate the charts you provided. We hear a lot about productivity, of course, around this table, and not just this table but throughout the government. We are way behind in terms of average annual labour productivity growth rates, based on your charts here.

Can you tell me what other countries are doing that we're not, and why they're ahead of us on this?

[*Translation*]

Prof. Luc Godbout: No, because we are doing the same thing as other countries, even if we are not perhaps doing it as well. I emphasized investment and equipment, because that is where we are not doing as well. However, if we wanted to pat ourselves on the back today, we could talk about research and development, which also contributes to productivity and to technological progress.

In fact, we were lagging far behind in research and development 20 years ago. We are doing much better now. I do not have the figures for all of Canada, but I know that in comparison with OECD countries, Quebec has gone from the back of the pack into the lead. Of course, the idea here is not to emphasize what is going well, but to look at what can be improved. That is why I was talking about the importance of investing in machinery.

[*English*]

Mr. Mike Wallace: Based on the analysis you've done for us today, which we have in front of us, it's the investment, private or public, in production equipment that can make the most significant change to the productivity levels in comparison with GDP in this country. Is that where you would, from our perspective, focus our emphasis?

[*Translation*]

Prof. Luc Godbout: That is a change that can be made much more quickly than in areas of research and development and human capital, like education. Changes in those areas take about 20 years. We cannot expect our people to be better trained and more productive overnight. That is accomplished in the long term. However, investing in equipment can be done much more quickly. That is why I emphasize that, also because that is an area where, in comparison with others, they are not doing as well.

[*English*]

Mr. Mike Wallace: Thank you.

The Chair: Thank you very much.

We'll now move on. We have some motions that the committee has to take care of before the end of the meeting.

I want to thank you for coming in. It's been very interesting; I appreciate the work you've done in this area. I'm sure I speak on behalf of all the committee in saying thank you very much for contributing to the study we are doing.

We will take a two-minute break as we have our witnesses back away from the table, and we will reset for the motions.

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(Pause)

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• (1705)

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

We now have three orders of business. We'll start with the easy one first. It's one you don't have in front of you. It's a motion that the committee authorize the printing of 100 additional copies of the report on the pre-budget consultation.

(Motion agreed to)

An hon. member: I didn't hear a cost.

The Chair: No, we don't have a cost. It's not part of this.

Now, if the other two go as simply as that, we'll have it made.

We'll now move on to the notices of motion. Mr. Dykstra has presented a notice of motion.

Mr. Dykstra, are you in a position to move this?

Mr. Rick Dykstra (St. Catharines, CPC): Yes, I would like to move it and perhaps speak to it very briefly.

The Chair: Go ahead.

Mr. Rick Dykstra: Mr. Chair, there's been a bit of inspiration, actually, from Mr. Martin on this one in terms of the private member's bill that he moved last week. We all know the difficulties we face with a private member's bill if we're not at the top of the list. It's very difficult to know when it may come up. Even if the bill were to carry, it would come to this committee for further study, which we would be doing over that period of time. That could be next September, Mr. Chair; it could be a lot further on than that.

The time has come for us to take a little bit of time to study this. We spend millions of dollars producing the penny. The question of whether or not it is of value anymore has come up. It may have been 20, 30, 40, or 80 years ago.

Certainly Mr. Martin's private member's bill and the motion I put forward got all kinds of air time. I heard that on the weekend folks were talking about this issue. So I certainly think it's a relevant one. Whether there are cost savings involved in not having the penny anymore or whether there is an absolute need to continue producing this product certainly, at the very least, bears a study, albeit probably a brief one. But bringing some experts in to give us some thoughts on that and being able to produce a report at the end and make a recommendation to the Minister of Finance on that issue certainly is within the mandate of the committee.

I'm not suggesting we put all of our current business aside to study it. But when the time does come over the next while when you see fit to work in some of those meetings, Mr. Chair, I hope the finance committee would see fit to take a look at this issue.

The Chair: We have a motion before us.

For discussion on the motion, Mr. McCallum, you had your hand up first, so go ahead.

Then it will be Mr. Crête.

Hon. John McCallum: This is not an unworthy issue, but it's hardly at the top of our list of concerns, economically speaking. No doubt the government will want the budget implementation bill to come at the appropriate time.

This resolution we've agreed upon, in terms of the whole credit crunch and asset-backed commercial paper crisis.... I think after the vote we're going to want to see a lot of people, Purdy Crawford and many others. It seems to me this is a pressing issue and it's time-sensitive.

I'd just as soon defer this, at least until after we've covered the other items.

● (1710)

The Chair: Just to clarify, what I heard the mover say is that this not take priority over either our study on taxation or the bills, which take priority automatically.

Is that what you're saying?

Mr. Rick Dykstra: That's the case.

Usually Mr. McCallum listens intently to every word I say at finance committee. Perhaps I wasn't as clear as I should have been this afternoon, but certainly that is the case, Mr. Chairman.

The Chair: Mr. Crête.

[*Translation*]

Mr. Paul Crête: I share the concerns of the members of the Liberal Party, but I want to ensure that we will not consider this matter next week. There are many other important things to do.

I remember writing to the Minister of Finance in 1997 to ask him to eliminate the penny. I can wait another week.

[*English*]

The Chair: I'll put it this way, because I think there's a consensus. It's worthy of consideration, but not a priority. Is that fair?

[*Translation*]

Mr. Paul Crête: I think these points need clarifying, to avoid any misinterpretations by either side. That issue is relevant and warrants study. Under the rules, we have to deal with legislation first. Once that is done, the issue of bank paper will take priority over that, in my view.

[*English*]

The Chair: Okay, so I think everyone understands this one.

We're going to ask for a motion to pass this one, but it's clear that it's not a priority and that other things would be much more important than this issue.

(Motion agreed to [See *Minutes of Proceedings*])

The Chair: Now we'll move to another motion, which I question a little bit, because we had another motion last week, and I assumed that we were going to carry through with this. But we'll ask Mr. McCallum why this motion is here and if he's interested in moving it.

Hon. John McCallum: Mr. Chair, you and I had a brief discussion on this. If you're willing to proceed with the meetings on Thursday, April 10, then I guess we don't need a motion. But it wasn't clear to me at the last meeting whether that was your position.

If there's a consensus that we go ahead with meeting these retail investors on April 10, and if we can do that without a vote, that's fine with me.

The Chair: Okay, I assumed we were going to have the meetings this week, but the motion is here, so if you want to speak to it, go ahead.

My concern or recommendation, as chair of the committee, is that we not wade into this before the vote is taken. But the motion last week directed us to have the meetings this week. I would still caution the committee very carefully that this has danger signs written all over it, from my perspective. If we are going to go into this, I think we should offer both sides an opportunity to come before the committee.

Hon. John McCallum: That's fine.

The Chair: But I go back to my original caution to the committee that this is fairly serious, and I really would prefer not to get into it; but if it's the will of the committee to do this, I will accede to it.

Hon. John McCallum: Well, if it's your proposal to have meetings on Thursday and to invite both sides, and if that's the consensus, then I would be happy to proceed without a vote on the motion.

The Chair: Let's assume that we can do this on Thursday morning. Let's assume that we can offer it to both sides. Let's make another assumption, that you have a list of those who have asked to come forward on it.

What I would recommend is that we accept two witnesses from the Conservatives, two from the Liberals, one from the Bloc, and one from NDP, so that we don't get a bias from the witnesses coming forward.

Is that fair?

Hon. John McCallum: I'm not sure if they are enough. Maybe we can have three, and....

From my point of view, this is more a matter of our listening than asking questions. You just named six, but I think we could maybe have three, three, two, two, or something like that.

The Chair: Well, let's go with three, three, two, two, as far as our recommendation is concerned. But we will try it in order so that we can have a dispersion among the entire committee on the recommendation of who should come forward. I think that's fair.

If we're good with that, then let's proceed with Thursday morning, and we will schedule for—

● (1715)

Mr. Rick Dykstra: Would you just clarify what you meant by three, two, two?

The Chair: No, I'm sorry, it was three, three, two, two as far as the recommendations are concerned.

Hon. John McCallum: I was being generous to the other parties.

The Chair: Yes, but that doesn't mean we're going to have that many witnesses. It means that we will proceed on a fair basis, having a limit, I would suggest, of six, because if you have any more than that in an hour-and-a-half meeting, we're not being fair. So let's try to get six. I think that number will give us a snapshot of what's going on, and we'll use that as a priority for whom we will ask.

Is that fair?

Hon. John McCallum: How about for two hours?

The Chair: Well, we could go for two hours, but my recommendation would be for an hour and a half for one side and an hour and a half for the other side. But if you want to have two hours for one side and an hour for the other side....

Hon. John McKay: I don't know if there are different sides. I don't understand.

Hon. John McCallum: What do you mean by “other sides”? Aren't they all coming together?

The Chair: No, no. You're talking about the individual investors, right?

Hon. John McCallum: Right.

The Chair: You were wanting to have them in the first two hours, according to your motion. And I would suggest that we bring in, or we at least allow the opportunity for, the institutions to have their say in that third hour, let's say—if you want to do two hours of that, and one hour of the other.

I can live with that. I just think it's important that we give that offer.

Hon. John McCallum: I just didn't understand the process.

So you'd have the individual investors first, for two hours, and then the institutions second, for one hour?

The Chair: That's what I'm hearing right now.

I would suggest an hour and a half for each, but if you want to go two hours and one hour, I can live with that.

Hon. John McCallum: Okay, that's fine.

The Chair: If that's okay, then we'll proceed.

Hon. John McKay: Is that for 9 to 12?

The Chair: Yes, we'll schedule it for 9 to 12, and then we'll see.

Go ahead, Mr. Crête.

[*Translation*]

Mr. Paul Crête: The breakdown of hours, either three, three, two and two, is that for both appearances?

[*English*]

The Chair: Three, three, two, two, yes. *Oui.*

[*Translation*]

Mr. Paul Crête: That applies for both appearances?

The Chair: Yes.

Mr. Paul Crête: It is the first two hours and an additional hour?

[*English*]

The Chair: Yes, from this list.

[*Translation*]

Mr. Paul Crête: We would like to add a name.

[*English*]

The Chair: Yes, if you need another name, we'd be open to that, I suppose.

Okay, we'll proceed in that way. Is everything clear, so we don't need to deal with this?

Mr. McCallum, just to be sure, are you pulling this motion?

Hon. John McCallum: I'm very content.

An hon. member: Oh, oh!

The Chair: You don't hear that everyday, you know.

So by tomorrow morning, you'll have your recommended names to the clerk.

The meeting is adjourned.

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