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**Chair**

**Mr. Massimo Pacetti**

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• (1535)

[English]

**The Chair (Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.)):** We can begin.

[Translation]

I would like to ask you to make your opening remarks or your presentation within a five-minute period. The members of the committee will then ask their questions.

[English]

We are going to try to go for half an hour for questions. I know there are quite a few members, so maybe we'll have four minutes each, if that's okay with everybody. I request your indulgence on this.

I am going to go around the table.

[Translation]

Ms. Kozhaya.

**Ms. Norma Kozhaya (Economist, Montreal Economic Institute):** Good afternoon.

**The Chair:** Thank you for coming.

**Ms. Norma Kozhaya:** Thank you for having invited me this afternoon to discuss allocating the budget surplus. Please excuse me, but my presentation will be in French. As for the questions, you may ask them in English.

To begin with, I believe it is important to remember a few significant facts. First of all, tax revenues in Canada, in terms of GDP, are amongst the highest of the G-7. Moreover, tax expenditures for all levels of government have been climbing consistently over the last few years. In fact, the federal deficit has been eliminated more through an increase in revenues than a reduction in spending.

The other fact concerns the federal public debt. It has been significantly reduced over the last few years and seems under control, particularly if we compare it to other countries. This is therefore not an urgent problem.

From an economic perspective, the priority is to reduce taxes. What kinds of taxes? We propose a reduction in personal income tax rates—in the overall rates, including for the highest brackets—because of the negative effects of high tax rates on economic activity.

If we compare taxes here with those in the United States, our neighbour and principal trading partner, we can see that the threshold

for the highest tax rate in the United States is a little over \$300,000, whereas it is \$113,000 in Canada. This illustrates even more the relevancy of reducing taxes.

It is most important to note that economic theory and experience have shown that tax reductions have beneficial effects on the economy. In particular, when personal tax rates are reduced, people are encouraged to work more, to work in Canada rather than in the United States, for example, to save more, to invest more, to take more risks and to create more jobs. We are talking about significant beneficial effects. Experience backs that up. In this way, tax cuts in the United States were followed by periods of strong economic growth.

A second effect of tax reductions is seen on declared taxable income. In fact, as tax rates climb, people change their behaviour as to how they declare their income, whether it is legal or illegal. They may for example chose to declare a less significant portion of their compensation in the form of taxable income, and a greater proportion in the form of non-taxable benefits. As tax rates rise, of course, we also see more tax evasion and more work on the black market.

When we cut tax rates, the tax base increases and somewhat counterbalances the effects of these reductions. This is particularly true for the highest incomes: a reduction in these rates tends to finance itself.

A study done for Canada showed that when tax rates increased between 1988 and 1996, the \$50,000 to \$100,000 tax bracket acted as a shelter for the highest income earners. We therefore saw more income declared in that bracket than in the highest brackets, and so had more taxpayers in that bracket.

In conclusion, I would say that from a dynamic perspective, tax reduction and reduction of the debt are neither contradictory nor mutually exclusive. We can do both at the same time. We must begin with tax reductions in order to generate positive effects. A general tax reduction, for all levels of income, has beneficial effects on economic activity and growth as well as on declared taxable income. The effects on government revenues are felt afterwards. Five or six years later, we will find ourselves with a more prosperous economy. Taxpayers will pay less tax and the government will have more revenues and will therefore be able to pay down the debt.

Thank you for your attention.

• (1540)

**The Chair:** Thank you. We will now begin the question period.

Mr. Solberg, you have five minutes.

[English]

**Mr. Monte Solberg (Medicine Hat, CPC):** Thank you very much, Mr. Chairman.

I want to thank the Montreal Economic Institute for being here. In the short time they have been on the scene, I think they have done a lot to inspire some good debate on issues like taxation and government spending. It's very welcome to hear your views on these issues.

In your presentation you used the example of the United States when it comes to cutting taxes. Some people don't like to talk about the United States, for whatever reason, and somehow don't see it as a legitimate example of what Canada should do.

I'm wondering if you would maybe just say a few words about some of the other jurisdictions that have cut taxes and have seen revenues and standards of living grow as a result of that. It strikes me as true that there are Scandinavian countries who cut taxes, and Ireland and other countries. Could you just say a few words about some of these other jurisdictions and reflect on the results they've had as a result of cutting taxes of various kinds?

**Ms. Norma Kozhaya:** I can give the Canadian example, the federal example, and the Ontario example, and also, a bit extreme, but the countries from eastern Europe, such as Estonia, and even Russia. Maybe my colleague has some examples of this.

At the Montreal Economic Institute, a colleague prepared a study on this issue, where taxes have been reduced and government receipts have increased. In Russia, for instance, revenues jumped 35% from a 13% flat tax; government revenues exploded, because people now report more revenues and work more, so government receipts have actually increased. For these countries, it has been a difficult transition, but now they have lots of success. We invited the Estonian prime minister, who talked to us about the flat tax; they have had experience with reducing taxes and very good results from an economic activity point of view, and with government receipts, consequently.

**Mr. Monte Solberg:** Can you explain why cutting the top marginal rate is so important and why that makes such a big difference?

**Ms. Norma Kozhaya:** Actually, high-income earners are the ones who contribute the most to fiscal or government revenues. These people have a margin in the way they declare their revenues, and where they work, how they declare their revenues, and how much they work. So when we reduce the rate for these people, they have more incentive to declare more revenue—in Canada, for instance, rather than elsewhere. When we reduce it for them, experience shows that it is like self-financing, because even though the rates are lower, the revenues declared are a bit higher and compensate for the lower taxes. For instance, in the U.S., even though some people don't like to hear this example, when the top marginal rate was cut under Kennedy, for instance, the contribution of the top percentile of revenue earners or taxpayers to total income increased from 17% to 27%, even though the top rates have been reduced from 70% to 28%. The evidence is there and incentives are there for declaring more revenues.

• (1545)

**Mr. Monte Solberg:** Thank you very much.

I think my time is up. I just want to thank you for being here and for contributing to this debate.

I'm going to have to take my leave, as I have to go and speak in the House now.

**The Chair:** Thank you, Mr. Solberg.

Mr. Côté.

[Translation]

**Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ):** Thank you very much for your presentation.

Over the last few days, several people stated during their presentations that tax reductions should be very targeted, that general tax reductions would not have the effects that you suggest today, either for individuals or for businesses, and that we should instead opt for targeted tax reductions along with reduced spending.

Could you give us some details on the advantages and the effects of these two options?

**Ms. Norma Kozhaya:** When you talk about targeted tax reductions, are these intended for middle-income taxpayers, businesses or...

**The Chair:** That is a good question. May I interrupt?

In fact, we were not talking about targeted reductions. We were rather discussing specific deductions targeting particular industries or sectors.

**Ms. Norma Kozhaya:** From both a personal and a strictly economic perspective, I believe that in general, by targeting an industry or a sector, we risk creating distortions and not getting the optimal or beneficial effects. I do not know why one would decide that a particular sector should benefit from such a measure over another. This would not be a purely economic choice, but might rather be a political or economic decision. It is not really my field.

Another tax reduction that I did not address here, but that could be beneficial, concerns capital taxes. Everyone knows that this tax is harmful to investment. Moreover, given the revenue it generates, I don't believe it would be difficult to choose eliminating it completely, given its negative effects.

Moreover, general tax reductions do not create distortions between one sector and another, or between one taxpayer and another. On the contrary, everyone benefits. This fosters a dynamic economy. People in every income category are encouraged to produce more, to work more, to create more jobs and to invest more.

To my mind, that is advantageous. I may not have sufficient knowledge about one particular industry or sector, but from a general perspective, I believe that targeting a given sector risks creating more distortions than benefits.

**Mr. Guy Côté:** The federal government used its unintended surplus to massively invest in paying down the debt. If I understand correctly, you would like to see the debt-to-GDP ratio continue to diminish, even if it is only through economic growth. You would like the government to stop investing these sums, only keep a contingency fund for unforeseen circumstances, and allocate the better part of their budgetary surplus to general tax reductions, regardless of their revenue.

Do I understand your point of view correctly?

**Ms. Norma Kozhaya:** Yes. You spoke of caution and of flexibility. Obviously, everyone agrees on the subject. If we pay down the debt, we will save on servicing the debt. On the other hand, we are not creating any incentives, growth or prosperity for the future. From an accounting perspective, we can say that we are paying down the debt and that is a good thing, because we are saving, but in terms of dynamics, we are not adding much.

On the other hand, tax reductions have beneficial effects in terms of incentives and of prosperity. That is why we could do such a thing at the present time. If we do not allow ourselves to take such steps now, while we have a surplus and while the Bank of Canada is talking about full employment and very good economic conditions, it will be difficult to do so in five or ten years. We will therefore not benefit from the advantage of being more tax-competitive, which might allow us in time to allocate more significant amounts to paying down the debt.

For the moment, I believe the priority should be tax reduction so that we might be in a position to benefit from these favourable circumstances.

• (1550)

**Mr. Guy Côté:** Should the measures you are talking about go hand in hand with equivalent reductions in program spending?

**Ms. Norma Kozhaya:** Spending is a different problem. We should not necessarily reduce spending, but it should be subject to certain controls. If we want to spend more, we have to tax more, which means that people will be less inclined to work and will tend to favour the black market. We will then have to increase the tax burden again. The biggest priority is to provide tax relief so that we can become more competitive.

[English]

**The Chair:** Mr. McKay.

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

Thank you for your testimony.

As you know, this government is at the tail end of a \$100 billion tax cut, 75% of which is personal and 25% of which is corporate. Interestingly, in the final declaration of the government for the fiscal year ending March 31, 2004, the analysis shows that notwithstanding the tax cuts to corporate revenues, the corporate revenue take, if you will, the amount of money available to the government has actually increased by 23%. It seems somewhat counterintuitive: you cut your corporate taxes and your revenue actually increases. It has been somewhat less so with personal income taxes, where there have been tax cuts, as I say. The revenues have actually increased 3%. I'm wondering if you have thought about that. There are a variety of explanations as to why the tax take has actually increased this year in spite of the tax cuts. That would be the first question.

The second question has to do with the mix of taxes. There has been some criticism of the tax mix and whether it should be on the personal income tax side, the corporate side, the capital side, or the payroll side. I'd be interested in your views as to whether we have the mix correct or whether you think the mix should be reordered.

**Ms. Norma Kozhaya:** Unfortunately, I'm not able to answer your question correctly because I haven't worked out the details of this. I've mainly concentrated on reducing personal income taxation. It will also probably depend on what our neighbour does, for instance—in order to remain competitive.

Of course, reducing taxes on corporations is also beneficial. Taxes have increased for several reasons. One is maybe reducing the tax rates. There's also what has been going on in east Asia, for instance... increased demand for energy. All that stuff has also made corporations more profitable, with more revenue.

Unfortunately, as I said, maybe I haven't studied the issue in enough detail. This is something that eventually should be done.

**Hon. John McKay:** Let me ask you another question then. You said paying down debt doesn't create jobs. I put it to you that the \$61 billion that the government has paid off on its debt over the last seven years of surplus has in fact created jobs. As you know, we now have the second-best debt-to-GDP ratio in the G-7. We have among the lowest interest rates—historically low interest rates.

That \$61 billion had to go somewhere. It's not being used by the government, so presumably it's available for Canadian citizens and Canadian corporations. We have vacancy rates, particularly in my city of Toronto, at unheard of rates. The official vacancy rate on apartments is now 3%, but I think it's probably a lot closer to 5% or 6%. Housing starts are going through the ceiling. All that is because people can afford mortgages. Housing has become much more affordable.

So I might suggest to you that paying off debt does create economic conditions that lead to prosperity.

• (1555)

**Ms. Norma Kozhaya:** So you're mainly attributing low interest rates to having paid the debt?

**Hon. John McKay:** The Government of Canada is no longer in the market borrowing money. All it's doing is changing the mix so it's at more advantageous terms. Whether it's interest rates, term, foreign, domestic, or whatever, the mix is now much more favourable to the government.

**Ms. Norma Kozhaya:** Exactly. I'm not saying that having reduced the debt isn't good. I'm saying that since we have reduced it to its current level, maybe it's a less urgent problem now, so we can afford to do something else with the revenues we have. If it has created jobs, it's almost the same thing as reducing spending, but it's not the same kinds of personal incentives that we give, even though it might have....

Actually, this is another question: whether the fact that people buy more houses is eventually sustainable and is good in itself. In the current situation, it seems like a less urgent problem to deal with than doing something to improve levels of income of Canadians. I think we could do this better by reducing taxes and having more competitive taxes, giving people in Canada more incentive to work here rather than going to the U.S., for instance, because taxation levels are lower there.

**Hon. John McKay:** Thank you.

Do I have more time?

**The Chair:** That's it.

Mr. Penson.

**Mr. Charlie Penson (Peace River, CPC):** Thank you.

I'd just like to pick up on this. I understand what you're saying about debt payments—that it's a lower priority than reducing taxes. We've heard evidence, not just here today but over quite a number of years, that Canadian productivity and competitiveness have been in decline for quite some time, and there's quite a gap between us and our major trading partner, the United States.

One way to close that, if you like, is to lower taxes so Canadian companies would be able to reinvest in innovation and equipment in order to get their factories up and running and more competitive. That would give them a little more competitive edge. Is that one reason why you would give lowering taxes a higher priority than debt repayment?

**Ms. Norma Kozhaya:** So lowering taxes...?

**Mr. Charlie Penson:** I guess the question is, if Canadian factories or companies were able to reinvest because they had more money left on their bottom line because of lower taxes, is that one reason why you think lower taxes should be a higher priority right now than debt repayment?

**Ms. Norma Kozhaya:** Yes. Having more money because they were paying less tax would help them be more competitive, so that would generate more revenue...rather than having a lower debt.

• (1600)

**Mr. Charlie Penson:** I would just like to ask if you've been following the U.S. situation. Because of the elections in the last couple of days, there may be some change in policy. On the current account deficit they're running, if they decide to make some changes to lower the current account deficit, would one of the ways they might do that be to try to encourage higher interest rates? Is that a possibility we may have to watch for?

**Ms. Norma Kozhaya:** Higher interest rates....

[Translation]

I don't know that I am qualified to answer, but we could perhaps potentially consider an interest rate increase.

I do not know what they will decide, but I think they could perhaps start by reducing expenditures. In fact, if we watch closely, we can see that tax revenues have diminished in the United States, but that they have started to go up again. Given their huge budgetary deficit, this could improve the situation.

As far as interest rates are concerned, of course that depends on the situation. For the moment, interest rates do not seem to be rising significantly. I don't know what will happen when they will have settled their domestic employment problem and certain other problems, whether that is now or sometime in the future.

[English]

**Mr. Charlie Penson:** Just to get back to the area of the best types of taxes, or the worst types of taxes, that turn off an economy or allow it to grow faster, has your institute done any work looking at the Mintz report, or what he's been doing on the need for tax reform? There is the suggestion that certain types of taxes are a high disincentive to growth for income versus others. For example, with personal income tax, the more you make the higher bracket you get into; therefore people may not want to get into that next bracket. Have you looked at some of that work?

**Ms. Norma Kozhaya:** I think the studies mainly show that income taxes for individuals or corporations have disincentive effects, but consumption taxes, for instance, have less of a disincentive effect or none at all. If you look at the issue of the importance of taxes for saving and investing eventually, taxes on income...you tax savings in a way, but when you tax consumption you don't tax savings, you only tax consumption.

If we want to reduce taxes, of course, you have to reduce these disincentives for incomes and revenues, rather than for consumption taxes or other types.

**Mr. Charlie Penson:** Would you say then that the European countries that have a higher sales tax, value-added tax, than Canada are on the right approach?

**Ms. Norma Kozhaya:** As I understand it, for the time being we have surpluses.

[Translation]

For the moment, we have surpluses. If we were to eventually raise taxes, this would be done more through sales taxes, for example, rather than through income taxes.

[English]

**Mr. Charlie Penson:** Thank you.

**The Chair:** Mr. Hubbard, and then Mr. Loubier, quickly.

**Mr. Charles Hubbard (Miramichi, Lib.):** Thank you, Mr. Chair.

Welcome to our committee.

We're looking in terms of this regional view, and I'm not entirely familiar with the Montreal institute. How many economists work at it? Are you associated with the universities? Could you briefly explain to our committee your background? Above all, is it mainly Quebec, or are you looking at Canada, in terms of the total country?

• (1605)

**Ms. Norma Kozhaya:** We look mainly at Quebec issues, but also at Canadian issues. For instance, we've done some work on interprovincial trade and the health system, so it concerns Canada as a whole. Let's say 50% of our production is mainly for Quebec and the other 50% is more Canadian or even international.

We have some economists. Sometimes we have consulting work with university professors and we make them review our studies.

**Mr. Charles Hubbard:** You spend quite a bit of time talking about the surplus and the debt. Right now we're still paying a considerable amount of our total revenues toward servicing the debt. I know our GDP has gone up significantly; we have a better ratio than we did when our government took over in 1993.

What would the optimum level be? You seem to be saying seal the debt, but from your perspective, are you ready to continue a debt of \$500 billion that needs to be serviced? At the present time we're very lucky, because we have a very low cost of interest.

Could you give the committee some direction in terms of the optimum level of debt a country like Canada could cover?

**Ms. Norma Kozhaya:** I think that's a pretty hard question. I don't know if there's a consensus on an optimal level of debt. I know there are a lot of studies that try to show the optimal level of debt to GDP, for instance, but personally I don't know of any that give an exact figure. We can compare to other countries, for example the European countries, and see whether our level is acceptable or not.

My point is, even though I know we're paying to service debt, and we have a debt that is not zero—but all other countries have, also—if we want to have a more dynamic economy, if we want to have increasing revenues per capita, we can't do it by only lowering the debt. If we can't afford lower taxes now, after several years of surpluses, after several years of economic expansion—and we're doing great compared to other countries, compared to the U.S.—I think we'll never be able to afford them.

If we lower the taxes, we'll eventually be able to reduce the debt. I'm not satisfied with a \$500 billion debt, but I think it's not as urgent for economic prosperity as lowering the taxes.

**Mr. Charles Hubbard:** You're speaking specifically, and your main interest is in terms of the province of Quebec, which has a great amount of economic disparity within its regions—look at the fact that before the House on almost a daily basis we hear great concerns about unemployment in the province of Quebec. We would think with that we would need investment or some method by which more people would have the opportunity to work, because very few people want employment insurance; they want the ability to work.

What would you recommend to the committee in terms of some budgetary strategy that would improve the economic opportunities and increase investment to provide those opportunities in your own province?

**Ms. Norma Kozhaya:** Actually, the study I did with the figures was intended for Quebec, because as you know, the Liberal government promised to reduce taxes but it hasn't. Apparently they can't afford to reduce taxes.

I would still recommend lowering taxes, encouraging people to work. Unemployment is a very difficult question. We have a lot of constraints on the labour market, maybe coming from a stronger presence of unions or different types of constraints that make the unemployment level high in Quebec. If we want to bring people to invest more it will be by giving them more incentives and fewer constraints.

I would say, first, practically eliminate the tax on capital, for instance. Also, even lowering the income taxes can bring companies to invest more in Quebec, because they will have more qualified employees, more qualified persons available to work, and they will have more incentive to invest in Quebec.

• (1610)

**The Chair:** Merci.

Thank you, Mr. Hubbard.

Monsieur Loubier.

[*Translation*]

**Mr. Yvan Loubier (Saint-Hyacinthe—Bagot, BQ):** Thank you, Mr. Chair.

I have a short question. Has the Institut économique de Montréal done any assessments of the federal government's surpluses posted during this fiscal year? Do you have any projections of that kind?

**Ms. Norma Kozhaya:** Non, we don't do projections at the Institut économique de Montréal. We do more general studies. We have no tax specialists or accountants on staff. We study the work of the specialists.

**Mr. Yvan Loubier:** Thank you very much.

I told you my question was short.

**The Chair:** Very well.

Thank you for coming, Madam. You may stay if you like, but the members will now be addressing their questions to Mr. Gibbins.

[*English*]

Mr. Gibbins, thank you for appearing. We're going to change the structure a little bit due to the fact that you were here a bit later. What we're going to do is give you five minutes for your opening statement or remarks, and then we'll have the members ask questions. We'll try to keep it to about a half-hour of questions.

Thank you.

**Dr. Roger Gibbins (President and Chief Executive Officer, Canada West Foundation):** Let me thank you for the opportunity. I also apologize for being late—I had a prior speaking commitment that I couldn't shake.

Mr. Chair, let me begin by stressing that the Canada West Foundation has not taken a position on this matter. I'm not speaking for my board or for the foundation, nor would I dare to presume to speak on behalf of western Canadians or the west. I'm speaking for myself.

My comments are informed somewhat by a parallel debate that's going on in Alberta, where the question is what to do with a provincial surplus of approximately \$9 billion for the coming year. Many of the same options are on the table: discussions about increasing program spending, tax cuts, salting it away for a rainy day. Probably the only option not on the table in Alberta that is on the table here is paying down the provincial debt. We've been there, done that, and that's not an option.

There's another critically important difference between Alberta's debate and this committee's debate. The surplus in Alberta comes primarily from high energy prices for a non-renewable natural resource. Ottawa's surplus, in its simplest form, comes from taxing too much. Simply put, Parliament is raising money for which it has not authorized expenditures, and it's doing so year after year. Therefore, the simple answer to the surplus question is to give it back to those people who have paid for it. If you're taking more than you need and if you're doing this year after year, then give it back to Canadians.

The problem, however, from what we can tell, is that there's no strong public appetite, at least in my corner of the country, for tax cuts. There seems to be, in fact, stronger support for more program spending.

We did a very massive survey of 3,200 western Canadians in January of this year. We gave individuals 13 priorities to rank in order. Reducing taxes placed 10th out of 13 priorities. Even in Alberta, reducing taxes placed 10th out of 13 priorities.

In a survey that the provincial government did in terms of how to handle its own surplus, again it found there is much greater support for program expenditures on health and education than there is for tax cuts.

This brings me really to the crux of the issue as I see it. The ongoing federal surpluses dramatically illustrate the argument that provincial governments have been making about a vertical fiscal imbalance in the federal system. Ottawa is taxing more than it needs, and in the meantime, provincial and municipal governments have trouble meeting their own spending needs. The traditional solution has been to transfer resources from Ottawa to the provinces through transfer payments.

A better way, I would suggest, would be for Ottawa to cut its tax load and thereby create more tax room for provincial governments. Or, if we don't want to go through taxpayers, if we don't want to sort of give with one hand and take away with the other, then handle the surplus by transferring tax points to the provinces. In this way we can address the fiscal imbalance and not do it through transfers.

What I'm suggesting, I guess, is don't keep the surplus in Ottawa, but transfer it to those governments that need the financial support. To put it in other words, what I'm suggesting is that the federal government should stick to its knitting, stick to its core responsibilities.

If more money is raised than Parliament has approved to spend, give it back to Canadians and create more tax room for provincial and municipal governments. If the federal government wants to expand its knitting, then do so in direct and transparent ways: create new programs and new revenue sources through conventional parliamentary procedures, but don't do it through the back door of surpluses.

• (1615)

I have one final point. The argument is frequently made, both here and in the Alberta debate, that we should use the surplus to address the pressing needs of low-income and disadvantaged Canadians. I would agree if the surplus is to be addressed through tax cuts: by all means start low. However, I would disagree strongly if what we have

is increased program spending. How we treat the less fortunate is the true test of our citizenship. Therefore, as a Canadian, I find it deeply offensive to hear that we should address social needs through the surplus. This is a core responsibility of citizenship and a core responsibility of governments. It is not a frill, something we can address when times are good, when we have some extra jingle in our jeans. Therefore, it should be taken off the table with regard to the surplus. This really goes back to what Canadians and their governments are all about in a core sense.

Thank you very much for this opportunity.

**The Chair:** Thank you, Mr. Gibbins.

We're going to start with Ms. Ambrose.

**Ms. Rona Ambrose (Edmonton—Spruce Grove, CPC):** Thank you, Mr. Chair, and thank you, Dr. Gibbins, for your presentation.

I pretty much agree with everything you just said, but what I'd like you to elaborate on is in relation to the fiscal imbalance, about transfer of tax points and the pros and cons about transferring tax points to provinces as one way to address the fiscal imbalance, as opposed to transfers.

**Dr. Roger Gibbins:** I'll expand on it to the limits of my ability as a political scientist. Keep in mind that I am not an economist, so treat what I say with a very large grain of salt.

The evidence among scholars of a fiscal imbalance has been growing over the past 30 years, and the imbalance is between a government that has more revenue than it needs and governments that have more responsibilities than they can fund. The problem with addressing that imbalance through transfers of one sort or another is that they come wrapped in conditionality, and they impose then constraints on the receiving governments when they're really addressing matters of their own responsibility.

I understand, and to a degree I sympathize with, the way in which transfer payments in Canada have been used to create to a degree national standards and national standardization. I would not want to dismiss that approach altogether, but I think we have enough conditionality at the present time, and what we should be looking at is a more fundamental attempt to address the fiscal imbalance. That really means putting the taxing capacity back in the hands of the governments that are providing the services, thereby maximizing accountability within the political system. Because one of the costs of transfer payments is a lack of political accountability: one government is spending money raised by another government. To my mind, that's not an ideal situation.

• (1620)

**Ms. Rona Ambrose:** Based on what you've just said, one of the philosophical arguments we always hear is complete devolution and the federal government abdicating its national role. I wonder if you, as a political scientist, could comment on that approach.



**Dr. Roger Gibbins:** I don't think giving provincial and municipal governments more tax capacity is in itself an example of devolution. It can be done within the existing constitutional framework. It's simply strengthening accountability. To me, it makes sense without fostering a greater sense of devolution or decentralization. If you strip the federal government completely of its capacity to use conditional funding as a transfer mechanism, in my mind, you've gone a step too far. Our existing system is not lacking in conditionality at the present time, and therefore I think we can move more boldly on transfer mechanisms that really deal with tax sources and put the funding responsibility back in the hands of provinces and municipal governments.

**Ms. Rona Ambrose:** To shift to the present debate on equalization, I wonder if you could comment on the formula that's been thrown around, the discussion about whether or not to include non-renewable resources in the equalization formula.

**Dr. Roger Gibbins:** Again, I'll preface my remarks by pointing to my own limited expertise in this area.

I would argue that the uneven distribution of resource wealth within the country should be folded into our understanding of equalization payments in some way. So having Alberta, for example, outside the equalization formula, to me, lacks a certain logic in relation to what we're trying to do through equalization. So I tend to favour, without as much thought as I would like to give it, the ten-province formula. But at the same time, I recognize that this shifts the burden of equalization onto the federal government. It's a wash in relation to the Province of Alberta, because the provincial government is not paying into the equalization formula. So it creates a fiscal problem for the federal government that I think has to be thought through very carefully. But in a principled sense, to my mind, having the equalization formula based on ten rather than on five makes logical sense and is probably easier to convey to Canadians. One of the problems with the equalization formula right now is that it has taken on a degree of complexity that makes it difficult to talk about effectively in political debate. So I think if we can simplify it, rationalize it, it makes sense.

**The Chair:** Monsieur Loubier.

[*Translation*]

**Mr. Yvan Loubier:** Doctor Gibbins, thank you for your excellent presentation.

As I was listening to you, I felt that you were taking the words right out of my mouth. This morning, we debated equalization and fiscal imbalance, and I commented to my conservative colleague that our party entirely agrees with everything you said.

You are right in saying that we might be at a crossroads, as in 1964, when Mr. Pearson was the Prime Minister of Canada and Mr. Lesage was the Premier of Quebec, and a conference had led to the transfer of tax points. We had realized that specific responsibilities defined in the basic law of the land, known as the Constitution, called for a new balance between provincial fiscal powers and those of the federal government.

I also liked your presentation. You seem to have emphasized the fact that transfer payments are no longer a solution, because they cannot be forecast on a yearly basis. The process has to be started from scratch each year. When a province is in charge of providing

health, education and income support services to economically disadvantaged persons, it cannot do its year's work without knowing what the following or the five following years hold in store. This applies even more to health matters. You cannot hire a physician this year if you do not know whether there will be enough money to keep him on for the following year.

Please explain your preference. You mentioned transferring tax points, but it would also be possible to transfer specific fields of taxation from the federal government to the provinces, for instance, the GST revenue. Wouldn't it be worthwhile for the federal government to transfer the GST field of taxation to the provinces? This would give the provinces the independence they need to do their work, as well as the flexibility they need to make decisions about managing these monies, but above all, they would be able to forecast how much they would have because increases in GST revenue are directly linked to increases in the GDP.

• (1625)

[*English*]

**Dr. Roger Gibbins:** That's a very nasty question to ask an Albertan, because the effect of that would be that the Alberta government would suddenly be imposing a 7% provincial sales tax, which they would be very unhappy to do.

Let me answer you in a slightly indirect way. I agree completely that if the conversation is about a one-off budget surplus—boy, we've got more than we need this year—it's a very different conversation from the one you'd have if that budget surplus were structural, and it appears to be structural. From all the testimony last week, it seems this is an ongoing state of affairs. So I think you have to look first at the transfers within the tax system and tax points.

I'm less inclined to speak off the top of my head about the transfer of responsibilities—I haven't thought that through. My instinctive reaction is to see what we can do through realigning the tax points before looking at responsibilities. I wouldn't preclude that larger discussion, but I don't think it should stop us from looking, sooner rather than later, at tax point issues.

[*Translation*]

**Mr. Yvan Loubier:** Doctor Gibbins, I would like to invite you back later on during the year 2005, when a subcommittee will try to find solutions to the problem of fiscal imbalance. I found your presentation most interesting. Thank you very much.

**The Chair:** Thank you, Mr. Loubier.

I give the floor to Mr. Bell, followed by Ms. Minna, Mr. Côté and Mr. Hubbard.

[*English*]

**Mr. Don Bell (North Vancouver, Lib.):** Thank you, Mr. Gibbins.

On the total tax load on Canadians, which is made up of federal, provincial, municipal, school, regional, where it's appropriate, how much is too much? I've been in local government for 30 years at the different levels I mentioned there, and most people seem to feel the taxes they're paying generally, if you ask them, are too much. But too much compared to what? The surveys I have seen parallel what you made reference to, where you indicated that a survey you did, with 3,200 respondents, indicated that reducing taxes was a lower priority than increasing programs. As a municipal politician, I found that people did not want services or programs cut, they wanted an end to government waste, which is almost an annual statement. When you suggest that some of the federal tax room, if you want to call it that, should be shifted to another level, is that measurable in people's minds?

• (1630)

**Dr. Roger Gibbins:** My response comes again more as a citizen than as an economist.

When I read through the testimony to this committee last week, I was struck by two things. One was the impressive evidence that in many ways, the Canadian economy has performed very well over the last decade. On the other hand, there was an argument that we need a different kind of tax regime if we are to be globally competitive. My gut instinct here is that given the strong performance of the Canadian economy in recent years, the tax loads Canadians are bearing in total are not wildly out of line with reasonable expectations of citizenship and citizen programming. I don't see strong evidence that Canadians are rolling back their expectations about what governments should do. In fact, at the municipal level those expectations seem to be growing and are almost unbounded.

So personally, I'm not unhappy with the general tax load that Canadians pay at the present time. Where I think you get into a more contentious debate—and my colleagues will see this differently from I—is in the distribution of that tax load across levels of government. It's been pointed out in work that we've done and work that cities in western Canada have done that somewhere around 4% of the tax dollars collected stick to local governments, so an awful lot of it, 96%, goes somewhere else. I would like a tax system that more closely aligns what governments are doing with the tax revenues they collect. In my ideal world we would not have a sharply reduced tax load, but we would have a redistributed tax load, probably with municipalities and provinces taxing more and the federal government taxing less.

**Mr. Don Bell:** You said you were speaking as an individual. I would ask you a question on that basis, with your expertise. Credit advisers, I note, always say to individuals that if you have some extra money, or if you get an increase in wages that is going to be ongoing, such as has been the case with this Bill C-10 increase, or if you come up with a windfall for some reason, you should use it to pay down debt, if you have it, and pay off the most expensive debt first, the one at the highest rate. I see that as having been the challenge. The criticism I've heard in the past is that such a large percentage of what people pay as tax goes to pay down debt that came from deficit financing.

Wouldn't a priority be—and I've seen that in provincial governments, Alberta and others—to pay the debt down to the point that, theoretically, you eliminate it or get it down to a very low

level, and then look at cutting back the level of taxation or shifting it? Since the biggest debt lies with the federal government in terms of the percentage of the total tax bite that goes to paying down debt, shouldn't that be a priority? That's what I've heard. I've heard you expressing a different opinion.

**Dr. Roger Gibbins:** Given my own personal experience of paying down a mortgage and given my own experience living in Alberta and paying down the provincial debt and seeing the benefits of that, I certainly would not argue about paying down the federal debt as a priority. It does seem to me, however, that we can make very substantial progress on the debt by eliminating deficits, as we've done, and through economic growth. So I don't tend to be a debt hawk.

I like the idea of a schedule. I like the idea of a firm commitment from the Government of Canada in terms of addressing that debt, but I'm less inclined to see accelerating debt repayment as a high priority. My sense of public opinion, at least within western Canada, where I've done the most work, is that an accelerated debt repayment program is not a high priority among western Canadians.

**The Chair:** Thank you, Mr. Bell.

We have Ms. Minna, Monsieur Côté, Mr. Hubbard.

**Hon. Maria Minna (Beaches—East York, Lib.):** Thank you, Mr. Chairman.

I want to come back, Mr. Gibbins, to some of the comments you made earlier. We seem to be talking about provinces as if they're very fragile creatures without their own taxation powers and jurisdictions, which as another order of government they do have, in terms of taxing both individuals and companies, as well as having other sources of taxation that even the federal government doesn't have.

The other assumption we seem to be making, which I have some difficulty with, is that the surplus is so structural that it's going to be there forever. We seem to say that we've had a decade. It's not a decade, if I may correct; it's seven years. I remember very clearly the first three or four years we were here. They were not nice. Things were tough. The country was supposed to be bankrupt. We don't want to go there again.

I know that the United States has a huge deficit, as you know, and a huge trade deficit as well. I think that country is going to go bust, implode at some point. They cannot maintain the level of deficit they have. At that point, it's inevitable that they will affect our economy. Whether that happens two or four years from now, or years from now, something will happen.

I think making the assumption that the surplus is a structure that's going to be there forever, and therefore we can afford to divest ourselves of tax points, is not a correct one. I don't feel comfortable with it.

Thirdly, while we did cut taxes and cut the deficit, and have been cutting the debt, there are other kinds of huge deficits we have in the country that have to be addressed. Hopefully they will be addressed in the long term and we will continue to make those investments, such as environment and Kyoto. We cannot pretend otherwise; that's going to take a whole lot of investment. There is the area of research. We've invested a great deal in health research and technology and other areas, but that's, again, an area. There are others—defence, our international commitments, our health care, children; we're just talking about children right now in terms of having some pan-Canadian national programs the government can show some leadership in. Those are things that have to happen.

Given all of that, this constant discussion about having to spend and to transfer tax points to the provinces.... We've done that in the past. At the time—I know that it was back in the seventies—I recall being at a debate about whether the provinces would use this for the purpose for which the tax points were being transferred, which was health. As we know now, of course, the claim is it doesn't exist, that it's not there.

The other thing is that as we transfer more funds, it doesn't necessarily mean that it makes the province more able to deliver better programs to the people. If we use Ontario as an example, we went through ten years of tax cuts. The money the province had and the increased economic production it garnered, because Ontario had increased economic production just like the rest of the country, was used for tax cuts. It now has a huge deficit, for that province, which the Government of Canada has no control over.

What I'm saying basically is that I, as a federal parliamentarian who has a responsibility to try to balance out the country and the priorities of the country, and to make sure we're in a situation we can handle—a crisis that comes later—cannot take for granted that the surplus is there forever.

I don't understand your openness to say that it's there, transfer tax points, and that's the way to address issues. I don't see that. I see the responsibilities we have as a great many unmet things that have to be done. The fundamentals, I don't see.

• (1635)

**Dr. Roger Gibbins:** I want to be clear on a couple of points.

**The Chair:** Ms. Minna lasted about four minutes, so you have about a minute.

[*Translation*]

**Mr. Yvan Loubier:** Mr. Chairman, I can share my time with him, so that he can give his answer.

[*English*]

**Hon. Maria Minna:** That's fine.

**The Chair:** I want to be fair with everybody.

**Dr. Roger Gibbins:** I'll try to be much quicker.

**Hon. Maria Minna:** I apologize. We can talk after if you like.

**Dr. Roger Gibbins:** I'll try to be much quicker with the answer.

I agree completely that there's a need for caution in terms of the federal government divesting itself of revenue sources. However, I think there is a danger in having an accumulating federal surplus that provides too much of a temptation for the federal government to be involved in areas, perhaps, where it shouldn't be involved.

You mentioned the need for other forms of investment. I agree completely. A lot of the work my organization has done has focused on municipal infrastructure. I think there's a pressing need for reinvestment. It's just not clear to me that this investment should come through the federal government rather than through provincial governments, rather than through municipal governments. I don't find the need for other forms of an investment a compelling reason in and of itself to keep the fiscal power in Ottawa. I think there has to be a more principled argument or more principled framework. I think it would be a good discussion for the country to have.

• (1640)

**Hon. Maria Minna:** We'll continue the discussion, I'm sure.

**Dr. Roger Gibbins:** I hope so.

[*Translation*]

**The Chair:** It is now Mr. Côté's turn, and Mr. Hubbard will follow.

**Mr. Guy Côté:** You should not be surprised to learn that your presentation was like music to our ears. Everyone has a favourite topic, if I dare say. My favourite subject is the impact of unpredictable surpluses, year in year out, on accountability and democracy in this land. You mentioned this earlier and again just now, in the context of municipal infrastructures. Please give us some more details about this.

[*English*]

**Dr. Roger Gibbins:** About municipal infrastructure?

**Mr. Guy Côté:** Yes, and about the effect it has on democracy that they hide the surpluses year after year so they come up with a \$7 billion unexpected surplus.

**Dr. Roger Gibbins:** That's a tough question.

I would like to have a system where government budgeting is as close to the target as possible, where Parliament raises the money it needs, and no more and no less. I realize that there is some slippage, some unpredictability in this, and there is a need for some element of caution on the part of the federal government. But it seems that when you run surpluses on a continuing basis, it moves beyond caution to a more structural concern. That's why I would argue that it should be addressed by looking at the redistribution or reassignment of taxation capacity across different levels of government.

I'm not sure I can go much further than that. I would not accuse the Government of Canada of irresponsibility in this matter. What I would say is that through their caution they have nicely illustrated the argument the provinces have been making about a structural imbalance. They provided the evidence of what has been a more abstract argument by provincial governments, and now that the evidence is in hand, maybe we can turn to that question about vertical fiscal imbalance.

**The Chair:** Thank you.

Mr. Hubbard.

**Mr. Charles Hubbard:** Thank you, Mr. Chair.

I'm having some difficulty with some of the terminology we're using and some of the facts as they're being looked at.

First of all, it's very difficult for a government to project a year ahead whether it will have a surplus or whether it will have a balanced budget, and hopefully will not have a deficit. We have seen experienced governments here that have had annual deficits of over \$40 billion.

When we discuss this around the table, I'm not sure we realize that even in our country today, when we talk about debt-to-earning capacity, our debt is about three times the annual earning capacity. I'm not sure if we're putting on the table the fact that in the mid-1990s we had over 30¢ of every tax dollar going toward servicing the debt. Even today, around 23¢ of every tax dollar goes to that.

I'm also not sure of how we're relating this "imbalance" terminology that many are using. If we look at Canada, in terms of our federal government, our so-called debt is about three times annual income. Have we compared that, Mr. Gibbins, to the provinces that are complaining about their situation? If you look at their debt in terms of earning capacity, are we talking on the same platform? Have you studied that aspect of debt and relationships between the two levels of government?

• (1645)

**Dr. Roger Gibbins:** Let me respond to two questions you pose.

One, it is difficult to predict accurately what the expenditure load will be on the federal government, because lots of things will buffer a government during a one-year period. Over time, however, there has been a pattern of being systematically high, so I think after a while you look at that pattern and you think there's some room for adjustment. That's all I'm saying.

Two, I'm not trying to present a case for the poor provincial governments, and I'm not trying to argue that they are, in some sense, better at public finance, or that they have an intolerable debt load, or anything like that. All I'm saying is that there's something intuitively appealing about having governments with the capacity to finance the expenditures they're making and not being reliant on transfers from other levels of government. There's something clean about it, and I think provincial governments should be held to account. I have no problem with that.

**Mr. Charles Hubbard:** I would probably also like to say, Mr. Gibbins, that for about ten years we saw annual deficits growing ever greater, and our economy has improved significantly in the last seven or eight years to the point where we are today. But in terms of

the finance minister who appeared here, we have to recognize that with the amount of debt we're paying down each year, it will take our people at least another 45 years to pay down the national debt.

Can we afford, under the philosophy that some are presenting, to continue this tax burden on future generations—in fact, our grandchildren—to pay for things we have had in the past and what we have in the present? I would think we should be very happy to see the debt being paid down. We should be very happy, and I'm not sure why people complain in the House about paying down \$10 billion worth of debt. It's a very insignificant amount.

I would also think, Mr. Chair, that our researchers should probably look at some of the ratios I mentioned. Provinces are saying... But are the provincial debts in terms of their earning capacity equal, or are they in the great difficulty that some people would present?

Thank you, Mr. Chair.

**The Chair:** If I can answer that, this was the reason for the panels. We did the national panel, where we brought in the different interest groups on a national basis, and this was the idea with the regional... to get their points of view. I don't know if they met our objectives.

I want to thank all three of you for coming.

I just have one quick question. This was a question geared mainly toward one of the institutions from the Atlantic region that was supposed to come. As you well know, there are regional funds. In Quebec, we have the DEC, Développement économique Canada, and then there is ACOA in Atlantic Canada, and in the west they have the Western Economic Diversification Fund. They're designed to help specific programs for the regions. You're both from regions, so how do you feel about those?

I think Ralph Goodale, when he appeared before the committee, made reference to the fact that he wanted it to be mainly an innovation fund to try to promote research and development in regions, not just in Atlantic Canada. He referred to Atlantic Canada, but I think we'd like to use the model maybe for Quebec and western Canada and northern Ontario, where the regional funds exist.

That's to both of you.

[*Translation*]

I do not know whether you are able to answer my question. Are the programs that were specifically made for the regions really helpful to the development of these regions? Have you carried out any studies on this matter?

**Ms. Norma Kozhaya:** The short answer is no. This is proven by the fact that despite equalization and transfer payments of all kinds made especially to the Atlantic provinces, those regions are still very poor or still have very high unemployment rates.

**The Chair:** Thank you.

[*English*]

Mr. Gibbins, do you have a...?

**Dr. Roger Gibbins:** In the western Canadian case, Western Economic Diversification does not do much in terms of program delivery or redistribution. What it does do is allow the federal government to play a very important catalytic role in areas of mixed jurisdiction. So WED has been very instrumental in addressing or mobilizing other governments to address questions dealing with urban aboriginal peoples, for example, and in trying to fill in some of the gaps in an innovation agenda in western Canada. So I see the WED's role in western Canada not so much as promoting western economic development, but rather as giving the federal government a more flexible and creative role in the region, which it would not have if it relied only on mainline departments to deliver programs in the west.

• (1650)

**The Chair:** Thank you again.

[*Translation*]

Thank you for having spent this time with us.

[*English*]

I'm sorry about some of the witnesses who weren't here.

Mr. Bell, just quickly.

**Mr. Don Bell:** Do I have time for any other questions?

**The Chair:** Not really. We can speak to them after—

**Mr. Don Bell:** I thought we went until five.

**The Chair:** We had agreed to go until 4:30.

**Mr. Don Bell:** Okay, sorry.

**The Chair:** The meeting is adjourned.

Thank you.

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