HOUSE OF COMMONS
CANADA

MOVING FORWARD: BALANCING PRIORITIES AND MAKING CHOICES FOR THE ECONOMY OF THE TWENTY-FIRST CENTURY

REPORT OF THE STANDING COMMITTEE ON FINANCE

Massimo Pacetti, Member of Parliament
Saint-Léonard / Saint-Michel
Chair

December 2004

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THE STANDING COMMITTEE ON FINANCE

has the honour to present its

THIRD REPORT

In accordance with its mandate under Standing Order 83.1, your committee studied proposals on the budgetary policy of the government and has agreed to report the following:

COMMITTEE MANDATE

Standing Order 83.1

Each year the Standing Committee on Finance shall be authorized to consider and make reports upon proposals regarding the budgetary policy of the government. Any report or reports thereon may be made no later than the tenth sitting day before the last normal sitting day in December, as set forth in Standing Order 28(2).

House of Commons
Canada

Monday, December 13, 2004

Certified to be a true copy of the Journals of the House of Commons of Wednesday, December 1, 2004.

MOTION

The following extract of motion was concurred in on December 1, 2004:

"That, notwithstanding Standing Order 83.1, the Standing Committee on Finance be authorized to present its Report on the Pre-Budget Consultations 2004 between December 3 and December 17, 2004, and;

That, on any day that the House is not sitting in December 2004, the Standing Committee on Finance be authorized to deposit its report with the Clerk of the House, which shall thereupon be deemed to have been presented to the House."

ATTEST

The Clerk of the House of Commons

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CHAIR'S FOREWORD

What does a Committee report in a minority Parliament look like? As Chair, I invite you to read this report, which — with its four minority reports — provides you with a sense of the challenges in a minority situation. As Chair of the House Finance Committee, several people have asked: Why bother with a main Committee report, since you will have four minority reports? As I begin my reply to this question, let me extend my heartfelt thanks to my Committee colleagues both for the opportunity to lead this Committee over the last three months and for their hard work and dedication.

The challenge when preparing the main Committee report was gaining consensus, to the greatest extent possible. While unanimity on each issue and each recommendation was not possible, I was pleased with the Committee's dedication to seeking a consensus on as many issues as possible. As we started our review of the draft report, we had 33 recommendations. At the end of the review, we also had 33 recommendations. While we rejected a limited number of recommendations and replaced some of them with those that enjoyed a greater degree of consensus, many of the recommendations had support among most Committee members following minor — if any — modification.

This experience was a first for me as a Chair of a Parliamentary Standing Committee. I am proud of the dedication of my colleagues, who — with their diversity of views and backgrounds — worked together to prepare a report that we believe will help to move our country forward. Their professionalism allowed political partisanship to be put aside as we tried to determine the recommendations that would best lead to prosperity, growth and the realization of potential for all Canadians and Canadian businesses. Although my colleagues were unrelenting in their views, which led to interesting debate, at the end of the day we shared a common purpose: what priorities must be balanced and what choices must be made for our future? Recognizing our differences and the extent to which we were able to reach agreement, I am proud to be Canadian.

Having thanked my Committee colleagues, I must also recognize the efforts of others without whom the Committee could not have completed its work as effectively and efficiently as it did. Therefore, I would like to thank first the people sitting at the table with me, notably Richard Dupuis, Clerk of the Committee, as well as June Dewetering and Alexandre Laurin, the Committee's analysts. As well, thanks must also be extended to others who supported the Committee in a less visible manner, including Patrick Paradis, who led the team of administrative assistants at Richard's office, Matthew Carnaghan, who assisted June and Alexandre in their work, the logistics officers — Sharron Scullion, Robert Hoffman and John Bejermi — who contacted the witnesses, as well as the Translation Office, the Interpreters, the Publication Service and all other services of the House that contributed to the Committee's work.

Unlike past years, this year the Committee had only three weeks within which to conduct the pre-budget consultations. As a result, we were unable to travel across Canada to hear other individuals and groups who wanted to participate, and to you we extend our apologies. We did, however, hear from almost 300 witnesses representing nearly 200 groups during our more than 40 hours of pre-budget hearings. We thank all of you for sharing your thoughts and priorities with us. Many groups and individuals submitted written briefs to the Committee without making a public appearance, and we are both grateful for, and enlightened by, your written contribution to our pre-budget process. We thank you as well.

As Chair, I conclude by noting that, in the Committee's view, our recommendations give a useful direction for moving this country forward. We talk about many of the important issues that must be addressed as we move into the future: federal fiscal responsibility that will enable us to make the program, taxation and other choices that Canadians and Canadian businesses want; sustainable communities within which to live and work; measures to ensure that our businesses grow and prosper; and initiatives that will help all Canadians to maximize their potential, for their benefit and the benefit of the nation.

Massimo Pacetti, Member of Parliament
Saint-Léonard / Saint-Michel

INTRODUCTION

In October 2004, the House of Commons Standing Committee on Finance began its pre-budget consultations for 2004. As in years past, Canadians were invited to share with the Committee their views about the taxation, spending and other measures that should be contained in the upcoming federal budget.

For the most part, Canada finds itself in an enviable position. Economic growth is solid, inflation is relatively low and stable, employment growth is strong, unemployment rates are relatively low, the value of the Canadian dollar is rising relative to its U.S. counterpart, borrowing costs are relatively low, household debt is manageable, and a federal budgetary surplus is expected each year in the foreseeable future.

Within this context, a key challenge for the federal government is to determine how best to move forward. In essence, the government must determine how to balance priorities and to make choices for the economy of the 21st century, an economy that will ensure that Canadian businesses and Canadian citizens can prosper and maximize their potential.

It was with a view to the future that the Committee asked witnesses to develop responses to questions that we believe are important as we look toward the future:

- What should be the program spending, taxation and other priorities of the federal government in the next budget?

- What federal budgetary measures are needed to ensure a strong economy with low rates of unemployment, high levels of research, productivity and innovation, etc.? Are federal tax revenues sufficient to enable adequate services for, and investments in, Canada’s people, regions and sectors, etc.?

- What is the estimated cost of your proposal, and if program spending reductions and/or tax changes were required to finance the cost of your proposal, which programs should have their funding reduced and/or what tax changes would you suggest?

- With the federal government’s five-year tax reduction program completed, should the federal government institute another broadly based tax reduction program and, if so, what taxes should be reduced and by how much?

- What are the opportunities, costs and benefits to reducing the tax burden — through tax rate reductions and changes to thresholds — on low- and modest-income families, consistent with the federal government's overall commitment to balanced budgets and sound fiscal management?

- What changes, if any, should be made to the fiscal arrangements between the federal and provincial/territorial governments to correct what some call "the fiscal imbalance" and to alleviate other fiscal pressures in order to stabilize the situation?

- What is the optimal rate of growth of federal program spending in relation to the Canadian economy?

- In the event of a federal budget surplus, how should the surplus be allocated among debt repayment, transfers to the provinces/territories, tax reductions, and — recognizing the constitutional distribution of powers — increased program spending in areas such as quality child care, post-secondary education, housing, research and development, etc.?

From the broad range of ideas shared with the Committee by witnesses representing diverse interests, we have developed recommendations that we believe — if implemented — would move this country forward. We believe that our future success is a function of success at many levels: at the governmental level in terms of sound fiscal finances that enable us to afford to plan for the future; at the business level in terms of prosperity and profitability for the benefit of companies but also Canadian citizens and communities; and at the individual level in terms of access to health care, lifelong learning and employment opportunities, sustainable communities, affordable housing and the range of supports needed in various circumstances throughout life.

In the Committee's view, governments, businesses and individuals are interdependent: the success of any one hinges on the success of the other two. We cannot view governments in isolation: we must consider the effects of government decisions on business activity and individual behaviour. We cannot view businesses in isolation: we must consider the need of businesses for well-educated and productive employees and for a competitive environment within which to operate. We cannot view individuals in isolation: we must consider their need for employment and for public services. This very interdependence means that all levels of government, industry and individuals must work together on a variety of fronts and must be accountable to one another.

Chapter One focuses on preserving Canada's fiscal discipline, since this discipline enables us to have better, and a wider range of, options from which to choose. For example, with reduced debt servicing costs resulting from a lower federal debt, more funds are available to finance other priorities.

Chapter Two focuses on the investments that are needed in order that businesses and individuals have sustainable communities within which to work and live. A sustainable environment and adequate and well-maintained municipal infrastructure, as well as a caring and culturally rich environment, are important to Canadians' quality of life and the ability of businesses to prosper.

Chapter Three focuses on businesses, particularly the tax, regulatory, capital, trade, research and innovation measures that will ensure their growth and prosperity. An important element as well is the defence of our country and our management of the border we share with the United States, our largest trading partner.

Chapter Four focuses on individuals, especially vulnerable groups, and actions that should be taken with respect to issues such as health care, lifelong learning and taxation to ensure that their potential and opportunities are maximized.

As we move forward as a nation — as priorities are balanced and choices are made — the Committee believes that the right decisions with respect to federal finances, communities, businesses and individuals will help to ensure that Canada remains the envy of many countries worldwide. We want to ensure that Canadians — businesses and individuals — have the future that they deserve.

CHAPTER ONE: PRESERVING CANADA'S FISCAL DISCIPLINE

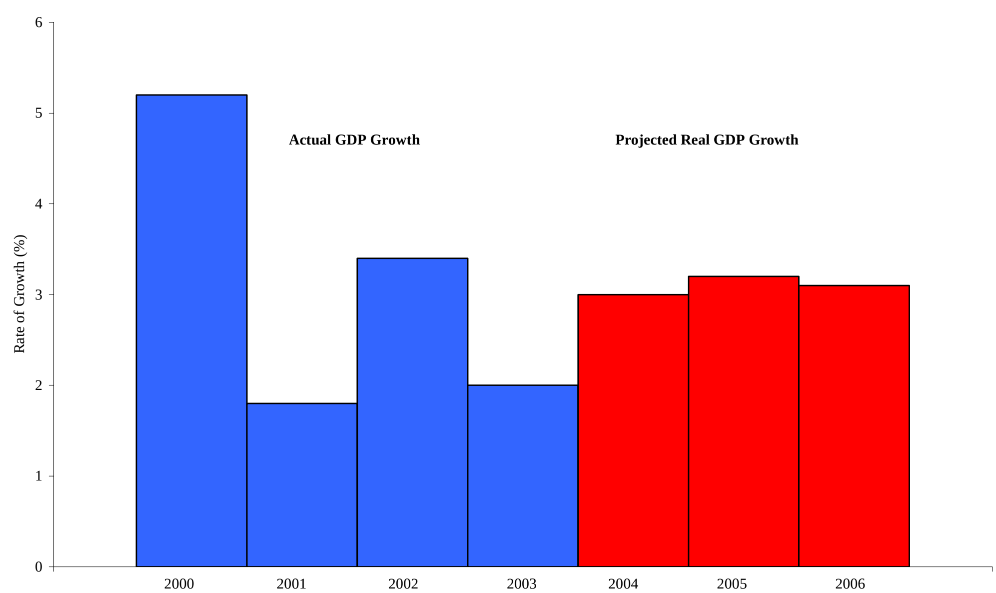
THE CURRENT ECONOMIC SITUATION

A. What the Federal Government Provides

The federal government plays an important role in contributing to an environment in which businesses can grow and prosper and citizens can maximize their potential and opportunities. Through its spending, taxation and other policies, the government establishes the parameters within which businesses and citizens can thrive.

The 2004 federal budget reported that private sector economists expected Canada's real economic growth rate to average 2.7% in 2004; to date, real Gross Domestic Product (GDP) grew by 2.7% in the first quarter of 2004, 3.9% in the second quarter and 3.2% in the third quarter (annualized rates). In his 16 November 2004 appearance before the House of Commons Standing Committee on Finance to provide an economic and fiscal update, the Minister of Finance indicated that GDP growth was almost 3.4% in the first half of 2004. Moreover, he said that private sector economists expect growth to be 3.0% in 2004 — an increase from 2.7% predicted in the 2004 budget — and to be 3.2% in 2005. Figure 1.1 shows GDP growth, both actual and projected, over the 2000 to 2006 period.

Figure 1.1: Real Gross Domestic Product (GDP) Growth, 2000 to 2006



Sources: Statistics Canada and Department of Finance, *Economic and Fiscal Update 2004*, p. 68.

Between 1997 and 2003, Canada led the G-7 countries in terms of real economic growth per capita.[1] This performance is largely the result of Canada's strong employment growth over the period, as Canada's rate of employment grew at a pace more than twice the average of the other G-7 countries.[2] In November 2004, the unemployment rate was 7.3% (seasonally adjusted).[3]

During the past year, the Canadian economy has been affected by the relatively rapid rise in the value of the Canadian dollar when compared to the U.S. dollar — the relative value rose 17% from January to December 2003 — and by the slow recovery in the U.S. economy in the first half of 2003. Since January 2004, the value of the Canadian dollar has continued to rise relative to its U.S. counterpart, consistently closing in recent months above US$0.80, a level unseen in many years.[4] The exchange rate between Canada and the United States over the 2003 to 2004 period is shown in Figure 1.2.

Figure 1.2: Canada - United States Exchange Rate ($US), 2003 to 2004

Source: Bank of Canada.

1 Department of Finance, *Economic and Fiscal Update*, 16 November 2004, p. 47, available at: www.fin.gc.ca/budtoce/2004/ec04_e.html.

2 Ibid., p. 46.

3 Ibid., p. 36.

4 Information on exchange rates is available at: www.bankofcanada.ca/en/can_us_close.htm.

Since the middle of 2003, however, economic growth in the United States has accelerated. The U.S. economy grew 4.8% in real terms from the second quarter of 2003 to the second quarter of 2004. In his appearance before this Committee on 16 November 2004, the Minister of Finance indicated that private sector forecasters expect growth in the U.S. economy to be 4.4% in 2004 and 3.5% in 2005. The growth in the U.S. economy, along with strong growth in Asia as well as higher world energy and commodity prices, has helped to offset the negative implications of the rising relative value of the Canadian dollar for our exports. As the Minister of Finance indicated in his appearance, however, "[w]hile it appears that exporters adjusted well to the Canadian dollar in 2003, it is not clear how the further 10-cent increase since May will affect the economy. Furthermore, it is very difficult to predict where the dollar will go next."[5]

Domestically, the rate of increase in household spending, which has been the main contributor to growth in economic activity in recent years, is also important. In the past, the Bank of Canada has played a central role in influencing domestic demand by lowering the overnight interest rate, resulting in increased consumer borrowing, record net saving by the corporate sector and a growing housing sector. While in September 2004 the Bank of Canada raised its overnight interest rate by 0.25 percentage points to 2.25%, and raised it by a similar amount in October 2004 to reach 2.5%,[6] borrowing interest rates in the economy are still relatively low by historical standards.

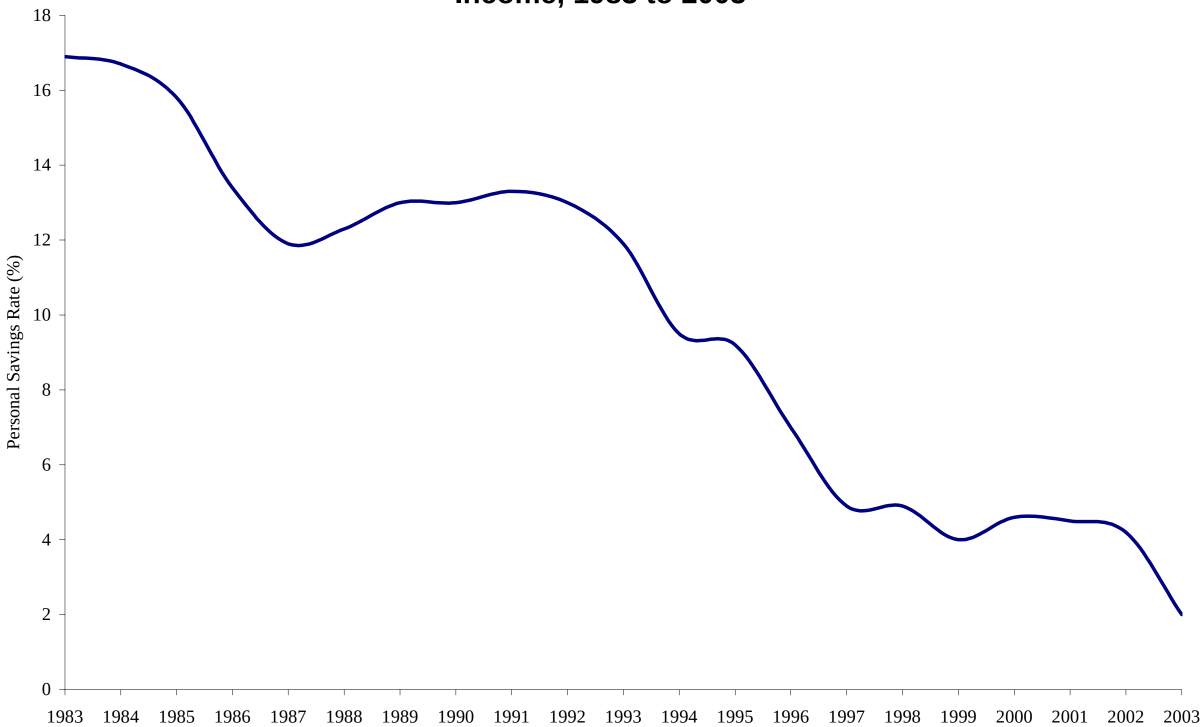
According to Statistics Canada, in the second quarter of 2004, the market value of household net worth grew at a faster rate than in the previous quarter in terms of both financial and non-financial assets, while the ratio of consumer credit and mortgage debt to personal disposable income stabilized at about 103% (seasonally adjusted). Statistics Canada reported that the consumers' savings rate reached a record low of 0.7% in the third quarter of 2003 before rising again and reaching 1.5% in the second quarter of 2004.[7] Figure 1.3 shows the personal savings rate over the 1983 to 2003 period.

5 House of Commons Standing Committee on Finance, "Presentation by the Minister of Finance on the *Economic and Fiscal Update*," 16 November 2004.

6 Information on the Bank of Canada's overnight interest rate is available at: www.bankofcanada.ca/en/.

7 Statistics Canada, *The Canadian Economic Observer*, September 2004.

Figure 1.3: Savings Rate as a Percentage of Personal Disposable Income, 1983 to 2003



Source: Statistics Canada.

The management of mortgage, credit card and other personal debt is a source of concern for some Canadian households. A recently published survey carried out for a Canadian financial institution found that 70% of respondents were worried about their ability to manage their personal debt in the context of rising interest rates, and that almost 75% claimed that they had made little or no progress in reducing their debt or increasing their savings over the past year.[8]

While there may be a concern among some that rising personal debt levels can present serious risks to individuals' finances and to economic growth, the RBC Financial Group has argued that "most bearish views overstate the risks posed by household finances to either lenders or the economy."[9] Currently, the cost of borrowing is relatively low.

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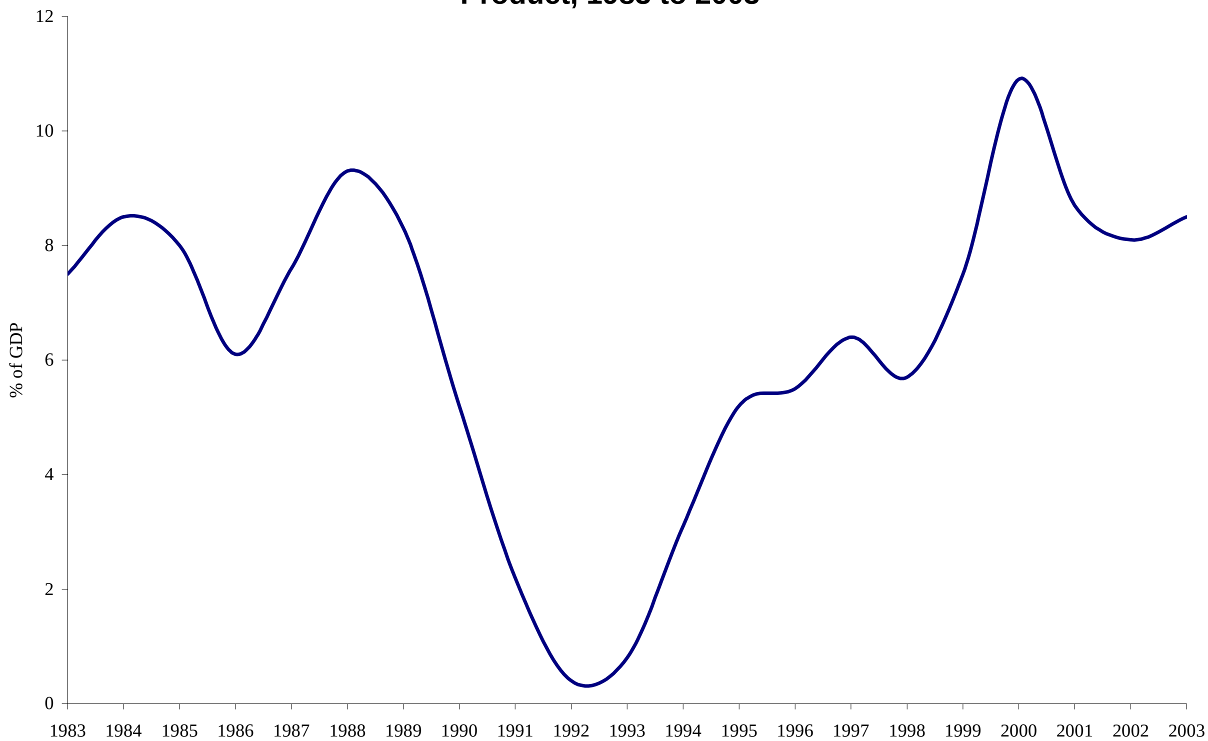
[8] The survey was conducted for Manulife Bank of Canada by Maritz Research. Survey results were released in October 2004, and a press release about the results is available at: www.manulife.com/corporate/corporate2.nsf/Public/canada101304.html.

[9] RBC Financial Group, "Seven myths about household finances," *Current Analysis*, March 2004, available at: www.rbc.com/economics/market/pdf/myths.pdf.

While relatively low interest rates have made relatively high levels of debt affordable, rising and high debt levels could leave consumers vulnerable to an economic downturn or to high and rising interest rates.

The fairly low personal savings rates in recent years should be considered in light of the relatively sizeable increase in total domestic savings over the same period. Total domestic savings consider individuals as well as corporations and governments. Domestic savings as a percentage of GDP exceeded 8.5% in 2003, close to the levels reached in the late 1980s, as shown in Figure 1.4. While individuals did not increase their savings rate for a number of years, governments and corporations did so beginning in the mid-1990s.

Figure 1.4: Domestic Savings as a Proportion of Gross Domestic Product, 1983 to 2003



* Total savings of governments, corporations and individuals, excluding savings of non-residents.

Source: Statistics Canada.

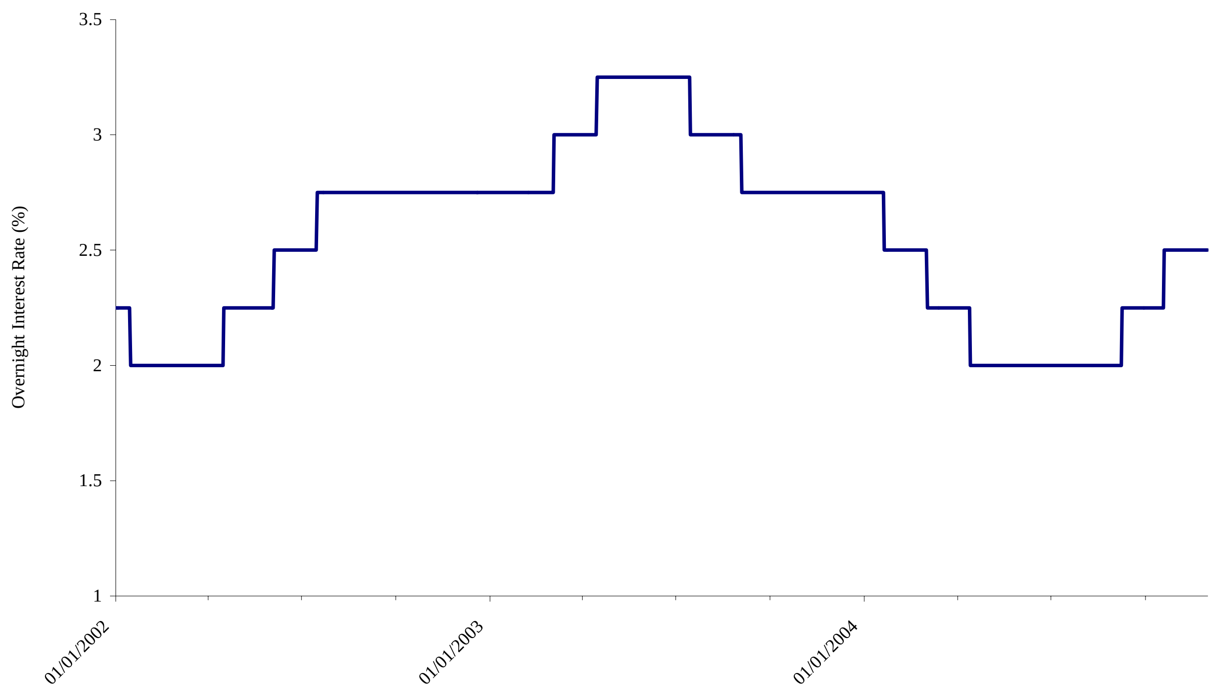
When the Bank of Canada raised its overnight interest rate to 2.5% in October 2004, the Bank reported that it expected that core inflation[10] would, by the end of 2005, be at the 2% target rate,[11] an increase from its current rate of 1.4%. Since the economy

[10] "Core inflation" is the All-Items Consumer Price Index minus its eight most volatile components and the effects of changes in indirect taxes.

[11] This 2% rate is the mid-point in the Bank of Canada's target range for inflation.

has grown more than was expected and core inflation reached 1.9% in July 2004, the Bank of Canada twice raised its overnight interest rate in recent months in order to help reduce inflationary pressures. Changes in the Bank of Canada's overnight interest rate over the January 2002 to November 2004 period are shown in Figure 1.5. Moreover, the Bank has indicated that more rate increases may be required over time to constrain inflation.

Figure 1.5: Bank of Canada's Target for the Overnight Interest Rate (%), January 2002 to November 2004



Source: Bank of Canada.

The price of oil has risen steadily since the second quarter of 2003, when its price was about US$30 per barrel. If the price rises to — and remains at — a price of US$50 a barrel or higher for any length of time, the Canadian economy — which is both a producer and an importer of oil — may be significantly affected.

B. What the Witnesses Said

During the Committee's pre-budget consultations, witnesses shared their concerns about the rapid increase in the relative value of the Canadian dollar. They observed that exporters of final goods are particularly affected, since their earnings are reduced and, unlike some other sectors of the Canadian economy, they do not benefit from increasing world market prices — denominated in U.S. currency — for their exports.

Other witnesses noted that capital inputs imported from the United States are becoming less expensive, and that the rise in the relative value of the Canadian dollar presents an excellent opportunity for Canadian businesses that import capital inputs, such as machinery and high-tech equipment, from the United States.

Finally, it was suggested to the Committee that the Bank of Canada should act to ensure that the rise in the relative value of our currency is kept in line with Canadian exporters' best interests.

C. What the Committee Believes

The Committee believes that the Canadian economy is strong and growing. We commend governments and such institutions as the Bank of Canada for their decisions that have resulted in low rates of inflation, a declining federal debt-to-GDP ratio, an appreciation in the relative value of the Canadian dollar, rising employment growth and declining rates of unemployment. We also praise the businesses that produce products that domestic and international consumers want, and the employees who are vitally important in producing those goods and services. We feel that continued prosperity — for the nation, for businesses and for citizens — will occur only if governments and government agencies continue to make decisions that will result in a strong economy.

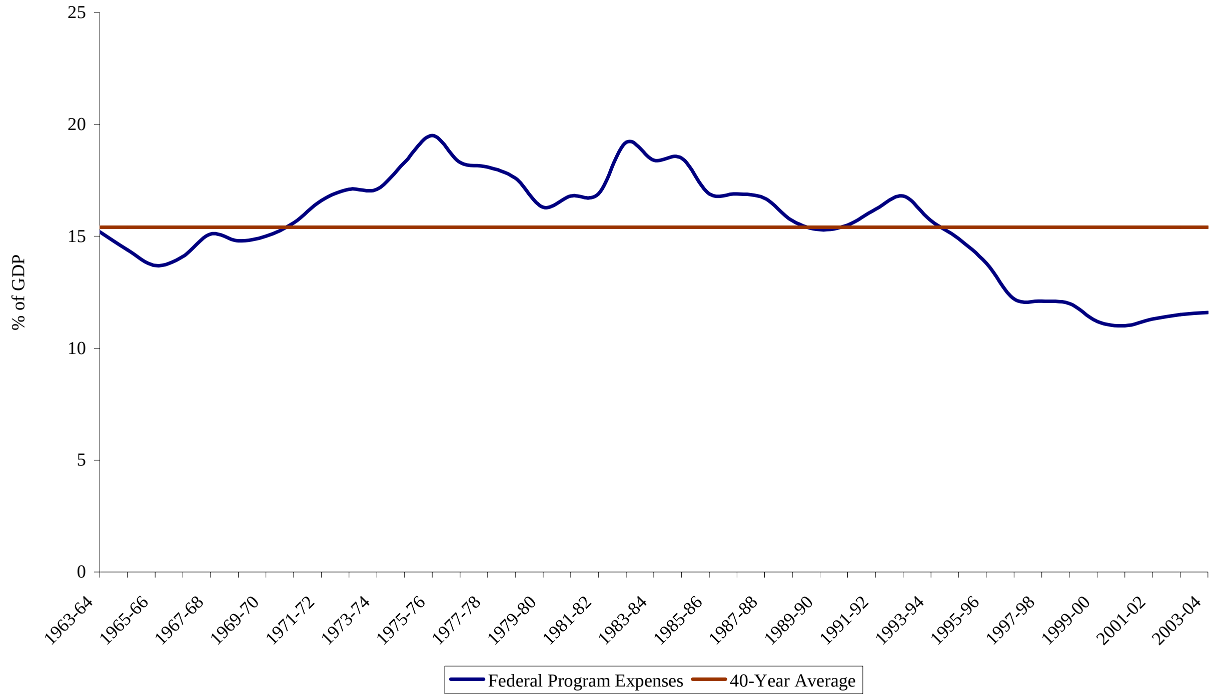
Consequently, the Committee urges the making of prudent decisions that will enable us to remain a strong nation, characterized by businesses that are able to operate in an environment in which they can grow and prosper and by citizens who are provided with the tools that they need to maximize their potential and opportunities.

EXPENDITURE REVIEW AND FEDERAL PROGRAM SPENDING

A. What the Federal Government Provides

Since federal program review was last undertaken in any comprehensive manner in the mid-1990s, total federal program spending — including transfers to persons and other levels of government — has risen from a low of $102.3 billion in 1996-1997 to $141.4 billion in 2003-2004, a 38% increase over the period. Despite these increases, however, federal program spending as a proportion of GDP remains relatively low. In 2003-2004, federal program spending as a proportion of GDP was 11.6%, a reduction from 12.2% in 1996-1997. Furthermore, federal program spending as a proportion of GDP remains markedly below the 40-year average, as shown in Figure 1.6.

Figure 1.6: Federal Program Expenses as a Percentage of Gross Domestic Product, 1963-1964 to 2003-2004



* Data before 1983-1984 are not strictly comparable.

Source: Department of Finance, *Fiscal Reference Tables*, October 2004, Table 2.

In December 2003, the federal government announced the creation of a Cabinet-level Expenditure Review Committee (ERC). Documents accompanying the 2004 federal budget summarized the Committee's mandate:

> [The Expenditure Review Committee] will set stringent new standards for every department to ensure spending remains under control and is aligned with the evolving priorities of Canadians. It will also focus on such major activities as government-wide procurement, property management, and information technologies.
>
> Within a period of four years, the government expects the ERC process to identify at least $3 billion annually in savings for new investments in the ever-evolving priorities of Canadians — in health care, learning and innovation, communities, Aboriginal Canadians and the disabled.[12]

[12] Department of Finance, *The Budget Plan 2004: Responsible and Prudent Financial Management*, available at: www.fin.gc.ca/budget04/pamph/pafine.htm.

The 2004 federal budget identified seven tests against which existing federal program spending would be assessed:[13]

- the public interest test — whether the public interest continues to be served by the program area or activity;
- the role of government test — whether the federal government has a legitimate and necessary role;
- the federalism test — whether the federal government's current role is appropriate;
- the partnership test — whether transfer of activities, in whole or in part, to the private/voluntary sector should or could occur;
- the value for money test — whether Canadians are receiving value for their tax dollar;
- the efficiency test — whether — and, if so, how — the efficiency of the program area or activity could be improved; and
- the affordability test.

Following the federal election in June 2004, the ERC became the Expenditure Review Sub-committee of the Treasury Board, and the Minister of National Revenue became the Chair. In his appearance before the House of Commons Standing Committee on Finance on 28 October 2004, the Minister of National Revenue said that "the government has decided to shift $12 billion of expenditures from low-priority areas to high-priority areas over the next five years." He also commented that the Subcommittee has another mandate "which is to develop a permanent mechanism so every year, as a matter of the regular budgetary cycle, there will be a review of expenditures."[14]

B. What the Witnesses Said

Many witnesses expressed concerns that federal spending is rising too quickly, and urged a limit on spending. Some proposed that the federal government limit annual program spending growth to no more than the total of the rates of inflation and population growth. It was noted that this rate of increase would be about 3% annually. Others suggested that annual growth in federal program spending should be limited to no more than the expected rate of GDP growth. They argued that program spending that increases more quickly than the rate at which the economy grows cannot be sustained

13 Department of Finance, *The Budget Plan 2004*, p. 57, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

14 House of Commons Standing Committee on Finance, "Presentation by the Minister of National Revenue," 28 October 2004.

without increasing federal budgetary revenues, which would require an increase in tax or in non-tax revenues, such as user fees.

Not all witnesses, however, shared the view that federal program spending growth should be limited. For example, the Committee was told that the current level of federal program spending, as a share of GDP, is currently low from an historical perspective.

Moreover, it was pointed out that the federal government can continue to allocate new funds to urgent priorities if the current effort to reallocate federal spending from existing uses to more urgent purposes proves to be successful. In fact, most witnesses supported the ongoing review of federal government expenditures and advocated the need to reallocate government spending from lower priority areas to more urgent priorities.

For many witnesses, new federal spending in priority areas must not create unsustainable pressures on federal government finances. The Committee was told that the Expenditure Review Subcommittee is central to controlling expenditures and to ensuring continued balanced budgets.

The Committee was also told that expenditure review must be carried out carefully. At the provincial/territorial level, problems have arisen with the operation of a performance funding system.

C. What the Committee Believes

The Committee, like a number of our witnesses, believes that expenditure review is a critically important exercise, and is one that should be undertaken on an ongoing and comprehensive basis. We live in a world characterized by change, and as change occurs, responsible use of taxpayer funds requires that governments undertake the consultations and other reviews needed to ensure that funds continue to be allocated to the programs and services that are most highly valued by Canadians. Continual review to ensure that spending is directed away from low-priority areas to those that have a higher priority should become a permanent feature of the way governments operate.

Governments have an obligation to ensure that tax revenues are spent in the most effective and efficient manner possible and are consistent with the priorities of Canadians. Quite simply, the Committee believes that we cannot afford to fund programs and initiatives that no longer serve a useful purpose, that do not deliver the maximum benefit in the most effective and efficient manner, and that do not reflect the needs and desires of the Canadians who fund them. In our view, programs and activities must meet the following criteria: they must serve the public interest; they must support the notion that there is a legitimate and necessary role for the federal government in this area; they must meet the needs of Canadians in the most effective and efficient manner possible; they must provide Canadians with value for their money; and they must be affordable within the federal fiscal context and consistent with the activities identified by Canadians as priorities for them.

The Committee recognizes the Expenditure Review Subcommittee's work, and hopes that the $3 billion annual target is not only reached, but surpassed, bearing in mind that difficult choices may have to be made about what constitutes a low-priority area of spending activity. In this regard, we believe that the seven tests identified above from the 2004 federal budget are useful in identifying those areas where reallocation should occur. We also support the adoption of a permanent mechanism to review federal expenditures and thereby ensure that, as a responsible government, funding is allocated to those programs and activities most valued by Canadians. It is from this perspective that the Committee recommends that:

RECOMMENDATION 1

The federal government institute a permanent mechanism by which federal tax and program expenditures are reviewed annually. This mechanism should require consultations with Canadians about their priorities within the context of public interest, role of government, federalism, partnership, value for money, efficiency and affordability tests.

Regarding the rate of increase in federal program spending, the Committee supports a target for the rate of spending increase. In our view, such a target should be used as a general guide to ensure that spending does not rise too quickly, recognizing that extraordinary and changing circumstances may require spending at a higher rate. Certainly, constrained program spending increases was a priority for some of our witnesses, and it is a priority for us as well. Thus, the Committee recommends that:

RECOMMENDATION 2

The federal government ensure that annual rates of increase in federal program spending do not exceed the rate of growth in the nominal Gross Domestic Product, except in extraordinary circumstances.

THE CONTINGENCY RESERVE, ECONOMIC PRUDENCE AND ALLOCATING FEDERAL BUDGETARY SURPLUSES

A. What the Federal Government Provides

The explicit use of a contingency reserve to protect against the possibility of a federal budgetary deficit resulting from unforeseen negative economic developments and forecasting errors dates to the mid-1990s, when the federal budget-making process was reformed. Along with a contingency reserve, a two-year budget planning horizon was established rather than the five-year projections that had been used in the past, and private sector economic forecasts, adjusted to add a measure of caution, were used instead of economic forecasts produced by the Department of Finance.

Initially, the federal government's contingency reserve had a value of $2.5 billion in the first year of its two-year planning horizon, and a reserve of $3 billion was used in the final year. Beginning with the 1997 federal budget, the contingency reserve is $3 billion in both years of the planning period. Prior to the elimination of federal budgetary deficits in 1997, the contingency reserve — if not required — was used to reduce the federal deficit. Beginning with the 1998 budget, the policy was changed. Now, when the contingency reserve is not needed, the funds are used to reduce the federal debt, as indicated in the 1998 budget's *Debt Repayment Plan*.[15]

An explicit economic prudence measure with a value of $1 billion in the first year of the two-year federal budgeting period was added to the budget plan for the first time in the 2000 federal budget. Previous budgets had included the economic prudence measure in computing revenue and expenditure projections. That is, an additional measure of prudence was added to the private sector average projections for the economic assumptions used to forecast the federal budgetary balance. For example, the 1997 budget contained prudent assumptions about nominal GDP growth that were 20 basis points lower than the private sector average for 1997 and 60 basis points lower for 1998.[16]

The conceptual difference between the contingency reserve and the measure for economic prudence must be realized. As indicated in the November 2004 *Economic and Fiscal Update*, "if the Contingency Reserve is not required, it is applied to reduce the federal debt (accumulated deficit). If the economic prudence is not required, it is made available for budget planning."[17]

As shown in Table 1.1, since 1998-1999, federal debt repayment using the federal budgetary surplus has exceeded the amount of the contingency reserve in all years but one: 1998-1999. Similarly, beginning with the fiscal year in which the economic prudence measure was first explicitly budgeted, federal debt repayment using the federal budgetary surplus has exceeded the federal government's planned prudence amounts. Moreover, in each year, spending on new federal policy initiatives announced after the federal budget exceeded the planned prudence amounts.

15 Department of Finance, *The 1998 Budget: Overview,* available at: www.fin.gc.ca/budget98/fact/overfte.html.

16 House of Commons Standing Committee on Finance, *Keeping the Balance: Security and Opportunity for Canadians*, December 1997, available at: www.parl.gc.ca/committee/CommitteePublication.aspx?SourceId=36162.

17 Department of Finance, *Economic and Fiscal Update*, 16 November 2004, p. 75, available at: www.fin.gc.ca/budtoce/2004/ec04_e.html.

Table 1.1 — Contingency Reserve, Economic Prudence, Federal Debt Repayment and Federal Policy Initiatives Announced after the Budget, 1998-1999 to 2003-2004

Fiscal Year	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Planned Prudence Amounts	($ billion)					
Contingency Reserve	3	3	3	3	2	3
Economic Prudence			1	1		1
Total	**3**	**3**	**4**	**4**	**2**	**4**
Actual Fiscal Results						
Federal Surplus Used to Reduce the Federal Debt	2.8	13.1	20.2	7.0	7.0	9.1
Policy Initiatives Announced After the Federal Budget	5.7	6.2	7.2	5.3	7.3	4.8
Total	**8.5**	**19.3**	**27.4**	**12.3**	**14.3**	**13.8**
Sources: All sources are from the Department of Finance.						
Contingency Reserve and Economic Prudence	1998 Budget Plan	1999 Budget Plan	2000 Budget Plan	2000 Economic Statement and Budget Update	December 2001 Budget Plan	2003 Budget Plan
Federal Surplus Used to Reduce the Federal Debt	Fiscal Reference Tables, October 2004, Table 1					
Policy Initiatives Announced After the Federal Budget	1999 Budget Plan	2000 Budget Plan	2000 Economic Statement and Budget Update	December 2001 Budget Plan	2003 Budget Plan	2003 Economic and Fiscal Update
			2001 Economic Update	2002 Economic and Fiscal Update		2004 Budget Plan

* Totals may not add due to rounding.

Some confusion exists about the uses to which any federal surplus can be allocated. In 2001, the Auditor General of Canada commented that "[t]he surplus for the year does not automatically pay down the debt. There is neither any law nor accounting rule that requires this. This year's surplus was applied to several areas, only one of which was the reduction of debt. Part of the surplus was used, for example, to support increases in financial assets such as loans, investments and advances."[18] Table 1.1 demonstrates the truth in the Auditor General's statement, since the federal government has both reduced the federal debt and allocated funds for new initiatives since 1998-1999. This ability to fund new initiatives suggests that, over the 1998-1999 to 2003-2004 period, federal finances have had flexibility beyond the planned prudence amounts. Reasons for this flexibility might include stronger than expected economic growth and the very nature of prudent planning.

In the 1997 *Economic and Fiscal Update*, the federal government made a commitment about how the projected federal budgetary surplus that would arise in the absence of any new program spending initiatives and new tax reductions would be allocated. In particular, a 50:50 allocation to address economic and social needs and to reduce taxes and the federal debt was proposed.[19]

Determining the manner in which the federal government has allocated the federal budgetary surplus that would have arisen in the absence of any new federal program spending initiatives and new tax reductions since 1997 presents a number of difficulties, and the results are very sensitive to both the period that is chosen as the base year and the assumptions made. That being said, over the 1998-1999 to 2003-2004 period, it was recently estimated that:

- the amount of federal revenues collected in the absence of any federal tax reductions would have been $57 billion higher;
- the amount of federal program spending that would have occurred in the absence of any new policy actions to increase program spending would have been $65 billion lower; and
- the federal debt was reduced by $59 billion over the period.[20]

In essence, it was estimated that — in the absence of any new federal program spending initiatives or tax changes — the federal government would have had a cumulative surplus of about $181 billion over the 1998-1999 to 2003-2004 period. Of that amount, 64% was used to reduce taxes and debt, while the remaining 36% was used to fund social and economic needs through federal program spending. This result is not consistent with the 50:50 allocation commitment contained in the 1997 *Economic and Fiscal Update*.[21]

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[18] Auditor General of Canada, *Auditor General's Observations on the Financial Statements of the Government of Canada for 2001-2002*, p. 1.39, available at: www.oag-bvg.gc.ca/domino/other.nsf/html/99pac_e.html/$file/2002agobs_e.pdf.

[19] Department of Finance, *The Economic and Fiscal Update — 1997: An Overview*, available at: www.fin.gc.ca/update97/factOVER-E.html.

[20] Dale Orr, "Did the Government Split the Fiscal Dividend 50:50 as Planned and What Can We Learn from That?" *Global Insight*, November 2004.

[21] Ibid.

B. What the Witnesses Said

Many witnesses who appeared before the Committee expressed support for the federal government's contingency reserve and measure for economic prudence. For example, it was noted that Canada is the only G-7 country to incorporate such reserves into its fiscal planning, and it was urged that the government's current practice of allocating $3 billion annually to the contingency reserve and an increasing amount for economic prudence over the planning period be maintained.

Although witnesses generally supported the current amounts designated for the contingency reserve and economic prudence, it was suggested that the contingency reserve be increased to $5 billion. There was also general support for the notion that these amounts should be used for federal debt reduction if not required for other unforeseen purposes.

The Committee heard a variety of views about how the federal budgetary surplus, above the planned amounts for prudence, should be spent. Some advocated that at least some portion be used to reduce taxes. In their view, tax reductions would improve Canada's economic productivity and competitiveness; eventually, these improvements would lead to strong economic growth and an expanded tax base.

Others offered the opposite view of how the federal budgetary surplus should be spent, arguing that it should be used to fund new and existing social, cultural and infrastructure program expenditures. The Committee was told that the so-called "50:50" commitment, as described above, has not been respected. According to this view, about 22% of the federal budgetary surplus that would have arisen in the absence of any new federal program spending initiatives and new tax reductions since 1997 was allocated to increase federal program expenditures, which is less than the 50% committed. Consequently, the federal government would need to devote future surpluses to new program spending to fulfill its "50:50" commitment.

Others advocated a more balanced approach. Some suggested that the federal budgetary surplus should be allocated to both federal program spending and tax reductions; others suggested that the surplus should be allocated among tax reductions, debt repayment and spending in areas such as research, training and infrastructure.

Finally, the Committee was told that the federal budgetary surplus allocation process must be more transparent, regardless of the size of the surplus. It was also suggested that informed decision making about allocating the surplus requires reliable projections. It was argued that the federal government's official budget figures are often misleading: although the federal budget process always begins by assuming limited fiscal room for new initiatives, year after year large surpluses materialize at the end of the fiscal year. Several witnesses advocated independent fiscal forecasts for Parliament prepared by a "parliamentary budget office," based on the U.S. model, or by the Auditor General of Canada.

C. What the Committee Believes

The Committee, like some of our witnesses, supports the notion of a contingency reserve and a measure for economic prudence, believing that both are important elements of the responsible fiscal planning that a country's citizens should expect from their governments. It is important, for example, that funds be available to deal with unforeseen crises, such as the outbreak of Severe Acute Respiratory Syndrome, the identification of a case of Mad Cow Disease and the terrorist attacks of 11 September 2001. In fact, these types of unexpected crises are precisely the type of circumstances that the contingency reserve was created to address.

In the Committee's view, the funds allocated to the contingency reserve and for economic prudence are key elements of cautious fiscal planning. We understand the need to use these funds to address extraordinary circumstances, but believe that in the absence of such circumstances, the contingency reserve — which we believe should have a value of at least $3 billion — should continue to be used to reduce the federal debt. We also support a measure for economic prudence, since fiscal forecasting is not an exact science, and feel that unused amounts should be part of the budget planning process. Consequently, the Committee recommends that:

RECOMMENDATION 3

The federal government continue to include, in its budget planning, an allocation of at least $3 billion as a contingency reserve.

Moreover, the government should also continue to include an appropriate amount for economic prudence, bearing in mind that forecasting becomes less reliable the farther into the future the period for which the forecast is made.

FEDERAL DEBT REDUCTION AND THE FEDERAL DEBT-TO-GDP RATIO

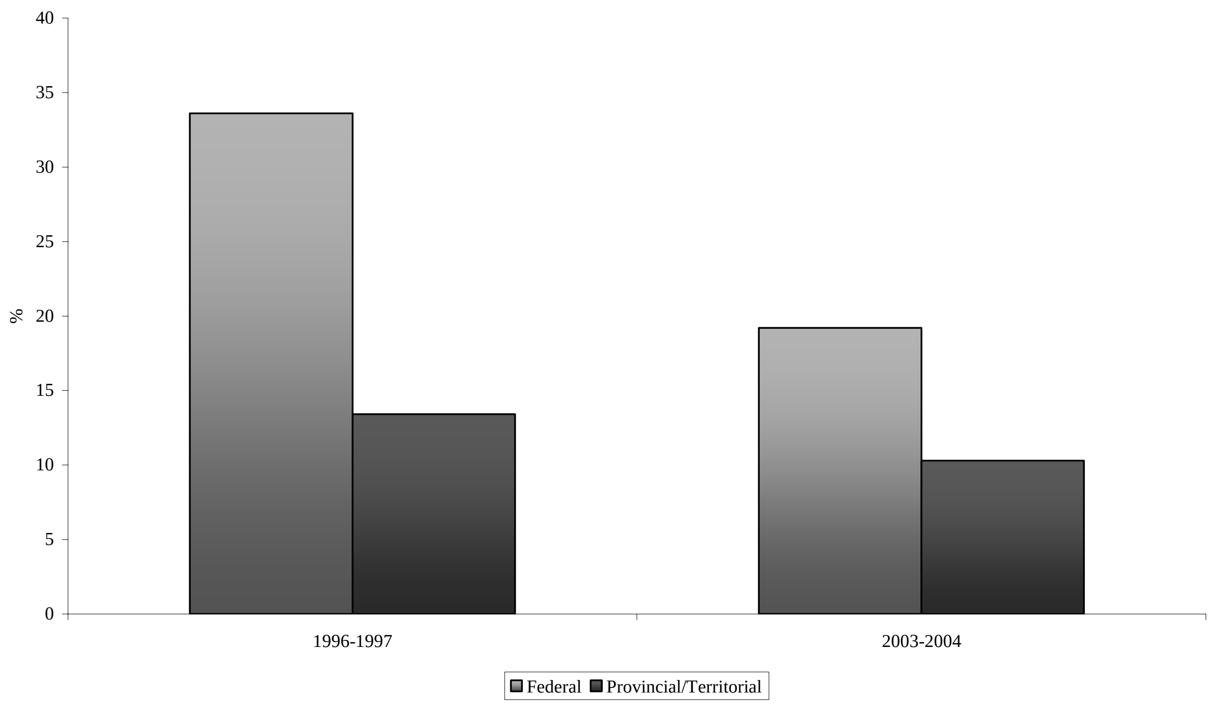
A. What the Federal Government Provides

Since 1995-1996, as a consequence of strong economic growth and reductions in the absolute size of the federal debt, the federal debt-to-GDP ratio has fallen from a peak of 68.4% to 41.1% in 2003-2004, its lowest level since 1983-1984. Moreover, the level of the debt has declined by $61.4 billion over the last seven years.[22] In the 2004 federal budget, the federal government announced the objective of reducing the debt-to-GDP ratio to 25% within 10 years. The Department of Finance projected that this debt-to-GDP objective could be achieved by reducing the federal debt by $3 billion annually — which, at least in the past, has equalled the value of the contingency reserve in most years — in conjunction with the rate of economic growth expected over that 10-year period. Over

[22] Department of Finance, *Economic and Fiscal Update*, 16 November 2004, p. 15, available at: www.fin.gc.ca/budtoce/2004/ec04_e.html.

10 years, $30 billion used to reduce the federal debt would represent about 2.5% of the current GDP. Consequently, most of the projected reduction in the debt-to-GDP ratio could be the result of economic growth.[23]

Figure 1.7: Cost of Servicing the Debt as a Percentage of Budgetary Revenues, 1996-1997 and 2003-2004



Source: Department of Finance, *Fiscal Reference Tables*, October 2004, Tables 1 and 30.

The cost of servicing the federal debt has declined markedly in the last eight years. As shown in Figure 1.7, federal debt servicing costs as a percentage of federal budgetary revenues fell from 33.6% to 19.2% over the 1995-1996 to 2003-2004 period. Nevertheless, the federal debt-to-GDP ratio is slightly less than double that of the provincial/territorial governments as a whole, as are the debt servicing costs as a proportion of budgetary revenues. There are, however, large variations in the debt-to-GDP ratios among the provinces, as shown in Figure 1.8. Ontario and British Columbia have a relatively low debt-to-GDP ratio, Alberta has net savings, and Québec, Nova Scotia, and Newfoundland and Labrador have a relatively high debt-to-GDP ratio.

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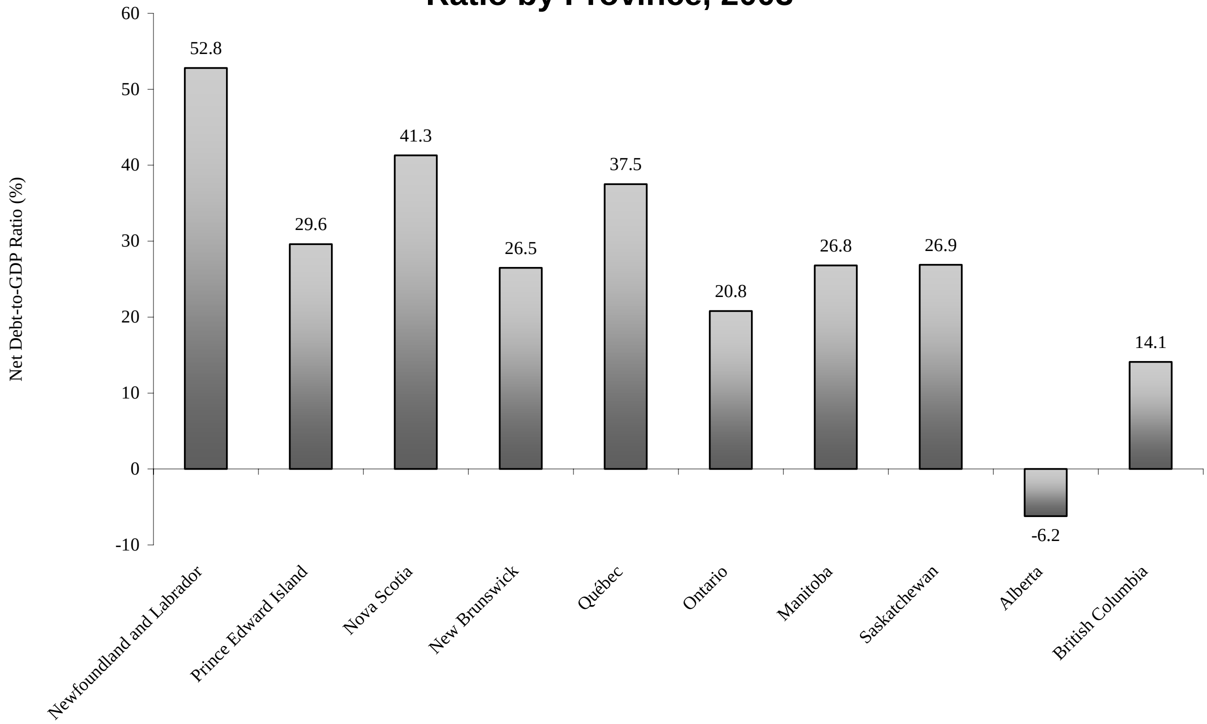
[23] Ibid.

Figure 1.8: Net Provincial Debt-to-Gross Domestic Product Ratio by Province, 2003



Source: Marcelin Joanis and Claude Montmarquette, “La dette publique : un défi prioritaire pour le Québec,” *Choix*, Vol. 10, No. 9, October 2004, p. 3 (www.irpp.org).

B. What the Witnesses Said

Federal debt reduction was identified by many witnesses as one of their main priorities: payments that reduce the debt are an investment in future generations. While many urged the allocation of unused contingency reserve and economic prudence amounts to debt reduction, some advocated more specific targets, including a federal commitment of at least $8 billion to debt reduction for 2005. Others recommended more explicit budgeting for debt repayment, urging that it not be contingent on other events. The Committee also heard a proposal for a legislated schedule of annual reductions in the federal debt equivalent to 5% of annual federal tax revenues collected; it was urged that proceeds from the sale of Crown assets, such as the shares in PetroCanada, be applied to reduce the debt.

Other witnesses, however, did not support continued federal debt reduction. In their view, funds currently allocated to debt reduction should instead be used to fund the social priorities of Canadians, including health care, education, child care, infrastructure and other needs. They believe that a normal rate of economic growth in the future would substantially reduce the federal debt-to-GDP ratio, assuming that the federal government just balances the budget. The Committee was told that using planned surpluses, such as the contingency reserve, to reduce the federal debt will make only a minimal contribution to achieving the federal government's debt reduction goal.

C. What the Committee Believes

The Committee makes two observations about the debt-to-GDP ratio. First, economists generally agree that there is no optimal debt-to-GDP ratio; consequently, any particular target is likely to be selected somewhat arbitrarily. Second, the federal debt-to-GDP ratio, which essentially measures the cost of carrying the country's debt, can be reduced in two ways: through reducing the absolute level of the debt — the numerator — or through economic growth — the denominator.

Of these two options, economic growth was responsible for most of the decline in the federal debt-to-GDP ratio since the federal government balanced the budget. Nevertheless, continued emphasis on both GDP growth and reductions in the federal debt would enable the ratio to reach a targeted lower level more quickly and would reduce debt servicing costs. In turn, the result would be more funds available for other purposes, including the program spending and tax reduction initiatives desired by Canadians. It was partly for this reason that the Committee recommended that the contingency reserve be *at least* $3 billion and that, throughout this report, we make recommendations that we believe — if implemented — would enhance GDP growth. We advocate working on both the numerator and the denominator. Both are important. It would take almost 170 years to eliminate the federal debt if the only action taken was the use of a $3 billion contingency reserve to reduce the federal debt.

Consistent with the recommendations of a number of the Committee's witnesses, we continue to support efforts that contribute to a decline in the federal debt-to-GDP ratio. Reductions in the absolute level of debt result in lower interest payments, and moneys saved can be used for other purposes that are priorities for Canadians. Moreover, interest payments are more easily financed with continued economic growth, and this growth results in greater prosperity more generally. While we recognize the consensus view among economists that the selection of any particular target and any specific timeframe for its achievement are somewhat arbitrary, we believe that a target and a timeframe are important for providing a goal the country can strive to reach and against which progress can be measured, both domestically and internationally.

The Committee supports the goal of a federal debt-to-GDP ratio of 25%. We are reminded that a lower ratio reduces debt servicing costs, and we want those costs to be reduced in order that funds are available to meet the priority needs of Canadians. It is for this reason that the Committee recommends that:

RECOMMENDATION 4

The federal government continue the rate at which a federal debt-to-GDP ratio of 25% is realized.

THE FEDERAL BUDGETARY PROCESS AND PRUDENT PLANNING

A. *What the Federal Government Provides*

The budgetary process involves making choices. The federal government, in developing its budget, must balance requests for sustained and new spending in a range of areas with proposals for a variety of tax changes designed to increase the competitiveness of the economy. It must also consider the need to act in a fiscally responsible manner and to ensure that spending today does not unreasonably burden future generations. The annual pre-budget consultations conducted by the House of Commons Standing Committee on Finance are a key part of this process, since they provide Canadians with an opportunity to share their preferred taxation, spending and other priorities with the government.

Table 1.2 presents potential amounts that may be available for federal budget planning for the current fiscal year and the next five fiscal years, based on the average of private sector surplus projections as reported in the November 2004 *Economic and Fiscal Update*. These amounts include the contingency reserve which, as a matter of policy, is used to reduce the federal debt if not required for other purposes; the amounts budgeted for economic prudence, which may be available for budgetary planning if not needed; and the minimum amount anticipated to be available as a result of the Expenditure Review Subcommittee's work to identify $3 billion in savings annually to be reallocated from low-priority to high-priority areas.

Table 1.2: Potential Amounts Available for Federal Budgetary Allocation, 2004-2005 to 2009-2010

Fiscal Year (amounts in $ billion)	**2004-2005**	**2005-2006**	**2006-2007**	**2007-2008**	**2008-2009**	**2009-2010**
Projected Federal Budgetary Surplus (based on average of private sector forecasts)	8.9	4.5	5.9	9.2	14	18.5
Contingency Reserve (used to reduce the federal debt if not required for other purposes)	3	3	3	3	3	3
Projected Federal Budgetary Surplus, net of potential debt repayment (as a matter of policy)	**5.9**	**1.5**	**2.9**	**6.2**	**11.0**	**15.5**
Economic Prudence (may be available for budget planning)		1	2	3	3.5	4
Expenditure Review Subcommittee (amounts available for reallocation)		3	3	3	3	3
Potential Amount Available for Federal Budgetary Allocation	**5.9**	**5.5**	**7.9**	**12.2**	**17.5**	**22.5**

Sources: Department of Finance, November 2004 *Economic and Fiscal Update*, p. 77 and computations by the Library of Parliament.

There is, however, some concern about the current approach to federal budget planning, whereby the federal government consults with private sector economic forecasting organizations to perform its budget projections, using relatively conservative assumptions and a measure for prudence, over a two-year budget planning horizon. As shown in Table 1.1, the federal government's budgetary surplus has consistently exceeded its planned prudence amounts in recent years, and sometimes by large margins.

On 29 September 2004, the Minister of Finance announced that Dr. Tim O'Neill, Chief Economist and Executive Vice-President of BMO Financial Group, "will conduct a comprehensive, independent review of the Government's economic and fiscal forecasting."[24] Dr. O'Neill is expected to present an analysis of the discrepancies between fiscal forecasts presented in federal budgets and actual outcomes over the last decade. The primary goal of the review is to find ways to improve the preparation and accuracy of economic and fiscal forecasts. The review "will also compare Canada's approach to fiscal forecasting with that employed by selected countries in the Organisation for Economic Co-operation and Development."[25] The review is expected to be completed early in 2005.

Finally, with an amendment to the October 2004 Speech from the Throne, "the creation of an independent parliamentary budget office to give regular advice on fiscal forecasts of the Government of Canada" was recommended.[26]

B. What the Witnesses Said

Most of the Committee's witnesses supported the principles of prudent fiscal planning and the federal government's commitment to a balanced budget. Many witnesses observed that maintaining prudent fiscal planning in order to ensure that the budgetary balance does not return to a deficit position is an essential factor in securing Canada's economic prosperity. We were told that, over the 1988 to 1997 period, Canada had the fourth-lowest growth in per capita income among all OECD countries. Since then, Canada has done much better because of tax reductions and federal budget surpluses.

C. What the Committee Believes

The Committee believes that prudent financial planning is — or should be — the foundation of the budgetary process, since safeguarding Canada's fiscal health will enable us to provide Canadians with the programs, tax and other measures that they

[24] Department of Finance, "Minister of Finance Appoints Prominent Canadian Economist to Review the Government's Economic and Fiscal Forecasting," *News Release*, Ottawa, 29 September 2004, available at: www.fin.gc.ca/news04/04-057e.html.

[25] Ibid.

[26] The amendment to the October 2004 *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada* is available at: www.parl.gc.ca/38/1/parlbus/chambus/house/debates/003_2004-10-06/han003_1600-e.htm.

desire and need. Since balancing the federal budget in 1997-1998, prudent planning has meant that the federal government has avoided deficit spending, reduced the federal debt-to-GDP ratio, and allocated funds to the contingency reserve and to economic prudence in order to avoid the possibility of a budgetary deficit.

Nevertheless, while the Committee supports prudent fiscal planning, we are convinced that this planning must occur within the context of the best possible information, using the most accurate forecasts — and forecasting methods — available. It is for this reason that, in 2005, the Committee will continue its work on federal fiscal forecasting issues. This work will involve additional hearings as well as quarterly presentations to us by specialists in budgetary estimates based on the release of quarterly national income accounts data.

As in years past, and within the context of the Committee's future work on the topic of federal fiscal forecasting, we continue to support a cautious approach to budgeting. Like many of the witnesses who made presentations to us, we hold the view that the federal government must not incur a budgetary deficit in order to finance current activities. We believe that to do so would be irresponsible and would ignore the sacrifices made by Canadians over time as the country worked toward a balanced budget. The avoidance of federal budgetary deficits must continue to be a priority. Consequently, the Committee recommends that:

RECOMMENDATION 5

The federal government continue to pursue a balanced federal budget in order to avoid federal budgetary deficits.

FISCAL FEDERALISM

A. What the Federal Government Provides

The question of fiscal balance and imbalance in Canada is linked to the issues of how to balance national standards in the delivery of public services with provincial/territorial autonomy and how to distribute revenue and spending responsibilities. With much debate currently occurring about the financial framework of the Canadian federation, the general position taken by the provinces/territories is that they lack sufficient revenues to meet their constitutional spending responsibilities at the same time that there are federal budgetary surpluses.

For its part, the federal government has reasoned that both levels of government have access to all major revenue sources and that, as well, the provinces/territories have exclusive access to such tax bases as resource royalties, and gaming and liquor profits; the federal government does, however, have exclusive jurisdiction with respect to such levies as customs import duties and taxes on non-residents. It has also suggested that provincial/territorial tax reductions in recent years might indicate that the provincial/territorial governments had sufficient revenues, and that during the years of federal budgetary deficits the federal government did not make the types of arguments about imbalance that are currently being made by the provinces/territories.

These views lead to discussions about whether a vertical fiscal imbalance exists and, to a lesser extent, about the existence of a horizontal fiscal imbalance. A vertical fiscal imbalance occurs when the fiscal capacities of different levels of government and their spending responsibilities are not properly aligned. A horizontal fiscal imbalance occurs when the fiscal capacities of different provinces/territories are not the same.

The Equalization program and Territorial Formula Financing are designed to correct horizontal fiscal imbalances.[27] The Equalization program was first introduced in 1957 and was subsequently enacted as section 36(2) of the *Constitution Act, 1982,* which says: "Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."[28]

The purpose of the program is to reduce fiscal inequalities among the provinces by increasing the revenues of the less wealthy provinces. To achieve this goal, unconditional federal payments are made to recipient provinces in order that they can offer relatively comparable public services without having to levy excessively high taxes. The Equalization program is renewed every five years to ensure the integrity of the formula on which payments are based.

The territories are involved in Territorial Formula Financing, through which unconditional grants are given to the territories. The revenue-raising capacity of the territories, as well as the higher costs and unique circumstances in Northern Canada, are considered. Like the Equalization program, a review occurs every five years.

In October 2004, a new legislated financial framework for the Equalization program and for Territorial Formula Financing was reached starting in 2005-2006. Funding in 2005-2006 will be $10.9 billion and $2 billion for the Equalization program and Territorial Formula Financing respectively; these amounts will grow at the rate of 3.5% annually. Agreement was also reached concerning a review of overall funding levels after a five-year period, with any needed adjustments made in 2009-2010.[29]

A public review of both programs will by undertaken by a panel of experts, which will examine and provide advice to the federal government on the issues of: the allocation

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27 Information on the Equalization program and Territorial Formula Financing is available at: www.fin.gc.ca/facts/tfsh2_e.html.

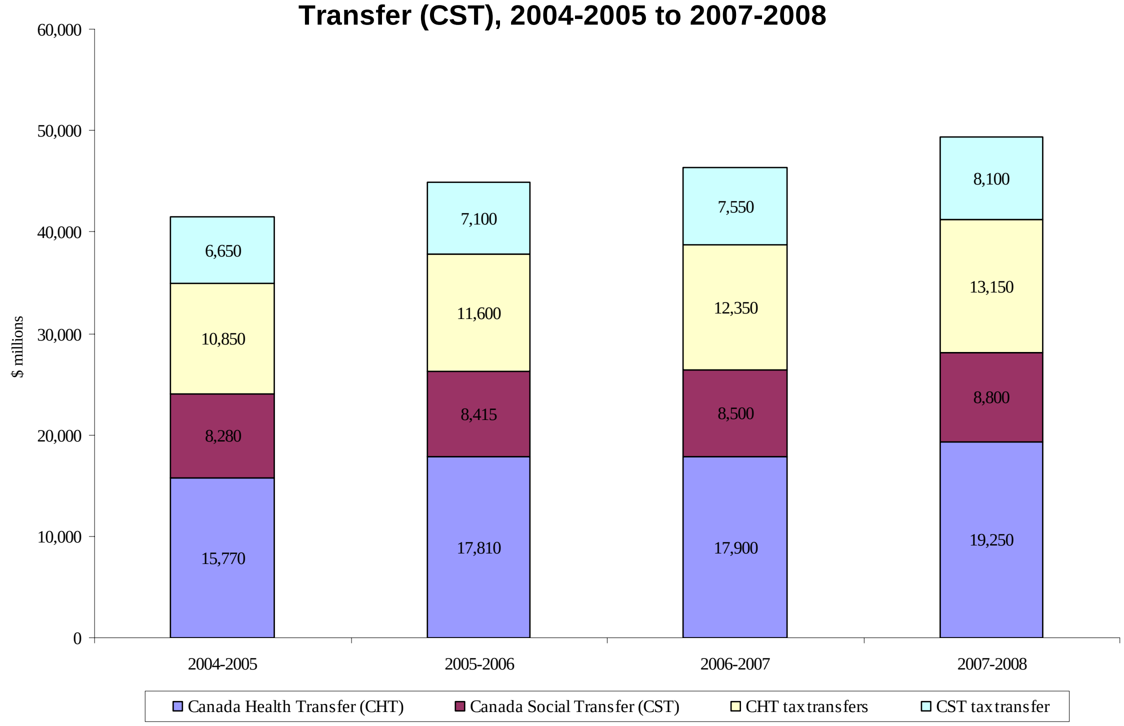
28 *Constitution Act*, 1982, Section 36(2).

29 Information on the new framework for Equalization and Territorial Formula Financing is available at: www.fin.gc.ca/toce/2004/eq_tff-e.html.

among provinces and territories of the annual allotment under the programs; evidence-based aggregate measures of the evolution of fiscal disparities among provinces and of the evolution of costs of providing services in the territories; and whether Canada should have a permanent independent body to provide ongoing advice to the federal government about the allocation of Equalization and Territorial Formula Financing within the framework of legislated levels.[30]

The Canada Social Transfer (CST) and the Canada Health Transfer (CHT) are intended to reduce any vertical fiscal imbalance that exists between the federal and provincial/territorial levels of government.[31] Transfers from the federal government to provincial/territorial governments are used to fund health in the case of the CHT, and education, social assistance and other social services in the case of the CST. While CHT transfers must be spent on health, transfers under the CST can be allocated to education, social assistance and social services in the proportion favoured by the province/territory. As shown in Table 1.9, federal cash and tax transfers to the provinces/territories under the CST and the CHT are expected to rise over time.[32]

Figure 1.9: Canada Health Transfer (CHT) and Canada Social Transfer (CST), 2004-2005 to 2007-2008



Source: Department of Finance, *The Budget Plan 2004*.

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30 Ibid.

31 Information on the Canada Social Transfer and the Canada Health Transfer is available at: www.fin.gc.ca/facts/tfsh2_e.html.

32 Department of Finance, *The Budget Plan 2004*, p. 92, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

B. What the Witnesses Said

Several witnesses told the Committee that a vertical fiscal imbalance exists between the federal and provincial/territorial levels of government. In fact, they remarked that this imbalance may progressively worsen because spending on costly items — such as health care, education and social services — are mainly under provincial/territorial jurisdiction. According to one view, the evidence of a vertical fiscal imbalance has been growing over the past 30 years. Because the federal government addresses the fiscal imbalance mainly through transfer payments to the provinces/territories, there is an accountability problem within the Canadian political system whereby one level of government is spending money raised by another level of government to meet its constitutional responsibilities. The Committee was told that ensuring that provincial/territorial governments have the necessary fiscal capacity to fulfill their core constitutional responsibilities would strengthen political accountability within the federation.

The Committee was told that a transfer of fiscal capacity between federal and provincial/territorial governments could be achieved by reducing taxes at the federal level — thereby leaving fiscal room that could be filled by the provinces/territories through higher taxes — or by transferring additional tax points to the provinces/territories. It was observed that one of the qualities of federalism is that the provinces/territories have important responsibilities.

Other witnesses opposed the creation of tax room for the provinces/territories and the transfer of tax points to them. Instead, they supported the current system of transfer payments, which enables the federal government to use conditional funding as a transfer mechanism and to ensure that, in every province/territory, public services with similar attributes and generosity are offered.

Finally, many witnesses stressed that the federal government must work co-operatively with the provinces/territories to ensure that there are sufficient funds for services provided by all levels of government; moreover, coordinated efforts among all levels of government with respect to the delivery of these services is needed. Witnesses identified numerous instances where levels of government have worked together in formulating and delivering better services and programs to Canadians.

C. What the Committee Believes

The Committee believes that governments at all levels must work together to identify the best means of meeting the needs of Canadians since, at the end of the day, there is only one taxpayer. We recognize the constitutional distribution of powers, as well as the measures and programs that currently exist within Canada to address what might be seen as vertical and horizontal fiscal imbalances. In our view, energy that is currently being expended about whether an imbalance exists and, if so, what its magnitude might be, should be redirected to working together in order to best meet the needs of Canadians. It is from this perspective that the Committee recommends that:

RECOMMENDATION 6

The federal government engage in ongoing discussions with provincial/territorial governments about the correct magnitude of, and accountability mechanisms for, spending on health, education, social assistance and other social services, bearing in mind the relative size of the federal and provincial/territorial debt.

CHAPTER TWO: INVESTING IN SUSTAINABLE COMMUNITIES

ENVIRONMENTAL ISSUES

A. What the Federal Government Provides

Among the many issues facing Canadians, those related to climate change and the environment are likely to have significant and long-lasting effects. Many scientists believe that climate change will result in harsh weather conditions, including storms, floods and forest fires, and that these conditions will become more severe over time. For example, warmer temperatures in forested areas may lead to increased evaporation and the loss of soil moisture, and grasslands may replace forests in areas that become too dry for trees. Higher temperatures and drier conditions may increase the frequency of forest fires, and forest disease and pest infestations may also increase as warmer summers place additional stress on trees and warmer winters increase pest survival. Air and water quality issues are also likely to exist for some time.

In recent years, the federal government has announced several environmental initiatives. For example, in November 2002, prior to its December 2002 ratification of the Kyoto Protocol, the federal government released its Climate Change Plan for Canada designed to reduce annual greenhouse gas emissions. In particular, the plan set out a three-step plan to reduce annual greenhouse gas emissions by 240 megatonnes.[33]

The Climate Change Plan was supported in the 2003 federal budget by an allocation of $1.7 billion over five years to support innovation and cost-effective measures resulting in greenhouse gas emission reductions; this allocation is part of a $3 billion plan to address climate change and the environment, with the $3 billion plan itself augmenting $2.3 billion invested in climate change and the environment since 1997. Furthermore, in August 2003, the federal government committed an additional $1 billion to implement the Plan through incentives for individuals to make their homes more energy-efficient, among other things, and to help industry, governments and communities reduce emissions. Initiatives include, for example, Technology Early Action Measures (TEAM), which bring industry, community and international partners together in support of projects that develop technologies that reduce greenhouse gas emissions and that sustain economic and social development. Previously, support was provided through the Climate Change Action Fund as well.[34]

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33 The Climate Change Plan is available at: www.climatechange.gc.ca/plan_for_canada/plan/pdf/full_version.pdf.

34 Information on Technology Early Action Measures is available at: www.climatechange.gc.ca/english/team_2004/.

Homeowners are encouraged to contribute to greater energy efficiency through such measures as Home Energy Efficiency Retrofit Grants, launched by the federal government in 2003 to encourage homeowners to retrofit their homes for greater energy efficiency.[35]

Federal support also exists for renewable energy, which is beneficial in an economic sense and as a means of improving the environment and meeting Canada's Kyoto commitments. The 2001 federal budget proposed a production incentive for electricity produced from qualifying wind energy projects. It announced the Wind Power Production Incentive with an initial incentive of 1.2¢ per kilowatt hour of production, gradually declining to 0.8¢ per kilowatt hour, for eligible projects commissioned after 31 March 2002 and before 1 April 2007; the incentive is available for the first 10 years of production.[36] Renewable energy also received support in the 2003 budget, as did ethanol and methanol. In particular, the budget proposed that the ethanol or methanol portion of blended diesel fuel would be exempted from the federal excise tax on diesel fuel, as well as bio-diesel when used as a motive fuel blended with regular diesel fuel.[37]

As well, the 2003 federal budget allocated $2 billion over five years to support climate science, environmental technology and cost-effective climate change measures and partnerships in areas such as renewable energy, energy efficiency, sustainable transportation and new alternative fuels. Particular initiatives included funding to Sustainable Development Technology Canada (SDTC) and the Canadian Foundation for Climate and Atmospheric Sciences, as well as funding for other climate change measures, including targeted initiatives and partnerships. SDTC, which received additional funding and an expanded mandate in the 2004 budget, is an arm's-length foundation supporting the development and commercialization of new technologies that address climate change, clean air, water and soil. The 2004 budget announced an investment of $15 million over two years to develop and report better environmental indicators on clean air, clean water and greenhouse gas emissions, as well as a Green Procurement Policy to govern federal purchases.[38]

As well, brownfield redevelopment has received federal support. Brownfields are polluted lands, and are often found within cities. Even when they are located in desirable areas, liability issues and cleanup costs frequently mean that the lands remain undeveloped. In addition to the benefits of cleaning up the environmental damage of

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35 Information on Home Energy Efficiency Retrofit Grants is available at: www.oee.nrcan.gc.ca/houses-maisons/English/homeowners/grant/grant.cfm.

36 Department of Finance, *The Budget Plan 2001*, p. 128, available at: www.fin.gc.ca/toce/2001/budlist01_e.htm.

37 Department of Finance, *The Budget Plan 2003*, p. 148-155, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

38 Department of Finance, *The Budget Plan 2004*, p. 181-186, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

brownfields themselves, greater redevelopment of brownfields increases urban intensification while reducing urban sprawl and air pollution. Recognizing these benefits, the 2003 federal budget allocated $175 million over two years to address the highest-risk federal sites. It also indicated its commitment to supporting the clean-up of the Sydney tar ponds.

Green space is also supported by the federal government. For example, the 2003 federal budget committed the federal government to establishing 10 new national parks and 5 new national marine conservation areas, and to restoring the ecological health of existing parks. The budget allocated $74 million over two years for these measures.[39]

Measures to enhance air and water quality also receive federal support. In the 2003 federal budget, $40 million was allocated over two years to promote best practices and to develop regulations on air pollution, recognizing the transborder nature of air quality concerns. As well, as mentioned in Chapter Four, the budget allocated $600 million over five years to upgrade, maintain and monitor water and waste water systems on reserves.[40]

The Green Municipal Enabling Fund and the Green Municipal Investment Fund, which are funded by the federal government and administered by the Federation of Canadian Municipalities, assist with environmental initiatives. In particular, the Enabling Fund is a $50 million revolving fund that provides grants to support studies of the technical, environmental and/or economic feasibility of innovative municipal projects, while the $200 million revolving Investment Fund supports the implementation of innovative environmental projects.[41]

Urban public transit, which has environmental, trade and quality-of-life aspects, is also supported by the federal government. By moving people from cars to buses, subways and light rail, public transit relieves pollution and congestion on roadways, reduces the amount of time it takes for employees to get to work and improves delivery times for trucks that ship goods. The federal government provides support for urban public transit. For example, funding is provided across Canada, from the Halifax Regional Municipality in Nova Scotia to GO Transit in Ontario to the Greater Vancouver Transportation Authority (Translink) in British Columbia. Federal tax assistance might also occur. The Greater Vancouver Transportation Authority, for example, is exempt from federal income and capital taxes.

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39 Department of Finance, *The Budget Plan 2003*, p. 148-155, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

40 Ibid.

41 Information on the Green Municipal Investment Fund and the Green Municipal Enabling Fund is available at: www.kn.fcm.ca/ev.php?URL_ID=2825&URL_DO=DO_TOPIC&URL_SECTION=201&reload=1043178382.

In commenting on the need for "fundamental change in the way in which we think about the environment," the October 2004 Speech from the Throne committed the federal government to working with "the private sector to improve the commercialization of the best new environmental technologies… .The Government will place increased focus on energy efficiency and energy research and development. It will engage stakeholders in developing comprehensive approaches to encourage increased production and use of clean, renewable energy and to promote greater energy efficiency… . [I]t will continue to pursue multilateral and bilateral approaches to what are ultimately global challenges."[42]

B. What the Witnesses Said

The Committee received a broad range of suggestions about how Canada might ensure a sustainable environment and meet Kyoto commitments. These included ideas about incentives for the production and use of renewable energy. For example, we were told that low-impact renewable energy is the fastest-growing source of new energy in the world, and it was urged that the following suggestions be implemented in order to encourage its use in Canada: establishing other incentive programs similar to the Wind Power Production Incentive (WPPI) in order to encourage the development of other low-impact renewable power technologies; expanding the existing Market Incentive Program; enhancing — by $50 million annually — federal research spending on the research and development of innovative Canadian technologies for low-impact renewable energy; and establishing a "Sustainable Energy Trust" with proceeds from the sale of the federal government's PetroCanada shares that would provide long-term funding for the deployment of sustainable energy technologies.

The development of wind energy capacity received particular attention, and the Committee was told that companies that make use of the WPPI are not permitted to use the Canadian Renewable and Conservation Expense, despite the fact that the two initiatives serve fundamentally different purposes. We were also informed that, under the current proposal for a national greenhouse gas emissions trading system, companies that use the WPPI would not be allowed to create a greenhouse gas offset credit despite the fact that offset credits are financed by the private sector and that the WPPI does not require participants to transfer the environmental attributes of the energy produced to the federal government.

Regarding the Green Municipal Funds administered by the Federation of Canadian Municipalities, it was observed that many of the funds are now committed. As such, it was suggested to the Committee that the federal government double the Funds' endowments to $500 million from the current $250 million.

Witnesses also shared their concerns about the implementation of the Kyoto Protocol and its potential consequences for several industries. In their view, reductions in

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42 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: http://www.pm.gc.ca/eng/sft-ddt.asp.

greenhouse gas emissions must be done in such a manner that the international competitiveness of Canadian producers is protected. The Committee was told that the reduction targets must be reasonable, cost-effective and achievable in practice, and that market-based incentives should be provided for businesses to meet these targets.

Many witnesses proposed that the federal government establish investment incentives to accelerate the transition of existing production facilities to more environmentally friendly technology. For example, it was urged that the government provide businesses with an immediate tax deduction for 100% of the cost of vehicles that meet low emission standards, a measure that was introduced in the United Kingdom in 2002.

Another suggestion presented to the Committee was the need to support and encourage investment in green car manufacturing in Canada by leveraging the manufacturers' investment to produce energy-efficient vehicles. The Committee was told that General Motors is currently evaluating whether to produce hybrid vehicles at its Ingersoll and Oshawa plants. Market-based incentives could also be directed at consumers by providing a $4,000 incentive to consumers and a $500 incentive to dealers for the purchase or sale, as the case may be, of low-emission vehicles. Such other consumer incentives as consumer rebates, sales tax rebates and income tax credits for the purchase of Advanced Technology Vehicles and Alternative Fuel Vehicles were urged.

With respect to nature conservation, two approaches were proposed. First, the federal government could establish a leveraged national conservation fund with an initial investment of $250 million to support, on a project-by-project basis, priority initiatives identified in the government's Environmental Policy Framework. Second, the government could use the tax system to create incentives for the conservation of ecologically sensitive private lands, such as eliminating the remaining capital gains tax on gifts of ecologically sensitive lands or conservation easements.

The Committee was told that there are many benefits to encouraging brownfield redevelopment, including revitalized communities, reduced urban sprawl and increased tax revenues for all levels of government. We were informed that the federal government could encourage brownfield redevelopment through such initiatives as existing infrastructure programs, targeted programs, revenue-sharing agreements, brownfield-specific mortgage insurance and tax credits. Several witnesses also recommended that the government amend the *Income Tax Act* in order to treat remediation expenses for the development of brownfield sites as a deductible expense.

C. What the Committee Believes

The Committee supports the ratification of the Kyoto Protocol by the federal government and the initiatives that have been taken to date to meet our commitments. We believe, however, that vigilance is required on an ongoing basis to ensure continued progress toward both meeting our commitments and ensuring the health of our environment. A sustainable environment is an important contributor to the health and quality of life of Canadians, and to the prosperity of Canadian businesses. Moreover, Canada has an obligation to be part of the solution in meeting global environmental challenges.

The Committee believes that the federal government should lead by example on environmental issues. We recognize the commitment made in the October 2004 Speech from the Throne to "build sustainable development systematically into decision making," and the announcement in the 2004 federal budget of a Green Procurement Policy to govern federal purchases. While we support both statements, we believe that more specific recommendations for action are required. It is from this perspective that the Committee recommends that:

RECOMMENDATION 7

The federal government take a leadership role with respect to protecting the environment by: purchasing fuel-efficient vehicles for government use; ensuring that government buildings are energy-efficient; encouraging the use of public transit by public service employees; and maintaining the commitment to its Green Procurement Policy.

In the Committee's view, a range of investments in our environment — including in renewable energy and alternative energy development and commercialization, energy efficiency, and energy research and development — continue to offer a great deal of potential, both in an economic sense and as a means of meeting our Kyoto commitments. Moreover, we believe that brownfield redevelopment could make an important contribution to improving the environment and, because of its effects on urban sprawl and air pollution, the health and well-being of Canadians. We believe that the positive benefits of action in this area would outweigh any costs. Moreover, attention must be paid to the quality of our air, water and soil, recognizing that cooperation with the United States may be required to ensure that citizens in both countries benefit from clean, high-quality shared ecosystems. We also feel that consumers, homeowners and other individuals should be provided with incentives to encourage their adoption of more energy-efficient measures and behaviours. Consequently, the Committee recommends that:

RECOMMENDATION 8

The federal government — in order to encourage more environmental production, practices and purchases by businesses and individuals — develop and implement appropriate incentives and supportive policies in the following areas:

- **the production, purchase and use of fuel efficient vehicles;**

- **housing retrofits and other measures that would result in enhanced energy efficiency;**

- **public transit, including measures related to the tax treatment of employer-financed transit passes;**

- **renewable and alternative energy development and commercialization, including measures related to wind energy and fuel cells, as well as ethanol and methanol;**

- **within the context of Recommendation 14 regarding revision of Canada's capital cost allowance rates, the treatment of Class 43.1 regarding renewable and alternative energies;**

- **the commercialization of new environmental technologies;**

- **brownfield redevelopment; and**

- **green space.**

Moreover, the government should develop and implement measures designed to enhance air, water and soil quality, bearing in mind the need for transborder cooperation in areas where ecosystems are shared.

COMMUNITIES

A. What the Federal Government Provides

Like many other countries, Canada is a nation of communities, and our cities and towns are the engines that, in some sense, power the Canadian economy. Sustainable communities that are desirable places within which to live and work are a key ingredient for providing Canadians with the standard of living and quality of life we need and deserve.

Data from the 2001 census reveal that, in that year, 79.4% of Canadians lived in an urban centre of 10,000 people or more, an increase from 78.5% in 1996. Most of this growth was centred in four major urban regions: Ontario's extended Golden Horseshoe;

Montreal and the adjacent region; British Columbia's Lower Mainland and southern Vancouver Island; and the Calgary-Edmonton corridor.[43]

In contrast to cities and suburban areas, rural and small-town areas[44] experienced a population decline of 0.4% between 1996 and 2001.The population in these areas fell in every province except Ontario, Manitoba and Alberta. In 2001, 20.3% of Canadians lived in rural and small-town areas, a decrease from 21.5% in 1996. Some rural and small-town areas did, however, grow over the 1996 to 2001 period. For these areas, growth depended on the proportion of their residents that commuted to urban centres. The population of rural areas in which more than 30% of the residents commuted to urban centres increased 3.7% over the period, largely as a result of people who moved just beyond urban boundaries to live in a more rural setting.

The Rural Secretariat within Agriculture and Agri-Food Canada is the focal point for the federal government's work with Canadians in rural and remote regions to build their communities. It provides leadership and coordination, facilitates the creation of partnerships regarding rural issues and priorities, promotes discussion between rural stakeholders and the government, plays a role in the ongoing rural dialogue, and promotes the use of the Rural Lens to ensure that rural concerns are considered throughout the government.[45] The government also has regional development agencies that may play an important role in remote regions of Canada, including the Federal Economic Development Initiative for Northern Ontario and the Economic Development Agency of Canada for the Regions of Quebec.

Sustainable communities — large, small, urban, rural and remote — share some common characteristics. They have strong, safe and reliable social and physical infrastructure: recreational facilities, walkways and bike paths, roadways, sewers, telephone lines, power plants, water and waste water systems, public transit and housing, among other elements. Infrastructure is the responsibility of all levels of government, although it is often thought that municipalities lack adequate financial capability to address infrastructure needs, since they rely mainly on property taxes to raise revenues.

Federal efforts to address Canada's infrastructure deficit involve a number of initiatives. For example, the 2000 federal budget introduced the $2.05 billion Infrastructure Canada Program, which was created to enhance municipal infrastructure in rural and

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43 Information on Canada's urban areas is available at: www.geodepot.statcan.ca/Diss/Highlights/Page1/Page1_e.cfm, and at: www.geodepot.statcan.ca/Diss/Highlights/Page9/Page9_e.cfm.

44 These areas are outside urban centres and have core populations of 10,000 or more persons. Information on Canada's rural and small-town areas is available at: www.geodepot.statcan.ca/Diss/Highlights/Page11/Page11_e.cfm.

45 Information on the Rural Secretariat is available at: www.agr.gc.ca/policy/rural/rsmenue.html.

urban communities, and to improve Canadians' quality of life through investments that protect the environment and support long-term economic growth.[46]

The Canada Strategic Infrastructure Fund was created in the 2001 federal budget to fund, through private-public partnerships, large-scale strategic infrastructure projects that improve quality of life and further economic growth. The budget provided at least $2 billion through 2007-2008, which was augmented by $2 billion over 10 years in the 2003 budget. A maximum of 10% of the $2 billion allocation, or $200 million, has been designated for use in national priority projects that will be of national importance such that the federal government is required to take a leadership role. Moreover, at least 20% has been allocated for projects that benefit communities with fewer than 250,000 people.[47] Other funds will finance new municipal infrastructure investments over the next 10 years that will focus on projects that are typically smaller in scale.

Rural communities received targeted support with the announcement of the Municipal Rural Infrastructure Fund in the 2003 federal budget. The $1 billion in funding, which in accordance with the 2004 budget will now be allocated over 5 years rather than the 10 years initially proposed, focuses on the needs of communities with fewer than 250,000 people and includes a component addressing the infrastructure needs of First Nations communities. In particular, 20% of the funds are targeted to projects that benefit communities of 250,000 or more residents, while the remaining 80% of the funds are dedicated to municipalities with a population of fewer than 250,000 people. The fund addresses such areas as water quality, waste water treatment and local roads.[48]

As noted in Chapter Three, trade with the United States is critically important, and mutually beneficial trade requires that the shared border function well. In cooperation with provincial/territorial/municipal governments, and academic and research institutes — and with Canadian and American partners from the public and private sectors — the federal government operates the $600 million Border Infrastructure Fund that supports key infrastructure initiatives identified in the December 2001 Smart Border Action Plan.[49]

Also important for reasons that include trade is the Strategic Highway Infrastructure Program, which was announced in 2001. Canada's National Highway System, covering more than 25,000 kilometres of roads running across the country, is essential for the prosperity of the economy, and must be well maintained to protect the health and safety of Canadians. Announced in the 2000 federal budget, the Program has been allocated $600 million over four years, with $500 million directed to highway

46 Information on the Infrastructure Canada Program is available at: www.infrastructure.gc.ca/funding/index_e.shtml.

47 Information on the Canada Strategic Infrastructure Fund is available at: www.infrastructure.gc.ca/funding/index_e.shtml.

48 Information on the Municipal Rural Infrastructure Fund is available at: www.infrastructure.gc.ca/funding/index_e.shtml.

49 Information on the Border Infrastructure Fund is available at: www.infrastructure.gc.ca/funding/index_e.shtml.

construction and the remaining $100 million to national system integration. According to the allocation formula with respect to the $500 million in the Program, each jurisdiction receives a minimum of $4 million as well as a share based on population and a 50:50 cost-sharing ratio. Initiatives to be funded by the $100 million in the Program include the deployment of Intelligent Transportation systems, improved border crossings and better transportation planning.[50]

The Green Municipal Enabling Fund and the Green Municipal Investment Fund, mentioned above, also support Canadian communities. As well, the 2004 federal budget announced $7 billion in Goods and Services Tax/Harmonized Sales Tax (GST/HST) relief for municipalities over the next decade. This goal will be achieved through increasing the rebate to 100% in respect of the GST/HST for municipalities.[51]

In the October 2004 Speech from the Throne, the federal government recognized communities as being key to Canadians' social goals and Canada's economic competitiveness, and mentioned the New Deal for Canada's Cities and Communities, a component of which involves giving municipalities part of the federal tax on gasoline. The Speech also made a commitment to regional and sectoral development.[52]

While all communities in Canada face challenges, the challenges they face are not necessarily the same. Canada's large urban communities, for example, may have challenges related to the integration of immigrants to Canada. Rural and remote communities may have challenges that might be met, in part, through healthy regional economies. In particular, the October 2004 Speech from the Throne said that "Canada's regional economies are a vital source of economic strength and stability. Support for regional and rural economic development will target the fundamentals — skills upgrading, support for research and development, community development, and modern infrastructure such as broadband communication. … "[53]

The October 2004 Speech from the Throne also mentioned Canada's North, and indicated that the federal government "will develop, in cooperation with its territorial partners, Aboriginal people and other northern residents, the first-ever comprehensive strategy for the North. This northern strategy will foster sustainable economic and human development; protect the northern environment and Canada's sovereignty and security; and promote cooperation with the international circumpolar community."[54]

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50 Information on the Strategic Highway Infrastructure Program is available at: www.tc.gc.ca/SHIP/menu.htm.

51 Department of Finance, *The Budget Plan 2004*, p. 166-167, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

52 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: http://www.pm.gc.ca/eng/sft-ddt.asp.

53 Ibid.

54 Ibid.

B. What the Witnesses Said

Many witnesses commented on the need for sustainable communities and on the sizable infrastructure deficit that currently exists in many of our communities. The Committee was told that a revenue-sharing agreement is needed to provide municipalities with a new, stable and predictable revenue source to address the infrastructure deficit — estimated at $60 billion — faced by them. The federal government was urged to conclude agreements with provincial/territorial governments by the end of 2004 to provide municipal governments with a total of $2.5 billion in federal fuel tax revenue annually — the equivalent of 5¢ per litre of the federal gasoline tax and 2¢ per litre of the federal diesel fuel tax — to support needed infrastructure investments. Moreover, a fuel-tax escalator tied to GDP was urged in order to ensure that the revenues are not linked to fuel consumption but rather to economic growth.

It was observed, however, that revenue-sharing agreements will not replace the need for ongoing capital grants to support large-scale strategic projects and infrastructure investments. As a result, current federal commitments of $1.1 billion annually for infrastructure, currently delivered through the Canada Strategic Infrastructure Fund and the Municipal Rural Infrastructure Fund, are still needed, and it was suggested that funding should be increased because of serious municipal infrastructure requirements. Furthermore, the federal government was urged to amend the investment categories under the Canadian Strategic Infrastructure Fund so that marine infrastructure projects could be eligible for funding.

Witnesses also shared the view that a portion of the funds transferred to municipalities should be used for direct investments in public transit, cycling and pedestrian infrastructure in cities and in freight rail and road infrastructure in rural communities. Similarly, it was suggested that a portion of the funding directed to urban transportation should be allocated to "active transportation" infrastructure, including bike paths and lanes, sidewalks, paths and trails, and inter-modal connection facilities, such as secure bicycle parking at transit connections. This type of infrastructure has community, environmental and health benefits.

It was also proposed that the *Income Tax Act* be amended to make employer-provided transit passes a tax-exempt benefit. In this regard, the Committee was informed that 80% of Canadian automobile commuters receive subsidized parking from their employers, but most do not pay tax on this benefit; on the other hand, employer-subsidized transit fares are a taxable benefit for employees.

The Committee was told that Canadian transit authorities are facing a $9 billion shortfall in funding for the 2004 to 2008 period, and that an estimated $6.9 billion is needed to keep existing equipment in good repair during this period. In the view of witnesses, improved transit and active transportation infrastructure would both improve the standard of living in our communities and contribute to reducing carbon dioxide emissions, thereby helping Canada to fulfill its commitments under the Kyoto Protocol.

With respect to remote communities, several witnesses urged the federal government to expand broadband access to rural and remote communities. Moreover, the Committee was told that per capita funding for new infrastructure or infrastructure upgrading does not meet the needs of small and rural communities, since these communities lack the funds to finance the gap between the amounts that they need and what they receive on a per capita basis. Consequently, distribution formulas that mitigate the inequalities associated with per capita funding should be considered; in some circumstances, allocating funds on the basis of land mass or other factors may be appropriate.

The Committee was told that, despite the significant federal funding for highways announced in the 2002 federal budget through the Strategic Highway Infrastructure Program, Canada's highways are still being neglected. We were informed that highways are vital for Canada's commercial well-being. At present, since the United States is investing more funds into its highway systems, Canada is being placed at a competitive disadvantage. The federal government was urged to enhance the Strategic Highway Infrastructure Program by providing sustainable, predictable long-term funding dedicated to the National Highway System.

Moreover, witnesses described the St. Lawrence Seaway as an important federal facility that has had insufficient investments made in upgrading and improvements. Therefore, it was suggested that the federal government adopt a long-term infrastructure strategy for the St. Lawrence Seaway and ensure that sufficient funds are allocated to finance the strategy.

C. What the Committee Believes

The Committee agrees that Canada has a substantial infrastructure deficit, and that action is needed on a priority basis to ensure that our economic prosperity and quality of life are not further compromised. This deficit exists across Canada — in urban, rural and remote areas — and across types of infrastructure — roads, public transit, waterways, water and waste water systems, and others. In our opinion, infrastructure renewal is a responsibility shared by all levels of government, and governments must work cooperatively toward the development of a comprehensive plan for infrastructure renewal.

Difficult choices may be required and investments may have to be phased in over time, but the Committee believes that all levels of government are committed to sustainable communities within Canada, and sustainability requires infrastructure investments. The need is urgent and the time for action is now. Further delay is not, in our opinion or in the opinion of our witnesses, an option. Therefore, the Committee recommends that:

RECOMMENDATION 9

The federal government develop and implement a long-term, adequately funded infrastructure plan consistent with its responsibilities. The development and implementation of the plan should occur only after consultations with relevant non-governmental stakeholders. In determining how infrastructure funds should be allocated, an allocation mechanism that is not limited to population but that recognizes the strategic and development needs of communities should be considered.

Moreover, the government should allocate the equivalent of 5¢ of the federal tax on gasoline to a program delivered through the provinces/territories for cities and communities. These funds should be used for sustainable infrastructure investments.

Finally, the government should, in conjunction with stakeholders, undertake a comprehensive review of the Canada Strategic Infrastructure Fund, the Municipal Rural Infrastructure Fund, the Border Infrastructure Fund and the Strategic Highway Infrastructure Program. This review should focus on funding levels and allocation mechanisms, and should be completed no later than 30 June 2005.

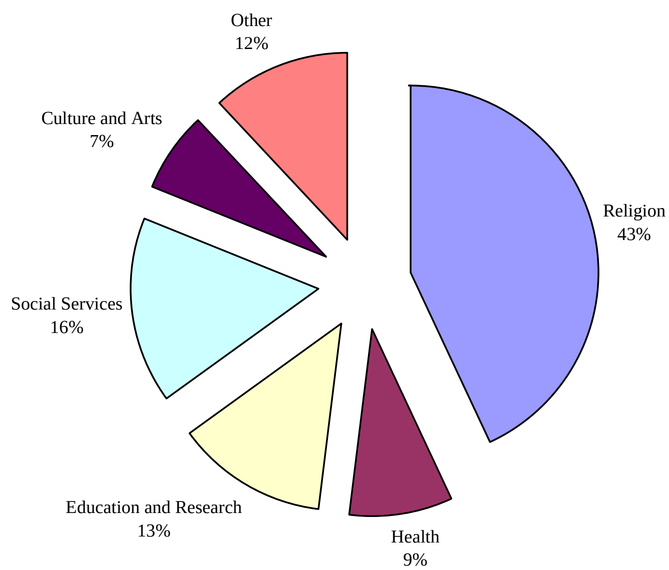
CHARITABLE GIVING AND VOLUNTEERISM

A. What the Federal Government Provides

Charities play an important role in providing services to Canadians. Figure 2.1, for example, shows that Canadian charities have the following purposes: religion, health, education and research, social services, and culture and art. In recognition of their value, the federal government has developed tax measures designed to encourage charitable donations and to lessen the financial burden of reduced direct government funding to charities.[55]

[55] Department of Finance, *The Budget Plan 2004*, p. 218-219, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

Figure 2.1: Distribution of Registered Charities by Category of Primary Purpose, 2001



Source: Department of Finance.

One such initiative was the implementation, in 1997, of a temporary measure to set the capital gains inclusion rate on donations of publicly traded securities to public charities at one-half the amount included for other capital gains. A similar measure was introduced for donations of ecologically sensitive lands in the 2000 federal budget. In 2001 and beyond, 25% of the capital gains resulting from the donation of publicly traded securities or ecologically sensitive lands to a registered public charity must be included in the donor's income, rather than the 50% rate that would have applied had the measures not been implemented.[56]

In the 1997 federal budget, the federal government indicated that the temporary provision would be terminated after five years if it had not been effective in increasing donations and in distributing the additional donations fairly among charities. In October 2001, following a study of the temporary measure, the Department of Finance reported that these objectives had been achieved and the tax measure was made permanent.

Charitable giving by individual donors is also encouraged through the non-refundable charitable donations tax credit, which is worth 16% of the first $200 donated and 29% of donations exceeding this amount, up to 75% of the taxpayer's

[56] Ibid.

annual net income. As indicated in the 2004 federal budget, in 2002, about 5.5 million Canadians made financial or in-kind donations that had a value of about $5.8 billion. Federal tax revenues forgone as a result of these donations totalled more than $1.7 billion.[57] Corporations, on the other hand, can deduct the fair market value of charitable donations up to a maximum of 75% of net income. Moreover, corporations making a charitable gift for the purpose of earning business income can deduct the amount of the donation as an ordinary business expense in computing their taxable income.[58]

Currently, the *Income Tax Act* restricts the kind of activities that charitable organizations are allowed to undertake if they wish to retain their charitable status. Restrictions also exist with respect to the disbursement quota for charitable endowments. The 2004 federal budget proposed changes to the rules for registered charities, in particular by proposing a new compliance regime, a more accessible appeals regime, and improved transparency and more accessible information. As well, it was announced that the rules that determine the proportion of charitable donations that registered charities must devote to delivering charitable programs and services would be improved. Announcements were also made regarding a Charities Advisory Committee, additional funding of $6 million over two years to advance the Voluntary Sector Initiative (VSI), a proposed Not-for-Profit Corporations Act and the notion of a bank for the charitable sector. The VSI was launched in 2000 with funding of $95 million.[59]

Noting the role played by voluntary organizations and social economy enterprises in finding local solutions to local problems, the October 2004 Speech from the Throne committed the federal government to helping create the conditions for the success of these organizations and enterprises. The Speech commented that a new Not-for-Profit Corporations Act will be introduced.[60]

B. What the Witnesses Said

As in previous years, witnesses' concerns with respect to charitable giving focused on essentially three issues: the elimination of the capital gains inclusion rate on donations of publicly traded securities and ecologically sensitive lands to public charities; the extension of the preferential tax treatment of these donations to private foundations; and the extension of the preferential tax treatment to donations of other asset classes. In their view, donors should be allowed to benefit from favourable tax treatment when giving other

57 Ibid., p. 177.

58 Information on the non-refundable charitable donation tax credit and the corporate deduction for charitable donations is available at: http://www.cra-arc.gc.ca.

59 Department of Finance, *The Budget Plan 2004*, p. 175-179, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

60 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: http://www.pm.gc.ca/eng/sft-ddt.asp.

types of assets, and private foundations should not face discrimination. Moreover, they believe that eliminating the capital gains will enhance the level of charitable donations.

Other charitable giving requests were also made. Witnesses advocated changes to the *Income Tax Act* that would allow charities to engage more actively in the public policy process without losing their charitable status. They told the Committee that, at present, charities cannot use more than 10% of their financial and human resources on “political activities.” These activities include advocacy efforts directed at effecting changes in government policies. They argued that this restriction is inconsistent with the role of charities in a modern democracy.

Witnesses also spoke to the Committee about the impact of rising insurance costs on charities, since rising liability insurance rates have had detrimental effects on many Canadian voluntary sector organizations and have reduced their ability to deliver services.

Other suggestions presented to the Committee included a proposal that charities be given preferential treatment by Canada Post when they use address admail and business reply mail services, and when they mail donation receipts. As well, it was proposed that registered charities be exempt from the requirement to issue receipts for income tax purposes when donations are less than $250; this change would eliminate red tape. Finally, federal examination of potentially unfair competition between the not-for-profit and private sectors was urged.

C. What the Committee Believes

The Committee continues to support measures that would improve the ability of Canadians to contribute to the work of charitable organizations, both as volunteers and as donors. Such activities have wide-ranging benefits for the volunteers, the donors, the donee charitable organizations and the ultimate recipients of the charitable organizations’ efforts. While we have, in the past, supported the elimination of the capital gains inclusion rate on donations of publicly traded securities and ecologically sensitive lands to public charities, we feel that we are unable to do so this year. Instead, we believe that a more appropriate action, in the context of other recommendations that we make with respect to capital gains, is to urge reduction in the capital gains inclusion rate for these donations, rather than elimination.

The Committee believes that donors should have greater flexibility with respect to the assets that they can donate to charitable organizations and qualify for the lower capital gains inclusion rate. We support a number of our witnesses in believing that the eligible asset classes should be extended to include donations of real estate and of land, subject to proper valuation. It is for this reason that the Committee recommends that:

RECOMMENDATION 10

The federal government, bearing in mind Recommendation 16 regarding a review of capital gains, take the following two actions:

- **reduce the capital gains inclusion rate for donations of publicly traded securities and ecologically sensitive lands to public charities; and**
- **subject to proper valuation, extend the asset classes to which this reduced capital gains inclusion rate applies to include real estate and land.**

CULTURE

A. What the Federal Government Provides

Canadian culture — however it is defined — makes a vital and pervasive contribution to the lives of our citizens. The ongoing challenge for our cultural industries, however, has been to compete in a marketplace with a high proportion of foreign content. Consequently, nurturing Canadian content and Canada's cultural industries has been a longstanding objective of the federal government.

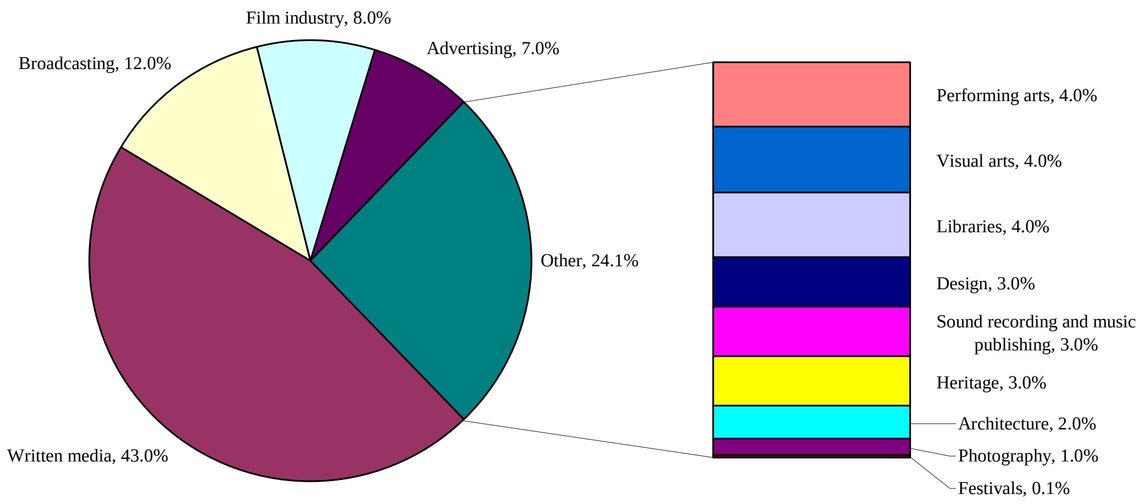
The federal government undertakes a range of activities to support Canada's cultural industries, which receive about $3 billion annually from the federal government, contribute about $28 billion to our GDP and employ about 740,000 individuals. Figure 2.2 shows the average contribution to GDP by cultural sub-sector over the 1996 to 2001 period. Most of the federal government's arts and culture programs operate under the Department of Canadian Heritage. Programs that provide financial support for arts and culture include:[61]

- Arts Presentation Canada
- the Canada Travelling Exhibitions Indemnification Program
- the Book Publishing Industry Development Program
- the "Celebrate Canada!" Program
- the Canada Magazine Fund

[61] Information on the Department of Canadian Heritage arts and culture programs is available at: www.canadianheritage.gc.ca/pc-ch/pubs/2004/1_e.cfm, and at: www.canadianheritage.gc.ca/pc-ch/pubs/2004/7_e.cfm.

- the Movable Cultural Property Program
- the Canada Music Fund
- the Museums Assistance Program
- the Canadian Film or Video Production Tax Credit
- the Applied Research in Interactive Media Program
- the Film or Video Production Services Tax Credit
- the Canadian Independent Film and Video Fund
- the Canada New Media Fund
- the Canadian Television Fund
- the Canadian Memory Fund
- Cultural Capitals of Canada
- the Community Memories Program
- Cultural Spaces Canada
- the Electronic Copyright Fund
- the National Arts Training Contribution Program
- Francommunautés virtuelles
- the National Training Program in the Film and Video Sector
- the New Media Research Networks Fund
- the Publications Assistance Program
- the Partnerships Fund
- the Virtual Museum of Canada Investment Program
- Trade Routes.

Figure 2.2: Percentage Share of Culture Gross Domestic Product, 1996 to 2001 average



Source: Statistics Canada.

In 2001, the federal government announced the creation of the Tomorrow Starts Today initiative, which is the most significant cultural investment made by the government since the establishment of the Canada Council for the Arts. The Tomorrow Starts Today initiative includes a number of the programs noted above, while the Canada Council for the Arts provides financial support to artists and art organizations in performing, literary and visual arts. As well, the government supports Telefilm Canada, which develops and promotes the Canadian film, television, new media and music industries.

Of particular importance to the television sector is the Canadian Television Fund (CTF), which was created in 1996 to encourage the production of Canadian television programming. The CTF is a public/private partnership with an annual budget of approximately $250 million, funded by the federal government, cable companies and direct-to-home satellite service providers. In the 2003 federal budget, the federal government announced that it would extend the CTF for an additional two years, but at a reduced level of funding. Annual federal support would have decreased from $100 million to $87.5 million in 2003-2004 and to $62.5 million in 2004-2005.[62] The 2004 budget, however, announced that the funding would be restored to $100 million annually.[63]

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[62] Department of Finance, *The Budget Plan 2003*, p. 111, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

[63] Department of Finance, *The Budget Plan 2004*, p. 62, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

Moreover, the 2003 federal budget increased the rate available under the Film or Video Production Services Tax Credit, which is a refundable credit for the cost of Canadian labour engaged in foreign films and videos produced in Canada. The budget increased the tax credit rate from 11% to 16%. Regarding the Canadian Film or Video Production Tax Credit, which is a refundable investment tax credit equal to 25% of labour costs incurred in Canadian film or television productions, the budget indicated that consultations with the industry would continue in order to ensure that the structure and operation of the credit are appropriate to achieve the intended support.[64]

Sport is also supported by the Department of Canadian Heritage through such programs as:

- the Athlete Assistance Program
- the Hosting Program — International Single Sports Event
- the National Sport Organization Support Program
- the Sport Participation Development Program.

Sport is an element of our national pride. It is also an important means by which Canadians can take preventative action that will have positive health effects. The federal government currently invests $75 million annually in a range of sport activities. The importance of sport to the welfare of Canadians was identified in the October 2004 Speech from the Throne in the context of health, when it was noted that better health for Canadians requires "the promotion of healthy living, addressing risk factors such as physical inactivity … " and the commitment was made that the federal government will "work with partners to enhance sports activities at both the community and competitive levels."[65]

In addition to arts and sport, another aspect of our cultural heritage is the preservation of our historic buildings. The 2003 federal budget built on the Historic Places Initiative announced in 2000 by creating a three-year contribution program with $10 million annually to compensate businesses for a portion of the costs incurred in restoring heritage buildings. In addition to developing incentives for the private sector to preserve heritage properties, the Department of Canadian Heritage has been developing a national register in respect of restoration expenditures.

The October 2004 Speech from the Throne recognized cultural life, and commented that the federal government "will foster cultural institutions and policies that aspire to excellence, reflect a diverse and multicultural society, respond to the new

[64] Ibid., p. 147.

[65] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: http://www.pm.gc.ca/eng/sft-ddt.asp.

challenges of globalization and the digital economy, and promote diversity of views and cultural expression at home and abroad."[66]

B. What the Witnesses Said

The Committee received a wide range of suggestions about how the federal government should be supporting culture and the arts. For example, we were told that the government must look at ways of improving the financing of production companies as well as cultural industries in general. It was suggested that the government collaborate with industry to find new and innovative ways of attracting corporate private investment to the industry.

Many witnesses spoke to the Committee about the increased credit rate for the Film or Video Production Services Tax Credit that occurred in the 2003 federal budget. They noted that, at that time, no corresponding increase occurred in the credit rate for the Canadian Film or Video Production Tax Credit. Consequently, the rate differential between the two tax credits was changed, and witnesses urged the federal government to increase the tax rate under the Canadian Film or Video Production Tax Credit in order to restore that differential.

Furthermore, witnesses remarked that the three-year $560 million financing plan for the Tomorrow Starts Today initiative will end in 2005. They noted that since no commitment has been made about the initiative's renewal, the uncertainty creates difficulties for artists and arts organizations. Witnesses urged renewal of the Tomorrow Starts Today Initiative, with a permanent funding commitment.

The Committee's witnesses also expressed their support for the Canada Council for the Arts, and asked that its funding be increased. Regarding the Canadian Television Fund, most witnesses expressed support for the re-establishment, in the 2004 federal budget, of funding to the previous level of $100 million for the next two years, but urged permanent funding of at least $100 million annually in order to reduce uncertainty.

Witnesses also suggested that the upcoming federal budget should include an increased and stable funding commitment to the Canadian Broadcasting Corporation for at least the next five years, arguing that the Corporation's role within the broadcasting system has been weakened by a lack of funding in past years. It was also pointed out that the Corporation allocates a large share of its prime-time programming to Canadian-produced television shows, unlike the majority of English-speaking privately owned Canadian television networks.

Furthermore, the contribution of physical activity, sport participation and athletic development to our health and culture was noted by witnesses. The Committee was told

66 Ibid.

that the federal government should contribute at least 1% of the federal health care budget to predictable and adequate long-term investments for sport participation, physical activity and athletic development. More specifically, in their view, minimum annual commitments of $180 million for sport and $100 million for physical activity are required. Witnesses also urged the implementation of a number of tax measures recommended by the 1998 report of the SubCommittee on the Study of Sport in Canada of the House of Commons Standing Committee on Canadian Heritage.

In addition, the Committee was informed that Canada lost between 21% and 23% of its historical housing stock between 1970 and 2000. Witnesses pointed out that the Auditor General of Canada concluded in a 2003 report that Canada's built heritage is currently jeopardized. It was recommended that federal funding for the Historic Places Initiative be renewed on an ongoing basis, that the capital gains inclusion rate on donations of real property to such bodies as the Heritage Canada Foundation be reduced to zero and that, among other recommendations, the federal government consider the conclusions reached by the Auditor General of Canada with respect to heritage properties.

Moreover, the Committee was told that the federal government's museum policy is 14 years old. Over this period, there has been a substantial reduction in federal government support for museums and a deterioration in museum assets. We were informed that cutbacks at all levels — from operating grants to education and community outreach programs — have meant that many museums are facing critical shortfalls, and are unable to plan adequately for the future or to maintain facilities and collections.

The Committee was told that the Canadian Arts and Heritage Sustainability Program, through which grants are provided to arts organizations in order to encourage private donations to endowment funds that assist in diversifying and sustaining revenue sources, does not apply to museums. Witnesses urged the federal government to expand this Program's endowment incentives to museums. It was also recommended that federal funding for the Museums Assistance Program be increased to $1 per capita. Finally, it was suggested that increased investments in museums and other tourism attractions, as well as a $100 million increase in Park Canada's budget for the repair and maintenance of current infrastructure, would encourage tourism activity and thereby benefit the Canadian tourism industry.

C. What the Committee Believes

The Committee believes that culture is central to our quality of life. It helps to define who we are as individuals and who we are as a nation. It is pervasive, and extends beyond a discussion of arts and culture to include discussions of how we do business, what we value and why we act in the manner that we do.

The Committee was struck by the broad range of initiatives that exist to support arts and culture in Canada and, like a number of our witnesses, believe that long-term and stable funding in a number of areas is required in order that activities can be planned appropriately. We are proud of what our artists — regardless of their medium — have accomplished domestically and internationally, and feel that continued federal support of arts and culture is both desirable and in the best interests of Canadians. Like many of the witnesses who made presentations related to arts and culture, certain initiatives seem to be particularly desirable, and specific support should be directed to them. We also believe that heritage buildings and museums must be supported and preserved for our benefit, the benefit of future generations, and the benefit of those who visit our country. It is from this perspective that the Committee recommends that:

RECOMMENDATION 11

The federal government provide stable, long-term funding to the following elements of federal support for arts and culture: the Tomorrow Starts Today program; the Canada Council for the Arts; Telefilm Canada; the Museums Assistance Program; the Community Access Program; the Canadian Television Fund and initiatives designed to promote Canadian culture internationally.

Moreover, the government should increase funding for the Canadian Broadcasting Corporation and Radio-Canada.

As well, the government should allocate funds to build capacity and assist archives with respect to archival content.

Finally, the government should increase the Canadian Film or Video Production Tax Credit to 30%.

CHAPTER THREE: ENSURING BUSINESS GROWTH AND PROSPERITY

CORPORATE TAXES

A. What the Federal Government Provides

Canadian businesses pay a variety of taxes and to all levels of government, including corporate income taxes, capital taxes, property taxes, sales taxes, excise taxes and other levies. Corporate taxes — income and capital — are imposed by federal and provincial/territorial governments. For fiscal year 2003-2004, corporate taxes represented about 15% of federal tax revenues and about 9% of provincial/territorial tax revenues, as shown in Table 3.1.[67]

Table 3.1: Corporate Taxes in Canada, 2003-2004

	Federal level		Provincial/Territorial level	
	$ Billion	**% of Federal Tax Revenues**	**$ Billion**	**% of Provincial/ Territorial Tax Revenues**
Corporate Income Taxes	27.1	14%	11.6	7%
Corporate Capital Taxes	1.4	1%	3.3	2%
Total	**28.6**	**15%**	**14.8**	**9%**

Source: Computations based on Department of Finance, *Tax Expenditures and Evaluations — 2004*, p. 68.

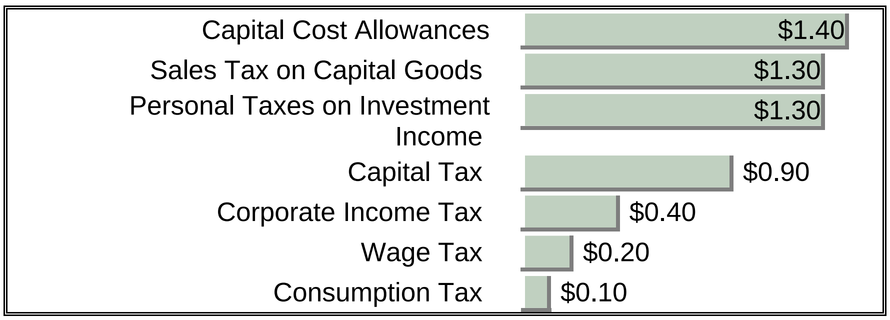
Corporate taxes affect the rate of return on equity capital and investment incentives. Investors are sensitive to the after-tax return on investment, and reducing the marginal effective tax rate on capital investment may result in additional business investment because projects would be more profitable, after tax, than would otherwise be the case.

As shown in Figure 3.1, the Department of Finance has estimated that the long-run welfare gains obtained from reducing corporate taxes — that is, sales tax on capital goods, capital cost allowances, capital taxes and corporate income taxes — as well as personal taxes on investment income are larger than the gains obtained from reducing

[67] Department of Finance, *Tax Expenditures and Evaluations — 2004*, p. 68, available at: www.fin.gc.ca/toce/2004/taxexp04-e.html.

taxes on employment income or consumption.[68] The larger long-run effects from tax reductions for saving and investment can be attributed to the positive impact on capital accumulation of increasing the net-of-tax rate of return on investment. More capital available per hour of work means a higher rate of Gross Domestic Product (GDP) growth in the long term, which results in higher fiscal revenues for governments as the tax base expands.

Figure 3.1: Long-Run Economic Well-Being Gain Per Dollar of Tax Reduction*



* The revenue loss is assumed to be recovered through lump-sum taxation.
Source: Department of Finance, *Tax Expenditures and Evaluations — 2004*, p. 71.

The model used by the Department of Finance, however, may underestimate the beneficial impact of reducing corporate income tax rates, since it does not take into account the tax planning effect on potential foreign investors. The international competitiveness of the Canadian business tax system was one of the main principles underlying the introduction of the 2000 federal tax reduction plan for corporate income, as other jurisdictions had already reduced — or were in the process of reducing — their taxes on corporate income.

Corporate taxes have important policy implications for Canada, which is an open economy that relies heavily on international trade and global capital markets. Higher and less competitive tax rates may lead to erosion in the tax base as corporations shift income from high- to low-taxed jurisdictions. As well, it is thought that more internationally competitive tax rates result in increasing inflows of foreign direct investment.

The most significant tax on Canadian companies is the corporate income tax, which is imposed by the federal and provincial/territorial governments. Corporate income taxes accounted for about 14% of total federal tax revenues in 2003-2004, as shown in Table 3.1.[69]

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68 Department of Finance, *Tax Expenditures and Evaluations — 2004*, p. 71, available at: www.fin.gc.ca/toce/2004/taxexp04-e.html.

69 Department of Finance, *Tax Expenditures and Evaluations — 2004*, p. 68, available at: www.fin.gc.ca/toce/2004/taxexp04-e.html.

In 2000, the federal government announced a five-year, $100 billion tax reduction plan for individuals and businesses.[70] As part of that plan, the general federal corporate tax rate was reduced by 7%, falling from 28% in 2000 to 21% in 2004; with the addition of the 1.12% federal corporate surtax, the rate fell from 29.12% to 22.12% over the period, as shown in Table 3.2. The tax reduction plan did not eliminate the federal corporate surtax, which was initially introduced in order to reduce the federal budgetary deficit. Over the 2000-2001 to 2004-2005 period, these tax reductions were expected to cost more than $10 billion.[71]

Table 3.2: Federal Income Tax Rates on Corporate Income, 2000-2005

	Tax Rate (including 1.12% Surtax) (%)					
Year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
General Corporate Income	29.12	28.12	26.12	24.12	22.12	22.12
Small Business Income						
Up to $200,000	13.12	13.12*	13.12*			
Up to $225,000				13.12*		
Up to $250,000					13.12	
Up to $300,000						13.12

* 22.12% tax rate (including surtax) is applied to income up to $300,000.

Sources: Department of Finance, October 2000 *Economic Statement and Budget Update*, p. 101-102 and *The Budget Plan 2004*, Table A1.2.

In addition, the 2003 federal budget announced changes to the taxation of the resource sector. The changes, to be phased in over five years, include:

- a reduction in the federal corporate tax rate on income from resource activities from 28% to 21%, plus the 1.12% corporate surtax;
- a deduction for income tax purposes of actual provincial and other Crown royalties and mining taxes paid;
- the elimination of the existing 25% resource allowance; and
- a new 10% investment tax credit for corporations with qualifying mineral exploration expenditures in Canada.

70 Department of Finance, *The Budget Plan 2004*, p. 202-209, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

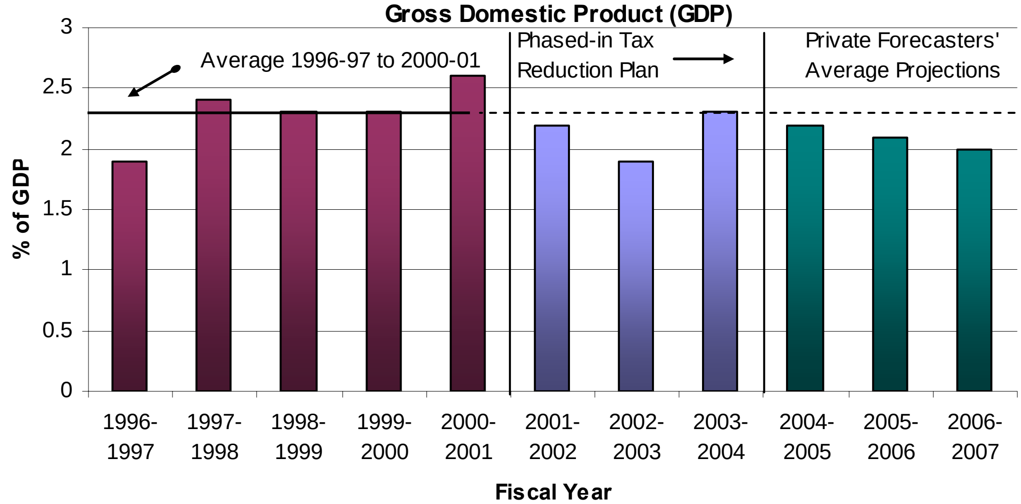
71 Department of Finance, *October 2000 Economic Statement and Budget Update*, p. 97, available at: www.fin.gc.ca/toce/2000/ec00e.htm.

These tax changes for the resource sector are among the most significant changes in tax policy for the sector since the 1970s. According to the Department of Finance's 2003 *Technical Paper on Improving the Income Taxation of the Resource Sector in Canada*, the tax changes will improve the international competitiveness of the Canadian resource sector, in particular relative to the United States. The changes will also simplify and streamline compliance and administration, treat all costs in a more consistent manner and preserve incentives for mineral exploration.[72]

Moreover, the 2003 federal budget announced that the amount of annual qualifying income eligible for the 12% federal tax rate for small business corporations will be increased from $200,000 to $250,000 by 2004 and to $300,000 by 2006; the 2004 budget accelerated the latter measure, so that the $300,000 threshold amount will be reached by 2005. This small business deduction is available to all Canadian-controlled private corporations with capital not exceeding $10 million.

Revenues from corporate income taxation are difficult to forecast. Corporate profits can vary significantly from year to year. As well, the existing system of tax loss offsetting, which allows corporations to carry backward or forward negative tax liabilities over years in which taxable income is positive, means that corporate tax receipts in a given year may be lower than otherwise expected because of deferred or current tax losses.

Figure 3.2: Federal Corporate Income Tax Revenues as a Percentage of Gross Domestic Product (GDP)



Sources: Department of Finance, *Fiscal Reference Tables*, October 2004 and November 2004 *Economic and Fiscal Update*.

As shown in Figure 3.2, over the 1996-1997 to 2003-2004 period, federal corporate income tax revenues as a share of GDP were at their highest level in 2000-2001, which is not surprising given that corporate profits as a percentage of GDP reached 12.6% in 2000, a level that had not been realized since the 1970s. Over the

[72] Department of Finance, *Technical Paper on Improving the Income Taxation of the Resource Sector in Canada*, March 2003, p. 5, available at: www.fin.gc.ca/toce/2003/rsc_e.html.

1996-1997 to 2000-2001 period, corporate income tax revenues as a share of GDP averaged 2.3%, a rate equal to that of 2003-2004. Private sector forecasters consulted by the Department of Finance project that, on average, the federal budgetary revenues from the federal corporate income tax will be 2.2% of GDP in 2004-2005, and 2.1% and 2.0% in 2005-2006 and 2006-2007 respectively.[73]

In 2002, all Canadian corporations were subject to the federal large corporations tax (LCT) of 0.225% applied to paid-up capital in excess of $10 million. In addition, financial institutions are subject to a tax of 1.25% applied to paid-up capital exceeding $200 million employed in Canada. Unlike corporate income taxes, which are paid when a corporation has taxable income, capital taxes must be paid regardless of whether a corporation is profitable.

The 2003 federal budget announced the elimination of the federal LCT over five years, and an increase in the capital threshold to $50 million effective 2004. Consequently, starting in 2004, the tax is completely eliminated for medium-sized corporations, or those with less than $50 million in taxable capital. The capital tax on financial institutions has been maintained, and ensures that large financial institutions pay some minimum amount of tax to the federal government.[74]

Although Canada's average corporate income tax rate is now lower than that of the United States, when other factors such as capital depreciation, capital taxes and provincial/territorial sales taxes are considered, Canada's average effective tax rate on capital investment for medium- and large-sized companies is about 6% above that of the United States, as shown in Table 3.3. Table 3.3 shows that, with the elimination of the federal large corporations tax and other provincial/territorial tax changes, in 2008 Canada's average effective tax rate on capital is expected to be about 3% lower than is currently the case. Assuming that corporate tax changes do not occur in Canada or the United States,[75] however, Canada's average effective tax rate on capital investment for medium- and large-sized companies would be about 3% higher than the rate in the United States in 2008, as shown in Table 3.3.

[73] Department of Finance, *November 2004 Economic and Fiscal Update*, p. 79, available at: www.fin.gc.ca/budtoce/2004/ec04_e.html.

[74] Department of Finance, *The Budget Plan 2003*, p. 144, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

[75] This assumption is, perhaps, unrealistic, since during the November 2004 election President Bush campaigned for tax reforms aimed at encouraging domestic capital investment.

Table 3.3: Average Effective Tax Rate on Capital Investment for Medium- and Large-Sized Companies

Year	Canada	United States
2004	31.7	25.8
2008	28.9*	25.8*

* Assuming no corporate tax changes occur.

Source: Duanjie Chen and Jack M. Mintz, "Corporate Tax Changes, 2004: Federal and Provincial Governments Part Ways," C.D. Howe Institute, *e-brief*, 6 October 2004.

B. What the Witnesses Said

Many of the Committee's witnesses shared their view that Canada's effective corporate tax rate on capital investment is still too high. We were told that the Department of Finance provides incomplete information on its Web site about the competitiveness of the Canadian corporate tax system, and considers only statutory corporate income tax rates and capital taxes; in particular, the Department does not consider depreciation, inventory deductions, provincial/territorial sales taxes on capital inputs, and other taxes that affect capital investment. In the view of witnesses, if the full range of taxes are considered, Canada has one of the highest effective tax rates on capital investment in the world, even though good progress has been realized over the past five years.

The Committee was told that there is a great deal of evidence showing a lack of private sector investment in Canada. It was argued that productivity and competitiveness are enhanced when businesses are able to adopt new technologies through the acquisition of capital goods; greater productivity and competitiveness mean that businesses are in a better position to provide higher compensation to their employees.

A number of witnesses maintained that reducing corporate taxation — thereby reducing the effective rate of taxation on capital investment — would encourage more domestic capital investment to take place and would lead to more foreign direct investment in Canada. In turn, it was argued, higher rates of private investment would result in higher productivity growth and higher incomes. The Committee was told that the per capita income difference between Canada and the United States is approximately $6,000 per person, and that this gap could be entirely due to the lower level of labour productivity in Canada.

The Committee was informed that the aging population will, in the future, place greater demands on public services, resulting in increased public spending of at least 6% of GDP in the next 35 years. At the same time, personal taxes as a share of GDP will decline by about 1% because post-retirement incomes typically are lower than incomes earned during working lives. Witnesses told us that the federal government should adopt long-term fiscal policies that will provide opportunities for Canadians to accumulate resources more quickly in order to fund age-related public spending; otherwise, future working-age Canadians will face significant fiscal pressures to fund public services for the elderly. The point was made that both productivity and demographic issues indicate a need for tax reform designed to lower taxes on investments.

Many witnesses supported reductions in the general corporate income tax rate, and argued that the recent corporate tax rate reductions have resulted in improved economic performance and net increases in federal fiscal revenues. It was felt that the general corporate income tax rate should be reduced to 17% by 2008. As well, the Committee was told that, dollar for dollar, no other form of tax reduction is more effective in accelerating economic growth than a reduction in corporate taxes. Moreover, we were told that the federal government should eliminate the corporate surtax, since the surtax was originally introduced to combat federal budgetary deficits, and the federal budget has had a surplus for a number of years.

For their part, witnesses from the resource sector requested that the federal government accelerate the phased-in reduction of the corporate tax rate on income from resource activities. Also, witnesses from the manufacturing sector reminded the Committee that the corporate income tax rate for their industry was not affected by the recent reductions.

Witnesses' concerns also focused on federal capital taxes, with many urging an acceleration in the phased-in elimination of the federal large corporations tax, since the detrimental effects of this tax on investment and the economy are clearly recognized. It was also recommended that the federal capital tax on large financial institutions be gradually eliminated.

Witnesses also urged changes to the non-resident withholding tax regime to ensure that Canada remains competitive. It was suggested, for example, that the Department of Finance negotiate a new provision with the United States eliminating withholding taxes on all dividends and interest payments to both related and unrelated parties. They mentioned a recent study that claims that the elimination of withholding taxes on all dividends and interest payments would result in increased capital investment in Canada of $28 billion, and an increased income of $7.5 billion annually. It was pointed out that while there would be a federal fiscal cost associated with eliminating withholding taxes, the economy would benefit in the long run.

Another aspect of corporate taxation presented to the Committee was the taxation of dividends. We were told that the current tax system discriminates against dividend-paying large and medium-sized corporations. Dividends are taxed more highly than capital gains, as well as other sources of income, once both corporate and personal taxes have been taken into account. This result may cause businesses to avoid paying dividends to shareholders in favour of retained earnings. The Committee also heard that Canada's dividend tax rate is now much higher than the U.S. federal 15% tax rate.

Moreover, a number of witnesses were concerned about the Department of Finance's draft legislation regarding the deductibility of interest and other expenses. Some thought that the draft legislation, if enacted, would reduce entrepreneurial activity in Canada. The draft legislation was described as problematic.

The Committee was urged to support a recommendation with respect to automobile dealers, who finance their inventory with lien notes; these notes are considered taxable capital under the *Income Tax Act.* In order to qualify for the 12% small business tax rate on income of up to $250,000,[76] taxable capital must not exceed $10 million. Because of the manner in which capital is defined, many automobile dealers do not qualify for the lower rate; consequently, it was recommended that the definition of taxable capital in subsection 181.2(3) of the *Income Tax Act* be amended to exclude "lien notes."

Finally, the Committee was told that foreign-owned property and casualty insurance companies doing business in Canada often benefit from tax provisions in other countries that allow them to set aside, free from income tax, reserves to meet their obligations in cases of catastrophes. The establishment of catastrophe reserves in Canada, free from income tax and similar to the catastrophe reserves found in many European countries, was urged in order that the Canadian mutual insurance industry can compete with foreign competitors on a level playing field.

C. What the Committee Believes

The Committee recognizes that a country's tax environment is only one of many elements that influence investment flows and economic activity. Among other influences, a healthy, educated and skilled workforce, well-maintained and adequate infrastructure, and a stable political climate all contribute to a positive business climate.

That being said, Canada's tax environment for businesses is, undeniably, important to our economic prosperity as a nation and, consequently, to Canadians' standard of living and the sustainability of public finances. The federal government has a role to play in this area, and should ensure that the tax environment contributes to business success. We believe that the five-year tax reduction plan introduced in 2000 has had beneficial effects, and feel that further tax reductions should occur. Like a number of our witnesses, the Committee believes that our tax environment should be competitive with that of the United States, recognizing that competitive does not mean identical. Otherwise, there is a danger that Canadian businesses will not prosper to the extent that they can, and to the extent that they should. Ultimately, the Canadian economy and Canadians' standard of living will also suffer.

[76] The income threshold will be increased to $300,000 starting in 2005.

The Committee feels that lower corporate taxes on capital investment have many beneficial effects: greater employment opportunities for Canadians as businesses decide to invest and locate here; enhanced productivity for businesses that in turn might lead to higher levels of profitability; more generous compensation for employees and larger contributions to the communities within which the businesses operate and the employees live; and a more prosperous nation as a consequence of these factors. It is from this perspective that the Committee recommends that:

RECOMMENDATION 12

The federal government ensure that the effective tax rate for Canadian corporations is competitive with that in the United States and elsewhere. Within that context, the government should:

- **review the timetable for elimination of the federal large corporations tax;**
- **review the timetable for the tax changes for the resource sector;**
- **consider immediate elimination of the corporate surtax; and**
- **review the corporate income tax rates and other taxes paid by corporations.**

The Committee is concerned about the current tax treatment of dividend income, which results in dividends being taxed at a higher rate than capital gains and at a higher rate than in the United States. We believe that a review of the tax treatment of dividends is needed in order to ensure that Canada's treatment of dividend income is competitive with that of the rest of the world, particularly the United States; that the ability of Canadian companies to attract capital investment is not impeded; and that capital gains, interest payments and dividend income are treated similarly. Therefore, the Committee recommends that:

RECOMMENDATION 13

The federal government, bearing in mind Recommendation 16 regarding a review of capital gains, review the current federal tax treatment of dividend income and non-resident withholding taxes with a view to ensuring that the tax treatment in Canada remains competitive with the rest of the world, particularly the United States, and that the tax treatment does not distort investment decisions.

CAPITAL COST ALLOWANCE RATES

A. What the Federal Government Provides

The capital cost allowance (CCA) is a tax deduction for business-related capital property that provides for the depreciation of these assets. Businesses can deduct up to a fixed percentage of the depreciated cost each year, with 44 CCA classes described in the *Income Tax Act*. The CCA rate applicable to each class is usually intended to "reflect, as closely as possible, the useful lives of the assets."[77]

The 2000 federal budget improved the treatment of several classes of assets. This budget, as well as the 2003 budget, also implemented changes to Class 43.1, which addresses renewable and alternative energies. Moreover, in the 2003 budget, the federal government committed to assessing "in particular, the appropriateness of capital cost allowance rates that, as a general principle, should reflect the useful life of assets and thus provide adequate recognition of capital costs."[78]

The 2004 federal budget increased the capital cost allowance rate for computer equipment to 45% from 30% and for broadband, Internet and other data network infrastructure equipment to 30% from 20%. To date, no other changes to the CCA rate schedule have been announced.

B. What the Witnesses Said

As in past years, witnesses spoke to the Committee about the federal government's capital cost allowance rate structure, and often provided specific proposals about what they believe the rates should be. Many witnesses indicated that the rates are inconsistent with the economic lives of some assets. For example, we were told that the current rates for Canadian railways and for rail leasing companies are considerably lower than those for U.S. railroads, and that the rate for rail equipment is also considerably lower than that for Canadian trucks and marine vessels.

Other industries are also negatively affected by the current CCA rate structure, according to witnesses. The Committee was told that the electricity industry is the only sector that does not receive adequate tax treatment for the depreciation of used and new assets, and that the printing industry is disadvantaged since the rate applied to computers does not apply to computer equipment. The agriculture industry also believes that rates must be updated in order to encourage greater investments in farm capital.

Furthermore, the Committee was told that harmonizing rates and the method of calculating capital cost allowances with those in the United States would provide

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77 Department of Finance, *The Budget Plan 2000*, p. 260, available at: www.fin.gc.ca/budget00/pdf/bpe.pdf.

78 Department of Finance, *The Budget Plan 2003*, p. 144, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

additional incentives for business investment in Canada. They urged a review of the rates applicable to all asset classes in order to align capital cost allowance rates with the true economic life of the assets.

C. What the Committee Believes

The Committee believes that capital cost allowance rates must be reviewed as soon as possible. We are reminded of the announcement in the 2003 federal budget that these rates should be assessed and that they should, as a general principle, reflect the useful life of the asset in question. Moreover, while we recognize that the 2004 budget announced changes for certain asset classes, much more remains to be done. In our view, changes are needed to ensure both that similar asset classes are treated in a similar manner and that Canadian companies are not disadvantaged relative to their international competitors, particularly those in the United States.

In particular, the Committee was struck by what we perceive to be certain anomalies in the current treatment of some asset classes, and we believe that these anomalies should be corrected immediately. More generally, however, we are of the view that the long-awaited assessment must occur. Consequently, the Committee recommends that:

RECOMMENDATION 14

The federal government revise Canada's capital cost allowance rates by 31 March 2005 such that they meet three criteria:

- **similar asset classes are treated similarly;**
- **Canadian rates are similar to the rates for comparable asset classes in the United States and other countries; and**
- **Canadian rates reflect the useful life of the assets.**

Moreover, the government should review these rates annually to ensure that they continue to meet the three criteria identified.

ACCESS TO CAPITAL

A. What the Federal Government Provides

Businesses can finance capital investments through debt, equity or a combination of the two. Smaller businesses, however, may be limited in their ability to access traditional sources of capital because of their financial situation and the availability of risk capital. Traditional creditors may view such businesses as relatively riskier, particularly if they operate in knowledge-intensive industries. For these businesses and in these types of industries, traditional debt financing may not be readily available because they lack sufficient equity, machinery or inventory to use as collateral.

Since the 2000 federal budget, the federal government has implemented a range of tax measures to help facilitate the growth of small companies, entrepreneurship and the commercialization of innovative ideas, including:[79]

- a reduction in the capital gains inclusion rate from 75% to 66.6% to 50%;
- the introduction of a small business capital gains rollover provision;
- a measure permitting the deferral of the income inclusion from exercising qualifying stock options until disposition;
- a reduction in the general corporate income tax rate from 28% in 2000 to 21% in 2004;
- an increase in the small business deduction limit from $200,000 to $300,000 in 2005;
- improvements to capital cost allowance rates for certain asset classes;
- extension of the non-capital loss carry-forward period from 7 years to 10 years; and
- elimination of the federal large corporations tax over 5 years.

Moreover, in recent years the federal government has removed certain regulatory impediments and committed additional funding in order to enlarge the pool of risk capital for promising start ups and small businesses, including:[80]

- the removal of tax-related impediments to venture capital investment in Canada through the use of partnerships by Canadian pension plans and by foreign investors;
- the removal of impediments to the use of qualifying limited partnerships as investment vehicles for Canadian venture capital funds;
- amendments to the Scientific Research and Experimental Development investment tax credit rules so that small Canadian-controlled private corporations that have a common group of shareholders who are not acting together will not have to share the $2-million expenditure limit; and

79 Department of Finance, *The Budget Plan 2004*, p. 223-224, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

80 Department of Finance, *The Budget Plan 2004*, p. 141, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

- additional federal funding for venture capital financing by the Business Development Bank of Canada and by Farm Credit Canada.

As well, the federal government, through the *Canada Small Business Financing Act*, increases the availability of financing for small businesses through access to debt financing. Through this legislation, the federal government partially guarantees loans up to $250,000 to eligible new and established small businesses with annual gross revenues of less than $5 million. Although banks and other financial institutions make the loans, the federal government bears a significant portion of any loss incurred as a consequence of default. The term loans are for the purchase or improvement of fixed assets, which may limit the usefulness for start-up companies, particularly those that require few fixed assets.

The Business Development Bank of Canada (BDC) offers financial and consulting services to small businesses, both individually and jointly with other institutions. It provides venture capital in exchange for equity participation of between 15% and 49% or unsecured convertible debt financing, venture loans where repayment is a combination of interest payments and royalties tailored to the company`s cash flow, and seed capital. Initial investments typically range from $500,000 to $3 million as part of a package of financing that may total $1 million to $10 million. The BDC will reinvest to maintain its pro-rata share of the investment along with other investors. The nature of its support means that new firms are not overburdened with higher interest payments on debt.

Microcredit funds are also available from the BDC for entrepreneurs who do not have access to bank credit. Local economic development centres offer security to lending institutions and will primarily support community projects that promote employment for specific target clienteles. These loans are under $25,000 and are to be used to finance the start-up of businesses with fewer than five employees and gross revenues of less than $500,000. As well, the BDC has a Venture Capital Division and offers Co-Vision start-up financing for term financing of up to $100,000.

Through the labour-sponsored venture capital corporation (LSVCC) program, the federal government has been involved in venture capital financing. This program provides small individual investors with federal and provincial/territorial tax credits for investing in eligible, union-sponsored funds mandated to make investments in smaller businesses. In the 1980s, the federal government offered a tax credit of 20% on investments up to $5,000; these amounts were subsequently changed to 15% on investments up to $3,500, and later to 15% on investments up to $5,000.[81] According to the Department of Finance, the federal fiscal cost of the LSVCC tax credit in 2003 was about $155 million.[82]

81 Department of Finance, "Secretary of State Jim Peterson Announces Tax Proposals for Labour-Sponsored Funds," News Release, 31 August 98, available at: www.fin.gc.ca/news98/98-086e.html, and Günseli Baygan, *Venture Capital Policy Review: Canada*, Organisation for Economic Co-operation and Development, STI Working Paper 2003/4, 28 January 2003.

82 Department of Finance, *Tax Expenditures and Evaluations — 2004*, Table 1, available at: www.fin.gc.ca/toce/2004/taxexp04-e.html.

The creation of the LSVCC program has been important to the development of the Canadian venture capital industry; in some periods, the LSVCCs were raising the majority of all new venture capital in Canada. In recent years, their share of the Canadian venture capital market has declined to about 40%.[83] Moreover, the federal government has been directly involved in venture capital through the Business Development Bank of Canada and, more recently, Farm Credit Canada. At the end of 2003, the amount of venture capital under management in Canada exceeded $22 billion.[84] According to the Organisation for Economic Co-operation and Development, the size of the Canadian venture capital market as a share of GDP ranked third among the G-7 countries in 2001, behind the United Kingdom and the United States.[85]

B. What the Witnesses Said

Witnesses shared with the Committee a number of concerns about access to capital and made recommendations that they believe would facilitate access. Some, for example, urged further increases in the small business deduction threshold, and suggested that it be increased to $400,000 or $500,000, depending on the witness. According to witnesses, an increase in the threshold would encourage small business owners to invest and grow their businesses.

As noted earlier, the Committee was also informed that Canada's dividend tax rate is much higher than the U.S. federal 15% tax rate, thereby making Canadian equity markets less competitive as businesses find it less expensive to issue shares in the United States. In addition, we were told that the Canadian tax treatment of dividends discriminates against dividend-paying large and medium-sized corporations, with the result that tax planning opportunities are created and the effectiveness of Canada’s capital markets is reduced. Aligning the effective taxation of dividends to that of capital gains would eventually reduce the cost of capital for small businesses by eliminating opportunities for market distortions and increasing the expected after-tax rate of return on investment in shares of small companies.

Moreover, the Committee was told that the Lifetime Capital Gains Exemption for small businesses is an important incentive for business growth and expansion. Several witnesses recommended that the federal government increase the exemption limit from $500,000 to $1 million, possibly phased in over time. A similar proposal was made with respect to agricultural property that continues to be operated as a farm. This new threshold would facilitate the intergenerational transfer of farms by better reflecting the current farming environment.

83 Information on the Canadian venture capital market is available from Macdonald & Associates Limited, available at www.canadavc.com.

84 Ibid.

85 Günseli Baygan, *Venture Capital Policy Review: Canada*, Organisation for Economic Co-operation and Development, STI Working Paper 2003/4, 28 January 2003.

The Committee was told that small and medium-sized businesses face great challenges in financing their growth using private sources of equity. We were informed that, last year, the market for venture capital financing fell to its lowest level in five years. Witnesses suggested that reducing the capital gains inclusion rate from 50% to 25% on shares of small publicly listed companies would increase the availability of risk capital for businesses at their early stages.

A proposal to increase the maximum amount eligible for the 15% tax credit for investment in labour-sponsored venture capital corporations — to $15,000 from the current $5,000 — was presented to the Committee. It was also mentioned that the *Income Tax Act* inhibits labour-sponsored venture capital corporations from making "sub-debt" investments, which are loans with equity characteristics; in this regard, it was recommended that the *Income Tax Act* be amended to allow labour-sponsored venture capital corporations to make such investments.

The Committee was also informed about deficiencies in Canada's capitalization environment for technology start-up companies. In particular, we were told that there is a shortage of seed and pre-seed investment capital; this shortage may be as large as $5 billion. This type of investment is generally made by private "angel" investors, and it was recommended that the federal government introduce a tax incentive for early-stage private equity investments to enhance access to this type of equity capital for start-up technology companies.

C. What the Committee Believes

The Committee believes that access to capital is critical to business success: it is needed in order for businesses to form, grow and prosper. We feel that insufficient entrepreneurial activity is being financed, particularly at the start-up and early stages of businesses, despite actions that have been taken by the federal government in recent federal budgets. A lack of entrepreneurial activity, and financing for it, may have particularly negative consequences in the future, since it may mean insufficient investment in — to mirror the October 2004 Speech from the Throne — "Canadian capabilities in key enabling technologies … which will be the drivers of innovation and productivity" as we move forward.

Moreover, in the Committee's view, as long as businesses continue to face challenges in accessing the capital they need, labour-sponsored venture capital corporations will play an important role in the venture capital market, providing stability of supply, regional diversity, an emphasis on start-up financing and funds to market niches currently underserved.

Like a number of our witnesses, the Committee feels that concerted efforts must be made to ensure that federal actions create an environment that fosters, rather than erects barriers to, the investments needed for business prosperity and, by extension, the prosperity of the Canadian economy and Canada's citizens. Certainly, business prosperity should be enhanced through corporate tax changes and the revisions to capital cost allowance rates recommended above, but other actions could also be taken in an effort to support entrepreneurs — and others who need access to reasonably priced capital — within Canada. It is for this reason that the Committee recommends that:

RECOMMENDATION 15

The federal government work with venture capitalists to identify new sources of financing. As well, the government should increase its funding to the Business Development Bank of Canada and to Farm Credit Canada in order that they can increase their venture capital activities. Finally, changes should be made to the federal Small Business Loan Program to allow this funding source to be accessed for a range of other uses, including operating capital.

The Committee believes that the federal government must take the actions needed to ensure the best possible business climate for businesses of all sizes and in all sectors. Moreover, like some of our witnesses, we feel that more could — and should — be done to create a tax environment conducive to early-stage private equity investment in start-up companies, particularly the small technology companies involved in the research and development that will be important for our future growth and prosperity. At the early stages of development, the return on equity investments made by private investors usually occurs in the form of capital gains. Thus, the Committee recommends that:

RECOMMENDATION 16

The federal government review the tax treatment of capital gains in order to ensure that start-up technology and other small companies are able to access private equity capital at the lowest possible cost, and that the tax treatment of capital gains in Canada remains competitive with that of the rest of the world, particularly the United States.

RESEARCH, INNOVATION AND COMMERCIALIZATION

A. What the Federal Government Provides

Innovation is a key contributor to the productivity growth that is felt to be important for economic growth and rising standards of living. Moreover, technological advancements are important in enhancing the ability to produce more goods and services with fewer resources. The development of new ideas and processes does not, however, occur without cost, and this cost can sometimes be substantial. Moreover, both basic and applied research must be recognized for the contribution they make to technological advancement, as well as research undertaken by companies and research that occurs in universities, colleges, research hospitals and government laboratories.

As noted in the 2004 federal budget, “Canada now ranks among the top five in the Organisation for Economic Co-operation and Development (OECD) and is first in the Group of Seven (G-7) in terms of publicly performed research (at universities, research hospitals and government laboratories) as a proportion of gross domestic product (GDP).”[86] Businesses also provide research funding to universities and may perform their own research, although their involvement in research is mostly concentrated in applied research and product development, rather than in basic research. The knowledge that flows from basic research activities is the foundation for the applied research and new product development that occur.

The federal government has a role to play both in funding basic research and in ensuring an environment in which worthy ideas can be commercialized, whether by it or in partnership with the private sector. The government supports research, innovation and commercialization activities through a variety of policies, tax measures and spending programs.

In February 2002, the federal government announced its Innovation Strategy, which commits Canada to, by 2010:

- rank among the top five countries in the world in terms of R&D performance;
- at least double the federal government’s then-current investment in R&D;
- rank among the world leaders in the share of private sector sales attributable to new innovations; and
- raise venture capital investments per capita to prevailing U.S. levels.

Federal support for basic research occurs through funding for the three federal granting councils and research agencies, including universities and hospitals, among others. Table 3.4 below shows the major federal research funding agencies and their respective mandates.

[86] Department of Finance, *The Budget Plan 2004*, p. 134, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

Table 3.4: Major Federal Research Funding Agencies, Canada

Institution	Description
Canada Foundation for Innovation	Funds the modernization of research infrastructure at Canadian universities and colleges, research hospitals and other not-for-profit research institutions
Federal Granting Councils	
Canadian Institutes of Health Research	Funds research related to health
Social Sciences and Humanities Research Council of Canada	Funds research related to the social sciences
Natural Sciences and Engineering Research Council of Canada	Funds research related to science and engineering
Genome Canada	Has responsibility for developing and implementing a national genomics strategy
Canada Research Chairs	Establishes 2,000, research professorships in universities across Canada
National Research Council Canada	Delivers such programs as the Industrial Research Assistance Program, which assists small and medium-sized businesses in developing and using new technologies and processes
Technology Partnerships Canada	Works with the federal government and the private sector to make strategic, high-risk investments in R&D to achieve specific objectives
Canadian Institute for Advanced Research	Funds researchers, with about one-third of its budget coming from the federal government

Source: Library of Parliament.

Canada's three granting councils — the Natural Sciences and Engineering Research Council of Canada (NSERC), the Social Sciences and Humanities Research Council of Canada (SSHRC) and the Canadian Institutes of Health Research (CIHR) — as well as the Canadian Institute for Advanced Research (CIAR) and the Canada Foundation for Innovation (CFI), among others, are important if Canada is to realize its Innovation Strategy. As shown in Table 3.5, in recent years the federal government has markedly increased its funding to the higher education sector in order to strengthen research capacity at universities, colleges and research facilities.

Table 3.5: Federal Funding for University-Based Research

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
	(millions of dollars)							
Canada Foundation for Innovation	30	115	185	240	480	360	450	550
Genome Canada				43	60	90	125	40
Canada Research Chairs			60	120	180	240	300	300
Canada Graduate Scholarships						25	55	85
Medical Research Council of Canada/Canadian Institutes of Health Research	40	72	145	255	330	385	385	385
Natural Sciences and Engineering Research Council of Canada	71	111	118	118	154	209	209	209
Social Sciences and Humanities Research Council of Canada	9	26	38	58	67	82	82	82
Indirect costs of research				200		225	225	225
Networks of Centres of Excellence		30	30	30	30	30	30	30
Total (annual)	**150**	**354**	**576**	**1,064**	**1,301**	**1,646**	**1,861**	**1,906**
Total (cumulative)	**150**	**504**	**1,080**	**2,144**	**3,445**	**5,091**	**6,952**	**8,858**

Source: Department of Finance, *The Budget Plan 2004*, p. 134, 135, 160.

With increases to funding for the three granting councils announced in the 2004 federal budget, the annual budgets will total approximately $654 million for the CIHR, $654 million for the NSERC and $192 million for the SSHRC. Consequently, for 2004-2005, their combined annual federal funding is projected to be about $1.5 billion.[87]

The 2003 federal budget commitment of $1.7 billion between 2002-2003 and 2004-2005 to research and development brought federal funding since 1998-1999 to more than $11 billion.[88] The 2003 budget also allocated an additional $500 million to the CFI to enhance health research facilities. Additional research and development support was identified in the 2004 budget, which announced a $60 million increase in funding for Genome Canada, adding to the $375 million already invested by the federal government. In 2005, Genome Canada's original five-year mandate will end.[89]

87 Department of Finance, *The Budget Plan 2004*, p. 135, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

88 Department of Finance, *The Budget Plan 2003*, p. 123,124, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

89 Department of Finance, *The Budget Plan 2004*, p. 136, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

For some institutions, the indirect costs associated with research — libraries, infrastructure and other items — can be sizable, and may impose a significant cost burden, thereby forcing institutions to reallocate funds either from direct research grants or from core operating costs. As a result, the federal government allocated $200 million in 2001-2002 to fund a portion of the indirect costs of federally sponsored research, and in the 2003 federal budget established an annual program with a budget of $225 million per year to help alleviate these costs. The 2004 budget increased this amount by $20 million annually, with the result that the federal government will provide an annual allocation of $245 million to help fund the indirect costs of federally sponsored research.[90]

The federal government also provides assistance to businesses in undertaking and commercializing research. The Scientific Research and Experimental Development (SR&ED) investment tax credit provides qualifying Canadian-controlled private corporations having less than $200,000 in taxable income during the previous year with a refundable investment tax credit of up to 35% for qualifying expenses, to a limit of $2 million; this limit is reduced by $10 for every $1 of taxable income between $200,000 and $400,000 in the preceding year. Other Canadian corporations, proprietorships, partnerships and trusts are eligible for a 20% non-refundable tax credit on qualifying expenses; they may be carried back 3 years or carried forward 10 years to reduce tax liability.[91]

The 2004 federal budget removed an impediment in accessing the SR&ED credit. Prior to the budget, two or more small businesses could not access the credit fully where associated through common investors, even when the investors did not act together. With the change, small businesses conducting SR&ED and raising funds from common investors not acting as a group can fully access the tax credit.[92] According to the Department of Finance, the SR&ED investment tax credit is projected to involve a tax expenditure of $1,750 million in 2004.[93]

Moreover, the Industrial Research Assistance Program (IRAP), which has existed for about 60 years and is available through National Research Council Canada, provides small and medium-sized businesses with technological and business advice, financial assistance and other innovation assistance, such as networking and partnerships, with a view to enhancing their innovation capacity.[94] The 2003 federal budget provided the Council with $25 million annually to expand the IRAP's core programming, and $10 million annually to establish new regional innovation centres and to secure Canada's

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90 Department of Finance, *The Budget Plan 2004*, p. 135, 136, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

91 Department of Finance, *The Budget Plan 2004*, p. 146, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

92 Department of Finance, *The Budget Plan 2004*, p. 145, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

93 Department of Finance, *Tax Expenditures and Evaluations 2004*, Table 2, available at: www.fin.gc.ca/taxexp/2004/TaxExp4_e.pdf.

94 Information on the Industrial Research Assistance Program is available at: www.rap-pari.nrc-cnrc.gc.ca/English/main_e.html.

participation in astronomy projects.[95] The 2004 budget allocated an additional $5 million annually to the IRAP to strengthen regional innovation and commercialization strategies.[96]

Commercialization of research is important in order to ensure that consumers can access the best products, that businesses can profit from their investments, and that the Canadian economy can grow and prosper. The federal government supports commercialization, in part through funding for pre-commercial development and the Intellectual Property Management Program, the Proof of Principle and Proof of Principle Partnered Program, and the Idea to Innovation Program of the federal granting councils.

Activities related to commercialization were enhanced in the 2004 federal budget, with an announcement that $50 million would be allocated over five years for a pilot competitive fund, managed by Industry Canada. The budget also committed $25 million over five years for a pilot program that will support proposals by federal science-based departments and agencies to improve their research commercialization activities, and funding of $270 million to enhance access to venture capital financing for companies turning research into new products and services.[97]

The October 2004 Speech from the Throne reiterated the federal commitment to venture capital financing, and mentioned — in particular — early-stage businesses. The Speech also indicated the government's commitment to "foster Canadian capabilities in key enabling technologies … which will be drivers of innovation and productivity in the 21st century economy."[98]

B. What the Witnesses Said

Witnesses presented the Committee with testimony that could be interpreted as suggesting that, in some sense, federal granting councils are victims of their own success. Despite the relatively large increases in the budgets of the federal granting councils over time, as noted above, several witnesses advocated additional investments and informed us that the demand for funds continues to exceed supply by a sizable amount.

It was proposed that, by 2008-2009, the federal government double the base funding for the Social Sciences and Humanities Research Council to $460 million, increase the budget of the Canadian Institutes of Health Research to $1 billion and increase the budget of the Natural Sciences and Engineering Research Council to

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95 Department of Finance, *The Budget Plan 2003*, p. 129, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

96 Department of Finance, *The Budget Plan 2004*, p. 138, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

97 Department of Finance, *The Budget Plan 2004*, p. 132, 137-139, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

98 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

$1.2 billion. Witnesses also requested that the federal granting councils be permitted to carry over a minimum of 5% and a maximum of 10% of annual funding from one fiscal year to the next. It was also proposed that the federal government cease to invest in the Canada Foundation for Innovation and instead increase funding for the granting councils. The Committee was told that inadequate funding for research makes it difficult for Canada to attract and retain the talented personnel that are required to sustain a climate of innovation.

Particular comments were made with respect to the Social Sciences and Humanities Research Council. A number of witnesses commented that the SSHRC continues to be disproportionately underfunded relative to the other granting councils. The Committee was told that the SSHRC receives 12% of the total funding for the three federal granting councils, although it supports 69% of all undergraduate students, 67% of graduate students and 53% of permanent university faculty.

The importance of ensuring that all regions of Canada benefit from federal research and development funds was noted by witnesses. The Committee was asked to support the National Research Council's role in the development of technology clusters in regions across the country. This effort, we were told, helps the commercialization of research and therefore benefits all Canadians. This year, the five-year funding for the Atlantic Technology Cluster initiative ends, and we were informed that the federal funding for it should be renewed.

The Committee was also told that funding from the Canadian Foundation for Innovation and the awarding of Canada Research Chairs is biased towards larger institutions and several provinces. It was recommended that the federal government conduct a review of research funding initiatives with the goal of modifying these programs to ensure greater equity, regionally and among institutions. Moreover, in developing any new programs, the government was urged to be sensitive to the particular needs of regions and smaller institutions.

As well, the Committee was told that significant declines in operating grants to universities have had detrimental impacts on research capacity. It was indicated that approximately one-third of all research and development in Canada occurs in post-secondary institutions; consequently, the federal government should increase its core funding for these institutions.

Some witnesses observed that the funds invested by the federal government in research ignore a substantial portion of the costs incurred by universities: the indirect costs of research. In the absence of federal funding for the indirect costs of research, universities must fund these costs from other sources. Several witnesses advocated funding the indirect costs proportionately to the level of direct research grants, while others recommended that the government increase funding for indirect costs associated with federally sponsored research to $400 million, effective in 2005.

Many witnesses shared the view that greater efforts should be directed toward the commercialization of research. It was argued that Canada is underperforming, relative to other nations, in bringing new knowledge and research discoveries to market, which prevents Canada from fully capitalizing on its research investments. The Committee was told that the federal government should introduce measures to help accelerate commercialization of research and to improve the commercialization environment in Canada.

For example, it was proposed that flow-through shares, as currently used in the oil and gas industry, could be available for technology companies to help them finance their research and development costs with private equity, rather than with government grants; the criteria used to determine the scope of eligible research activity could be modeled on the existing SR&ED program. Another suggestion was that the federal government should develop a version of the Québec program “bio-levier,” which was designed to enhance the equity capital financing of biotechnology corporations at their early stage of development.

Furthermore, several witnesses observed that the administrative aspects of the SR&ED initiative have become very complicated, and advocated simplification of the system as well as its expansion. The Committee was told that the credit would be more useful if the carry-forward period was extended to 15 or 20 years, and it was suggested that the current cap of $2 million on expenditures should be raised to at least $6 million by 2005. Some argued that reform of the SR&ED initiative should be a priority, since companies in the technology sector cannot take advantage of the tax credit because they do not have taxable income. They advocated measures that would allow companies to use their tax credits to offset other federal taxes, such as employment insurance premiums and capital taxes. In their view, these types of changes would encourage more R&D investment.

C. What the Committee Believes

The Committee has long supported measures that improve productivity in Canada, believing that productivity improvements — that is, the ability to produce the same amount of goods or services using fewer resources or to produce more goods and services using the same amount of resources — will become increasingly important as demographic changes continue and as we continue to compete in the global marketplace.

Consistent with the views of some of our witnesses, the Committee believes that productivity growth is linked to research and development spending, and to a highly educated workforce that is able to access post-secondary education and lifelong learning opportunities. We note the goals contained in the federal Innovation Strategy, and the moneys allocated to federal granting councils and research agencies and for the indirect costs of research in recent federal budgets. In our view, investments in research and development are not an end unto themselves but — instead — a means to an end:

raising business prosperity and the quality of life of Canadians through productivity growth and technological advances.

Significant funds from Canadian taxpayers have been allocated to research and development in recent years, and the Committee believes that accountability and responsible expenditure of these funds require that information be more widely disseminated about successes, since it is important to know whether the research and development funding is having the desired effects. Canadians must be assured that the expenditure of their tax dollars on research and development is resulting in more than employment for researchers. Thus, we urge federal research agencies to take every opportunity to publicize their accomplishments to date, the manner in which funds are allocated to regions and to institutions, and the effects of their investments on productivity and the quality of life of Canadians.

Like a number of our witnesses, the Committee sees commercialization as the final step in the research and development process, although it must be recognized that commercialization should not be the expected outcome with respect to all research. For example, research in the humanities and social sciences may offer few opportunities for commercialization.

That being said, however, the Committee feels that — wherever practicable — commercialization must occur for the benefit of all. In our view, the commercialization of research requires a particular skill set, one that is not typically found within universities themselves. We believe in the benefits of specialization: university researchers should specialize in the research activity, while others should specialize in the commercialization of that research. Commercialization must be seen as a priority since it is, in some sense, part of the return on the investment that Canadians make in research and development through the federal government.

Along with federal funding for federal granting councils and research agencies, as well as the Industrial Research Assistance Program, all of which have received increased funding in recent federal budgets, the Committee views the SR&ED tax credit as a useful means by which research and development — with its consequent benefits for productivity, business prosperity and the quality of life of Canadians — can be encouraged. Like a number of our witnesses, however, we feel that the credit could be improved so that more companies could benefit from it. Therefore, the Committee recommends that:

RECOMMENDATION 17

The federal government work with business to simplify the process by which firms access the Scientific Research and Experimental Development investment tax credit.

Moreover, the Committee agrees that flow-through shares, which are currently used successfully in the oil and gas industry, are useful for companies that want to finance their research and development with private equity investment. We believe that this mechanism could be useful for certain technologies that would have benefits in their own right but which could also help Canada to meet its environmental goals. Thus, the Committee recommends that:

RECOMMENDATION 18

The federal government review access to flow-through shares for specific expenses related to research and development with a view to expanding access for other sectors. This review should, in particular, consider early expansion of access for the fuel cell and hydrogen as well as the biotechnology industries.

SMART REGULATION

A. What the Federal Government Provides

Government regulations exist for a variety of purposes, including to protect the health and safety of Canadians; to protect the natural environment; and to ensure a fair and efficient marketplace for industry and consumers domestically and, to the extent possible, internationally. Other federal actions, such as taxation, program spending, legislation, standards, guidelines and codes might also be used to achieve these goals. Globalization and changing expectations require that regulations be adapted to ensure that the most effective and efficient means are used to provide the level of protection and governance desired. Effective regulation should have social, environmental and economic benefits.

The 2003 federal budget implemented a commitment made in the 2002 Speech from the Throne, which said: "The government will move forward with a smart regulation strategy to accelerate reforms in key areas to promote health and sustainability, to contribute to innovation and economic growth, and to reduce the administrative burden on business."[99] To that end, the budget allocated $4 million over two years for the External Advisory Committee on Smart Regulation to examine and report on redesign of Canada's regulatory approach "to create and maintain a Canadian advantage."[100]

In May 2003, the External Advisory Committee on Smart Regulation was established by the federal government in order to provide external advice on the redesign of Canada's regulatory system in order to serve better the needs of Canadians and the

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99 Governor General, *Speech from the Throne to Open the Second Session of the 37th Parliament of Canada*, 30 September 2002, available at: http://www.pco-bcp.gc.ca/default.asp?Language=E&Page=InformationResources&sub=sftddt&doc=sftddt2002_e.htm.

100 Department of Finance, *The Budget Plan 2003*, p. 187, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

country in the current century. The Committee, which was comprised of 10 members with knowledge of regulatory issues and a commitment to the public interest, held the view that smart regulation "is about finding better, more effective ways to provide a high level of protection to Canadians, promote the transition to sustainable development and foster an economic climate that is dynamic and conducive to innovation and investment. It must exist in a system that sets clear policy objectives and is transparent and predictable …."[101]

The External Advisory Committee on Smart Regulation released its report, *Smart Regulation: A Regulatory Strategy for Canada*,[102] in September 2004. The report proposed a new regulatory strategy for the 21st century, with cooperation — among governments and between government and such other parties as business and non-governmental entities — as an important requirement in a regulatory regime that will advance Canadian interests and national priorities. Recommendations in the report included a focus on:[103]

- international regulatory cooperation as a distinct component of Canadian foreign policy;
- federal-provincial-territorial regulatory cooperation, formalized in a discussion by First Ministers and the conclusion of a joint arrangement;
- federal regulatory cooperation among federal departments and agencies, with overarching strategic frameworks with clear policy objectives;
- risk management, involving a government-wide approach to risk prioritization, assessment and communication;
- instruments for government action, with a framework to guide their design and use;
- the regulatory process, with the development of a new federal Regulatory Policy to include performance measurement, compliance, enforcement plans, approaches for timely development of regulations, improved consultation practices, independent recourse mechanisms and task teams to lead regulatory reform processes; and
- government capacity to support a regulatory cultural change within government, to include comprehensive learning strategies as well as regulatory policy research and development agendas.

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101 External Advisory Committee on Smart Regulation, *EACSR Backgrounder*, available at: www.smartregulation.gc.ca/en/01/b-01.asp.

102 The report is available at: www.smartregulation.gc.ca.

103 External Advisory Committee on Smart Regulation, *EACSR Backgrounder*, available at: www.smartregulation.gc.ca/en/01/b-01.asp.

In response to the External Advisory Committee on Smart Regulation's report, the Prime Minister has asked the President of the Treasury Board, in his capacity as the Minister responsible for the Government of Canada Regulatory Policy, to lead the development of a regulatory government framework for this century. The President of the Treasury Board will work with other federal Ministers, representatives of provincial/territorial governments, industry representatives, members representing civil society and citizens as changes are made to modernize regulation in areas that might include natural resources, the environment, biotechnology, health, food safety and transportation.[104]

Finally, in terms of the regulation of securities in Canada, the December 2003 release of the report by the Wise Persons' Committee to Review the Structure of Securities Regulation in Canada, *It's Time,* is important.[105] The Committee, which was established by the then-Minister of Finance in March 2003, undertook an independent, objective review of the current regulatory framework for securities in Canada, and made recommendations about what might be an appropriate regulatory model.

The report by the Wise Persons' Committee advocated the creation of a single regulator using a joint federal-provincial/territorial model; at this time, Canada is the only major industrialized country without a national regulator. The proposed Canada Securities Commission would have nine regionally representative commissioners appointed by the Minister of Finance, and a framework for provincial/territorial input to securities policy. The system's administration would be provided by a securities policy ministerial committee comprised of the provincial ministers responsible for securities regulation as well as the Minister of Finance.

It is thought that a single regulator would result in strengthened enforcement, better policy innovation and development, enhanced branding of Canadian securities regulation internationally and, ultimately, better protection for investors and improved access to capital for companies.

The 2004 federal budget supported the recommendation by the Wise Persons' Committee for a single securities regulator, and committed the federal government to working with "provincial and territorial governments to … act quickly or run the risk that our capital markets will be left behind."[106]

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[104] Prime Minister of Canada, "Prime Minister receives report on smart regulation from the External Advisory Committee on Smart Regulation," *News Release*, 23 September 2004, available at: www.pm.gc.ca/eng/news.asp?id=269.

[105] The report is available at: www.wise-averties.ca.

[106] Department of Finance, *The Budget Plan 2004*, p. 155, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

B. What the Witnesses Said

Many of the Committee's witnesses supported the work of the External Advisory Committee on Smart Regulation, and urged early review and implementation of the Advisory Committee's recommendations by the federal government. It was observed that the overall regulatory burden on businesses must be reduced, and that government commitments about smart regulation offer a low-cost opportunity to enhance significantly the Canadian business environment, thereby attracting more investment, raising productivity and increasing competitiveness.

Furthermore, a number of witnesses argued that Canada should establish a single national securities regulator to lower administrative and compliance costs and to provide consistent interpretation and enforcement of rules.

C. What the Committee Believes

The Committee has long supported the benefits of regulatory improvement as a contributor to Canadian productivity. We believe that while regulations must provide Canadians with a stable and fair economic environment and protect their health and safety, an appropriate level of regulation is needed in order that Canadian business is not unnecessarily impeded.

A regulatory regime that is too burdensome can impede both productivity improvements and prosperity, and thereby limit opportunities and prosperity for Canadian businesses and Canada's citizens. Striking the appropriate balance between beneficial regulation and reducing red tape can be difficult to achieve. Difficulty in achieving the balance is not, however, an excuse to avoid the attempt. A number of the Committee's witnesses commented on the report by the External Advisory Committee on Smart Regulation, and we join them in believing that the External Advisory Committee's recommendations should be reviewed and adopted as soon as possible. It is for this reason that the Committee recommends that:

RECOMMENDATION 19

The federal government review and implement, on an expeditious basis, the recommendations made by the External Advisory Committee on Smart Regulation.

Regarding securities regulation, the Committee agrees with witnesses that a more streamlined, coordinated and harmonized securities regulation process is needed. Unnecessary duplication increases costs and harms the capital markets that are vital to our prosperity as a nation. In supporting the notion of a national securities regulator, we believe that all provinces must play a role, since they are closer to the markets and each has a different perspective. Consequently, the Committee recommends that:

RECOMMENDATION 20

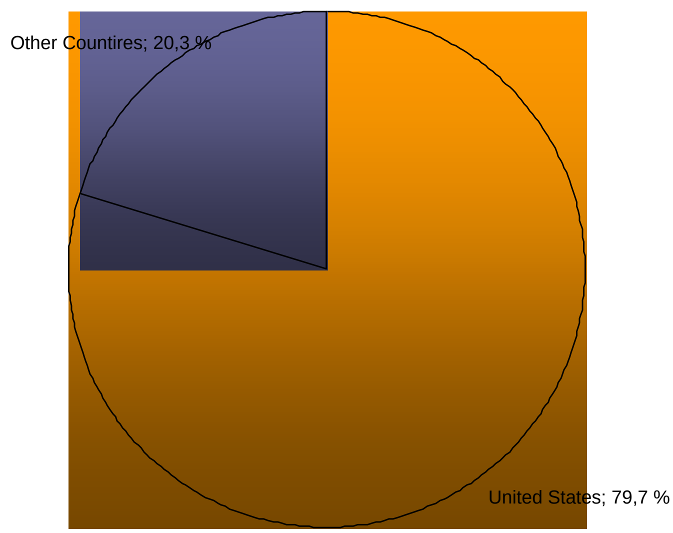
The federal government take a leadership role and meet with provincial/territorial governments no later than 28 February 2005 with a view to adoption of a national securities regulator scheme no later than 30 June 2005.

TRADE

A. What the Federal Government Provides

Canada is a trading nation.[107] In 2003, Canadian exports of goods and services had a value of $457.8 billion, representing 37.7% of GDP, and Canadian imports of goods and services were $409.1 billion, representing 33.7% of GDP. The United States is the most important destination for Canadian exports, as shown in Figure 3.3. In 2003, the United States received $364.8 billion in Canadian goods and services, representing 79.7% of total Canadian exports.

Figure 3.3: Canadian Exports , United States and Other Destinations, 2003



Source: Department of Foreign Affairs and International Trade.

107 Information on Canada's trade can be found in Department of Foreign Affairs and International Trade, *Fifth Annual Report on Canada's State of Trade: Trade Update*, March 2004, available at: www.dfait-maeci.gc.ca/eet/trade/state-of-trade-en.asp.

For countries such as Canada, which relies heavily on trade, effective and properly enforced international trade rules are critically important. Canada's future economic prosperity continues to be tied to an open, transparent, rules-based international trading system with predictable and enforceable trade rules, improved access to global markets and openness to world trade while maintaining fundamental Canadian interests and values.

In 1999, in Seattle, a new round of multilateral trade negotiations was launched, with agriculture and service negotiations beginning in 2000 and a new, comprehensive round of negotiations announced in November 2001 at Doha, Qatar. Known as the Doha Development Agenda, although the round was to have been completed by 1 January 2005, it is unlikely that an agreement will be concluded by that date. In general terms, negotiations are aimed at further trade liberalization, strengthened multilateral rules and increased integration of developing nations into the world trading system.

Conceived in principle in September 1994 at the inaugural Summit of the Americas, the Free Trade Area of the Americas (FTAA) negotiations are a part of the larger Summit process, which is aimed at strengthening democracy, promoting human rights and creating prosperity. The negotiations themselves were launched at the second Summit in April 1998. For Canada, strengthening economic ties with the region is a priority, since the Americas region is Canada's most important market. It is unlikely that the original deadline for the conclusion of negotiations — 1 January 2005 — will be met.

Recognizing that Canada is a trading nation that needs secure and expanding access to markets, the October 2004 Speech from the Throne committed the federal government to continuing to "push for an open, rules-based international trading system and a successful conclusion of the Doha Round of global trade negotiations," to "build on the successful Smart Borders initiative and on measures designed to develop a more sophisticated and informed relationship involving business and government officials in the United States," and to enhance government's "capacity to expand international trade and commerce, with a particular focus on North America and emerging markets."[108]

Interprovincial trade is governed by the Agreement on Internal Trade signed by First Ministers in July 1994. The Agreement, whose goal is to "reduce barriers to the movement of persons, goods, services and investments within Canada,"[109] provides for:

- rules that prevent governments from erecting new barriers to trade and that require the reduction of barriers in areas covered by the Agreement;
- specific obligations in identified sectors;

[108] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

[109] Information on the Agreement on Internal Trade is available at: www.strategis.ic.gc.ca/epic/internet/inait-aci.nsf/en/Home.

- the streamlining and harmonization of regulations and standards;
- a formal dispute resolution mechanism that can be used by individuals, businesses and governments; and
- commitments to further liberalization, with continuing negotiations and specified work programs.

Finally, the October 2004 Speech from the Throne indicated that, as a complement to international commerce initiatives, the federal government "is determined to forge a stronger Canadian economic union, free of the internal barriers that still diminish opportunities and reduce our competitiveness."[110]

B. What the Witnesses Said

A number of the Committee's witnesses mentioned our trading relationship with the United States, and stressed both the importance of ensuring a secure and efficient border and the need to resolve bilateral trade irritants as they arise. Regarding the border, comments were made about the priority that should be given to enhanced border and trade infrastructure, in part to minimize the cost of congestion and delays.

On the issue of resolving bilateral trade irritants, some witnesses highlighted the need to work toward the resumption of normalized trade in live cattle and beef in the North American market in the aftermath of a single case of mad cow disease in Canada. Comments about the closed border for cattle and beef prompted requests for increased federal assistance for the cattle and beef industry, including slaughter and processing capacity. The current dispute with respect to hogs and the ongoing softwood lumber dispute with the United States were also noted.

The Committee also heard concerns about trade friction more generally, with the United States and with Europe, and about the importance of protecting certain industries during trade negotiations while at the same time securing market access. In particular, we were told that the federal government must protect Canada's agricultural supply management systems and ensure transparent market access. Concerns were also voiced about the extent to which Canadian agricultural producers suffer as a consequence of significant agricultural support in the United States and the European Union. One example that was brought to our attention involved the Canadian dehydrator industry, which exports about 80% of its production. This industry is experiencing plant closures, job losses and reduced exports, in part because subsidized European Union products entered the industry's largest export market. Federal assistance for the dehydrator industry was requested.

[110] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

More generally, the suggestion was made that the federal government should work with producers to diversify export markets for Canadian products; this diversification would reduce vulnerability to unforeseen events and trade actions. As well, more effective financing mechanisms were advocated for Canadian exporters engaged in new market development efforts worldwide.

Witnesses also noted the importance of adequate and timely trade dispute mechanisms, mentioned the need to ensure that bulk water exports do not occur, and identified the priority that must be given to protecting Canadian producers against unfairly traded and unfairly priced steel imports.

Moreover, the Committee was told that while most Canadian companies do not charge the Goods and Services Tax when they export goods or services, this exemption does not apply to certain types of intangible property. Moreover, the exemption on exports of telecommunications services applies only if the customer also supplies telecommunications services. To correct the narrowness of these exemptions — which place Canadian companies at a competitive disadvantage — it was recommended that the federal government expand export rules to cover all types of intangible property and to extend the exemption to all customers of telecommunications services.

Support was expressed for the role taken by the federal government as the International Convention on the Protection of the Diversity of Cultural Content and Artistic Expression is being developed at UNESCO. In particular, culture would be exempted from international trade agreements.

While some witnesses identified federal government support regarding international undertakings, as indicated above, federal support was found to be lacking with respect to other international commitments. For example, the Committee was told that the government is retreating from the Beijing Platform for Action commitments, which it made in 1995 and recommitted to in 2000. Canada made a national and international commitment to ensuring that women's equality was protected and enhanced. In the view of these witnesses, government actions in the last decade have been directed to initiatives that neither directly nor indirectly advance the Beijing commitments, despite the fiscal ability of the government to take action. We were also informed that more resources are required if Canada is to meet its international human rights obligations to women consistent with the United Nations Convention on the Elimination of All Forms of Discrimination Against Women.

Positive comments were made by witnesses regarding tourism, and about the need to support tourism in Canada. In the view of witnesses, Canada has much to offer as a destination for foreign tourists, and their contribution to the Canadian economy — and the effect of their visits on employment in Canada's tourism industry — were noted.

C. What the Committee Believes

The Committee believes in the value of transparent and predictable rules governing trade, both within our country and with other countries. It is these types of rules that will ensure our ongoing prosperity as a nation. We are a trading nation, and to maximize the extent to which our providers of goods and services can export their products for their own good and the good of Canada, progress must be made — on an ongoing basis — in securing market access and in ensuring that our trading partners are meeting their international trading obligations. Where this latter circumstance does not occur, we believe that the government must be tireless in its efforts to defend Canadian interests against unfair challenges. The negotiation of bilateral and multilateral trade agreements is critically important as we move forward, as are labour and environmental standards within those agreements. It is from this perspective that the Committee recommends that:

RECOMMENDATION 21

The federal government continue to work toward the conclusion of international trade agreement negotiations, including through the World Trade Organization, the Free Trade Area of the Americas and other bilateral initiatives, to enhance international market access for Canadian products. Labour and environmental standards should be part of all trade negotiations.

Moreover, the government should vigorously defend Canadian interests against unfair trade actions initiated by our trading partners. Where Canadian producers are harmed by unfair trade actions taken by trading partners, including high levels of subsidies by those countries, the government should consider appropriate support for affected sectors.

While the Committee certainly supports efforts to enhance the ability of producers of Canadian goods and services to access international markets, we also believe that impediments to trade across our provincial/territorial borders must be removed. Canadian businesses — for their prosperity and in order that they can maximize their contribution to the Canadian economy and the quality of life of Canadian citizens — must operate within an environment where goods and services flow at least as easily across our internal borders as they do across our international borders. Thus, the Committee recommends that:

RECOMMENDATION 22

The federal government take a leadership role and meet with provincial/territorial governments with a view to eliminating the barriers to interprovincial/interterritorial trade.

EMPLOYMENT INSURANCE CONTRIBUTIONS

A. What the Federal Government Provides

The Employment Insurance (EI) program provides temporary financial assistance to eligible unemployed Canadians who are: looking for work or upgrading their skills; pregnant or caring for a newborn or adopted child; sick; or providing temporary compassionate care or support to a family member who is gravely ill with a significant risk of death. The program is financed by employers and employees, with employers contributing 1.4 times the contribution made by employees. Contributions are subject to an annual maximum, and are calculated by applying the contribution rate to insurable earnings up to a certain earnings level. Unlike the Canada/Quebec Pension Plan, contributions are made on all earnings up to that earnings level.

For 2004, the employee and employer contribution rates are, respectively, $1.98 and just over $2.77 for every $100 of insurable earnings up to $39,000 in insurable earnings.[111] For 2005, employees and employers will contribute at the rate of $1.95 and $2.73 respectively for every $100 of insurance earnings up to $39,000 in insurance earnings. As shown in Figure 3.4, EI premium rates have declined each year since 1994, when the employee and employer rates per $100 of insurance earnings were $3.07 and $4.30 respectively.[112]

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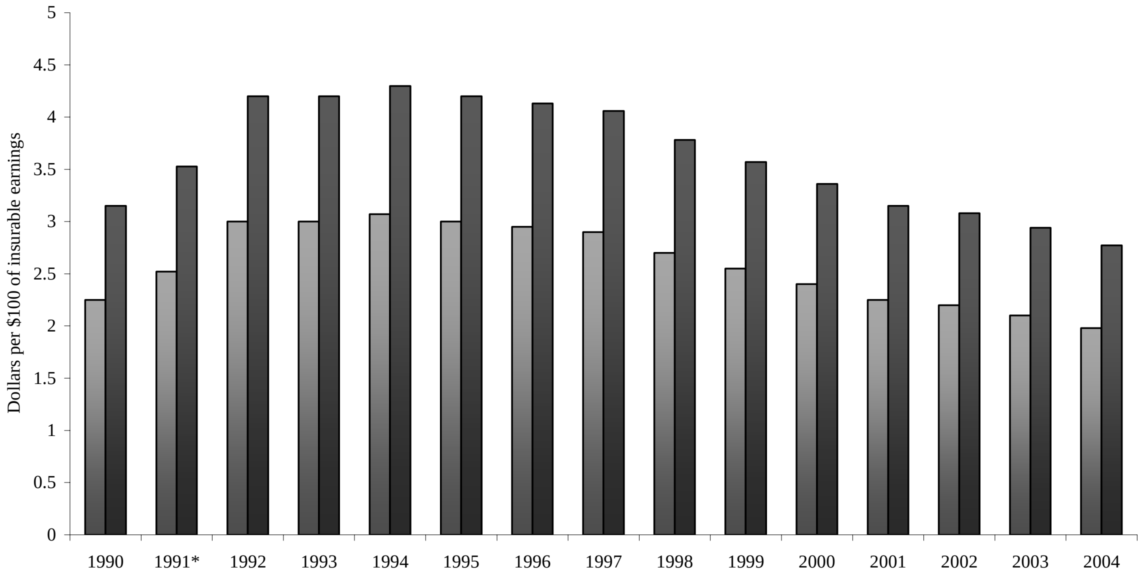
111 Information on Employment Insurance rates and maximum insurable earnings is available at: www.cra-arc.gc.ca/tax/business/topics/payroll/calculating/ei/menu-e.html.

112 Department of Finance, *The Budget Plan 2003*, p. 183, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

Figure 3.4: Employment Insurance Premiums, 1990 to 2004



* Two premium rates were established in 1991 - $2.25 and $2.80. The rate displayed in the chart is an average of these rates.

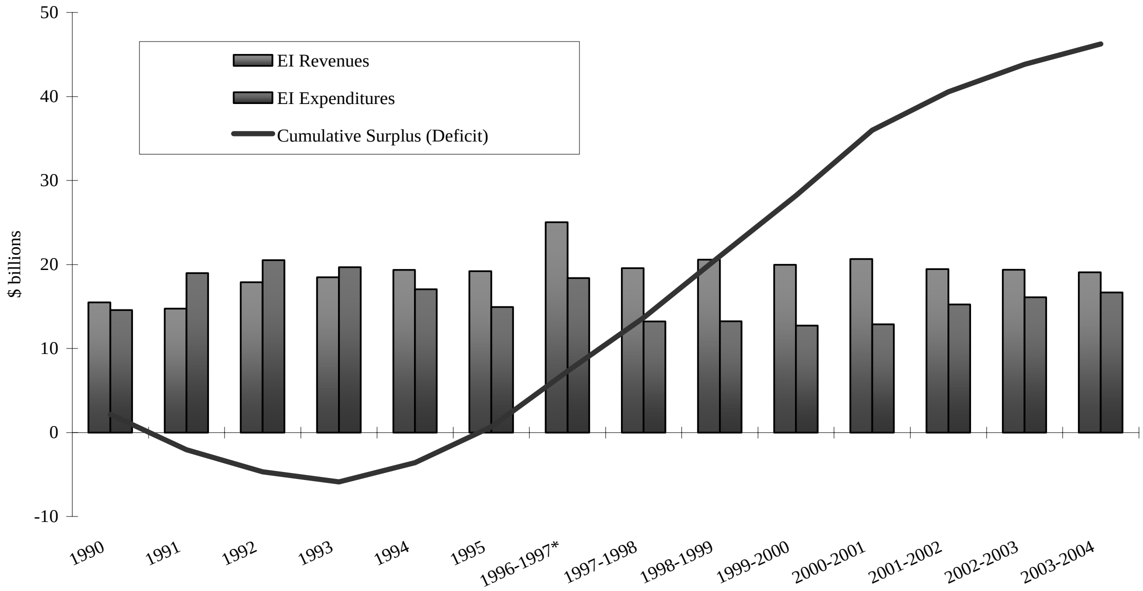
Source: Human Resources and Skills Development Canada, *Chief Actuary's Report on Employment Insurance Premium Rates* and Library of Parliament.

The annual maximum contribution for insurable earnings applies to each job held by the employee with different employers. While contributions made above this annual maximum by employees who hold a number of jobs in a year are refunded to them, the same is not true for employers.

The Employment Insurance Account, which is a Specified Purpose Account in the Accounts of Canada, has had a surplus for many years, as shown in Figure 3.5, and is expected to have a cumulative surplus of $47.2 billion in 2004-2005. The Minister of Finance determines the interest rate that will be applied to any Account surplus.[113]

[113] Human Resources and Skills Development Canada, *Report on Plans and Priorities 2004-2005*, available at: www.tbs-sct.gc.ca/est-pre/20042005/HRSDC-RHDCC/HRSDC-RHDCCr4501_e.asp.

Figure 3.5: Employment Insurance Account, 1990 to 2003-2004



* Refers to the 15-month period from January 1996 to March 1997.

Sources: Public Accounts of Canada and Library of Parliament.

B. What the Witnesses Said

Witnesses shared their concerns with the Committee about a range of Employment Insurance issues, including the EI Account surplus, premium rates, the sharing of program costs, the absence of a Yearly Basic Exemption in the program, the treatment of employer overcontributions in respect of an employee having several employers during the course of a year and experience rating, among others.

Several witnesses expressed concern about the use of the EI Account surplus for such purposes as reducing the federal debt rather than for increasing benefits, while others suggested that the sizable EI Account surplus is an indication that premium rates are too high and should be reduced. The Committee was told that since eligibility criteria have been tightened, 35% of unemployed workers are able to qualify for EI benefits; in their view, eligibility criteria should be changed in a manner that would allow at least 70% of unemployed workers to be able to access benefits. Proposals were also made regarding the establishment of a dedicated EI trust fund operated at arm's length from the federal government, and a more equal sharing of program premiums and costs. The Committee also heard a proposal urging the extension of the Employment Insurance program to self-employed workers, including artists.

Finally, as in previous years, some witnesses advocated the creation of a Yearly Basic Exemption (YBE) for the Employment Insurance program, similar to the exemption that exists with respect to contributions to the Canada Pension Plan. A YBE would mean that employees and employers would not pay premiums on some portion of earnings, a measure that could provide assistance to low-income employees and labour-intensive businesses. A YBE of $3,000 was suggested.

C. What the Committee Believes

The Committee believes that the Employment Insurance program is an important initiative in helping those who are unemployed in a variety of circumstances to meet their income — and, in some cases, training — needs. We are cognizant of the study underway by the Subcommittee on the Employment Insurance Funds of the House of Commons Standing Committee on Human Resources, Skills Development and the Status of Persons with Disabilities, and are anxious to read the Subcommittee's recommendations. The Subcommittee held quite extensive consultations prior to preparing its report, and is likely to have a much more extensive and considered plan for reform. Consequently, the Committee's recommendations regarding the Employment Insurance program — which appear in Chapter Four — are likely to be considerably more general.

SECURITY, DEFENCE AND THE SHARED BORDER

A. What the Federal Government Provides

Increased spending on security, at the Canada-U.S. border as well as at ports and airports, has been partly aimed at responding to the desire by the United States for more secure borders following the terrorist attacks of 11 September 2001. This desire must be weighed against the Canadian economic need for more open borders. Canada and the United States have one of the closest, and one of the closest trading, relationships in the world, and events of 11 September 2001 reinforced the need to work together to secure North America, since our security and prosperity are inextricably linked.[114]

The 2001 federal budget allocated $7.7 billion over five years for security-related measures, as well as $345 million over five years for a security contingency reserve for unforeseen future security needs. These funding initiatives were in addition to the $280 million in security-related spending announcements made prior to the budget. The 2003 budget allocated an additional $75 million over two years to this reserve, and an additional $605 million over five years was announced in the 2004 budget.[115]

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[114] Information on actions that have been taken by Canada since 11 September 2001 is available at: www.dfait-maeci.gc.ca/can-am/menu-en.asp?act=v&mid=1&cat=1&did=1684.

[115] Department of Finance, *The Budget Plan 2004*, p. 195, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

The Smart Border Declaration, signed by Canada and the United States on 12 December 2001, includes a 30-point Action Plan based on four pillars: the secure flow of people; the secure flow of goods; secure infrastructure; and coordination and information sharing. The Action Plan focuses on risk management, allowing both countries to concentrate on unknown and high-risk traffic while facilitating the flow of legitimate commerce. The 2001 federal budget announced funding of $1.2 billion over five years to strengthen border security and infrastructure and, according to the 2003 budget, an additional $286 was allocated from the security contingency reserve for the development and implementation of key border management programs. The 2003 budget also provided $600 million in funding for the Border Infrastructure Fund.[116] As well, it reduced the Air Travellers Security Charge from $12 to $7 for one-way travel and from $24 to $14 for round-trip travel; this Charge was further reduced in the 2004 budget.[117]

Several programs have been put in place to ease congestion and delays, and thereby facilitate the flow of goods and people, at the shared border in the context of tighter security measures. For example, the NEXUS program provides dedicated/fast lanes for pre-approved, low-risk travelers, and the Free and Secure Trade (FAST) program partners Canada and the United States with the private sector to ensure a secure supply chain for low-risk goods. In particular, pre-approved importers, carriers and drivers process low-risk goods using dedicated FAST lanes, with the result that cross-border commercial shipments are easier, less expensive, and subject to fewer delays while still ensuring a high level of security.

As well, the number of Integrated Border Enforcement Teams (IBETs) has been increased. The IBETs, which are overseen by police and customs agencies on both sides of the border, protect national security, combat organized crime and address other border criminality.

Other areas where bilateral progress has been, or is being made, include:

- developing commons standards for biometric identifiers;
- coordinating visa policy;
- sharing advance passenger information; and
- establishing joint customs teams to examine container cargo.

More recent actions have also been taken in Canada to enhance security:

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116 Department of Finance, *The Budget Plan 2004*, p. 195, 196, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

117 Department of Finance, *The Budget Plan 2004*, p. 196, 197, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

- the Department of Public Safety and Emergency Preparedness will integrate and enhance coordination of intelligence gathering, assessment and dissemination across a number of agencies, including the Royal Canadian Mounted Police, the Canadian Security Intelligence Service, and the immigration and customs intelligence functions of the Canadian Border Security Agency under one Minister;

- the position of National Security Advisor to the Prime Minister has been created, and this Advisor is responsible for intelligence and threat assessment integration and interagency cooperation as well as for assisting in the development and overall coordination of an integrated policy for national security and emergencies; and

- a comprehensive National Security Policy has been released, with an addition $690 million in new security investments.

The 2004 federal budget noted the launch of the International Policy Review, which is designed to reassess Canada's foreign policy objectives and defence requirements, among other elements. The current defence policy objectives, for example, were established in 1994. Recent budgets have allocated resources to defence, including the 2000, 2001 and 2003 federal budgets.[118]

The 2003 federal budget allocated $270 million for Operation Apollo in Afghanistan, as well as for urgent capital and other requirements, $800 million annually in new funding, and a $125 million reserve for contingencies in 2002-2003 and $200 million in 2003-2004. It also announced funding of $94.6 million to the Canadian Coast Guard for major repairs to its fleet for shore-based infrastructure and capital replacement purchases.[119]

Moreover, the 2004 federal budget announced an additional $250 million over two years for Canada's participation in peacekeeping missions in Afghanistan and the fight against terrorism, and an additional $50 million for Canada's participation in the peacekeeping force in Haiti. The budget also made income earned by Canadian Forces personnel and police while serving on high-risk international missions exempt from taxation.[120]

B. What the Witnesses Said

Several of the Committee's witnesses observed that the implementation of the Smart Border Declaration has proceeded smoothly, and urged the federal government to

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118 Department of Finance, *The Budget Plan 2004*, p. 191, 192, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

119 Department of Finance, *The Budget Plan 2003*, p. 160, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

120 Department of Finance, *The Budget Plan 2004*, p. 192, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

ensure that further improvements are made to the security and efficiency of our shared border. We were told that congestion at the Canada-U.S. border costs Canadian businesses billions of dollars annually in lost productivity. A new border crossing in southern Ontario was identified as a particular priority requiring early implementation.

Other witnesses urged the federal government to increase its spending on various aspects of defence, including the Department of National Defence, the Canadian Coast Guard and marine security. Adequate funding in these areas is important in its own right; however, it is also important to our relationship with the United States.

Finally, the Committee was told that inadequate funding in certain areas and an inability to access funds in others make it difficult for fire departments to be as fully prepared in the event of an emergency as Canadians might wish. The federal government was urged to commit itself to the principle that federal funding is required for all Canadians to receive basic fire protection services.

C. What the Committee Believes

The security of our nation — both physical and economic — is of vital importance to the Committee. Canada has a long and proud history of defending Canada's citizens, Canada's interests and Canada's allies, both domestically and internationally. To be effective — and to be respected worldwide — it is, however, important that our military be properly funded, both generally and when peacekeeping missions arise. Defence has taken on greater importance since the terrorist attacks on 11 September 2001, and we hold the view that the United States wants Canada to do more in terms of both defence spending and defence activities in fighting terrorism.

In the Committee's view, it is particularly important that adequate attention be paid to security and defence at our shared border with the United States. That shared border — its defence and facilitation — is critically important in assuring our American neighbours that they will not face a threat coming from Canada. Moreover, we believe that border facilitation is also important from a trade perspective, since the United States is the largest export market for Canadian products. It is from this perspective that the Committee recommends that:

RECOMMENDATION 23

The federal government ensure that the funds current allocated for Canada's defence, emergency response and security needs are being properly allocated and used effectively and efficiently. Following this review, the government should ensure that adequate funds are allocated to meet the country's defence, emergency response and security needs, including port security.

Moreover, the government should ensure that sufficient resources are committed to meet the needs at the shared border with the United States, including any funds required to implement the Smart Border Declaration between Canada and the United States.

Finally, the government should provide the funds immediately needed to re-capitalize the Canadian Coast Guard, as well as annual, secure, stable funding for future Coast Guard operations.

CHAPTER FOUR: MAXIMIZING HUMAN POTENTIAL AND OPPORTUNITIES

PERSONAL TAXATION

A. What the Federal Government Provides

Taxation of individuals and businesses enables governments to collect the revenues needed to provide public goods and services. The structure of the tax system can, however, also allow other policy objectives to be realized. For example, tax measures can be used to redistribute income or to alter the behaviour of individuals or corporations, and may be preferred to such other instruments of government as direct spending and regulation.

Canada has a progressive personal income tax system, whereby individuals with higher incomes pay a greater percentage of their incomes in taxes. The basic personal amount for 2004 is $8,012, and personal income tax rates for 2004 are:[121]

- 16% on the first $35,000 of taxable income;
- 22% on taxable income between $35,001 and $70,000;
- 26% on taxable income between $70,001 and $113,804; and
- 29% on taxable income over $113,804.

Personal income taxes are the most important source of revenue for the federal government, as shown in Figure 4.1. In 2003-2004, about 54% of total federal tax revenues and almost 46% of total federal budgetary revenues came from personal income taxes.[122]

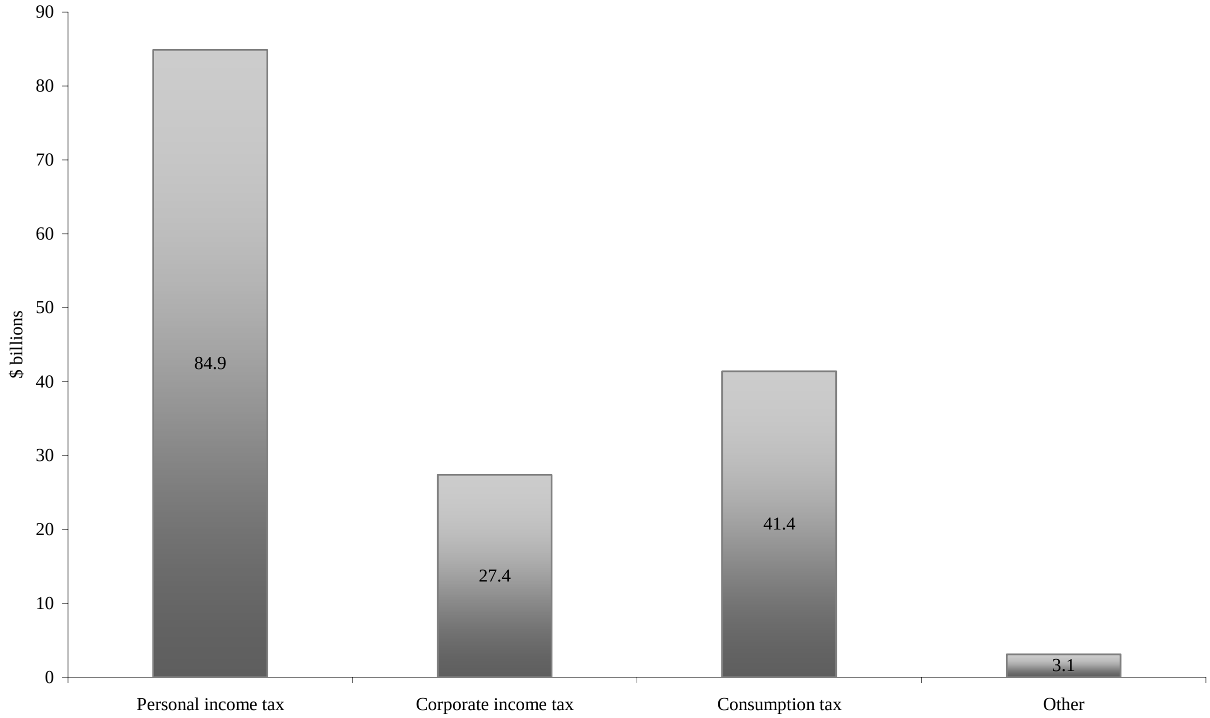
In 2000, the federal government announced a five-year, $100 billion tax reduction plan that lowered corporate tax rates, reduced personal income tax rates, changed the income tax bracket thresholds, increased the basic personal amount and the spousal/equivalent-to-spouse amount, eliminated the personal deficit reduction surtax, enhanced the Canada Child Tax Benefit and restored full indexation. In particular, personal income taxes, especially for low- and modest-income Canadians, were expected to be reduced by about $75 billion over the five-year period. By 2004-2005, federal

[121] Information on personal taxation is available at: www.cra-arc.gc.ca/tax/individuals/menu-e.html.

[122] Department of Finance Canada, *Fiscal Reference Tables*, October 2004, Table 3, available at: www.fin.gc.ca/toce/2004/frt_e.html.

personal income taxes will have been reduced by 21% on average, with the tax burden reduced by 27% for families with children.[123]

Figure 4.1: Federal Tax Revenue by Source, 2004



Source: Statistics Canada.

The tax-to-GDP ratio is an economic indicator that indicates the significance of a country's taxes relative to its economic activity. Using taxes on personal income, Figure 4.2 presents this ratio for Canada, the United States, Australia, the United Kingdom, Sweden and the average for all member countries of the Organisation for Economic Co-operation and Development.[124]

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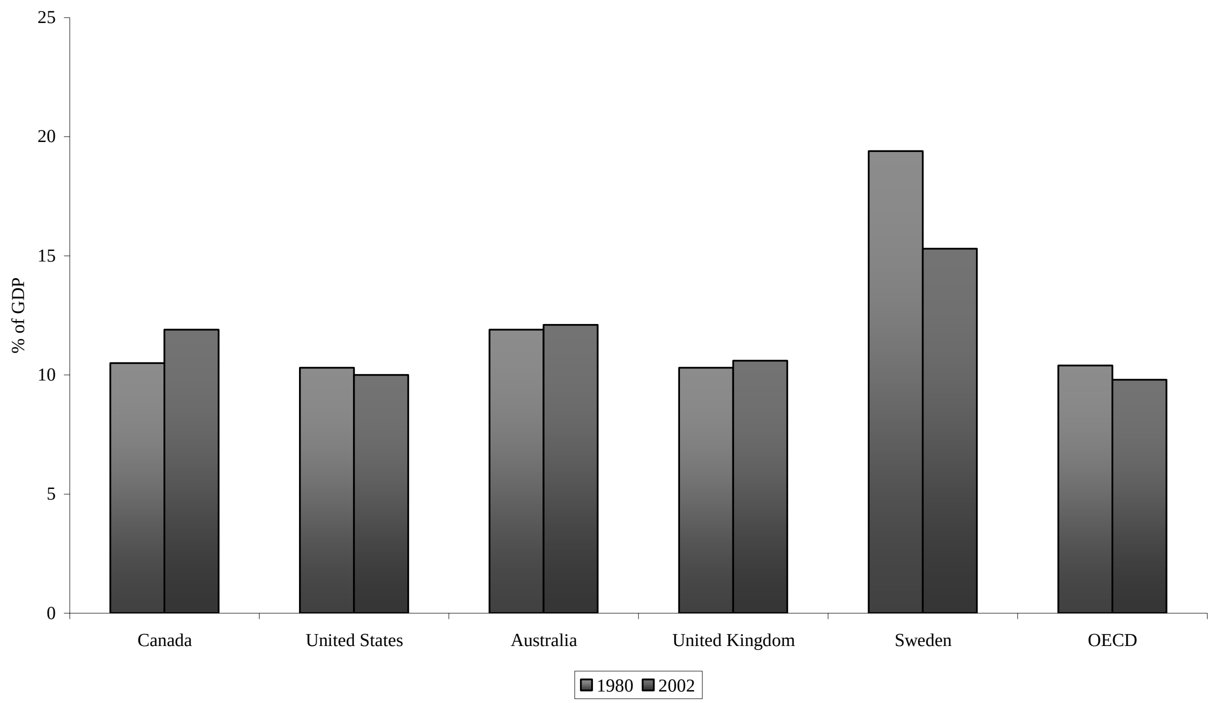
[123] Department of Finance, *The Budget Plan 2004*, p. 202, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

[124] While relatively widely used in the media and economic literature, tax-to-GDP ratios offer limited information on the tax burden of a country and must be interpreted with caution. According to the OECD, factors that can affect the level and trend of tax-to-GDP ratios, and which may vary across countries and therefore affect comparability of results, include the extent to which countries provide social or economic assistance through tax expenditures rather than through direct government spending, whether social security benefits are subject to taxation, the relationship between the tax base and GDP, and the economic cycle.

Figure 4.2: Taxes on Personal Income as a Percentage of Gross Domestic Product, Various Countries, 1980 and 2002



Source: Organisation for Economic Co-Operation and Development.

In 1980, taxes on personal income as a percentage of Gross Domestic Product in both Canada and the United States were approximately equal to the OECD average of 10.4%. Since that time, however, Canada's personal tax-to-GDP ratio has remained above that of the United States. In 2002, the ratio was 11.9% for Canada and 10.0% for the United States. The average among OECD countries in that year was 9.8%, a figure that is similar to the U.S. ratio.[125]

Low- and modest-income tax filers may receive the Goods and Services Tax/Harmonized Sales Tax (GST/HST) credit, which is designed to offset GST and/or HST paid by them. The tax-free payment, which is paid quarterly, is based on the number of children for whom the tax filer has registered for the Canada Child Tax Benefit or the GST/HST credit; and family net income.[126]

125 In 1980, taxes on personal income as a percentage of GDP were 10.5% in Canada and 10.3% in the United States. These figures are from the Organisation for Economic Co-operation and Development report *Revenue Statistics: 1965-2003: 2004 Edition*, Table 10.

126 Information on personal taxation is available at: www.cra-arc.gc.ca/tax/individuals/menu-e.html.

Finally, an amendment to the October 2004 Speech from the Throne advocated consideration of reduced taxes for low- and modest-income families.[127]

B. What the Witnesses Said

While the Committee's witnesses provided many ideas about changes that should be made to personal income taxation, their proposals often on tax rates and tax brackets. Some witnesses argued that tax changes should be targeted in order to assist low and middle-income Canadians. In their view, across-the-board tax cuts may be relatively costly and may not have the intended effects. As well, tax relief is needed by these families because they face the highest effective marginal tax rates once clawbacks are considered. The federal government was also urged to eliminate income taxes completely for low-income families with children; under this proposal, taxes would begin to be paid at $10,000 this year, with the $10,000 threshold rising by $1,000 each year for the next three years. It was also recommended that tax rates for the upper income thresholds be raised.

Across-the-board personal income tax rate reductions were advocated by some witnesses, while others argued for increases in the basic personal amount and the spousal/equivalent-to-spouse amount; one proposal involved an increase in the value of these amounts to $10,000 over two years and to $15,000 within five years, indexed to inflation. In the view of these witnesses, our personal tax burden — which is too high — is reducing productivity, deterring wealth creation and making Canada less competitive than the United States. They believe that the five-year personal tax reduction plan announced in 2000 has had a positive impact on the economy without depleting government revenues, and should be repeated.

Some witnesses on personal income tax bracket thresholds, rather than the income tax rates. For example, it was suggested that the upper threshold for the third tax bracket should be raised from $113,804 to $150,000. According to this view, such an increase would make the Canadian personal income tax system more competitive with the United States, which could halt the "brain drain" to the United States and could make it easier for Canadian employers to attract and retain American workers or Canadians who have been working in the United States.

Other witnesses advocated no changes in personal income taxation, feeling that tax reductions would decrease federal revenues to the point that the federal government would be unable to finance needed program spending.

[127] The amendment to the October 2004 *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada* is available at: www.parl.gc.ca/38/1/parlbus/chambus/house/debates/003_2004-10-06/han003_1600-e.htm.

As well, a broad range of other issues related to personal taxation were brought to the Committee's attention, many of which were limited in application to a narrow group of taxpayers. These other proposals included:

- income averaging over a five-year period for self-employed Canadians, including artists who can have highly variable income from year to year;
- the deductibility of expenses for tools incurred by construction workers and by automobile mechanics;
- changes to withholding taxes on dividends, interest and royalties;
- an exemption for annual copyright income, up to a limit of $60,000;
- an exemption for annual artistic income, up to a limit of $60,000;
- measures related to the taxation of off-farm income and restricted farm losses;
- a reduction in the administrative burden associated with taxation, including motor vehicle deduction expenses;
- the elimination of the education and tuition fee tax credit for those earning more than $70,000;
- a clarification of what constitutes a legitimate business expense;
- the deductibility of interest and other expenses;
- tax deductions for teachers;
- the deductibility of meals for truck drivers;
- the taxable benefit status of employer-subsidized transit fares;
- the deductibility of forest management expenses;
- the double taxation of dividend income;
- tax discrimination based on marital status;
- the taxation of large intergenerational transfers of wealth; and
- the allocation of taxable income for those residing in a Hutterite colony.

Several witnesses commented on the personal tax treatment of dividends and withholding taxes on dividends and interest payments to non-residents. As well, the Committee was told about the double taxation of dividends paid by large and medium-sized businesses, with the result that dividends are taxed at a higher rate than are capital gains, and about the relatively higher rate of dividend taxation in Canada when compared to the United States. Finally, we were told that the elimination of withholding taxes on dividends and interest payments to non-residents could lead to increased inflows of foreign capital investment, which would benefit the Canadian economy.

C. What the Committee Believes

The Committee believes, like some of our witnesses, that the federal government's five-year tax plan announced in 2000 has been beneficial. Lower personal income taxes have several benefits: they help alleviate what is often referred to as "the brain drain;" they reduce the tax burden on individuals, which means that the country's citizens have a higher level of disposable income that they can then save or spend on the products that they want; and they improve incentives to work. On balance, we believe that personal tax reductions are stimulative, thereby contributing to economic growth.

The Committee believes that personal taxes on investment income have important implications for Canada's capital markets and the ability of Canadian businesses to access the capital they need to form, grow and prosper. We trust the Recommendations 13 and 16 — recommending that the federal government review, respectively, the tax treatment of dividend income and non-resident withholding taxes as well as the tax treatment of capital gains — will address issues related to the personal taxation of investment income.

Like some of the Committee's witnesses, we also feel that changes to the personal income tax system are needed in order to achieve a number of goals: to increase the degree to which low- and modest-income Canadians are supported by the federal government; to ensure that Canadians continue to be provided with the correct incentives to work and save; to increase personal disposable income as an aid to economic growth and to make the economy more competitive; to halt any "brain drain" that might occur; and to lead Canada to be seen — by its citizens as well as by the global community — as a desirable place in which to live and work. Consequently, the Committee recommends that:

RECOMMENDATION 24

The federal government undertake a comprehensive review of the personal taxation system in Canada, including:

- **the value of the basic personal amount;**
- **the value of the spousal/equivalent-to-spouse amount;**
- **the thresholds of the income tax brackets;**

- **the income tax rates; and**

- **differential treatment of dual- and single-income households.**

This review should be undertaken with a view to ensuring that Canada's personal taxation system is both fair and as competitive with other countries, particularly the United States, as possible.

Moreover, in the review of the personal taxation system, particular attention should be paid to how the system might be modified to assist those with low income.

EMPLOYMENT INSURANCE ISSUES

A. What the Federal Government Provides

As noted in Chapter Three, the Employment Insurance (EI) program provides temporary financial assistance to unemployed Canadians while they look for work or upgrade their skills, while they are pregnant or caring for a newborn or adopted child, while they are sick, or while they are providing temporary compassionate care or support to a family member who is gravely ill with a significant risk of death.

The EI program is financed by employer and employee contributions, with employers subject to a contribution rate that is 1.4 time the employee rate. For 2004, the employee and employer contribution rates are, respectively, $1.98 and just over $2.77 for every $100 of insurable earnings up to $39,000 in insurable earnings; consequently, the maximum employee contribution is $772.20 and the maximum employer contribution is $1,081.08.[128] As indicated in Chapter Three, the employee and employer contribution rates will be reduced to $1.95 and $2.73 respectively for 2005. As shown in Figure 3.4 in Chapter Three, EI premium rates have declined each year since 1994, when the employee and employer rates per $100 of insurance earnings were $3.07 and $4.30 respectively.[129]

The annual maximum for insurable earnings applies to each job held by the employee with different employers; while overcontributions by employees who hold a number of jobs in a year are refunded to them, the same is not true for employers. Entitlement to benefits, and the duration of any benefit paid, depend on the employee's hours of work. Benefits are subject to a maximum entitlement, and the amount of any benefit may be affected by earnings. As well, some benefits may have to be repaid under certain circumstances.

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[128] Information on employment Insurance rates and maximum insurable earnings is available at: www.cra-arc.gc.ca/tax/business/topics/payroll/calculating/ei/menu-e.html.

[129] Department of Finance, *The Budget Plan 2003*, p. 183, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

For many years, the Employment Insurance Account, established as a specified purpose account in the Accounts of Canada, has had a surplus, as shown in Figure 3.5 in Chapter Three. Benefits and administrative costs are paid out of the Consolidated Revenue Fund and are charged to the EI Account, and an account surplus receives interest at a rate established by the Minister of Finance. According to the *Report on Plans and Priorities 2004-2005* for Human Resources and Skills Development Canada, in 2004-2005 the cumulative surplus is expected to reach $47.2 billion.[130]

In the Auditor General of Canada's December 2002 report, the federal government was criticized for accumulating surpluses that exceed the $15 billion target set by the Chief Actuary. The Auditor General urged the government to clarify the EI rate-setting process and to improve its transparency.[131] The 2003 federal budget announced public consultations on a new rate-setting regime.[132]

Finally, with an amendment to the October 2004 Speech from the Throne, it was recommended that an arm's length, tripartite commission be established to ensure that employment insurance premiums are used only for workers' benefit.[133]

B. What the Witnesses Said

Chapter Three presents some of the comments made by witnesses about the Employment Insurance program, although many are worth reiterating. In general, the Committee's witnesses spoke about the surplus in the Employment Insurance Account, premium rates, the sharing of program costs, participation in the program by self-employed workers, overcontributions by employers in certain circumstances and the notion of a yearly basic exemption analogous to that which exists within the Canada Pension Plan.

In addition, witnesses recommended that the *Employment Insurance Act* be amended to increase eligibility for benefits by introducing a uniform 360-hour qualifying requirement, and to extend the EI benefit period to one year to protect all earners, including low-income parents, when the economy is in recession. The Committee also heard suggestions that maternity/parental benefits should be increased to cover 75% of lost income and that they be expanded to cover self-employed parents and parents enrolled in educational or training institutions.

130 Human Resources and Skills Development Canada, *Report on Plans and Priorities 2004-2005*, available at: www.tbs-sct.gc.ca/est-pre/20042005/HRSDC-RHDCC/HRSDC-RHDCCr4501_e.asp.

131 Office of the Auditor General of Canada, *Report of the Auditor General of Canada*, December 2002, Chapter 11, available at: www.oag-bvg.gc.ca/domino/reports.nsf/html/02menu_e.html.

132 Department of Finance, *The Budget Plan 2003*, p. 183, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

133 The amendment to the October 2004 *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada* is available at: www.parl.gc.ca/38/1/parlbus/chambus/house/debates/003_2004-10-06/han003_1600-e.htm.

C. What the Committee Believes

The Committee believes that the Employment Insurance program plays a critical role in ensuring that employees who are temporarily absent from the workplace for a period of time are provided with a source of income that enables them to meet their needs. In our view, it is important that EI program participants be able to access benefits when they need them, that the qualifying requirement be reasonable, that the benefits paid be adequate in size and duration, and that premium rates be set appropriately.

The Committee is reminded of the May 2001 report by the House of Commons Standing Committee on Human Resources Development and the Status of Persons with Disabilities entitled *Beyond Bill C-2: A Review of Other Proposals to Reform Employment Insurance*. Moreover, as indicated in Chapter Three, the Subcommittee on the Employment Insurance Funds of the House of Commons Standing Committee on Human Resources, Skills Development, Social Development and the Status of Persons with Disabilities is currently studying these issues. While we look forward to the Subcommittee's report, we wish to make one recommendation at this time. Therefore, the Committee recommends that:

RECOMMENDATION 25

The federal government, while considering the forthcoming recommendations of the Subcommittee on the Employment Insurance Funds of the House of Commons Standing Committee on Human Resources, Skills Development, Social Development and the Status of Persons with Disabilities, amend the *Employment Insurance Act* so as to establish a transparent employment insurance rate-setting process.

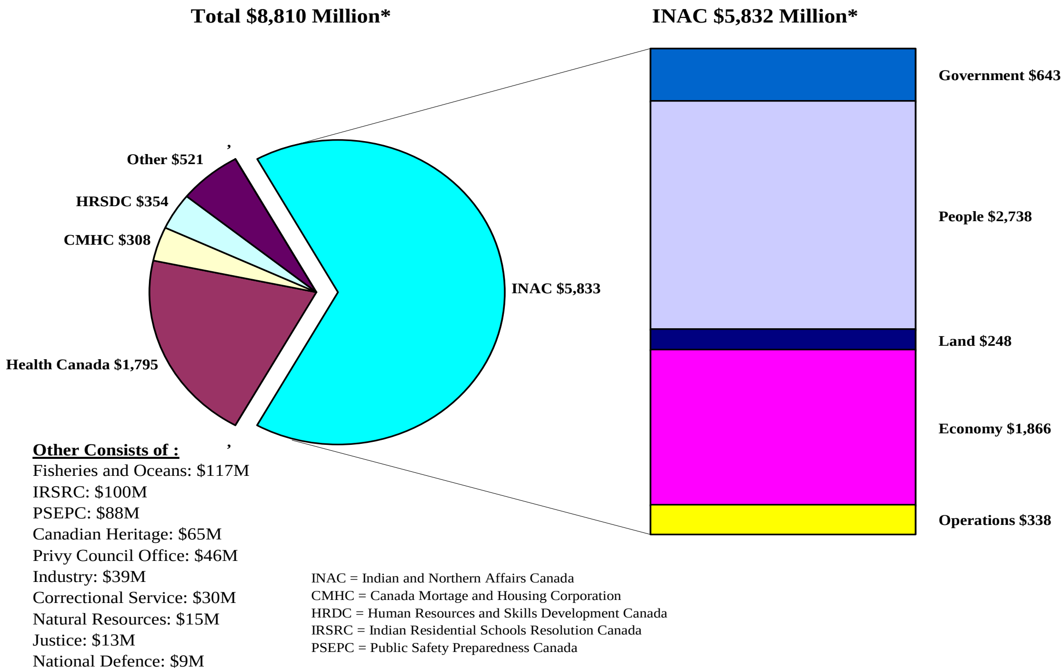
ABORIGINAL CANADIANS

A. What the Federal Government Provides

Almost every economic, social and health indicator suggests that Canada's Aboriginal peoples generally experience a lower quality of life than other Canadians. Unemployment and prison incarceration rates are relatively higher, suicide rates among Aboriginal youth are the highest in Canada, and average life expectancies for Aboriginal Canadians are the lowest in the country. Moreover, Aboriginal labour force participation and employment rates, as well as median income, are lower and relatively fewer Aboriginal Canadians pursue post-secondary education.

Federal government support for Aboriginal Canadians occurs mainly through Indian and Northern Affairs Canada and Health Canada, although spending also occurs through other federal departments and agencies, as shown in Figure 4.3. In particular, each year, Parliament approves appropriations to Indian and Northern Affairs Canada for funding arrangements that support a range of programs and services in Aboriginal communities, including capital facilities, elementary and secondary education, social assistance, housing, health services and economic development initiatives. Most of the budget is managed by First Nations directly, while another portion is transferred to the provinces/territories for the delivery of services to Aboriginal Canadians.

Figure 4.3: Federal Programs Directed to Aboriginal Peoples, Planned Spending for 2004-2005



Source: Indian and Northern Affairs Canada, Reports on Plan and Priorities.

To recognize the health, education, infrastructure, employment and other needs of Aboriginal Canadians, the federal government has developed programs and allocated funding in a range of areas.[134]

In 1999, the federal government initiated the Aboriginal Human Resources Development Strategy, with an allocation of $1.6 billion over five years to help Aboriginal peoples develop their skills as well as find and retain employment with the assistance of Aboriginal organizations across Canada. The 2004 federal budget indicated continued support of the Strategy, with funding of $125 million over five years. The 2003 budget provided $85 million over five years for Aboriginal Skills and Employment Partnerships to facilitate access to training and employment opportunities.

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[134] Department of Finance, *The Budget Plan 2004*, p. 128-130, available at: www.fin.gc.ca/budtoce/2004/budliste.htm. Information on federal support for Aboriginal Canadians is also available at: www.ainc-inac.gc.ca.

The federal government has also invested in the early years of Aboriginal children. In 2002, the government announced an investment of $320 million over five years to support and enhance the early childhood development of Aboriginal children; this initiative complements the 2000 Early Childhood Development agreement announced by First Ministers. The 2003 federal budget committed $355 million over five years for early childhood development, with a particular focus on First Nations on reserves.

Specific initiatives for Aboriginal children include: Aboriginal Head Start On Reserve; Aboriginal Head Start (Urban and Northern Communities); First Nations and Inuit Child Care; Fetal Alcohol Syndrome/Fetal Alcohol Effects; New Research Initiatives; and the First Nations Child & Family Services Program. The Head Start initiatives have six program components: culture and language; education and school readiness; health promotion; nutrition; social support; and parental and family involvement. The First Nations and Inuit Child Care initiative, which supports more than 7,000 child care spaces in 390 communities, is part of the Aboriginal Human Resources Development Strategy.

Education of Aboriginal Canadians also receives federal support. For example, the 2001 federal budget allocated $60 million over two years to the Special Education Program for Aboriginal children living on reserves who have special learning needs at school, and the 2003 budget allocated $35 million over two years to address issues such as the high turnover among teachers in some First Nations schools as well as the need to affirm and support the active involvement of parents and other family members in their children's education. The budget also allocated $72 million to improve educational outcomes for Aboriginal peoples and to ensure they are provided with training and employment opportunities on major projects across Canada.

Specific educational support is provided through such initiatives as the Post-Secondary Student Support Program and the University College Entrance Preparation Program, which assist with education-related costs, as well as the Indian Studies Support Program, which supports the development and delivery of special programs. At the elementary and secondary school level, funding is provided to Band Councils or other First Nation education authorities through the Elementary/Secondary Education Program.

Programs also exist for Aboriginal peoples living in urban centres, including the 2003 federal budget's announcement of $17 million over two years for cost-shared pilot projects that will explore ways to better meet the needs of urban Aboriginal peoples in select cities. The Urban Aboriginal Strategy was extended in the 2004 budget to 2006-2007, with a doubling of its total budget from $25 million to $50 million.

Specific support for Aboriginal infrastructure occurred in the 2003 federal budget, when the federal government committed $600 million over five years to upgrade, maintain and monitor water and waste water systems on reserves, as well as ongoing efforts to ensure that all reserve communities have dependable water systems.

Aboriginal health is also an important issue, and the 1999 federal budget provided funding for a First Nations and Inuit home and community care program and a First Nations health information system. One component of health efforts is the Adult Care Program, which assists registered First Nations individuals on reserves who have functional limitations resulting from age, health problems or disability and require care; in-home care, foster care and institutional care are provided. Moreover, the 2003 budget allocated $1.3 billion over five years to support the First Nations and Inuit Health Program as part of the First Ministers' Accord on Health Care Renewal.

Other support includes:

- $42 million over two years, announced in the 2003 federal budget, for the First Nations Policing Program;
- $172.5 million over 11 years, announced in the 2003 federal budget, to support the creation and operation of an Aboriginal languages and culture centre under the stewardship of Aboriginal peoples;
- additional support of $10 million annually, announced in the 2003 federal budget, to Aboriginal Business Canada;
- $6 million over two years, announced in the 2003 federal budget, for the Office of the Federal Interlocutor for Métis and Non-Status Indians; and
- access to such initiatives as the Canada Mortgage and Housing Corporation's Residential Rehabilitation Assistance Program (RRAP) On-Reserve, the Conversion RRAP, the Shelter Enhancement Program, the On-Reserve Non-Profit Housing Program and the Loan Insurance Program On-Reserve with Ministerial Loan Guarantee.

Finally, the October 2004 Speech from the Throne noted the September 2004 meeting of First Ministers and Aboriginal leaders, where the federal government undertook to allocate $700 million for purposes such as: greater Aboriginal participation in the health professions; addressing chronic disease; and creating an Aboriginal health transition fund. The Speech also indicated that the federal government and Aboriginal peoples will develop specific quality-of-life indicators and a report card as drivers of progress and accountability.[135]

[135] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

B. *What the Witnesses Said*

The Committee heard from First Nations peoples — both those who live on-reserve and those who live off-reserve — the Inuit and the Métis. In general, they shared the same concerns with us about inadequate health care, inadequate and substandard housing, insufficient educational opportunities and support, infrastructure that is in disrepair, a lack of access to economic opportunities, insufficient early childhood development and child care, and inadequate skills training and labour market development assistance, among others.

Given their commonality of concerns, there was some similarity in what the witnesses advocated to improve the quality of their life. Moreover, as citizens of this country, it is not surprising that some of their needs mirror those of other Canadians, although their need is often more urgent. For example, the Committee was told that Aboriginal peoples need adequate housing, and the ability to repair their housing as required; a First Nations housing and infrastructure strategy was suggested, with a housing survey, inventory and inspection to determine the state of the housing and the funds needed to repair substandard housing, among other elements. As well, we were informed that infrastructure funds beyond those committed in recent federal budgets are needed to address the infrastructure deficit that exists with respect to water and waste water systems, and other infrastructure inadequacies.

While the Early Childhood Development strategy for Aboriginal peoples does provide some assistance, the Committee was informed that key elements are not included in the strategy, such as maternal health, parenting, services for special needs children and assistance for vulnerable families. Funding is also needed as children progress through school, since student assessment is needed in some cases, and First Nations culture and language programming in school must be enhanced. The Committee was told that additional funds are also needed for First Nations-controlled colleges, institutes and community learning centres, and for post-secondary student supports.

As well, the Committee heard that funding for Aboriginal health care must be adequate and must contain an escalator clause to recognize inflation, growing demands and increasing population; multi-year funding commitments should be made to facilitate planning. Mention was also made of the dental care needs of Aboriginal peoples.

The Committee also heard about the particular challenges faced by Aboriginal women who live on reserve and divorce their spouse. We were informed about problems associated with the division of matrimonial property in these situations. For example, because these women are unlikely to receive a 50% interest in the matrimonial home when the relationship is dissolved, they often must leave their community in their search for affordable housing.

Finally, witnesses — including some who do not represent Aboriginal peoples — advocated the commitment of resources to settle outstanding land rights obligations.

C. What the Committee Believes

The Committee believes that Canada's Aboriginal peoples are among the most disadvantaged and vulnerable individuals in our country. In our view, the prosperity and quality of life enjoyed by most Canadians must also be experienced by our Aboriginal peoples. Anything less than this equality is unacceptable.

Consequently, the Committee feels that federal funding for Aboriginal education, health and infrastructure — regardless of whether the Aboriginal peoples live on- or off-reserve — must be adequate and delivered in a manner that is as effective and efficient as possible. The governance concerns and divergent needs of Aboriginal Canadians must also be respected. In the event that the federal government determines that health, education, early childhood development, infrastructure and other investments should occur through general programs rather than through programs specifically targeted for Aboriginal peoples, we are concerned that funds not be allocated strictly on the basis of population. It is from this perspective that the Committee recommends that:

RECOMMENDATION 26

The federal government meet with Aboriginal Canadians and ensure that programs are designed and delivered in a manner that addresses their health, education, housing, infrastructure, early childhood development and care, and other needs.

In particular, these programs should:

- **respect the rights and governance concerns of Aboriginal Canadians;**
- **be delivered within the context of the Canadian constitution;**
- **be sufficiently flexible to meet the diverse needs of Aboriginal Canadians; and**
- **permit funding allocations that reflect the relatively small population base as well as the size and geographically large and remote nature of their communities.**

CHILDREN

A. What the Federal Government Provides

The federal government supports Canadian children through a range of initiatives, programs and projects either funded directly by federal departments or indirectly through grants and research funds provided to community groups for specific goals and objectives related to child development.

In 1997, federal and provincial/territorial governments launched the National Children's Agenda. Federal investments associated with this commitment include the Canada Child Tax Benefit (CCTB) announced in 1997, the National Child Benefit (NCB) Supplement (NCBS) announced in 1998, and the Early Childhood Development (ECD) initiative concluded by governments in 2000. The federal government has also extended and improved the parental benefit available under the Employment Insurance program and introduced the Child Disability Benefit (CDB) in 2003.

The CCTB provides a tax-free monthly payment to eligible families with children under the age of 18. The benefit was enhanced by the introduction of the NCBS, which provides additional monthly assistance to low-income families with children and is paid regardless of whether parents participate in the workforce or receive social assistance. The provinces/territories may reduce the amount they provide in social assistance to these families by the amount of the federal supplement, and re-invest the funds in provincial/territorial programs in five areas: child benefits and earned income supplements; child care initiatives; services for early childhood and children at risk; supplementary health benefits; and other services. The monthly Child Disability Benefit (CDB) assists eligible families with children suffering from a severe and prolonged mental or physical impairment.

For 2004-2005, the annual CCTB payment is $1,208 for each child under age 18.[136] A supplement of $84 per year is paid for the third and each subsequent child, with an additional $239 payable for each child under age 7, although this latter supplement is reduced by 25% of any amount claimed for child care expenses. As well, a benefit reduction occurs if family net income exceeds $35,000. In particular, the reduction is 2% of the amount of family net income in excess of $35,000 for one-child families and is 4% for those with two or more children.[137]

Moreover, for 2004-2005, the NCB Supplement is paid at the rate of $1,511 per year for one-child families, reduced by 12.2% of family net income that exceeds $22,615. For families with two children, the annual amount of $2,806 is reduced by 22.7% of family net income exceeding $22,615. Finally, families with three or more children receive an

[136] The value of this benefit is different for residents of Alberta.

[137] Information on the benefit and the benefit rate is available at http://www.cra-arc.gc.ca/benefits/faq_about-e.html.

annual supplement of $2,806 for the first two children and $1,215 annually for the third and each subsequent child, with the total reduced by 32.5% of family net income exceeding $22,615.[138]

The tax-free Child Disability Benefit provides, in 2004-2005, up to $1,653 annually to eligible families; that is, to those families having a child with a severe and prolonged disability. The amount of the benefit is calculated on base income, which is determined by the number of children for whom the CCTB is received. If family net income exceeds the base amount, the CDB is reduced by 12.2% of family net income exceeding the base amount in the case of one child qualifying for the CDB; by 22.7% in the case of two children qualifying for the CDB; and by 32.5% in the case of three or more children qualifying for the CDB.[139]

Parents can also claim the child care expense deduction, which allows child care expenses to be deducted where those expenses were incurred in order to earn employment income, operate a business, attend school under certain conditions or carry on research or similar work for which a grant was received. Net income is used to determine who will claim the expenses, and claiming these expenses may affect the value of the supplement available under the CCTB for children under 7 years of age.[140]

In 2000, First Ministers announced the Early Childhood Development initiative, under which the federal government agreed to transfer $2.2 billion in funds over five years to provincial/territorial governments through the Canada Health and Social Transfer to improve and expand early childhood development programs in the areas of: healthy pregnancy, birth and infancy; parenting and family supports; early childhood development, learning and care; and community supports. In 2002, the federal government announced an additional investment of $320 million over five years to support the early childhood development of Aboriginal children.[141] Moreover, in 2003, the federal government indicated that, after 2005-2006, annual funding of $500 million would be provided.[142]

As well, in 2003, federal and provincial/territorial ministers responsible for social services renewed their commitment to child development, and agreed to implement the Multilateral Framework on Early Learning and Child Care (ELCC), which is an expansion of the ECD initiative. Under this framework, the federal government agreed to provide $900 million over five years to provincial/territorial governments to improve access to affordable, quality and provincially/territorially regulated early learning and child care

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138 Information on the benefit and the benefit rate is available at: www.cra-arc.gc.ca/benefits/faq_about-e.html. As well, note that the Supplement may affect the amount of social assistance payments received.

139 Information on the benefit and the benefit rate is available at: www.cra-arc.gc.ca/benefits/faq_cdb-e.html.

140 Information on this and other elements of the tax system for individuals is available at: www.cra-arc.gc.ca/tax/menu-e.html.

141 Department of Finance, *The Budget Plan 2004*, p. 113, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

142 Ibid.

programs; this transfer, as well as the transfer associated with the ECD agreement, now occurs under the Canada Social Transfer.[143] Federal funding of this initiative was increased by $150 million in the 2004 federal budget.[144] Within the Framework, the federal government committed $35 million over four years for early learning and child care services for First Nations children living on reserves, an amount that was augmented by $10 million over four years in the 2004 budget.[145]

The 2004 federal budget also extended the community research pilot project "Understanding the Early Years," designed to provide research information to strengthen communities' ability to decide on the best policies and programs to support families with young children. Started in 1999, the budget announced an extension of the project to more than 100 communities over seven years, with funding of $14 million over two years.[146]

Finally, the October 2004 Speech from the Throne suggested that "[t]he time has come for a truly national system of early learning and child care, a system based on the four key principles [of] quality, universality, accessibility and development."[147] Figure 4.4 shows the various means by which society can benefit from spending on child care.

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[143] Ibid.

[144] Ibid., p. 114.

[145] Ibid., p. 115.

[146] Ibid.

[147] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

Figure 4.4: Child Care and the Benefits to Society

Source: Childcare Resource and Research Unit.

B. What the Witnesses Said

With respect to children, the Committee's witnesses generally commented on tax measures and supports that they believe would assist Canadian children and their parents. Many supported the development of a comprehensive national system of early childhood education and child care, noting that new investments in child care are important because of the many positive economic and social benefits that result from such investments. The Committee learned that Canada currently spends about 0.2% of GDP on early learning, which is about one-half the average amount spent by other industrialized countries in the OECD. It was suggested that the federal government should substantially increase its funding for a national system of universal child care that is accessible in all regions of Canada — urban, rural and remote — and to all Canadians, including Aboriginal families who live on- and off-reserve as well as disabled children.

The Committee was also told that the federal government should make a commitment to annual increases in early childhood education and child care services, to reach $6 billion by 2008. Other witnesses urged the government to establish a schedule for federal funding to reach 1% of GDP by 2020. In their view, this schedule should outline goals and timelines for funding and service provision in five-year increments over a 15-year period. The 15-year plan would involve federal funding of $5 billion annually by the fifth year of implementation, $8 billion annually by the tenth year and $10 billion annually by 2020.

Many witnesses urged the federal government to enact legislation that would guarantee that governments would allocate funds in accordance with the principles of universal entitlement, high quality, inclusiveness, comprehensiveness, affordability, public/non-profit administration and accountability in the delivery of the services. It was also stressed that a national child care strategy should ensure the full inclusion of children with disabilities. Witnesses also supported the principle that parents should not contribute more than 20% of the overall cost along with a phase-out of the Child Care Expense Deduction. Moreover, it was recommended that the government enter into direct agreements with regional governments in the event that a provincial/territorial government decides not to participate in a national plan.

Not all witnesses, however, believed that the federal government should institute a national child care program. The Committee was told that rather than investing in institutional, universal, subsidized child care, the government should introduce a child tax credit or a personal income tax exemption for each child.

The Committee was reminded that paid employment does not provide a guarantee against poverty. We were informed that 56% of low-income Canadian children in 2001 lived with parents who were in the paid workforce. Consequently, it was recommended that a federal-provincial-territorial living wage commission be established to study and make recommendations on a range of issues affecting wages, hours of work, benefits, collective bargaining and barriers to employment.

Some witnesses were very concerned about child poverty, and told the Committee that, over the past 30 years, the child poverty rate has remained above 15%, despite strong economic growth since the late 1990s. This rate means that an average of one Canadian child in every six has been growing up in conditions of poverty during the past 30 years. To combat child poverty, it was recommended that the federal government commit at least 1.5% of Canada's GDP annually to a social investment plan for children. Funding for this plan could come from a variety of sources, including federal budgetary surpluses or higher personal income taxes for high income earners.

Witnesses also suggested that the federal government should consolidate the Canada Child Tax Benefit and the National Child Benefit into a single program in order to eliminate the possibility of provincial/territorial clawbacks. It was also recommended that the maximum benefit be raised to $4,900 per child by 2007. If the increase in the benefit were phased-in over three years, witnesses estimated that an additional $4 billion in 2005, $3 billion in 2006 and $3 billion in 2007 in federal funding would be required.

Other witnesses proposed a different approach. They recommended that the rate of reduction — or clawback — for the National Child Benefit Supplement be reduced to 10% regardless of the number of children, and that the threshold at which the CCTB begins to be clawed back be raised accordingly. They stressed that in no instance should there be a simultaneous reduction in the NCB and the CCTB, since when the Supplement's clawback rate is added to regular federal and provincial/territorial tax rates, as well as to contribution rates to the Employment Insurance program and the Canada/Québec Pension Plans and the reduction in the GST tax credit, families with low and modest incomes pay about $0.60 in taxes for every $1 earned between $30,000 and $35,000. When other expenses such as child care and other reduction rates applied to provincial/territorial tax credits are considered, it may be more costly for a parent to enter the labour force than it is for that parent to remain at home. This unintended consequence can be a significant deterrent for parents of young children to enter the labour market or to increase their labour force participation, resulting in a net loss for the economy and the federal treasury as well as a deterioration in labour market skills.

C. What the Committee Believes

The Committee believes that governments must work together in funding and delivering initiatives that will meet the needs of children of all ages. Canadians expect, and deserve, this coordinated effort by governments. Such an approach will require a focus on measures to eradicate child poverty as well as early childhood development and care, in order that no child in Canada is hungry, inadequately housed or clothed, or unable to fully realize his potential.

Many of the initiatives require that the federal and provincial/territorial governments work together to implement needed solutions, since initiatives involve a shared jurisdiction. The Committee is confident that the federal and provincial/territorial governments — which share the same goals regarding Canada's children — will be able to work together cooperatively. We caution, however, that in so doing, governments must focus on children of all ages and the full range of needs, and not limit their focus to younger children or non-disabled children. We also note that the budget making process involves making choices, and although a number of our witnesses recommended changes to the CCTB and the NTB, among other measures, we believe that such an increase is not possible at this time; instead, other actions — those of direct benefit to children and those from which children will benefit indirectly — should occur. Therefore, the Committee recommends that:

RECOMMENDATION 27

The federal government, along with interested provincial/territorial governments, at the earliest opportunity announce initiatives to

reduce child poverty. These initiatives should include a national, accessible, affordable, high-quality, publicly funded, publicly regulated, not-for-profit child care system.

Provincial/territorial governments that decide not to participate in these initiatives — but that instead institute their own initiatives — should receive appropriate compensation.

DISABLED CANADIANS

A. What the Federal Government Provides

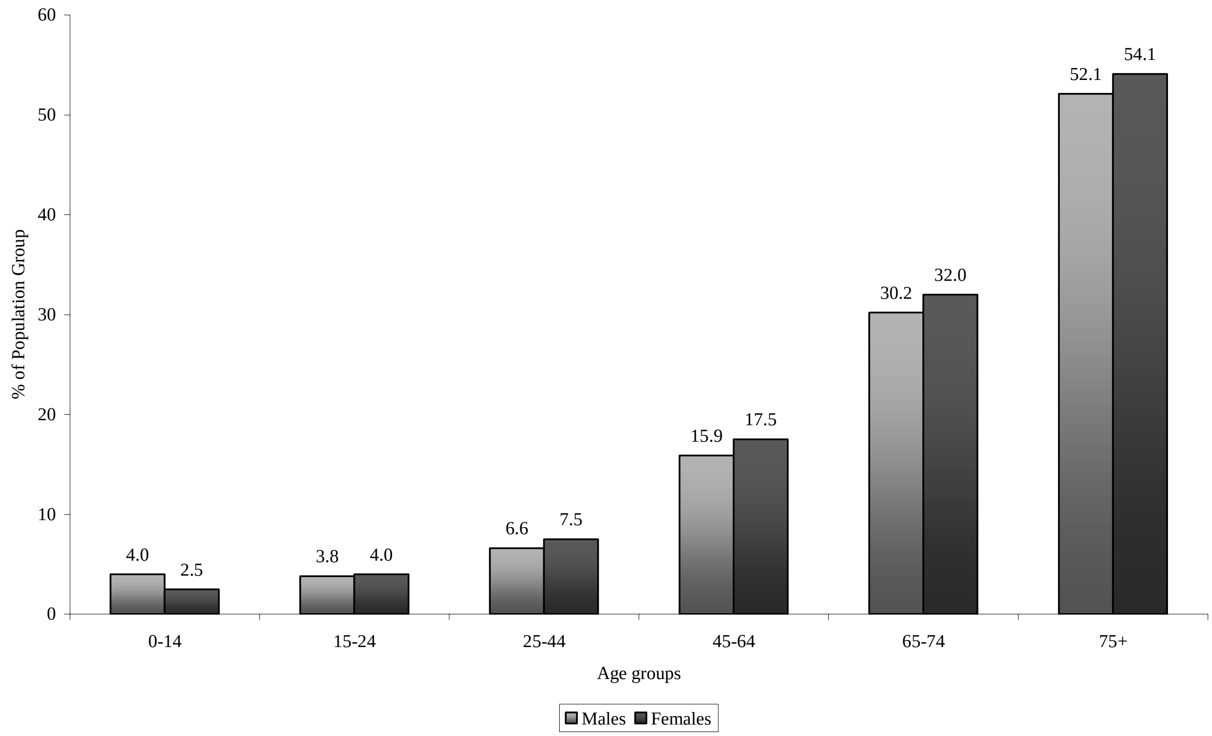
Disabled Canadians often need support — financial and otherwise — if they are to participate fully at the workplace and in the community, and to have a quality of life and standard of living that is as similar as possible to that of non-disabled Canadians. Statistics Canada data indicate that, in Canada, more than 3.4 million people over the age of 15 reported some level of disability in 2001, representing 14.6% of the adult population. These figures can be compared to the 3.6 million Canadians in the total population with activity limitations, representing a disability rate of 12.4% in that year.[148]

In terms of severity, the disability rate in the adult population in 2001 was 5.0% for a mild disability, 3.6% for a moderate disability and 5.9% for a severe or very severe disability. Among the adult disabled population, 34.1% reported a mild disability, 25.0% a moderate disability, and 40.9% a severe or very severe disability. In 2001, the disability rate was higher among adult women than among adult men, and the disability rate rose with age, as shown in Figure 4.5. The rate in that year was about 10% among adults 15 to 64 years, rising to 40% among those aged 65 and over. Moreover, at 13.3%, women were more likely in 2001 to report disability than men, at 11.5%. The incidence of disability for women begins to exceed that for men beginning at age 25.[149]

[148] Statistics Canada, *A Profile of Disability in Canada, 2001*, Catalogue No. 89-577-XIE, 2002, p. 7, available at: www.statcan.ca/english/freepub/89-577-XIE/pdf/89-577-XIE01001.pdf.

[149] Ibid., p. 8.

Figure 4.5: Disability Rate by Age and Sex, 2001



Source: Statistics Canada, Participation and Activity Limitation Survey, 2001.

Approximately 118,000 children aged 0 to 14 in 2001 were affected by a disability related to one or more chronic health conditions that cause activity limitations. Developmental delay was the most common disability identified in 2001 among children aged 0 to 4, while learning disabilities were most commonly identified among children 5 to 14 years; about 46,000 children aged 5 to 14 had a developmental disability. As well, in that year, 41,000 children aged 0 to 14 had hearing and vision difficulties. Moreover, about 67,000 children 5 to 14 years were identified as having a speech-related disability in 2001, and about 49,000 were identified by a parent as having activity-limiting emotional, psychological or behavioural conditions.[150]

The income tax system is one mechanism used by the federal government to financially support Canadians with disabilities.[151] Because of their disabilities, many disabled adults face additional costs that are not reimbursed by public or private programs that provide disability-related supports and services. As a result, federal tax expenditures — including the Disability Tax Credit and the Medical Expenses Tax

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150 Ibid., p. 9, 11-12..

151 Department of Finance, *The Budget Plan 2004*, p. 220-222, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

Credit — assist these individuals in meeting some of the expenses incurred as a result of their disability.

The Disability Tax Credit (DTC) is a non-refundable credit that reduces the amount of federal income tax payable by up to $1,004.64 in 2003 when claimed by a person with a severe and prolonged mental or physical impairment. Part or all of the credit may be transferred to a spouse, common-law partner or other supporting person. The supplement for a child under age 18 may reduce federal tax payable by up to $586.08, since the value is reduced if child care and attendant care expenses exceeding $2,415 are claimed for the child.[152] The attendant care expense deduction may provide tax assistance to those entitled to claim the DTC and who have incurred personal care expenses that are required in order for them to earn certain types of income or attend school. As mentioned earlier, the 2004 federal budget announced the creation of a $1,600 child disability benefit for families who receive the National Child Benefit supplement and who have a child that qualifies for the DTC.

The non-refundable Medical Expenses Tax Credit also provides tax assistance to disabled persons who have significant medical expenses on behalf of themselves or certain of their dependents. The amount of the credit is calculated by applying the lowest personal tax rate percentage, which is now 16%, to the amount of qualifying medical expenses that exceed certain amounts. The 2003 federal budget expanded the list of expenses eligible for the credit. A refundable medical expenses tax credit supplement may also be available.

Tax assistance intended to benefit caregivers include a supplement to the DTC for families caring for children with a severe and prolonged impairment, and the 2004 federal budget announcement allowing caregivers to claim up to $5,000 of the medical and disability-related expenses incurred on behalf of dependent relatives. Tax assistance related to disabled persons is also given through such tax measures as the Caregiver Tax Credit and the amount for infirm dependents.

Other tax-related measures that assist disabled Canadians and those who care for them include the 2003 federal budget announcement that will allow more infirm children to receive a tax-free rollover of a deceased parent's or grandparent's registered retirement savings plan (RRSP) or registered retirement income fund proceeds, and the creation for the 2004 taxation year of a deduction for disability supports incurred for purposes of education or employment.

Disabled Canadians are also often disadvantaged in the labour market for a variety of reasons, including: attitudinal barriers; the absence of workplace accommodations, such as workplace design and flexible working hours; inadequate

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[152] The amount of $1,004.64 is calculated by applying a 16% tax rate to the disability amount of $6,279. The amount of $586.08 is calculated by applying a 16% tax rate to the supplement amount of $3,663. Information on the Disability Tax Credit is available at: www.cra-arc.gc.ca/tax/indviduals/resourcekit2003/fs-disability-e.html.

training; the lack of accessible transportation; inappropriate tax treatment of disability-related expenses; and disincentives in disability pensions and insurance plans.

Beginning in 1997 with annual funding of $30 million, the Opportunities Fund for Persons with Disabilities assists disabled persons to prepare for, and obtain, employment or self-employment, and to develop the skills needed to maintain employment. Working in partnership with others, the federal government supports the integration of disabled persons into the labour market and addresses barriers to their labour market participation. The Fund is designed to assist in the return to work by disabled persons.[153]

As well, the federal government plays a role with respect to the successor to the Employability Assistance for People with Disabilities initiative, the Multilateral Framework for Labour Market Agreements for Persons with Disabilities reached in December 2003 by ministers responsible for social services. The goal of this framework and the resulting agreements is improved employment situations for disabled persons through enhanced employability and increased employment opportunities.[154] Earlier in 2003, the federal budget had renewed federal funding for the Employability Assistance for People with Disabilities initiative and its successor. The funding commitment is $193 million annually.

Federal support for the employment and training activities of disabled Canadians also occurred in the 2004 federal budget, with the creation of a new deduction for disability supports mentioned earlier. The budget also increased funding for the Multilateral Framework by $30 million annually beginning in 2004-2005, and indicated that changes would be made to the Canada Pension Plan in order that Canada Pension Plan disability benefits could be reinstated if a former recipient is required to cease working for reasons related to disability within two years of returning to work.

Furthermore, disabled Canadians may benefit from the Canada Mortgage and Housing Corporation's Residential Rehabilitation Program for Persons with Disabilities, which may provide financial assistance to homeowners and landlords modifying dwellings occupied by, or intended for occupancy by, low-income persons with disabilities.[155] As well, the 2003 federal budget announced the establishment of the Technical Advisory Committee on Tax Measures for Persons with Disabilities, which will advise the ministers of Finance, and National Revenue. It is expected that the Committee will provide a report to the ministers in December 2004. Funding was also allocated in the 2004 budget for a Participation and Activity Limitation Survey to be conducted as part of the 2006 census. Those who are students may benefit from the 2004 budget announcement of a grant for students with disabilities of up to $2,000 annually.

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[153] Information on the Opportunities Fund for Persons with Disabilities is available at: www.hrsdc.gc.ca/asp/gateway.asp?hr=/en/epb/sid/cia/grants/of/desc_of.shtml&hs=oxf.

[154] Information on the Multilateral Framework for Labour Market Agreements for Persons with Disabilities is available at: www.hrsdc.gc.ca/asp/gateway.asp?hr=/en/hip/odi/08_multilateralFramework.shtml.

[155] Information on the Canadian Mortgage and Housing Corporation's Residential Rehabilitation Program for Persons with Disabilities is available at: www.cmhc-schl.gc.ca/en/prfias/rerepr/index.cfm.

Finally, the October 2004 Speech from the Throne committed the federal government to improving existing tax-based support, to asking Parliament to consult nationwide on additional initiatives, and to assisting through the recommendations that will be made by the Technical Advisory Committee on Tax Measures for Persons with Disabilities.[156]

B. What the Witnesses Said

Witnesses shared with the Committee an indication of both the challenges faced by disabled Canadians and measures that would improve their financial situation and enable them to contribute to the economic and social life of Canada, as well as to realize their potential. For example, needs related to disability supports, poverty, equality of opportunity and full citizenship rights were identified.

In addressing the issue of disability supports, several witnesses indicated that the priority is a commitment by the federal government to a long-term investment for disability-related supports. A long-term plan is required to advance the full citizenship and inclusion of people with disabilities. The Committee heard that the use of the tax system has limitations and that — at this point in time — direct federal spending would make a significant difference to disabled persons who are living in poverty, experiencing problems accessing the labour market and needing support. Several witnesses recognized that disability-related supports fall primarily within provincial/territorial jurisdiction and, consequently, suggested that any plan — such as a federal-provincial-territorial transfer — must be based on agreed priorities established at the provincial/territorial level through a process of consultation with the disability community.

Witnesses informed the Committee that people with disabilities generally have the lowest incomes of all Canadians. Therefore, according to them, the Disability Tax Credit would better assist disabled Canadians if it were a refundable tax credit. As well, witnesses identified a number of aspects of the disability component of the Canada Pension Plan that should be improved; these aspects of the Plan were indicated in the 2003 report by the House of Commons Standing Committee on Human Resources and the Status of Persons with Disabilities entitled *Listening to Canadians: a First View of the Future of the Canada Pension Plan Disability Program*. Witnesses said that the changes suggested would not impose a major financial burden on the federal treasury.

A recurring theme among the Committee's witnesses who addressed disability issues was the need for an integrated approach to policy development for disability supports. It was recommended that the federal government initiate a review of federal programs and services to identify and remove barriers encountered by persons with disabilities. As well, witnesses outlined the importance of appropriate federal investments to ensure the full inclusion of children with disabilities and their families in a national child

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[156] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

care strategy, and urged the government to develop an agenda to ensure that children with disabilities fully participate, and are fully engaged, in all aspects of community life.

Also brought to the Committee's attention was the need for the federal government to develop a long-term national disability agenda. This agenda would support, among other things, the development of a strong research and knowledge network, a reporting and monitoring mechanism to track policy development and outcomes across key policy areas, a community forum to seek input from the disability community, and a policy table — modeled on the Technical Advisory Committee on Tax Measures for Persons with Disabilities — to develop specific policy recommendations.

Moreover, the Committee was told that about 10% of Canadians cannot access regular print due to a disability, and therefore require that material be translated from print to an alternative format, such as audio, electronic text or Braille. At the present time, however, 3% of published material is available in one of these alternative formats. We were informed that direct, ongoing federal funding is needed to support the production of library material in alternative formats for those who are unable to read print.

Finally, the Committee heard that the unemployment rate for persons with disabilities is markedly higher than the national average; many persons with disabilities are dependent on social assistance and, consequently, live in poverty. The federal government was urged to develop an employment strategy for persons with disabilities by becoming a model employer, by adopting inclusive labour market agreements with the provinces/territories, by addressing the employment and training needs of Canadians with disabilities, and by increasing funding for the Opportunities Fund and for the Multilateral Framework for Labour Market Agreements for Persons with Disabilities.

C. What the Committee Believes

The Committee believes that disabled Canadians are not receiving adequate support, either in value or in type. This inadequacy often means that disabled Canadians are unable to contribute meaningfully to our economy, to enjoy the standard of living realized by most other Canadians and to participate fully in society. To us, this situation is unacceptable and must not continue.

The Committee recognizes recent federal initiatives designed to improve the circumstances of disabled Canadians, but believes that federal and provincial/territorial governments must continue to work together in order that disabled Canadians have the quality of life and opportunities to contribute that are taken for granted by most Canadians. This cooperation must occur on a number of fronts and in a number of areas, including in future discussions related to disability benefits under the Canada Pension Plan. It is for this reason that the Committee recommends that:

RECOMMENDATION 28

The federal government meet with provincial/territorial governments and groups representing the disabled with a view to concluding a federal/provincial/territorial national disability strategy and a labour market agreement, as well as to identifying options for improved labour market supports for those who are disabled.

Moreover, the government should review and implement, on an expeditious basis, the recommendations of the Technical Advisory Committee on Tax Measures for Persons with Disabilities.

Finally, disability benefits available under the Canada Pension Plan should be discussed at the next meeting of ministers responsible for the Plan.

SENIORS

A. What the Federal Government Provides

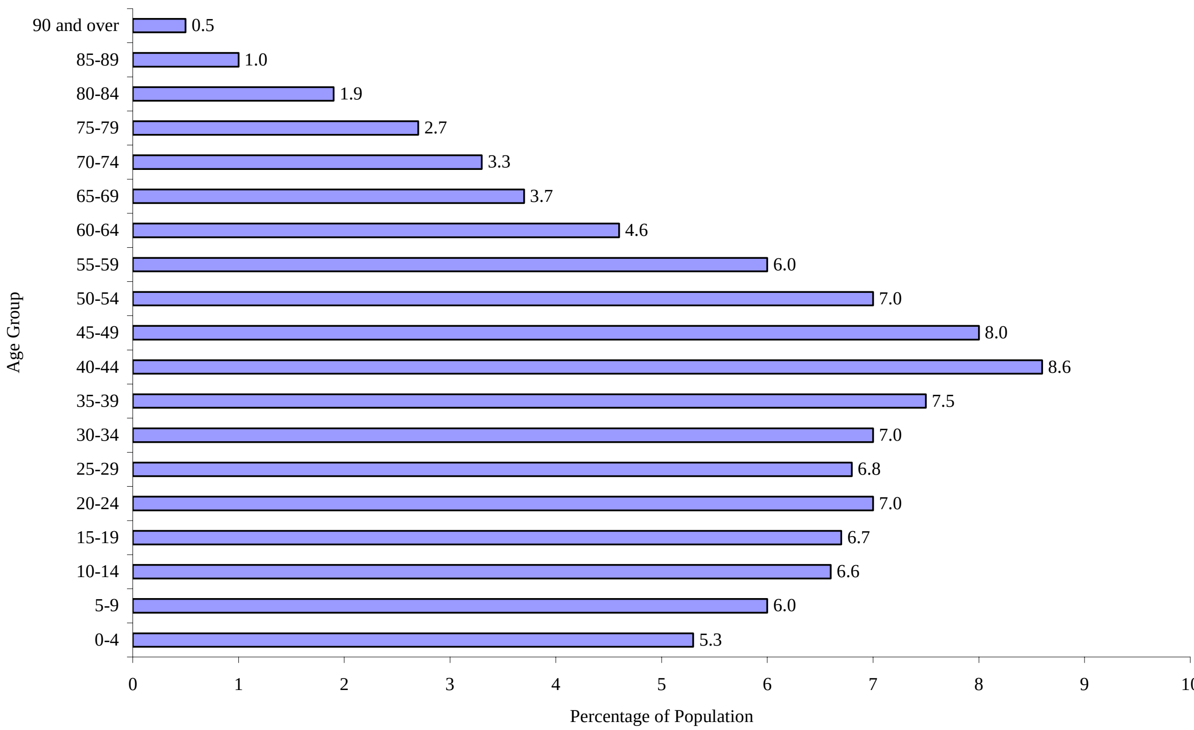
In 2004, more than 4.1 million Canadians were aged 65 and over, comprising about 13.1% of Canada's population, as shown in Figure 4.6.[157] By 2030, seniors are expected to represent about 25% of the Canadian population. Canada's seniors have an interest in all major fiscal and social policy debates, since they often depend on income security programs, are consumers of health care services, reside in our urban, rural and remote communities, sometimes experience housing affordability concerns,[158] and contribute to Canada as taxpayers and perhaps employees.[159]

[157] Statistics Canada, CANSIM 051-0001, Population by Sex and Age Group, 2004.

[158] According to Statistics Canada, in 1999, low-income senior renters spent 43% of their income on rent. See Statistics Canada, "Housing costs of elderly families," *Perspectives on Labour and Income*, July 2004, Vol. 5, No. 7, available at: www.statcan.ca/english/studies/75-001/10704/high-2.htm.

[159] Data suggest that, in 2001, more than 300,000 Canadians aged 65 or older were employed, 68% of whom were men. Over the 1996 to 2001 period, working seniors increased at a rate of 20%, a figure that exceeds their population growth rate of 11%. See Statistics Canada, "More seniors at work," *Perspectives on Labour and Income*, February 2004, Vol. 5, No. 2, available at: www.statcan.ca/english/studies/75-001/10204/high-1.htm.

Figure 4.6: Canadian Population by Age Group, 2004

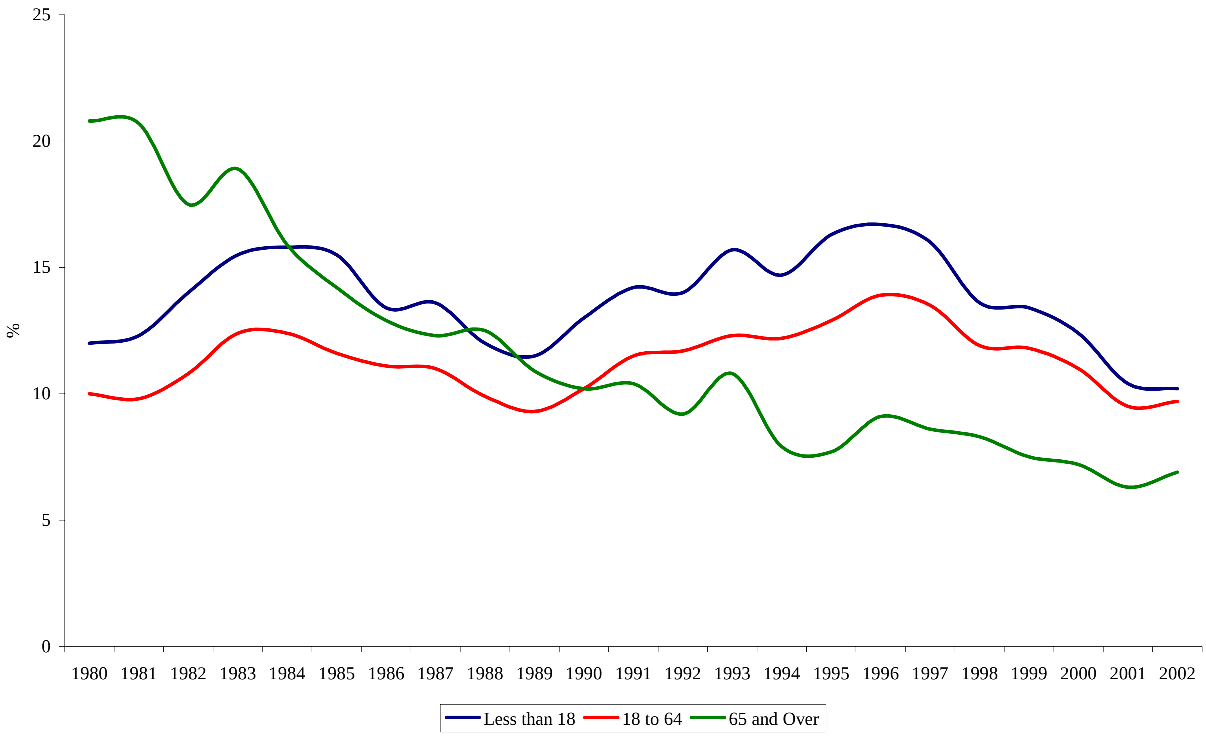


Source: Statistics Canada.

While seniors generally have a lower income than that of working-age Canadians, their economic situation has been improving. According to Statistics Canada, senior families had after-tax income of $43,400 in 2002, an increase from $39,000 in 1996. Growth in this period has largely been the result of increased market income, although government transfers are an important source of revenues for seniors. In 2002, an average of $20,200 in government transfers was received by senior families, which represents about 41% of their total pre-tax income.[160] The low-income rate among Canadian seniors continues to decline, as shown in Figure 4.7.

[160] Statistics Canada, "2002 income: An overview," *Perspectives on Labour and Income*, November 2004, Vol. 5, No. 11, available at: www.statcan.ca/english/studies/75-011/11104/art-2.htm.

Figure 4.7: Low Income Rate by Age Group, 1980 to 2002



Source: Statistics Canada.

In general, the Canadian retirement income system has three tiers: private pensions and other savings; the Canada/Quebec Pension Plan (C/QPP); and the Old Age Security (OAS), Guaranteed Income Supplement (GIS), Allowance and Allowance for the survivor programs.

Canadians may save for their retirement through tax-assisted retirement savings plans as well as through measures without tax assistance.[161] The level of savings affects a country's rate of capital formation, rate of economic growth and standard of living. Furthermore, some economists argue that a relatively high personal savings rate is important if a country is to experience rapid productivity growth and be internationally competitive. For most Canadians, savings are the means by which retirement is financed, homes are purchased, education is funded, and unforeseen financial needs are met.

In particular, the federal government encourages Canadians to save through such vehicles as registered pension plans (RPPs) and registered retirement savings plans

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161 Data suggest that seniors may continue to save during retirement. According to Statistics Canada, in 1999, about 46% of senior families had income that exceeded their expenses. Moreover, in that year, about two thirds of senior families had private pension assets; the median value of these assets was $115,700. See Statistics Canada, "Finances in the golden years," *Perspectives on Labour and Income*, November 2003, Vol. 4, No. 11, available at: www.statcan.ca/english/studies/75-001/01103/hi-fs_200311_01_a.html.

(RRSPs), both of which are tax-assisted. The 2003 federal budget announced increases in RRSP and RPP contribution limits to $14,500 and $15,500 respectively for 2003. Thereafter, the limit for RPPs will rise to $18,000 by 2005 and for RRSPs will rise to the same amount by 2006. The limits will then be indexed to average wage growth for subsequent years.

As well, seniors may receive a monthly taxable retirement benefit from the CPP, which has been in effect since 1966.[162] The CPP provides a monthly retirement benefit to plan contributors who are at least 60 years of age and who meet contributory requirements. This contributory pension plan, which requires employers and employees to make equal contributions on the basis of earnings above a basic exempted amount known as the Year's Basic Exemption and up to a maximum amount known as the Year's Maximum Basic Exemption,[163] is designed to replace about 25% of the earnings on which a beneficiary's contributions were based; the actual amount of the pension depends on the value and duration of contributions to the Plan as well as the age at which the pension begins to be paid. Retirement benefits can be paid as early as age 60 and as late as age 70.

In determining the amount of the retirement pension, certain periods of low income, such as those associated with child rearing, are excluded from the calculation. The maximum monthly retirement pension in 2004 is $814.17. To qualify, the beneficiary must have made at least one valid contribution to the Plan and be either at least age 65 or between age 60 and 64 and meet an earnings requirement.[164] Benefits are increased annually in accordance with increases in the cost of living.

With changes in the late 1990s, the Canada Pension Plan is now considered to be financially sound. According to the *21st Actuarial Report on the Canada Pension Plan*, the Plan is financially sound for at least the next 50 years at the current contribution rate.[165] Contributions by employers and employees are managed by the CPP Investment Board, which operates at arm's length from governments and invests in financial markets in order to maximize the rate of return without undue risk of loss. Accountability to the public and regular reporting are required.

[162] Information on the Canada Pension Plan retirement pension is available at: www.sdc.ca/asp/gateway.asp?hr=en/isp/pub/factsheets/retire.shtml&hs=cpr.

[163] The Year's Basic Exemption is frozen at $3,500 and the Year's Maximum Pensionable Earnings amount for 2004 is $40,500. Self-employed persons pay the employer and the employee share.

[164] This earnings requirement is less than the current monthly maximum CPP retirement pension benefit (which is $814.17 in 2004) in the month before the pension begins and in the month it begins. Once the pension begins to be paid, the beneficiary can work as much as he wishes without affecting the amount of the pension, although contributions to the Plan can no longer be made.

[165] The *21st Actuarial Report on the Canada Pension Plan* is available at: www.osfi-bsif.gc.ca/eng/office/actuarialreports/index.asp#cpp.

Old Age Security benefits have been paid in Canada since 1927, and are currently financed out of general tax revenues.[166] Monthly taxable benefits are paid to those aged 65 and older who meet residence requirements, and are adjusted quarterly in accordance with increases in the cost of living. Employment history and status do not affect eligibility, although higher-income OAS recipients repay at least a portion of their benefit because of the social benefit reduction tax. The amount of the benefit is determined by how long the recipient resided in Canada.

Low-income seniors may also be eligible to receive the income-tested Guaranteed Income Supplement.[167] This monthly non-taxable benefit may be paid to those who are receiving an OAS pension and who have little or no other income, although eligibility for and the amount of the benefit is related to marital status and family income. With one exception related to situations where only one spouse or common-law partner in a couple is a pensioner and the other receives neither OAS benefits nor the Allowance, there are two basic rates of payment under the program: for single, widowed, divorced or separated pensioners; and for legally married couples and couples in a common-law relationship where both are pensioners. GIS benefits cease to be paid if income thresholds are surpassed.

The monthly non-taxable Allowance may be paid to the low-income spouse or common-law partner of an OAS pensioner and GIS recipient, provided the spouse or partner is aged 60 to 64 and certain residence requirements are met.[168] If the spouse or partner is deceased, the non-taxable Allowance for the survivor may be paid.[169] Like GIS benefits, these benefits are income-tested and are adjusted quarterly in accordance with changes in the cost of living. The Allowance and Allowance for the survivor cease to be paid in a variety of circumstances, including: once age 65 is reached, since the OAS pension and possibly GIS benefits become payable; separation or divorce; GIS benefits cease to be paid to the pensioner spouse or common-law partner; income thresholds are surpassed; and remarriage or involvement in a common-law relationship for at least one year.

For December 2004, the maximum monthly OAS benefit is $471.76, for the Allowance is $836.97 and for the Allowance for the Survivor is $924.04. Maximum monthly GIS benefits are $560.69 for single pensioners and the spouse of a non-pensioner, while the maximum is $365.21 for spouses of pensioners and spouses of Allowance recipients. Pensioners with individual net income exceeding $59,790 for 2004 repay at least a portion of the maximum OAS amount, and the full OAS pension is

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166 Information on the Old Age Security program is available at: www.sdc.gc.ca/asp/gateway.asp?hr=/en/isp/oas/oasoverview.shtml&hs=ozs.

167 Information on the Guaranteed Income Supplement program is available at: www.sdc.gc.ca/en/isp/pub/oas/gismain.shtml.

168 Information on the Allowance benefit is available at: www.sdc.gc.ca/asp/gateway.asp?hr=en/isp/pub/oas/allowance.shtml&hs=fzf.

169 Information on the Allowance for the survivor benefit is available at: www.sdc.gc.ca/asp/gateway.asp?hr=/en/isp/pub/oas/allowsurv.shtml&hs=ozs.

eliminated if net income exceeds $97,074. GIS and Allowance benefits also cease to be paid beyond certain income levels.[170]

A range of other supports and services also exist for seniors. For example, Canada Mortgage and Housing Corporation's Home Adaptations for Seniors' Independence Program assists homeowners and landlords in financing minor home adaptations designed to lengthen the time that low-income seniors can live in their own homes independently.[171] Furthermore, Canada's seniors may benefit from the 2004 federal budget's announcement of $8 million in 2004-2005 and $10 million annually thereafter for the New Horizons for Seniors Program. The stated intention of the Program is to "support a wide range of community-based projects … that enable seniors to participate in social activities, pursue an active life and contribute to their community."[172]

Finally, the October 2004 Speech from the Throne committed the federal government to exploring "means of ensuring that we do not lose the talents and contribution that seniors can make to our society." It also announced that benefits under the Guaranteed Income Supplement program will increase.[173]

B. What the Witnesses Said

Witnesses spoke to the Committee about a range of issues that would help seniors in particular, but they also shared their views on social and fiscal issues that affect all members of Canadian society. This approach is not surprising, since health care, housing, charitable giving and volunteerism, taxation and the state of federal fiscal finances affect seniors, as they affect all Canadians.

The Committee was told that additional increases in Guaranteed Income Supplement payments are required to help low-income seniors address the rising cost of living. As well, we heard that the income threshold at which GIS benefits cease to be paid should be increased. More specifically, in the view of witnesses, GIS recipients should be allowed to earn up to $4,000 above the low-income cut-off threshold without loss of GIS income. It was also recommended that the GIS program be reformed to ensure that single low-income seniors would be able to retire with a guaranteed income of $15,000 per year, and that qualification requirements should be based on the net worth and needs of individual applicants.

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170 Information on OAS, GIS, Allowance and Allowance for the survivor payments rates is available at: www.sdc.gc.ca/asp/gateway.asp?hr=/en/isp/oas/oasrates.shtml&hs=ozs.

171 Information on the Canada Mortgage and Housing Corporation's Home Adaptations for Seniors` Independence program is available at: www.cmhc-schl.gc.ca/en/prfias/hasi/readaspr_002.cfm?renderforprint=1.

172 Department of Finance, *The Budget Plan 2004*, p. 181, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

173 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

Witnesses also argued that Old Age Security payments should be increased, especially for those recipients who have no other income than the GIS, because the combined benefit amount is not high enough to provide satisfactory living conditions. Several witnesses also expressed frustration about the “double taxation” of OAS, since OAS benefits are taxable and are subject to partial or full recovery based on the income level of the recipient.

Despite recent increases in annual Registered Retirement Savings Plan and Registered Pension Plan contribution limits, some witnesses believed that tax-assisted retirement savings limits should be increased, perhaps to $20,500 in the next federal budget, followed by annual increases until the contribution limits reach $27,000; at that time, the limits should be indexed to inflation. The Committee was told that Canada lags the United States and the United Kingdom in terms of the maximum amount that may be saved in retirement savings plans. Similarly, several witnesses suggested that the federal government should increase the defined benefit pension limit from $1,833 to $3,000.

Many witnesses urged the early adoption of Tax Pre-paid Savings Plans (TPSPs). The fundamental difference between TPSPs and RRSPs is that TPSP contributions are taxable in the year that they are made but withdrawals are tax-free, whereas RRSP contributions are deductible from taxable income in the year that they are made but withdrawals are subject to taxation. It was argued that TPSPs would encourage Canadians — especially low-income individuals — to save more for retirement.

Several witnesses commented on the age at which RRSPs must be converted into Registered Retirement Income Funds (RRIF). Although the 1996 federal budget reduced the age limit for RRSP contributions from 71 to 69 in order to better align the age limit and the age at which Canadians retire, the Committee was told that longer life expectancies may mean that some Canadians may outlive their retirement savings. Consequently, they advocated an increase in the age limit for RRSP contributions to 71, with consideration given to whether it should be increased to age 73.

C. What the Committee Believes

The Committee realizes the importance of savings, both to individuals and to the economy, and believes that Canadians should be given appropriate incentives to save, particularly for their retirement. While savings incentives would involve a short-term cost to the federal government, we agree that long-term benefits would accrue through relieving future fiscal pressures: allowing individuals to accumulate savings and capital would lessen their reliance on government-financed retirement income programs. Moreover, forgone tax revenues are recovered, to some extent, when workers retire and begin to spend their retirement savings.

At a more fundamental level, the Committee believes that seniors should be provided with incentives to save for their retirement, but in the event that this saving does not occur, or occurs but is not sufficient to meet their income needs in retirement, then federal support must be forthcoming, including through such programs as Old Age Security, the Guaranteed Income Supplement, the Allowance and the Allowance for survivors. Seniors who have served their country well must know that they will be able to live their retirement years in dignity, and with the supports that they need. Certainly, providing disability assistance, health care, strong communities and affordable housing will help ensure that this outcome occurs.

Like some of our witnesses, the Committee believes that a review of the full range of mechanisms that might be used by the federal government to encourage saving by Canadians should occur, since saving has benefits for both the individual and the nation. As this review is undertaken, it is important to bear in mind that individuals save not only for their retirement, but also for home purchase and the acquisition of other assets, education for themselves and their children, and for a variety of other reasons. Moreover, a comprehensive review of the federal programs that provide financial and other assistance to seniors is also required. It is from this perspective that the Committee recommends that:

RECOMMENDATION 29

The federal government implement, on a priority basis, increased benefits payable under the Guaranteed Income Supplement program. As well, the government should make every effort to identify — and compensate — those Canadian seniors who are eligible for Guaranteed Income Supplement benefits but have not received them.

The government should also undertake a comprehensive review of incentives for saving and the Canadian retirement income system to ensure that the financial and other needs — both current and future — of Canada's current and future seniors are being met. This review should be completed by 30 June 2005.

HEALTH CARE

A. What the Federal Government Provides

In recent years, the state of Canada's health care system has been at the forefront of the public's consciousness. An effective and efficient health care system is an essential contributor to both Canadians' quality of life and their standard of living. This attention culminated in several studies, perhaps most notably the November 2002 report by the Commission on the Future of Health Care in Canada, known as the Romanow Commission. Many of its recommendations were, in turn, included in the First Ministers'

Accord on Health Care Renewal, signed in February 2003. This accord built on the agreement on health reached by the First Ministers in 2000.[174]

Specifically, the First Ministers' Accord and the 2003 federal budget provide that federal support to health care will increase by $17.3 billion over the next three years and by $34.8 billion over the next five years, to include:

- $9.5 billion in transfers to the provinces/territories over the next five years;
- a $2.5 million investment through the Canada Health and Social Transfer (CHST) supplement to relieve existing pressures;
- $16.0 billion over five years to the provinces/territories for a health reform fund targeted to primary health care, homecare and catastrophic drug coverage;
- $5.5 billion over five years in health initiatives, including diagnostic/medical equipment, health information technology and the creation of a six-week compassionate family care leave benefit under the Employment Insurance program; and
- $1.3 billion over five years to support health programs for First Nations and Inuit peoples.

In the 2003 federal budget, the government also indicated planned levels for total cash transfers to 2010-2011.

In February 2003, the First Ministers also agreed that:

- an enhanced accountability framework to report on the progress of reform would be created, involving a health council that would monitor and report annually on the implementation of the Accord, particularly its accountability and transparency provisions;
- the federal government would set out a long-term funding framework to provide the provinces/territories with predictable, growing and sustainable support for health care and other social programs;
- the federal government, effective 1 April 2004, would create the Canada Health Transfer (CHT) and the Canada Social Transfer (CST) to increase transparency and accountability; and

[174] Department of Finance, *The Budget Plan 2004*, p. 88-101, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

- by the end of 2005-2006, Canadians — wherever they live — would have reasonable access to catastrophic drug coverage, and that First Ministers would take additional actions to promote optimal drug use, identify best practices in drug prescription and better manage the costs of all drugs, including generic drugs.

In his appearance before the House of Commons Standing Committee on Finance in November 2003, the Minister of Finance announced that up to $2 billion of any federal budgetary surplus realized in 2003-2004 would be transferred to the provinces/territories for health care spending. The 2004 federal budget confirmed additional funding for the provinces/territories of $2 billion, an amount that brings funding provided under the First Ministers' Accord to $36.8 billion.

The 2004 federal budget also announced the establishment of the Public Health Agency of Canada, with the appointment of a chief public health officer, and $665 million over three years to improve Canada's readiness to deal with public health emergencies. The funding will be allocated in the following manner: $100 million for frontline public health capacity; $300 million for new vaccine programs; $100 million for improved surveillance systems; and $165 million over two years for such other initiatives as strengthening preparedness against infectious diseases, creating health emergency response teams, replenishing the national emergency stockpile system, investing in federal laboratories and surveillance systems, and establishing National Collaborating centres for public health.

The federal government's commitment to health care was confirmed in the October 2004 Speech from the Throne, which noted the September 2004 agreement reached with the provincial/territorial First Ministers on a Ten-Year Plan to Strengthen Health Care.[175] Elements of the Ten-Year Plan include:

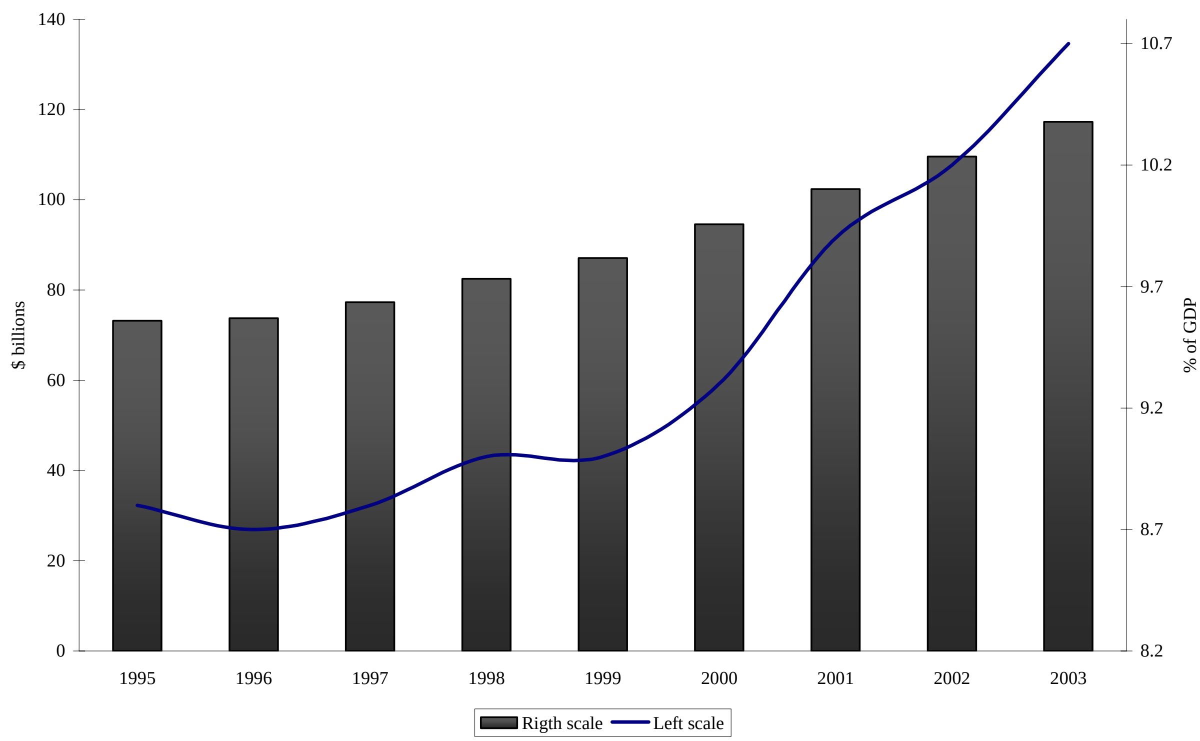
- a commitment to achieve tangible results, for example with respect to wait times for health services;
- a requirement to establish evidence-based benchmarks, comparable indicators, clear targets and transparent reporting to the public;
- accelerated reform and better access to key tests and treatments, including an increase in the number of doctors, nurses and other health professionals;
- improved access to homecare and community care services;
- improved access to safe and affordable drugs;
- a commitment to substantial, predictable long-term funding; and

[175] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

- measures to address the challenges of delivering health care services in Canada's North, including medical transportation costs and innovative service delivery.

The recent federal funding increases to health care will contribute to a continued upward trend in health spending in recent years, as shown in Figure 4.8. Since 1998, federal and provincial/territorial government investments in health care have increased at a higher rate than the rate of economic growth. As well, recent federal increases will be in addition to the tax transfers and equalization funds that are used by the provinces/territories to provide health care, as well as direct federal spending and tax measures in support of responsibilities with respect to, for example, First Nations, Inuit and veterans' health.

Figure 4.8: Recent Trends in Canadian Health Spending, 1995 to 2003



Source: OCDE Health Data 2004 and Statistics Canada.

B. What the Witnesses Said

Witnesses who appeared before the Committee to speak about health issues shared their views about elements of the recently signed Ten-Year Plan to Strengthen Health Care and about what future actions should be taken now that a ten-year plan has been reached. Some concerns were voiced about the specific targets and reporting mechanisms that will let Canadians know that progress is being made with respect to their health care. Others felt that more details are needed on how funds will be allocated to and among various components of the Ten-Year Plan.

Several witnesses spoke about specific aspects of the *Canada Health Act*. While witnesses generally support the principles contained in the Act, there was concern that some of the principles are not being respected and that information provided to Parliament is not accurately indicating the degree to which privatization initiatives are underway in several provinces. In particular, it was recommended that the ministers of Finance, and Health fully enforce the accountability mechanism in the *Canada Health Act* and that provinces/territories be required to provide information on the mode of delivery of health care services, in particular for-profit and investor-owned versus public and not-for-profit. Comments were also made about provincial/territorial protection of privacy as it relates to health information.

Some witnesses identified key elements that they believe are missing from the recently signed Ten-Year Plan, including funding for chronic long-term care, investments in the determinants of health, a health human-resources strategy that addresses the issue of culturally sensitive health services, the integration of disease prevention and health promotion as part of a health care strategy, the exemption of public health care from international trade agreements and regimes, greater support for publicly funded basic medical research, measures to close the gap between the health status of Aboriginal peoples and the Canadian public, measures to recognize and address the interprovincial mobility of health workers, subsidized tuition costs for health care workers, dental care and vision rehabilitation services.

Witnesses also recommended that, in order to align tax policy with health policy and the sustainability of the health care system, the federal government increase the GST rebate for publicly funded health care institutions and clinics to 100% and zero-rate GST on publicly funded health services provided by independent health care providers. They also spoke about the need for increased funding for the Canadian Strategy on HIV/AIDS. In their view, an increase to $100 million is needed.

Other witnesses commented on dental care, urging the federal government to continue tax incentives in this area of health care and to create a social safety net to provide oral care services to those Canadians who are socio-economically disadvantaged. These witnesses also recommended investigation of financial options that would encourage access to dental care, including — for example — the establishment of a medical savings plan, and urged consideration of oral health funding or delivery models that respect such principles as: the freedom of patients to attend the dentist of their choice; the ability of dentists and patients to make treatment decisions free from third-party interference based on coverage; and recognition that dentists are the only health care providers able to diagnose and develop full oral health plans for patients. As well, greater federal support for dental schools was advocated, with a link made to the provision of affordable dental care to low-income individuals and families.

Finally, the Committee also heard recommendations about vision care. In the view of witnesses, vision loss is common and often preventable, and can be rehabilitated; appropriate and timely vision rehabilitation services are needed in order to reduce the negative effects and costs of severe vision loss.

C. What the Committee Believes

The Committee believes that an effective and efficient health care system is an essential contributor to both Canadians' quality of life and their standard of living. We also feel that everyone in society benefits when citizens are healthy; certainly, the individuals themselves and their families benefit, but so too does the rest of society, including the businesses that employ them. As a single-payer system that provides coverage to all Canadians — regardless of their income or wealth — we are of the view that the Canadian health care system is, in part, an expression of what it means to be Canadian.

Recognizing the recently concluded Ten-Year Plan to Strengthen Health Care, the Committee — like many of our witnesses — believes that the important requirement now is ensuring that all partners to the Ten-year Plan respect their obligations under the Plan. Everyone must be vigilant — and ensure that responsibilities are met — in order that, as we move forward, Canadians can benefit from the health care they both expect and deserve.

With the signing of the Ten-Year Plan, the Committee feels that the focus should now shift somewhat. It is generally thought that prevention is better than a cure, and perhaps this adage is particularly true with respect to health. Like some of our witnesses, we believe that the focus should be directed to preventative measures in such areas as nutrition, sport and physical activity. As a society, we should not limit our focus to helping people once they are sick; we should also focus on helping them avoid sickness, including chronic disease. As a society, we need to take action now — to promote better nutrition and to encourage a more active lifestyle — in order to halt if possible and, if not halt then better manage, obesity, diabetes and similar health conditions within our nation. It is for this reason that the Committee recommends that:

RECOMMENDATION 30

The federal government — working with provincial/territorial governments, the Canadian Institutes of Health Research and health agencies — develop a public awareness program designed to educate Canadians about preventative measures, including those related to disease prevention and health promotion, to improve their health outcomes.

HOUSING AND HOMELESSNESS

A. What the Federal Government Provides

Access to adequate shelter is a basic necessity for individuals if they are to contribute meaningfully to society, whether at their workplace, in their community or in their household. Data for 2001 suggest that while most Canadian households had dwellings that were in adequate condition and were suitably sized,[176] and the number of households unable to access acceptable housing declined over the 1996 to 2001 period, many Canadian households are in "core housing need." That is, they are unable to afford shelter that meets adequacy, suitability and affordability norms, and spend more than 30% of their gross income on rent. Most households in core housing need are renters rather than homeowners,[177] and in 2001, renter households were 3.5 times relatively more likely to be in core housing need. Homeownership increased over the 1996 to 2001 period as a consequence of income growth and lower interest rates.[178]

According to Statistics Canada, and as shown in Figure 4.9, just over 1.7 million Canadian households, or 15.8%, were in core housing need in 2001; these figures represent declines from the almost 1.8 million Canadian households, or 17.9%, in core housing need in 1996.[179] Over that period, housing affordability improved for most Canadians, as household incomes grew more quickly than did shelter costs in all regions except Saskatchewan.[180] The incidence of households in core housing need declined in all provinces and territories except Newfoundland and Labrador, as indicated in Figure 4.10.[181]

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176 Canada Mortgage and Housing Corporation, *Canadian Housing Observer*, available at: www.cmhc-schl.gc.ca/en/cahoob/hoaf2004/index.cfm.

177 Ibid.

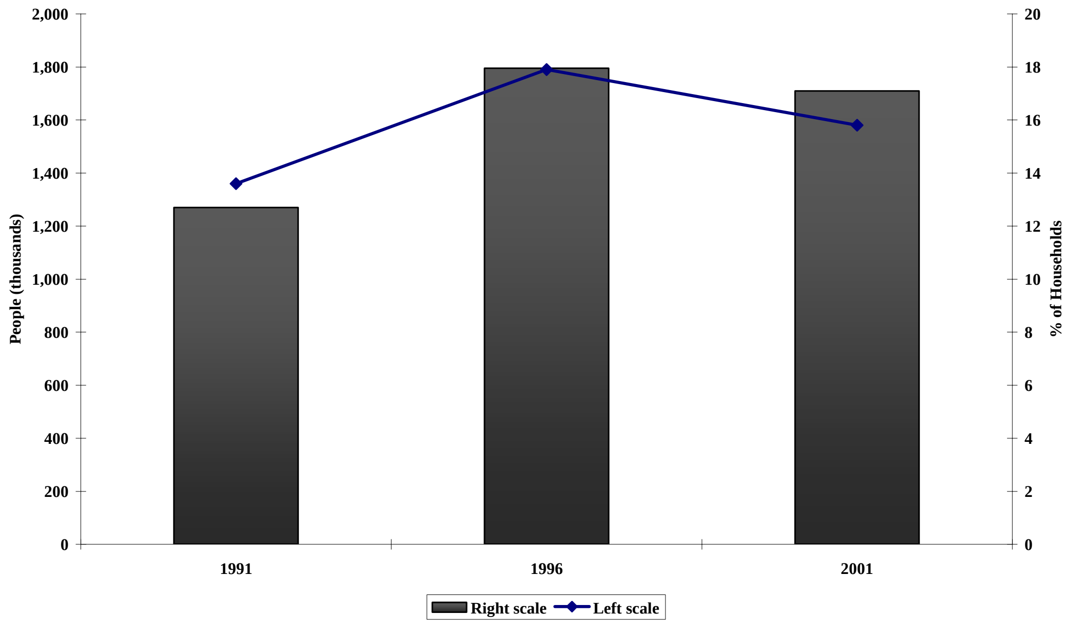
178 Ibid.

179 Ibid.

180 Ibid.

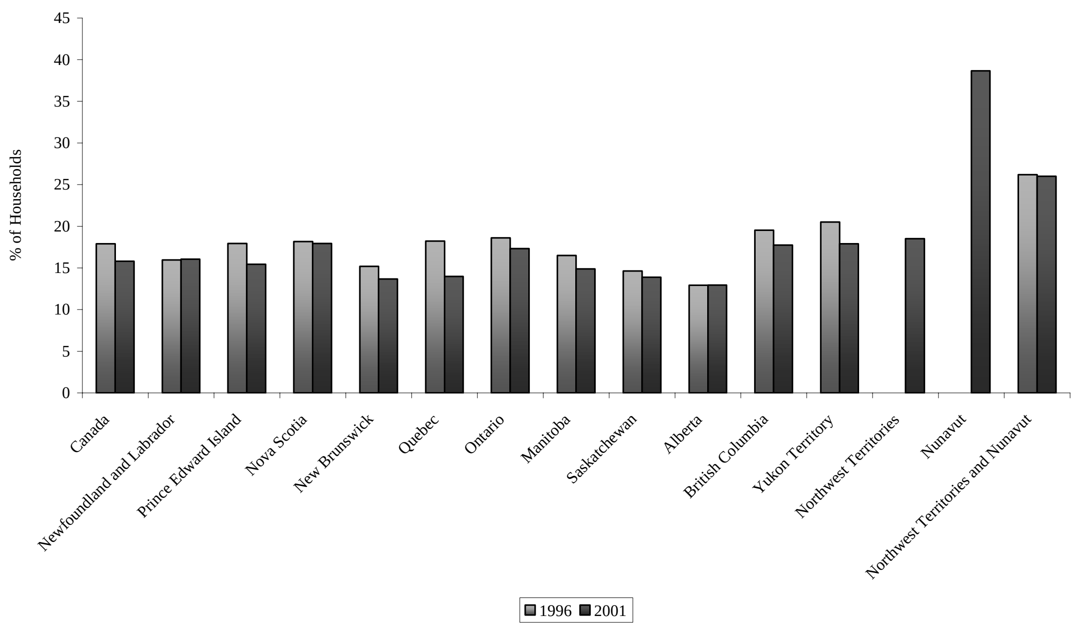
181 Ibid.

Figure 4.9: Canadian Households in Core Housing Need, 1991, 1996 and 2001



Source: Canada Mortgage and Housing Corporation.

Figure 4.10: Incidence of Core Housing Need Among Households, Canada, Provinces/Territories, 1996 and 2001



Source: Canada Mortgage and Housing Corporation.

The primary determinant of core housing need is affordability. In 2001, this determinant was the only contributing factor for 75% of households in core housing need.[182] In that year, these households generally had income gains that were relatively lower than those of other households.[183]

Some Canadians are at particular risk of being in core housing need, including Aboriginal peoples, immigrants, seniors aged 65 or older and living alone, and lone parents. In 2001, Aboriginal Canadian households in core housing need spent about 46% of their income on shelter and had average before-tax income of $17,712. Moreover, Canada's immigrant population is highly urbanized, and housing costs are usually higher in large urban centres. Data from 2001 suggest that more than 75% of recent immigrants to Canada settled in Toronto, Montreal and Vancouver, and the incidence of core housing need for this group was, on average, 4.8% higher than the incidence for non-immigrant households.[184] In 2001, about 53.3% of seniors living alone in rented accommodation were in core housing need, a figure that was 56.3% for senior female renters living alone.[185] Moreover, 48.8% of all lone parent households with children under age 18 living at home in rental housing were in core housing need in 2001; there has, however, been some improvement over time, since this figure was 57.0% in 1996.[186]

While homelessness is visible, ascertaining its breadth and its depth can be difficult. It does, however, affect people of any age, of both genders, of varied ethnic backgrounds, resident in communities across Canada and living in a range of family relationships. This diversity requires a range of supports. It is thought that homelessness is growing in Canada's major urban centres for such reasons as inadequate affordable housing units as well as reduced levels of income support.

In 1999, in response to what some Canadians saw as a homelessness crisis, the National Secretariat on Homelessness was established within Human Resources Development Canada to develop and implement the policy and framework for the National Homelessness Initiative. Announced by the federal government in 1999, the Initiative allocated $753 million over three years to alleviate homelessness as well as to help the homeless achieve and maintain self-sufficiency. The 2003 federal budget announced a three-year extension of the Initiative to 2006.[187] Figures 4.11 and 4.12 show the allocation of funds among its elements for the 1999 to 2003 and 2003 to 2006 periods respectively.

[182] Ibid.

[183] Ibid.

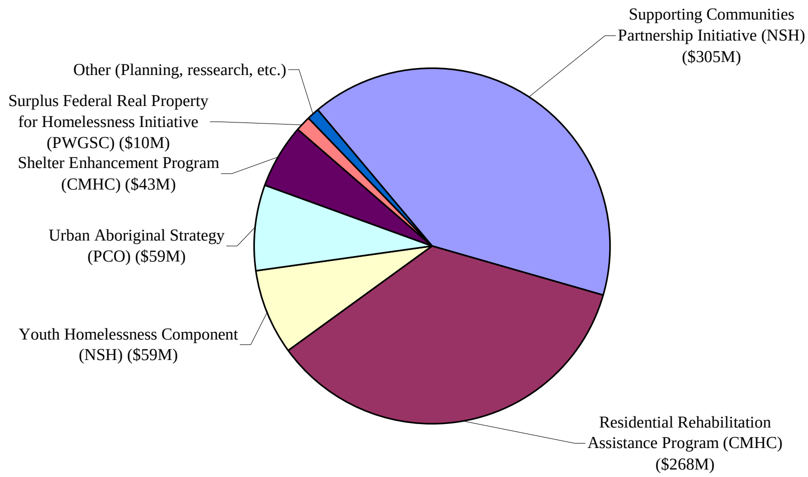
[184] Ibid.

[185] Ibid.

[186] Ibid.

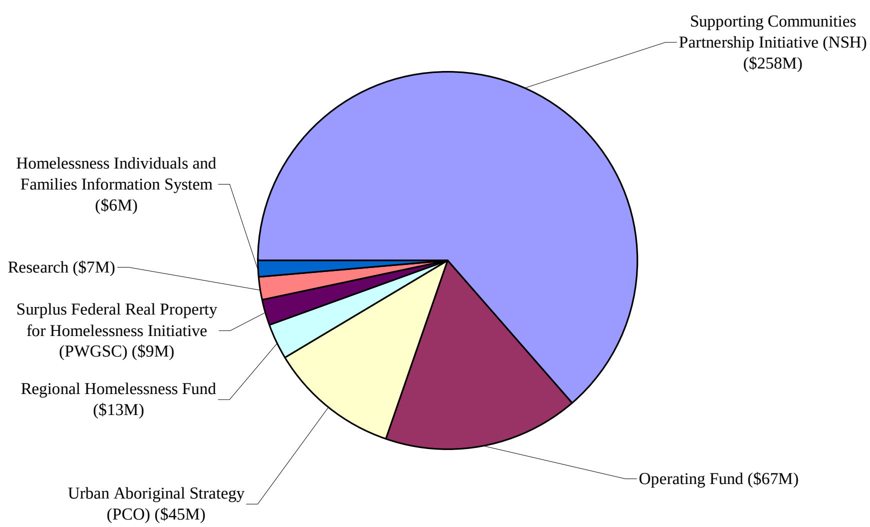
[187] Department of Finance, *The Budget Plan 2003*, p. 106, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

Figure 4.11: National Homelessness Initiative Phase I (1999-2003)
($ millions)
Total = $753M



Source: National Homelessness Initiative, *Progress Report*, 1999-2003.

Figure 4.12: National Homelessness Initiative Phase II (2003-2006)
($ millions)
Total = $405M



Source: National Homelessness Initiative, *Business Plan 2003-2006.*

When the National Homelessness Initiative was announced in 1999, the following elements were identified:[188]

- the Supporting Communities Partnership Initiative (SCPI), which provided $305 million to local community groups in 61 communities across Canada and cofunded such measures as emergency shelters, transitional and supportive housing, support facilities and services such as food/clothing/furniture banks and drop-in centres, capacity building and public awareness;

- the Residential Rehabilitation Assistance Program (RRAP), which provided $268 million to preserve and create low-cost housing, including for conversion, rental and rooming house initiatives;

- the Youth Homelessness Component, which received funding of $59 million to alleviate the growth in the number of youth living on the street;

- the Urban Aboriginal Strategy, which was allocated $59 million for the benefit of Aboriginal peoples living in urban centres;

- the Shelter Enhancement Program, which received funding of $43 million to provide capital assistance to repair, rehabilitate and improve existing shelters and to acquire or build new shelters for the benefit of women and their children, youth and men who are victims of family violence;

- the Surplus Federal Real Property for Homelessness Initiative, which was allocated $10 million to compensate custodian federal departments and agencies for making surplus federal real property available at nominal cost to community-based organizations addressing homelessness; and

- planning, research and related activities, which received funding of $9 million to undertake such activities as developing community plans to address homelessness and supporting research directed toward increased awareness and policy development.

The additional funding allocated for the three-year extension of the Initiative is expected to be directed to:[189]

- the Supporting Communities Partnership Initiative, with funding of $258 million;

[188] Human Resources and Skills Development Canada, *National Homelessness Initiative: 1999-2003 Progress Report*, p. 8, available at: www.homelessness.gc.ca.

[189] Human Resources and Skills Development Canada, *National Homelessness Initiative: 2003-2006 Business Plan*, p. 5, available at: www.homelessness.gc.ca.

- the Homeless Individuals and Families Information System, with funding of $6 million to collect and manage a national electronic database for the benefit of shelter service providers;

- the Surplus Federal Real Property for Homelessness Initiative, with funding of $9 million;

- the Urban Aboriginal Homelessness Component, with funding of $45 million to be used with the Urban Aboriginal Strategy to support integrated, culturally appropriate strategies and projects in eight cities;

- the Regional Homelessness Fund, with funding of $13 million to support small and rural communities in implementing measures to prevent at-risk individuals and families from becoming homeless and to stabilize their living conditions;

- the National Research Program, with funding of $7 million to support research and policy development as well as knowledge transfer and the sharing of best practices; and

- operating funds, with an allocation of $67 million.

The 2001 federal budget announced the Affordable Housing Initiative, a five-year program with an investment of $680 million. Through a partnership between the Canada Mortgage and Housing Corporation (CMHC) and provincial/territorial governments, private and non-profit developers are provided with funds to stimulate the construction of affordable rental housing. An additional $320 million investment over five years announced in the 2003 federal budget increased funding of the Initiative to $1 billion by 2007-2008.[190]

Moreover, the 2003 federal budget extended the RRAP for three years, with a contribution of $128 million annually.[191] At present, in addition to the RRAP initiatives for Aboriginal peoples, disabled Canadians and seniors mentioned earlier in Chapter Four, the following programs exist:

- Homeowner RRAP, which provides low-income households who own and occupy substandard housing with assistance for dwelling repair in order to reach a minimum level of health and safety;

- Rental RRAP, which assists landlords of affordable housing to finance mandatory repairs to self-contained units rented by low-income tenants in order to meet minimum levels of health and safety;

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190 Department of Finance, *The Budget Plan 2003*, p. 106, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

191 Ibid.

- Rooming House RRAP, which assists owners of affordable rooming houses renting to low-income tenants to finance repairs, including structural, electrical, plumbing, heating and fire safety; and

- Conversion RRAP, which assists in the conversion of non-residential properties to affordable rental housing units or bed-units for low-income renters.

Other assistance for low-income homeowners and occupants is also available, such as the Emergency Repair Program, which assists those in rural areas to make emergency repairs required for continued safe occupancy in their dwelling.[192]

Finally, the October 2004 Speech from the Throne committed the federal government to extending and enhancing the Affordable Housing Initiative, the Supporting Communities Partnership Initiative and the Residential Rehabilitation Assistance Program.[193]

B. What the Witnesses Said

Witnesses reminded the Committee that low-income families, social assistance recipients and many low-income seniors must allocate a significant portion of their income to housing. We were told that approximately 200,000 Canadians are homeless, and 1.7 million are in core housing need. Furthermore, we were informed that Canada is now the only industrialized country lacking a national housing program.

As well, the unique needs of women — across Canada and both on- and off-reserve — for adequate shelter were identified, including for recent immigrants, those who are recently separated, and those escaping violence and abuse. The Committee was told that homelessness and inadequate housing for women brings with it certain risks, including loss of their children, the possibility of violence and sexual assault, and health-related illnesses.

Many witnesses urged the federal government to develop an adequately funded national housing strategy. In the view of some of the Committee's witnesses, the government should commit $2 billion annually in each of the next five years for building 20,000 to 30,000 new social housing units to address the current shortage of affordable rental housing units. The creation of a national rent supplement program was also encouraged, with some witnesses suggesting that the Canada Mortgage and Housing Corporation's current surplus should be invested in social housing and rent supplement programs.

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192 Information on the Emergency Repair Program can be found at: http://www.cmhc-schl.gc.ca/en/prfias/otaspr/readaspr_001.cfm.

193 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

Others witnesses emphasized the importance of stimulating private investment in new and affordable rental units. The Committee was told that changes in the income tax treatment of rental housing since the 1970s have significantly reduced the attractiveness of private rental investment; consequently, reform of the income tax system to encourage private sector involvement in affordable housing was advocated.

The Committee heard a wide range of other suggestions as well: allowing a full GST rebate on new rental housing projects; increasing the capital cost allowance rate to 5% for new rental housing; extending the opportunity to deduct capital cost allowance losses against other income to all investors in rental housing projects; allowing landlords of smaller properties to qualify as small businesses; creating a new tax credit modeled after the tax credit available through labour-sponsored venture capital corporations; restoring the deductibility of land carrying costs; and allowing tax-free withdrawals from RRSPs for renovations generally and to meet the needs of seniors.

Several witnesses commented on the success of the CMHC's Residential Rehabilitation Assistance Program (RRAP), and recommended that it be extended beyond 2005-2006. It was also recommended that the upgrading of secondary suites — which are a significant source of affordable rental housing — to meet safety standards be included as a category for RRAP funding.

C. What the Committee Believes

The Committee believes that homelessness in Canada must end. In a country such as ours, it is not acceptable that anyone — including seniors, social assistance recipients and income earners — is homeless or living in unsuitable or substandard housing.

While a number of federal measures to address homelessness and affordable housing appear to be working well according to our witnesses — and according to us — there are some measures that should be reviewed in order to ensure that they are working as intended. As well, there are other measures that should perhaps be considered. With a problem of this type and magnitude, the solution is likely to require a variety of programs to meet a variety of needs. Consequently, the Committee recommends that:

RECOMMENDATION 31

The federal government review — together with provincial/territorial governments, advocacy groups representing the homeless, and private and not-for-profit developers — the measures that exist with respect to housing and homelessness. This review should be undertaken with a view to ensuring that funds are adequate in size and properly allocated, and to identifying programs that should be changed or implemented.

Moreover, the government should, on a priority basis, extend and enhance the Affordable Housing Initiative, the Supporting Communities Partnership Initiative and the Residential Rehabilitation Assistance Program.

LIFELONG LEARNING

A. What the Federal Government Provides

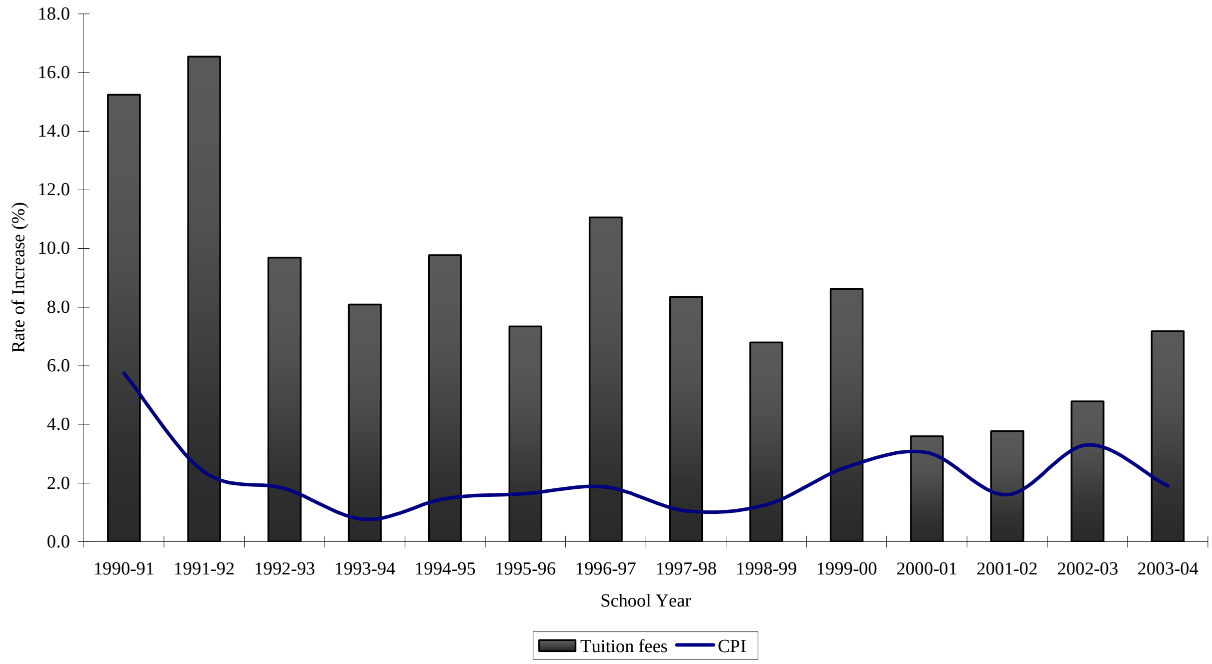
A highly educated, and well-educated, population is an important contributor to a nation's prosperity and the quality of life of its citizens. In general, a higher level of education can mean higher levels of productivity and more rewarding employment opportunities for employees. It can also mean higher-paid jobs, with the payment of higher taxes, which in turn enables the funding of the public goods and services that citizens desire. Canadians must embrace lifelong learning in order to maximize their potential as individuals and as employees, and in order for Canada to continue to compete effectively in the global marketplace.

Consequently, it is important that Canada's citizens have literacy, numeracy and other skills that at least meet — and ideally surpass — basic standards. In a society such as ours, literacy and numeracy are basic prerequisites if citizens are to participate fully in life. People with weak literacy and numeracy skills are relatively more likely to be unemployed, to work in lower-paying jobs and to live in a low-income household. Raising adult literacy and numeracy rates is generally thought to be an important goal.

While primary and secondary education in Canada are generally funded by governments, post-secondary and continuing education are funded from both private and public sources. In addition to financial assistance provided to the provinces/territories by the federal government for post-secondary education, the federal government provides loans and grants for qualifying students, grants to assist those saving for post-secondary education, student loan debt repayment and interest relief, and programs to help the unemployed re-enter the labour market, among other measures. Moreover, as discussed in Chapter Three, the federal government provides assistance through research granting councils.

The cost of post-secondary education continues to rise in Canada, although the rate of increase in undergraduate tuition fees slowed in 2004-2005. According to Statistics Canada, undergraduate university tuition fees increased 3.9% from 2003-2004 to 2004-2005, the smallest rate of increase in three years and markedly lower than the annual average rate of increase of 9.7% during the 1990s, although greater than the rate of inflation, as shown in Figure 4.13. For this academic year, undergraduate tuition fees are expected to be, on average, $4,172. By profession, average tuition fees in medicine will be $9,977, in law will be $6,471 and in dentistry will be $12,331 for the 2004-2005 academic year, although students in law and medicine experienced the largest tuition fee increases over the previous year, at 7.9% and 9.2% respectively. Graduate tuition fees also increased for the 2004-2005 academic year, reaching $5,475 on average; this level represents a 4.3% increase over 2003-2004, but is the smallest rate of increase since 1995-1996.[194]

Figure 4.13: Rate of Increase in Undergraduate Tuition Fees Versus Consumer Price Index Inflation, School Years 1990-1991 to 2003-2004



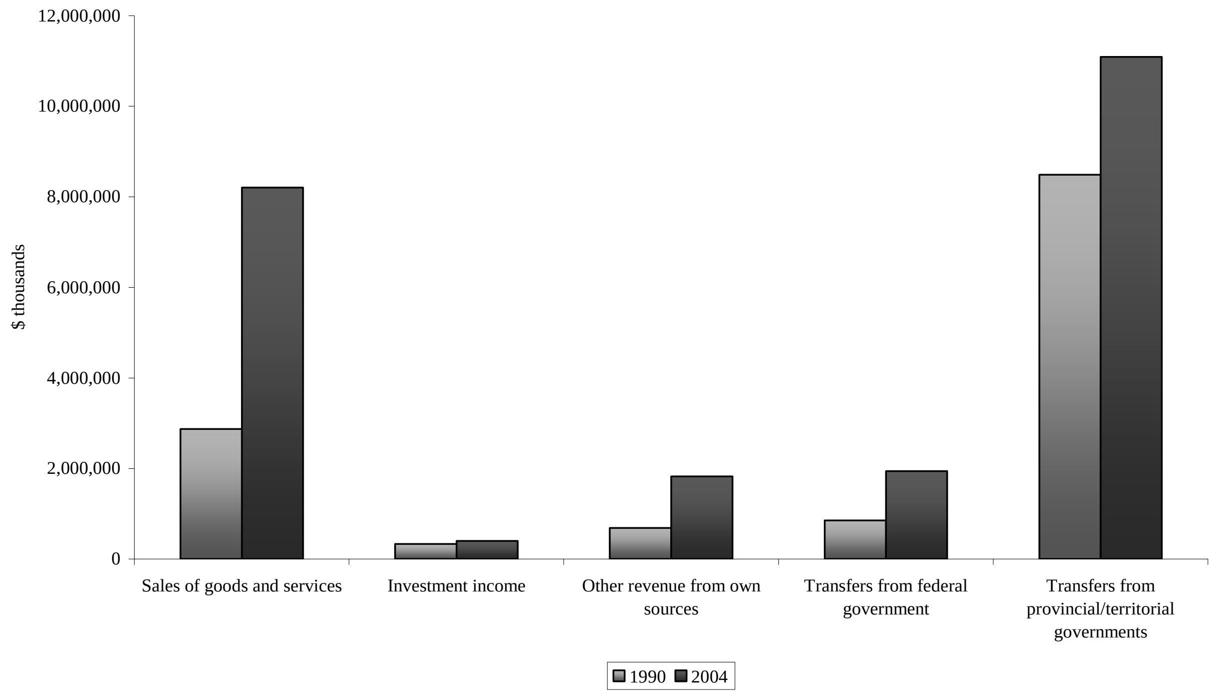
Source: Statistics Canada.

Moreover, Statistics Canada figures indicate that higher tuition fees and increased federal government grants resulted in higher revenues in 2002-2003 for Canada's universities and degree-granting institutions, the largest growth in three years. In that year, student fees accounted for 20.5% of revenue and government funding for 56% of revenue; revenue was $18.6 billion. Grants and contracts from all levels of government continued to increase for the fifth consecutive year, as shown in Figure 4.14, and totaled $10.4 billion in 2002-2003. Of this amount, the federal contribution was just over $2.2 billion, and was mostly allocated to support sponsored research.[195]

[194] Statistics Canada, "University tuition fees," *The Daily*, 2 September 2004, available at www.statcan.ca/Daily/English/040902/d040902a.htm.

[195] Statistics Canada, "University finances," *The Daily*, 19 August 2004, available at: www.statcan.ca/Daily/English/040819/d040819a.htm.

Figure 4.14: University and College Revenues, by Source, 1990 and 2004



Source: Statistics Canada.

Despite the rising cost of education, in the next decade the demand for university education is expected to rise as a consequence of a number of factors: a population surge of 18- to 24-year olds; and increased participation rates triggered by a growing number of university-educated parents, student responsiveness to labour market demands, and recognition of the economic and social benefits of a university education.

Since 1 April 2004, the federal government provides funding to the provinces/territories for education through the Canada Social Transfer (CST), which is to be allocated for education, social assistance and other social services in whatever proportions the provinces/territories deem to be appropriate. Unlike the Canada Health Transfer, the CST does not have specific conditions attached to its use; that is, there is no requirement that a certain proportion of the funds be allocated to education rather than to social assistance and social services, and accountability with respect to the funding allocated by the federal government for education is limited.

The federal government has a long history of supporting education, and of providing incentives to save for education.[196] In 1972, the first Registered Education

[196] Department of Finance, *The Budget Plan 2004*, pp. 216-217, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

Savings Plans (RESPs) were introduced to assist families in saving for education and, over time, changes have been made to encourage increased saving. For example, the 1996 federal budget increased the annual limit on contributions to RESPs to $2,000 from $1,500, and the lifetime contribution limit was increased to $42,000 from $31,500.

Moreover, changes to RESPs announced in the 1997 federal budget increased the annual limit to $4,000 and removed the requirement that all RESP income be used for the purpose of education; consequently, contributors whose children did not pursue post-secondary education could transfer their RESP investment to a Registered Retirement Savings Plan (RRSP) or, in the event that RRSP contribution room was unavailable, could receive the income directly with a charge of 20% in addition to taxes payable. As well, according to the 1997 budget, other siblings could benefit from income accumulated in a group RESP.

Federal support for education-related saving also occurred with the 1998 federal budget, when Canada Education Savings (CES) grants were announced. At that time, the grant was a contribution to an RESP by the federal government in the amount of 20% of the first $2,000 in annual contributions made in respect of a child up to age 18, to a maximum annual grant of $400 per child and with unused grant contribution room carried forward to future years. The maximum lifetime contribution by the federal government for a given beneficiary is $7,200. If no child benefits from the RESP, the full amount of the grant reverts to the federal government.

In the October 2004 Speech from the Throne, the federal government committed itself to introducing legislation that would implement the Canada Learning Bond (CLB) announced in the 2004 federal budget.[197] Consequently, on 8 October 2004, Bill C-5, *An Act to provide financial assistance for post-secondary education savings*, was introduced in the House of Commons. Designed to assist low- and middle-income families to save for the post-secondary education of their children, the measures in the legislation encourage families to establish a RESP and become eligible to receive the Canada Learning Bond.

As noted earlier, CES grant contributions are made by the federal government in respect of RESP contributions made from 1998 onward, and maximum annual and lifetime contribution limits exist. Under Bill C-5, the existing CES grants — which are not dependent on income earned in a given year — are retained, and a new CES grant is also available for low- and middle-income families making RESP contributions from 2005 onward. Low-income families are defined as those earning no more than $35,000 in a given year, while middle-income families are those earning more than $35,000 but less than $70,000 in a given year; they are entitled to new grants of no more than $100 and $50 respectively. The new grant is calculated on no more than the first $500 contributed to a RESP annually, with a 40% and 30% matching rate for low-income and

[197] Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

middle-income families respectively. The total amount of CES grant money in respect of a particular beneficiary over that beneficiary's lifetime continues to be $7,200, and the $35,000 and $70,000 threshold amounts are indexed to inflation in accordance with indexation of personal income tax brackets.

The legislation also provides for the payment of a CLB, provided certain eligibility criteria are met. For example, on application, the federal government can contribute to a RESP: in respect of someone who is a beneficiary under a RESP; if the beneficiary was born in 2004 or later; and if the beneficiary is under age 21 at the time of application for a CLB. The beneficiary is required to be under age 15 and a person for whom the National Child Benefit or a special allowance under the *Children's Special Allowances Act* is payable for at least one month of that year.

An amount of $500 is payable as a CLB in respect of the first year in which the person meets the entitlement criteria, with $100 payable for each successive year in which the criteria are met until age 15. The maximum lifetime amount contributed by the federal government is $2,000.

Federal support for education is also provided through the Canada Student Loan Program (CSLP), which has existed since 1964 and provides needy students with interest-free loans while they are in school and gives a six-month period after leaving school before interest payments are required. The provisions of the program have changed over time, and students have benefited through measures that have enhanced interest relief and the Debt Reduction in Repayment Program, among other initiatives; however, the goal of promoting accessibility by lowering financial barriers for needy students remains unchanged.

For example, the 2003 federal budget increased the CSLP annual exemption for in-study income and scholarship to $1,700 from $600 for income earned in school, with a separate $1,800 exemption for merit-based scholarships. It also enhanced the Debt Reduction in Repayment Program by increasing the income eligibility thresholds, removing the restriction limiting debt reduction to 50% of outstanding debt so that borrowers are eligible for an initial loan remission of up to $10,000 and an additional reduction of up to $5,000 one year after the initial debt reduction if the borrower is still in financial difficulty and a further reduction of up to $5,000 available two years after the first reduction for those borrowers who remain in financial difficulty. As well, individuals who default on their Canada Student Loans or who have declared bankruptcy have access to interest relief. Finally, the *Canada Student Financial Assistance Act* was amended to make protected persons, including Geneva Convention refugees, eligible for Canada Student Loans.

Changes to the Canada Student Loan Program also occurred in the 2004 federal budget, which increased — from $165 to $210 per week — the ceiling for Canada Student Loans, provided a 5% increase in the income thresholds used to determine eligibility for interest relief, and increased — from $20,000 to $26,000 — the maximum amount of debt reduction for students facing financial difficulty.

As well, the federal government assists students through a number of other tax and spending initiatives. For example, Canada Study Grants may be available for needy part-time students, women in certain doctoral studies, students with dependents and students with permanent disabilities. As well, the Canada Millennium Scholarship Foundation, created in 1998, allocates $285 million annually in bursaries, with assistance awarded to full-time students on the basis of need and merit. Federal tax measures that either directly or indirectly support students include the ability to withdraw Registered Retirement Savings Plan funds for lifelong learning, the education tax credit, the tuition and education deduction, and the tax credit for interest on student loans.

As well, the 2003 federal budget created a Canada Graduate Scholarships program supporting 4,000 new scholarships at program maturity, with the scholarships distributed through the federal granting councils according to the proportion of students in each discipline. The budget allocated $225 million annually for the indirect costs of federally sponsored research at universities, colleges and research hospitals, and increased funding by $125 million annually for the three granting councils — the Canadian Institutes of Health Research, the Natural Sciences and Engineering Research Council of Canada and the Social Sciences and Humanities Research Council of Canada — beginning in 2003-2004. It also provided $100 million for the creation of the Canadian Learning Institute to help improve the quality of information available on our education and learning system. Annual support for the indirect costs of research and for the three federal granting councils was increased in the 2004 budget, with $20 million and $90 million allocated respectively.

Moreover, the 2004 budget established a grant of up to $3,000 for first-year, post-secondary students from low-income families, extended the education tax credit to employees pursuing career-related studies at their own expense and, as mentioned earlier in Chapter Four, created a grant for students with disabilities of up to $2,000 annually.

Assistance is also targeted to meet the education needs of Aboriginal Canadians. In recent years, and as noted earlier in Chapter Four, the 2003 federal budget allocated $72 million to improve educational outcomes for Aboriginal people and to ensure they are provided with training and employment opportunities on major projects across Canada, and the 2004 budget increased support for the Aboriginal Human Resources Development Strategy and the Urban Aboriginal Strategy.

Because of the importance of ensuring that all of Canada's citizens can contribute, and recognizing the critical role that will be played by immigrants in the future, the 2003 federal budget allocated $41 million over two years to attract and facilitate the integration of skilled immigrants into the Canadian labour market and society. In particular, funding was provided for a fast-track system for skilled workers with permanent job offers from Canadian employers, the processing of study permits for foreign students, approaches to attract skilled workers to communities across Canada, foreign credential assessment and recognition, and seed money for the delivery of labour market language training on a pilot basis.[198]

Finally, in the October 2004 Speech from the Throne, the federal government noted the need for investment in helping workers to enhance their skills in light of constantly changing workplace requirements. It indicated that the government will develop a new workplace skills strategy, which will include a focus on enhanced apprenticeship systems, literacy and other essential job skills, training facilities, and labour market agreements developed with the provinces/territories, unions and sectoral councils. Moreover, it noted that efforts will be increased to help integrate new Canadians into the workforce.[199]

B. What the Witnesses Said

Witnesses spoke to the Committee about a range of lifelong learning issues, including tuition fees, student loans and student debt, the Canada Social Transfer, employment training and foreign credentials.

Regarding tuition fees, many witnesses were concerned about the recent rapid increase in tuition fees for post-secondary education in the last decade. In their view, accessibility to education has been harmed, since many students can no longer afford to pursue post-secondary education. Tuition fees were characterized as the single largest cost for students. It was proposed that federal transfer payments targeted for post-secondary education be increased in order to alleviate the pressures resulting in tuition fee increases.

Several witnesses commented on the manner in which the federal government supports students, and argued that the low-income grant should be available to low-income students throughout the duration of their studies, rather than just in their first year. As well, the Committee was told that many students begin university only to discontinue their studies for financial reasons. It was also proposed that the value of the low-income grant be increased from 50% of tuition fees to 100% of tuition fees, while eliminating the $3,000 ceiling. We also heard a proposal whereby students could apply their education and tuition tax credit to the principal of their Canada Student Loans after each year of study.

It was also recommended to the Committee that the federal government establish an independent task force to investigate the financial and non-financial barriers to

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198 Department of Finance, *The Budget Plan 2003*, p. 118, 131, 136, available at: www.fin.gc.ca/budtoce/2003/budliste.htm.

199 Governor General, *Speech from the Throne to Open the First Session of the Thirty-Eighth Parliament of Canada*, 5 October 2004, available at: www.pm.gc.ca/eng/sft-ddt.asp.

post-secondary education and to propose ways in which access might be increased for low-income students, persons with disabilities, visible minorities, Aboriginal peoples, residents of rural and remote communities, and mature students. Furthermore, it was recommended that the Canada Education Savings Grant and the Canada Learning Bond Programs, along with the Canadian Millennium Scholarship Foundation, be discontinued, with the funds allocated instead to a needs-based grants program providing assistance to qualified students in all years of their program of study.

The importance of post-secondary education was noted by many witnesses. It was proposed that the federal government take a leadership role in working with the provinces/territories to create a Pan-Canadian accord on post-secondary education. As well, it was recommended that federal funding for post-secondary education be separated from the Canada Social Transfer and restored to its 1992-1993 level adjusted for inflation and demographic growth, and that a post-secondary education Act be legislated.

A number of recommendations designed to increase awareness of Registered Education Savings Plans were made, and changes to RESPs were proposed, including: allowing unused contribution room to be carried forward beyond the year in which contributions are made; removing grant restrictions for contributions on behalf of children aged 16 and 17; removing the $5,000 cap on the initial education assistance payments made to beneficiaries; and increasing the contribution limits beyond the current lifetime limit of $42,000 and the annual limit of $4,000.

From a different perspective, some witnesses urged that the RESP program be replaced with a needs-based grant program. In their view, RESPs have the most benefit for families who can already afford post-secondary education.

Finally, the Committee was informed that, according to Statistics Canada, as many as eight million Canadians do not have the literacy skills needed to meet the demands of today’s rapidly changing society and economy. A national strategy for improving the literacy skills of Canadians was advocated.

C. What the Committee Believes

The Committee believes that lifelong learning is critically important: to individuals themselves to enhance their quality of life and their employment options, and to employers who want the well-educated and highly skilled employees that will contribute to productivity and prosperity. The challenge is designing the proper incentives and supports to ensure that lifelong learning is embraced by individuals and employers.

In the Committee’s view, there is a relatively vast array of programs and initiatives designed to support education in the country. It is not entirely clear to us, however, that we are experiencing the desired outcome: not all individuals have the opportunity or desire to engage in lifelong learning, literacy and numeracy skills are too low in some instances, and employers may not be able to recruit employees with the right skills and may not offer the training that is needed. In our view, the outcomes that we seek might be better realized if the Canada Social Transfer was split into two components: education, and social assistance and social services. We believe that this change would enhance outcomes with respect to each of the two components. It is from this perspective that the Committee recommends that:

RECOMMENDATION 32

The federal government review — with provincial/territorial governments and groups representing universities, colleges and students — the financial assistance measures for post-secondary education.

Moreover, the government should, on a priority basis, split the Canada Social Transfer into a Canada education transfer and a Canadian social assistance and services transfer.

Finally, the government should ensure that adequate measures exist or are implemented to address literacy and lifeflong learning issues in Canada.

FOREIGN AID

A. What the Federal Government Provides

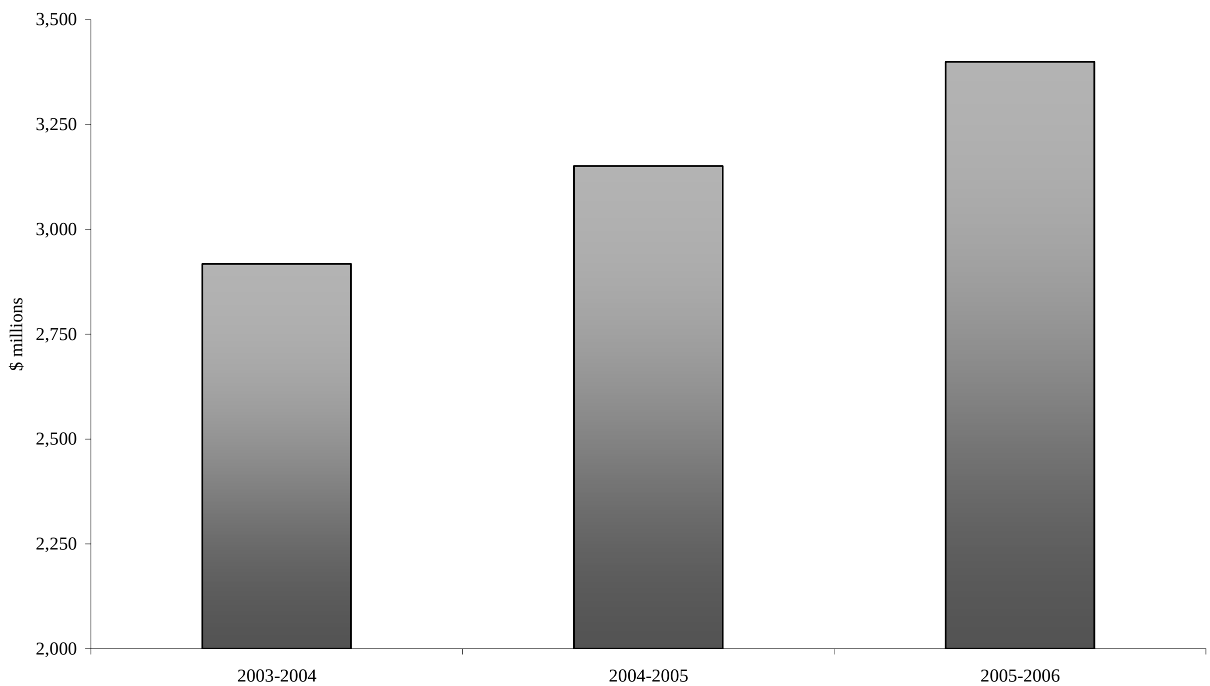
Canada has a long history of providing foreign aid to help the world's poorest countries.[200] Many developing countries have levels of foreign debt that are not sustainable. High debt payments, which sometime exceed the funds received in foreign aid, limit development since the funds that could be used for domestic economic development leave the country in the form of interest payments.

The primary multilateral measure providing debt-forgiveness is the World Bank's Highly Indebted Poor Countries (HIPC) initiative, which was started in 1996 and augmented in 1999. Countries may also take unilateral action. For example, the Canadian Debt Initiative was announced in March 1999 and expanded in February 2000; in January 2001, an immediate debt payment moratorium for HIPC countries committed to the goals of good governance and poverty reduction was implemented. Canada has forgiven Official Development Assistance debt to more than 45 developing countries since 1978.

[200] Department of Finance, *The Budget Plan 2004*, p. 197-199, available at: www.fin.gc.ca/budtoce/2004/budliste.htm.

At present, although Canada’s foreign aid is below the target of 0.7% of Gross Domestic Product set by a United Nations committee chaired by former Prime Minister Lester B. Pearson, it is increasing, as shown in Figure 4.15. The 2003 federal budget increased Canada’s international assistance by 8% annually through 2004-2005, with a view to doubling it by 2010. A portion of the increase is targeted to Africa as part of Canada’s support for the New Partnership for Africa’s Development and the G-8 Africa Action Plan adopted at the June 2002 Kananaskis G-8 Summit. Other areas that will benefit from this increase include: debt relief through the Heavily Indebted Poor Countries initiative; the G-8 Partnership Against the Spread of Weapons and Materials of Mass Destruction; land mine elimination; and the International Development Research Centre, which supports research aimed at finding innovative solutions to challenges facing developing countries.

Figure 4.15: International Assistance Spending, 2003-2004 to 2005-2006



Source: Canadian International Development Agency, *Reports on Plan and Priorities* and Department of Finance, *Budget Plan 2004*.

The 2004 federal budget also provided an 8% increase in international assistance for 2005-2006, and reiterated the Kananaskis G-8 Summit commitment to devote at least 50% of all international assistance increases to Africa. It also announced that the federal government would proceed with legislation to provide anti-HIV/AIDS drugs and other drugs at low cost to African countries. Bill C-9, which received Royal Assent in May 2004, amended the *Patent Act* and the *Food and Drugs Act* to facilitate access to pharmaceutical products in the developing world in order to address public health problems, especially those resulting from HIV/AIDS, tuberculosis, malaria and other epidemics.

B. What the Witnesses Said

Witnesses reminded the Committee how fortunate Canadians are to be able to benefit from their relatively high standard of living. Several witnesses pointed out that, in other parts of the world, large numbers of individuals live in extreme poverty. For example, we were told that 50,000 people die each day from preventable, poverty-related diseases, 800 million people suffer from hunger and 1.2 billion people live on less than $1 per day. It was pointed out that, as a nation, investing in international development is a good investment from many perspectives: reducing poverty; contributing to sustainable development; strengthening our reputation in the world; reflecting Canadian values around the world; and ensuring Canada's own long-term economic well-being.

Although witnesses generally supported the announcement of annual increases of 8% in Canada's international aid budget, many witnesses argued that the level of international aid must be increased beyond the current federal commitment in order to meet the target of 0.7% of gross national income for international aid, an objective that was part of the Millennium Development Goals established by the United Nations in 2000 and that Canada has endorsed. It was proposed that the federal government commit to increasing international aid by 12% for the next three years, and by 15% thereafter to 2015; this proposal would require an investment of $2.6 billion over the next three years, which represents $1 billion more than currently planned. In the view of witnesses, increases of this magnitude would allow the government to reach the target of 0.7% of gross national income directed to international assistance by 2015.

As well, witnesses urged the federal government to provide tax incentives that would encourage pharmaceutical and medical companies to provide — and, if necessary, manufacture — significant quantities of long-dated medicines that are most urgently required in accordance with World Health Organization guidelines. The Committee was told that a comparable tax deduction is available in the United States.

Finally, it was pointed out to the Committee that Canada has devoted 11% of its international aid to infrastructure at a time when the World Bank and African leaders have advocated that more international aid be devoted to building basic infrastructure services which would contribute greatly to increasing the standard of living for those experiencing extreme poverty. We heard a proposal whereby the federal government would re-establish balance in its international cooperation portfolio by reinstating funding for sustainable physical infrastructure investments in the developing world, and would move away from its recent shift towards providing aid in the form of monetary transfers to international financing institutions and governments, institutions and enterprises in developing countries.

C. What the Committee Believes

The Committee believes that the entire developed world has an obligation to help those in the world who are less fortunate. Like our witnesses, we believe that the benefits of assistance are more than just moral; they are economic as well. The world will benefit from greater global stability, increased care of the environment, a more inclusive trading environment with greater market access, and healthy, educated individuals that may one day be Canadian citizens and employees. In order to help those who are less fortunate, additional funding may be required for relevant federal departments — including the Canadian International Development Agency — and for settlement and integration programs as well as refugee processing for those who come to Canada.

In general, the Committee believes that once Canada signs international agreements and endorses international protocols, our commitments must be met, except under extraordinary circumstances. In our view, it is important that these commitments be respected in order that Canadians have faith in the declarations made by the federal government and as a signal to the international community. We believe that this statement is true both generally and with respect to a number of the international conventions that were brought to our attention, including the International Convention on the Protection of the Diversity of Cultural Content and Artistic Expression, the United Nations Convention on the Elimination of All Forms of Discrimination Against Women, the Beijing Platform for Action, the Kyoto Protocol and the United Nations Millennium Development Goals. It is for this reason that the Committee recommends that:

RECOMMENDATION 33

The federal government keep its commitment to contributing 0.7% of Canada's Gross Domestic Product to foreign aid.

Moreover, the government should take a leadership role and work with the private sector and non-governmental organizations in order to identify means by which the citizens of developing countries might be assisted.

Finally, the government should ensure that the hemispheric trade negotiations to which Canada is a party do not adversely affect developing countries.

CONCLUSION

In his appearance before the House of Commons Standing Committee on Finance on 16 November 2004, the Minister of Finance asked for the Committee's advice in five areas:

- how the federal government should allocate any available federal budgetary surplus among economic and social programs, tax cuts and debt reduction, and the considerations that should guide those decisions;

- with respect to the October 2004 Speech from the Throne and enhanced Canadian productivity and competitiveness in a global economy, the early steps that could be taken in the next federal budget to best advance those goals;

- in the context of the challenges that will be presented by an aging population, the additional steps that should be taken by the federal government now to prepare the Canadian economy for the significant demographic change that will occur in the years to come;

- the level of additional economic prudence that should be provided in the next federal budget; and

- how the Committee can contribute to fiscally responsible and coherent decision making, and the actions that could be taken to ensure that proposed spending and tax measures are examined objectively and in the context of all other priorities for possible inclusion in the federal budget.

In responding to the first area — the allocation of any available federal budgetary surplus among economic and social programs, tax cuts and debt reduction and what should guide those decisions — the Committee feels that a balanced approach must be taken. We do not advocate any particular formula, believing that in a rapidly changing world, some flexibility is required in order to respond to the priorities of Canadians — as citizens, employees and employers — as they evolve. Needs change, wants change, priorities change and the proper allocation of any surplus changes. In allocating any federal budgetary surplus, the federal government must respond in a manner consistent with the highest priorities of Canadians given that, in a very real sense, they own the surplus.

The Committee was asked to comment on the early steps that should be taken in the next federal budget to best advance the goals of enhanced Canadian productivity and competitiveness in a global economy. In our view, the recommendations we make throughout the report must be implemented in order to ensure Canadian productivity and competitiveness.

The country needs sound federal fiscal finances, and tax and program expenditures that focus on the highest priorities of Canadians and Canadian businesses. We need a competitive tax system for businesses and individuals, as well as the proper incentives to invest in research, development and innovation and the mechanisms to commercialize that research. We need strong communities, with adequate and well-maintained infrastructure, a sustainable environment and support for the charitable activities and culture that enrich the lives of Canadians and the environment within which businesses operate. We need a healthy, well-educated and highly skilled workforce that embraces the notion of lifelong learning, which will be critical to long-term business prosperity and which will enrich their lives. We need support for the vulnerable in our society — including the unemployed, the homeless, Aboriginal Canadians, disabled Canadians, seniors and children, as well as the vulnerable who live outside our country — and these supports must be adequate in both design and amount. We believe that progress in each of these areas must occur if we are to be as productive and competitive as we can be. All of these elements are part of the solution.

Regarding the additional steps that the federal government should take now to prepare the Canadian economy for the demographic change that is in our future, the Committee believes that, again, the implementation of many of the recommendations we make throughout the report will help us to prepare. Sound federal fiscal finances will ensure that we have the funds to finance such programs as Old Age Security, as well as the resources needed to ensure adequate health care and other supports — such as affordable housing — that may be needed by seniors. Tax measures that provide incentives to save for retirement will ensure that seniors have more dignity in retirement, and will have positive implications for the level of expenditures on such programs as the Guaranteed Income Supplement. Measures to ensure research, development and innovation will result in the productivity that will be critical as our population ages, and incentives for lifelong learning by all Canadians — immigrants and native-born — will ensure that businesses have the highly skilled employees they need. In our view, a multifaceted approach is needed to ensure continued prosperity — as a nation, as businesses and as individuals — as demographic change continues.

The Minister of Finance also sought the Committee's advice on the level of economic prudence that should be included in the next federal budget. We reiterate our ongoing support for the contingency reserve and economic prudence. In Chapter One, we recommend that the contingency reserve should be at least $3 billion annually. We also comment that it would take about 170 years to eliminate the federal debt if the only action taken was the use of a $3 billion contingency reserve. It was in part for this reason that we recommend that the contingency reserve be *at least* this amount. Moreover, in our view, the contingency reserve should continue to be used to reduce the federal debt if not required for other purposes. Debt repayment has significant benefits in reducing debt servicing costs, thereby increasing the funds available to finance the highest priorities of Canadians. While we cannot recommend a precise figure for economic prudence, we believe that an amount must exist in order to avoid a return to federal budgetary deficits. As we noted in Chapter One, forecasting is far from an exact science, and becomes more unreliable the farther in the future is the period for which you are developing the forecast. We cannot be more precise than to suggest that the figure for economic prudence should be an amount considered by experts to be adequate.

Finally, in commenting on how the Committee might contribute to fiscally responsible and coherent decision making, and on what should be done to ensure that proposed spending and tax measures are examined objectively and in the context of all other priorities for possible inclusion in the federal budget, we are reminded of several of our comments and recommendations in the report. We continue to believe that the annual pre-budget consultations undertaken by us are an important part of the federal budgetary process, since they give Canadians an opportunity to share with the Minister of Finance, through us, their priorities at that point in time. We note, however, that our pre-budget consultations were abbreviated this year because of the parliamentary schedule, and that our consultations are just one tool that may be used to communicate the priorities of Canadians to the Minister of Finance. We support the notion of ongoing expenditure review, and feel that the consultations that we recommend be undertaken with Canadians about their priorities are important in helping to determine what the appropriate federal budget measures might be.

In conclusion, the Committee believes that governments, businesses and individuals must work together as we move forward. Governments rely on businesses and individuals to pay the taxes needed to finance expenditures. Businesses rely on governments to make decisions resulting in an environment within which they can prosper, and on individuals to play a key role as employees and consumers. Individuals rely on governments to provide the public services they desire, and on businesses to employ them and to provide the goods and services that they want. We do, quite literally, share the same future, and success must be experienced by all if we are to prosper.

LIST OF RECOMMENDATIONS

RECOMMENDATION 1

The federal government institute a permanent mechanism by which federal tax and program expenditures are reviewed annually. This mechanism should require consultations with Canadians about their priorities within the context of public interest, role of government, federalism, partnership, value for money, efficiency and affordability tests.

RECOMMENDATION 2

The federal government ensure that annual rates of increase in federal program spending do not exceed the rate of growth in the nominal Gross Domestic Product, except in extraordinary circumstances.

RECOMMENDATION 3

The federal government continue to include, in its budget planning, an allocation of at least $3 billion as a contingency reserve.

Moreover, the government should also continue to include an appropriate amount for economic prudence, bearing in mind that forecasting becomes less reliable the farther into the future the period for which the forecast is made.

RECOMMENDATION 4

The federal government continue the rate at which a federal debt-to-GDP ratio of 25% is realized.

RECOMMENDATION 5

The federal government continue to pursue a balanced federal budget in order to avoid federal budgetary deficits.

RECOMMENDATION 6

The federal government engage in ongoing discussions with provincial/territorial governments about the correct magnitude of, and accountability mechanisms for, spending on health, education, social

assistance and other social services, bearing in mind the relative size of the federal and provincial/territorial debt.

RECOMMENDATION 7

The federal government take a leadership role with respect to protecting the environment by: purchasing fuel-efficient vehicles for government use; ensuring that government buildings are energy-efficient; encouraging the use of public transit by public service employees; and maintaining the commitment to its Green Procurement Policy.

RECOMMENDATION 8

The federal government — in order to encourage more environmental production, practices and purchases by businesses and individuals — develop and implement appropriate incentives and supportive policies in the following areas:

- **the production, purchase and use of fuel efficient vehicles;**
- **housing retrofits and other measures that would result in enhanced energy efficiency;**
- **public transit, including measures related to the tax treatment of employer-financed transit passes;**
- **renewable and alternative energy development and commercialization, including measures related to wind energy and fuel cells, as well as ethanol and methanol;**
- **within the context of Recommendation 14 regarding revision of Canada's capital cost allowance rates, the treatment of Class 43.1 regarding renewable and alternative energies;**
- **the commercialization of new environmental technologies;**
- **brownfield redevelopment; and**
- **green space.**

Moreover, the government should develop and implement measures designed to enhance air, water and soil quality, bearing in mind the need for transborder cooperation in areas where ecosystems are shared.

RECOMMENDATION 9

The federal government develop and implement a long-term, adequately funded infrastructure plan consistent with its responsibilities. The development and implementation of the plan should occur only after consultations with relevant non-governmental stakeholders. In determining how infrastructure funds should be allocated, an allocation mechanism that is not limited to population but that recognizes the strategic and development needs of communities should be considered.

Moreover, the government should allocate the equivalent of 5¢ of the federal tax on gasoline to a program delivered through the provinces/territories for cities and communities. These funds should be used for sustainable infrastructure investments.

Finally, the government should, in conjunction with stakeholders, undertake a comprehensive review of the Canada Strategic Infrastructure Fund, the Municipal Rural Infrastructure Fund, the Border Infrastructure Fund and the Strategic Highway Infrastructure Program. This review should focus on funding levels and allocation mechanisms, and should be completed no later than 30 June 2005.

RECOMMENDATION 10

The federal government, bearing in mind Recommendation 16 regarding a review of capital gains, take the following two actions:

- **reduce the capital gains inclusion rate for donations of publicly traded securities and ecologically sensitive lands to public charities; and**

- **subject to proper valuation, extend the asset classes to which this reduced capital gains inclusion rate applies to include real estate and land.**

RECOMMENDATION 11

The federal government provide stable, long-term funding to the following elements of federal support for arts and culture: the Tomorrow Starts Today program; the Canada Council for the Arts; Telefilm Canada; the Museums Assistance Program; the Community Access Program; the Canadian Television Fund and initiatives designed to promote Canadian culture internationally.

Moreover, the government should increase funding for the Canadian Broadcasting Corporation and Radio-Canada.

As well, the government should allocate funds to build capacity and assist archives with respect to archival content.

Finally, the government should increase the Canadian Film or Video Production Tax Credit to 30%.

RECOMMENDATION 12

The federal government ensure that the effective tax rate for Canadian corporations is competitive with that in the United States and elsewhere. Within that context, the government should:

- **review the timetable for elimination of the federal large corporations tax;**
- **review the timetable for the tax changes for the resource sector;**
- **consider immediate elimination of the corporate surtax; and**
- **review the corporate income tax rates and other taxes paid by corporations.**

RECOMMENDATION 13

The federal government, bearing in mind Recommendation 16 regarding a review of capital gains, review the current federal tax treatment of dividend income and non-resident withholding taxes with a view to ensuring that the tax treatment in Canada remains competitive with the rest of the world, particularly the United States, and that the tax treatment does not distort investment decisions.

RECOMMENDATION 14

The federal government revise Canada's capital cost allowance rates by 31 March 2005 such that they meet three criteria:

- **similar asset classes are treated similarly;**
- **Canadian rates are similar to the rates for comparable asset classes in the United States and other countries; and**
- **Canadian rates reflect the useful life of the assets.**

Moreover, the government should review these rates annually to ensure that they continue to meet the three criteria identified.

RECOMMENDATION 15

The federal government work with venture capitalists to identify new sources of financing. As well, the government should increase its funding to the Business Development Bank of Canada and to Farm Credit Canada in order that they can increase their venture capital activities. Finally, changes should be made to the federal Small Business Loan Program to allow this funding source to be accessed for a range of other uses, including operating capital.

RECOMMENDATION 16

The federal government review the tax treatment of capital gains in order to ensure that start-up technology and other small companies are able to access private equity capital at the lowest possible cost, and that the tax treatment of capital gains in Canada remains competitive with that of the rest of the world, particularly the United States.

RECOMMENDATION 17

The federal government work with business to simplify the process by which firms access the Scientific Research and Experimental Development investment tax credit.

RECOMMENDATION 18

The federal government review access to flow-through shares for specific expenses related to research and development with a view to expanding access for other sectors. This review should, in particular, consider early expansion of access for the fuel cell and hydrogen as well as the biotechnology industries.

RECOMMENDATION 19

The federal government review and implement, on an expeditious basis, the recommendations made by the External Advisory Committee on Smart Regulation.

RECOMMENDATION 20

The federal government take a leadership role and meet with provincial/territorial governments no later than 28 February 2005 with a view to adoption of a national securities regulator scheme no later than 30 June 2005.

RECOMMENDATION 21

The federal government continue to work toward the conclusion of international trade agreement negotiations, including through the World Trade Organization, the Free Trade Area of the Americas and other bilateral initiatives, to enhance international market access for Canadian products. Labour and environmental standards should be part of all trade negotiations.

Moreover, the government should vigorously defend Canadian interests against unfair trade actions initiated by our trading partners. Where Canadian producers are harmed by unfair trade actions taken by trading partners, including high levels of subsidies by those countries, the government should consider appropriate support for affected sectors.

RECOMMENDATION 22

The federal government take a leadership role and meet with provincial/territorial governments with a view to eliminating the barriers to interprovincial/interterritorial trade.

RECOMMENDATION 23

The federal government ensure that the funds current allocated for Canada's defence, emergency response and security needs are being properly allocated and used effectively and efficiently. Following this review, the government should ensure that adequate funds are allocated to meet the country's defence, emergency response and security needs, including port security.

Moreover, the government should ensure that sufficient resources are committed to meet the needs at the shared border with the United States, including any funds required to implement the Smart Border Declaration between Canada and the United States.

Finally, the government should provide the funds immediately needed to re-capitalize the Canadian Coast Guard, as well as annual, secure, stable funding for future Coast Guard operations.

RECOMMENDATION 24

The federal government undertake a comprehensive review of the personal taxation system in Canada, including:

- **the value of the basic personal amount;**
- **the value of the spousal/equivalent-to-spouse amount;**
- **the thresholds of the income tax brackets;**
- **the income tax rates; and**
- **differential treatment of dual- and single-income households.**

This review should be undertaken with a view to ensuring that Canada's personal taxation system is both fair and as competitive with other countries, particularly the United States, as possible.

Moreover, in the review of the personal taxation system, particular attention should be paid to how the system might be modified to assist those with low income.

RECOMMENDATION 25

The federal government, while considering the forthcoming recommendations of the Subcommittee on the Employment Insurance Funds of the House of Commons Standing Committee on Human Resources, Skills Development, Social Development and the Status of Persons with Disabilities, amend the *Employment Insurance Act* so as to establish a transparent employment insurance rate-setting process.

RECOMMENDATION 26

The federal government meet with Aboriginal Canadians and ensure that programs are designed and delivered in a manner that addresses their health, education, housing, infrastructure, early childhood development and care, and other needs.

In particular, these programs should:

- **respect the rights and governance concerns of Aboriginal Canadians;**
- **be delivered within the context of the Canadian constitution;**
- **be sufficiently flexible to meet the diverse needs of Aboriginal Canadians; and**
- **permit funding allocations that reflect the relatively small population base as well as the size and geographically large and remote nature of their communities.**

RECOMMENDATION 27

The federal government, along with interested provincial/territorial governments, at the earliest opportunity announce initiatives to reduce child poverty. These initiatives should include a national, accessible, affordable, high-quality, publicly funded, publicly regulated, not-for-profit child care system.

Provincial/territorial governments that decide not to participate in these initiatives — but that instead institute their own initiatives — should receive appropriate compensation.

RECOMMENDATION 28

The federal government meet with provincial/territorial governments and groups representing the disabled with a view to concluding a federal/provincial/territorial national disability strategy and a labour market agreement, as well as to identifying options for improved labour market supports for those who are disabled.

Moreover, the government should review and implement, on an expeditious basis, the recommendations of the Technical Advisory Committee on Tax Measures for Persons with Disabilities.

Finally, disability benefits available under the Canada Pension Plan should be discussed at the next meeting of ministers responsible for the Plan.

RECOMMENDATION 29

The federal government implement, on a priority basis, increased benefits payable under the Guaranteed Income Supplement program. As well, the government should make every effort to identify — and compensate — those Canadian seniors who are eligible for Guaranteed Income Supplement benefits but have not received them.

The government should also undertake a comprehensive review of incentives for saving and the Canadian retirement income system to ensure that the financial and other needs — both current and future — of Canada's current and future seniors are being met. This review should be completed by 30 June 2005.

RECOMMENDATION 30

The federal government — working with provincial/territorial governments, the Canadian Institutes of Health Research and health agencies — develop a public awareness program designed to educate Canadians about preventative measures, including those related to disease prevention and health promotion, to improve their health outcomes.

RECOMMENDATION 31

The federal government review — together with provincial/territorial governments, advocacy groups representing the homeless, and private and not-for-profit developers — the measures that exist with respect to housing and homelessness. This review should be undertaken with a view to ensuring that funds are adequate in size and properly allocated, and to identifying programs that should be changed or implemented.

Moreover, the government should, on a priority basis, extend and enhance the Affordable Housing Initiative, the Supporting Communities Partnership Initiative and the Residential Rehabilitation Assistance Program.

RECOMMENDATION 32

The federal government review — with provincial/territorial governments and groups representing universities, colleges and students — the financial assistance measures for post-secondary education.

Moreover, the government should, on a priority basis, split the Canada Social Transfer into a Canada education transfer and a Canadian social assistance and services transfer.

Finally, the government should ensure that adequate measures exist or are implemented to address literacy and lifeflong learning issues in Canada.

RECOMMENDATION 33

The federal government keep its commitment to contributing 0.7% of Canada's Gross Domestic Product to foreign aid.

Moreover, the government should take a leadership role and work with the private sector and non-governmental organizations in order to identify means by which the citizens of developing countries might be assisted.

Finally, the government should ensure that the hemispheric trade negotiations to which Canada is a party do not adversely affect developing countries.

APPENDIX A
LIST OF WITNESSES

Associations and Individuals	Date	Meeting
C.D. Howe Institute	2004/10/27	6
Jack Mintz, President and Chief Executive Officer		
Caledon Institute of Social Policy		
Sherri Torjman, Vice-President		
Canadian Centre for Policy Alternatives		
Ellen Russell, Senior Research Fellow		
Canadian Council on Social Development		
John Anderson, Vice-President, Strategic Partnership and Alliances		
Canadian Taxpayers Federation		
Bruce Winchester, Research Director		
The Conference Board of Canada		
Charles Barrett, Senior Vice-President, Program Strategy and Delivery		
Glen Hodgson, Vice-President and Chief Economist		
The Fraser Institute		
Niels Veldhuis, Senior Research Economist		
Air Transport Association of Canada	2004/11/02	9
Warren Everson, Vice-President, Policy and Strategic Planning		
Canadian Shipowners Association		
Don Morrison, President		
Canadian Trucking Alliance		
Ron Lennox, Vice-President, Regulatory Affairs		
Stephen Laskowski, Associate Vice-President		
Canadian Urban Transit Association		
Michael Roschlau, President, Chief Executive Officer		
Chamber of Maritime Commerce		
Raymond Johnston, President		
Federation of Canadian Municipalities		
Ann MacLean, President & Mayor of New Glasgow, N.S.		
James Knight, Chief Executive Officer		

Associations and Individuals	Date	Meeting
Railway Association of Canada	2004/11/02	9
Chris Jones, Director, Government Relations		
Sab Meffe, Assistant Vice-President		
Road and Infrastructure Program Canada		
Jeff Morrison, Executive Director		
Shipping Federation of Canada		
Anne Legars, Director, Policy and Government Affairs		
Assembly of First Nations	2004/11/02	10
Richard Jock, Executive Director		
Association of Fundraising Professionals		
Tad Brown, Finance and Development Counsel, Chair, Government Relation & Committee		
Michael Nilsen, Director, Public Affairs		
Canadian Association of Gift Planners		
Malcolm Burrows, Chair, Government Relations, Scotia Private Client Group, Executive Office		
Canadian Centre for Philanthropy		
Georgina Steinsky Schwartz, President & C.E.O.		
Peter Broder, Acting Vice-President, Public Affairs		
Community Foundations of Canada		
Monica Patten, President and Chief Executive Officer		
Congress of Aboriginal Peoples		
Dwight Dorey, National Chief		
Patrick Brazeau Vice-Chief, Governance Legislative Initiative Secretariat		
Health Charities Coalition of Canada		
David Armour, Steering Committee Member and CEO Canadian Medical Fdn.		
Marjolaine Lalonde, Director		
Métis National Council		
Tony Belcourt, Representative		
Kathy Hodgson-Smith, Interim Executive Director		
Native Women’s Association of Canada		
Terri Brown, President		
Pauktuutit (Inuit Women’s Association)		
Mary Palliser, President		
Jennifer Dickson, Executive Director		
Philanthropic Foundations Canada		
Hilary Pearson, President and CEO		

Associations and Individuals	Date	Meeting
Voluntary Sector Forum	2004/11/02	10
Jean Christie, Executive Director		
Laurie Rektor, Manager, National Issues		
Canadian Council for International Cooperation	2004/11/03	11
Gerry Barr, President and CEO		
Canadian Foundation for Climate and Atmospheric Sciences		
Gordon McBean, Chairman, Board of Trustees		
Dawn Conway, Executive Director		
Clean Air Renewable Energy Coalition		
Mark Rudolph, Coordinator		
Conference of Defence Associations		
Richard Evraire, Chairman		
Alain Pellerin, Executive Director		
Howard Marsh, Consultant, Technology, Strategy and Military Affairs Research		
David Suzuki Foundation		
Heather Deal, Marine Strategist		
Dale Marshall, Policy Analyst, Climate Change Program		
Go for Green		
Francine Godin, Executive Director		
Steve Grundy, Director of Development		
Green Budget Coalition		
Pierre Sadik, Program Manager		
Health Partners International of Canada		
Jake Epp, Chairman, Board of Director		
John Kelsall, President		
KAIROS (Canadian Ecumenical Justice Initiatives)		
Joe Gunn, Vice-President, Social Affairs Office, Canadian Conference of Catholic Bishops		
Michael Polanyi, Program Coordinator, Canadian Social Development		
Nature Conservancy Canada		
Thea Silver, Director of Government and External Relations		
Barry Turner, Director of Government Relations, Ducks Unlimited Canada		
Project Ploughshares		
Ernie Regehr, Director, Institute for Science and International Security		
Sierra Club of Canada (B.C. Chapter)		
Shawn-Patrick Stensil, Director, Atmosphere and Energy		

Associations and Individuals	Date	Meeting
The University of Western Ontario	2004/11/03	11
Dr. Gordon A. McBean, Professor of Political Science, Research Centres & Ancilliary Units		
World Vision Canada		
Kathy Vandergrift, Director of Policy		
Building and Construction Trades Department, AFL-CIO, Canadian Office	2004/11/04	12
Carol MacLeod, Executive Director, Government Affairs & Communications		
Business Tax Reform Coalition		
Roger Larson, President, Canadian Fertilizer Institute		
Paul Lansbergen, Director, Taxation and Business Issues		
Canadian Chamber of Commerce		
Tina Kremmidas, Senior Economist		
Michael Murphy, Senior Vice-President, Policy		
Canadian Chemical Producers' Association		
John Arnold, Senior Income Tax Advisor, Imperial Oil Ltd., Products & Chemical Division		
David Podruzny, Senior Manager, Business and Economics		
Canadian Council of Chief Executives		
David Stewart-Patterson, Executive Vice-President		
Sam Boutziouvis, Vice-President, Policy and Director of Research		
Canadian Federation of Independent Business		
Catherine Swift, President and Chief Executive Officer		
Garth Whyte, Executive Vice-President, National Affairs		
Canadian Labour Congress		
Andrew Jackson, Senior Economist		
Hassan Yussuff, Secretary Treasurer		
Canadian Manufacturers and Exporters		
Jayson Myers, Senior Vice-President & Chief Economist		
Canadian Union of Public Employees		
Teresa Healy, Research Officer		
Confederation of National Trade Unions		
François Bélanger, Councellor		
Pierre Patry, Treasurer		
Conseil du patronat du Québec		
Gilles Taillon, President		
Teamsters Canada		
Phil Benson, Lobbyist		
Benoit Brunet, Chair, Quebec Legislative Board		

Associations and Individuals	Date	Meeting
Union of Canadian Transportation Employees Michael Wing, National President	2004/11/04	12
United Steelworkers of America Dennis Deveau, Legislative Director, Legislative Office		
Canada West Foundation Roger Gibbins, President and Chief Executive Officer	2004/11/04	13
Montreal Economic Institute Norma Kozhaya, Economist		
Aerospace Industries Association of Canada Peter Boag, President	2004/11/16	14
Association of Canadian Travel Agencies Marc-André Charlebois, President		
BIOTECanada Janet Lambert, President John Mendlein, Chairman and CEO, Affinium Pharmaceuticals		
Canadian Association of Fire Chiefs Patrick Burke, Fire Chief, Niagara Falls		
Canadian Automobile Association David Flewelling, President		
Canadian Construction Association Michael Atkinson, President		
Canadian Home Builders' Association Mary Lawson, President David Wassmandorf, First Vice-President		
Canadian Printing Industries Association Pierre Boucher, President Bob Kadis, Chair, Senior Vice-President of Finance & Administration, CPIA Government Affairs Committee		
Canadian Real Estate Association Pierre Beauchamp, Chief Executive Officer		
Canadian Vehicle Manufacturers' Association Mark Nantais, President		
Cement Association of Canada François Lacroix, President Angela Burton, Director, Government Affairs		
Direct Sellers Association of Canada Ross Creber, President Jack Millar, Member of the Board		

Associations and Individuals	Date	Meeting
Hotel Association of Canada		
Anthony Pollard, President	2004/11/16	14
Department of Finance	2004/11/16	15
Hon. Ralph Goodale, Minister		
Ian Bennett, Deputy Minister		
Paul-Henri Lapointe, Assistant Deputy Minister, Economic and Fiscal Policy Branch		
Alliance to End Homelessness	2004/11/17	16
Tim Aubry, Chair, Evaluation Working Group		
Canadian Federation for Promoting Family Values		
Michael Gorman, Founder		
Canadian Teachers' Federation		
Harvey Weiner, Policy Advisor, Government and External Relations		
Child Care Advocacy Association of Canada		
Jamie Kass, Child Care Co-ordinator		
Lynell Anderson, Consultant		
Congress of Union Retirees of Canada		
Larry Wagg, First Vice-President, CLCPRA		
Kevin Collins, Executive Vice-President		
Co-operative Housing Federation of Canada		
René Daoust, President		
Mark Goldblatt, Senior Consultant		
Council of Canadians with Disabilities		
Laurie Beachell, National Coordinator		
Marie White, National Chairperson		
Movement for Canadian Literacy		
Wendy DesBrisay, Executive Director		
National Anti-Poverty Organization		
Robert Arnold, President, Board of Directors		
Dennis Howlett, Executive Director		
National Association of Friendship Centres		
Peter Dinsdale, Executive Director		
National Council of Women of Canada		
Catharine Laidlaw-Sly, President		
Retirement Income Coalition		
Andrew Jones, Director, Corporate and Government Relations		
Ian Markham, Fellow of the Canadian Institute of Actuaries, Watson Wyatt Canada		

Associations and Individuals	Date	Meeting
Salvation Army	2004/11/17	16
Danielle Shaw, Government Relations Director		
Glen Shepherd, Chief Secretary, The Salvation Army, Canada and Bermuda Territory		
Canadian AIDS Society	2004/11/18	17
Paul Lapierre, Executive Director		
Mark Creighan, Media Relations Officer		
Canadian Cancer Society		
Jo Kennelly, Director, Scientific Advancement and Public Policy		
Kenneth Kyle, Director, Public Issues		
Canadian Coalition on Public Health in the 21st Century		
Maureen Law, Consultant to the World Bank		
Canadian Dental Association		
Alfred Dean, President		
Andrew Jones, Director, Corporate and Government Relations		
Canadian Dental Hygienists Association		
Susan Ziebarth, Executive Director		
Judy Lux, Communications Specialist, Health Policy		
Canadian Health Coalition		
Michael McBane, National Co-ordinator		
Canadian Healthcare Association		
Sharon Sholzberg-Gray, President and Chief Executive Officer		
Mary Lapaine, Board Chair		
Canadian Medical Association		
Albert Schumacher, President		
William Tholl, Secretary General and CEO		
Canadian National Institute for the Blind		
Cathy Moore, National Director, Consumer and Government Relations		
Canadian Nurses Association		
Deborah Tamlyn, President,		
Lisa Little, Health Human Resources Consultant		
Canadian Paediatric Society		
Robin Walker, President		
Canadian Public Health Association		
Christina Mills, President		
Elinor Wilson, Chief Executive Officer		
Sport Matters Group		
Victor Lachance, Senior Leader		
Timothy Page, Executive Director, Diving Canada		

Associations and Individuals	Date	Meeting
Alliance of Canadian Cinema, Television and Radio Artists	2004/11/22	19
Thor Bishopric, President, ACTRA National		
Gordon Pinsent, Performer/Member, ACTRA National		
Association des producteurs de films et de télévision du Québec		
Jacquelin Bouchard, Chair, Executive Committee		
Nathalie Leduc, Director, Financing		
Association nationale des éditeurs de livres		
Hélène Derome, Vice-President, Literary Publishing		
Marc Laberge, Executive Secretary/Treasurer		
Association of Canadian Publishers		
Jack Wayne, President, Canadian Scholars’ Press Inc.		
Canadian Arts Summit		
Axel Conradi, President, Board of Directors		
Canadian Council of Archives		
Fred Farrell, Chair		
Christina Nichols, Executive Director		
Canadian Magazine Publishers Association		
Mark Jamison, President		
Robert Goyette, Reader’s Digest		
Council for Business and the Arts in Canada		
Sarah Iley, President		
Directors Guild of Canada		
Monique Twigg, National Research & Policy Manager		
Friends of Canadian Broadcasting		
Ian Morrison, Spokesperson		
Heritage Canada Foundation		
Brian P. Anthony, Executive Director		
Douglas Franklin, Director, Policy and Programs		
Independent Media Arts Alliance		
Linda Norstrom, President		
Peter Sandmark, National Director		
Literary Press Group of Canada		
Rolf Maurer, Chair		
Alana Wilcox, Vice-Chair		
Periodical Writers Association of Canada		
Liz Warwick, President		

Associations and Individuals	Date	Meeting
The Voice of Opera in Canada	2004/11/22	19
Bob McPhee, Director, Opera.ca, General Director, Calgary Opera Association		
Susan Ferley, Artistic Director, Grand Theatre		
Writers Guild of Canada		
Maureen Parker, Executive Director		
Gail Martiri, Director of Policy		
Writers' Union of Canada		
Christopher Moore, Chairperson		
Deborah Windsor, Executive Director		
Association of Consulting Engineers of Canada	2004/11/22	20
Claude Paul Boivin, President & Chief Operating Officer		
Allen Williams, Chairman, Board of Directors		
Association of Yukon Communities		
Doug Graham, President		
Tom Paterson, Executive Director		
Canadian Automobile Dealers Association		
Richard Gauthier, President		
Canadian Hardware and Housewares Manufacturers Association & Canadian Retail Building Supply Council		
Dave Campbell, President, Government Relations Committee, Canadian Retail Building Supply Council		
Canadian Housing and Renewal Association		
Joyce Potter, President		
Canadian Restaurant and Foodservices Association		
Joyce Reynolds, Senior Vice-President, Government Affairs		
Canadian Steel Producers Association		
Barry Lacombe, President		
Newfoundland and Labrador Federation of Municipalities		
Herbert Brett, President		
Nunavut Association of Municipalities		
Lynda Gunn, Chief Executive Officer		
Lootie Toomasie, Vice-President		
Retail Council of Canada		
Diane Brisebois, President and Chief Executive Officer		
Association of Universities and Colleges of Canada	2004/11/23	21
Peter MacKinnon, Chair, Board of Directors		
Claire Morris, President and CEO		

Associations and Individuals	Date	Meeting
Canada Foundation for Innovation Eliot A. Phillipson, President and CEO Carmen Charette, Senior Vice-President	2004/11/23	21
Canadian Association of Petroleum Producers Pierre Alvarez, President Brian Maynard, Vice-President, Public Affairs, Atlantic Canada		
Canadian Consortium for Research Paul Ledwell, Chair Don McDiarmid, Member		
Canadian Electricity Association Hans Konow, President and Chief Executive Officer Eli Turk, Vice-President, Government Relations		
Canadian Federation for the Humanities and Social Sciences Donald Fisher, President Elect		
Canadian Federation of Agriculture Marvin Shauf, Vice-President		
Canadian Fertilizer Institute Roger Larson, President		
Canadian Institute of Health Research Alan Bernstein, President		
Canadian Wind Energy Association Robert Hornung, President Glen Estill, Past Chairman of the Board		
Forest Products Association of Canada Avrim Lazar, President and Chief Executive Officer		
Genome Canada Martin Godbout, President & CEO Marc LePage, Executive Vice-President, Corporate Affairs		
Mining Association of Canada Gordon Peeling, President and Chief Executive Officer		
National Research Council Canada Michael Raymont, Interim President		
Natural Sciences and Engineering Research Council of Canada Tom Brzustowski, President		
Social Sciences and Humanities Research Council of Canada Marc Renaud, President		

Associations and Individuals	Date	Meeting
Association of Canadian Community Colleges	2004/11/23	22
Gerry Brown, President		
Canadian Alliance of Student Associations		
James Kusie, National Director		
Toby White, Government Relations Officer		
Canadian Association for Graduate Studies		
Jean-Pierre Gaboury, Executive Director		
John Lennox, Dean of Graduate Studies, York University		
Canadian Association of Student Financial Aid Administrators		
Judy Stymest, Past President		
Canadian Association of University Teachers		
James Turk, Executive Director		
David Robinson, Associate Executive Director		
Canadian Federation of Students		
George Soule, National Chairperson		
Michael Conlon, National Chairperson, National Graduate Council		
Canadian School Boards Association		
Gerri Gershon, Vice-President		
Michael Clarke, Superintendent of Business, Ottawa-Carleton District School Board		
Quebec Federation of University Students		
Guillaume Lavoie, Vice-President, International and Federal Affairs		
Campaign 2000	2004/11/23	23
Laurel Rothman, National Coordinator		
Campaign Against Child Poverty		
Caroline Di Giovanni, Executive Director, Hope for Children Foundation		
Gerald Vandezande, Steering Committee Member		
Canada’s Association for the Fifty-Plus		
Judy Cutler, Co-Director, Advocacy and Government Relations		
Bill Gleberzon, Co-Director, Advocacy and Government Relations		
Canadian Association for Community Living		
Michael Bach, Executive Vice-President, York University		
Anna Macquarrie, Policy Analyst, York University		
Canadian Association of Broadcasters		
Glenn O’Farrell, President and Chief Executive Officer		

Associations and Individuals	Date	Meeting
Canadian Association of Food Banks Charles Seiden, Executive Director	2004/11/23	23
Canadian Association of Research Libraries Timothy Mark, Executive Director Paul Wiens, University Librarian, Queen's University		
Canadian Conference of the Arts Jean Malavoy, National Director		
Canadian Film and Television Production Association Guy Mayson, President and Chief Executive Officer		
Canadian Library Association Don Butcher, Executive Director Barbara Clubb, City Librairian, Ottawa		
Canadian Museums Association John McAvity, Executive Director, Robert Spickler, Associate Director, Canadian Centre for Architecture		
Canadian Pensioners Concerned Inc. Gerda Kaegi, President		
Music in Canada Coalition Grant Dexter, Member Denise Donlon, Member		
National Council of Welfare Greg deGroot-Maggetti, Member David Welch, Member		
National Housing and Homelessness Network Michael Shapcott, Co-Chair		
Tourism Industry Association of Canada Randy Williams, President and Chief Executive Officer Wayne St. John, Chairman		
Association of Canadian Academic Healthcare Organizations Joe De Mora, President Glenn Brimacombe, Chief Executive Officer	2004/11/24	24
Canadian Association for HIV Research Jonathan Angel, Senior Scientist, Ottawa Health Research Institute, Associate Professor of Medecine, University of Ottawa		
Canadian Cattlemen's Association Jim Caldwell, Director, Government Affairs		

Associations and Individuals	Date	Meeting
Canadian Dehydrators Association	2004/11/24	24
Jim Boxall, Chairman of the Board, President & CEO, Tisdale Alfalfa Dehy. Ltd.		
Dale Pulkinen, Executive Director		
Canadian Treatment Action Council		
Louise Binder, Chair		
Tony Di Pede, Treasurer		
Centre for Science in the Public Interest		
Bill Jeffery, National Coordinator		
Coalition for Women's Equality		
Kim Brooks, National Association of Women and the Law		
Sherrie Lewis, Native Women's Association of Canada		
Ruth Rose, Fédération des femmes du Québec		
Armine Yalnizyan, Feminist Alliance for international Action		
Dairy Farmers of Canada		
Jacques Laforge, President		
Rick Phillips, Director, Policy and Government Relations		
Fédération des producteurs de lait du Québec		
Marcel Groleau, President		
Patrice Dubé, Assistant Director, Economical Research		
Grain Growers of Canada		
Cam Dahl, Executive Director		
L'Union des producteurs agricoles du Québec		
Serge Lebeau, Senior International Trade Advisor and Assistant Director, Agricultural Studies and Policies Department		
National Cancer Leadership Forum		
Nick Discepola, Member of the Steering Committee		
Pat Kelly, Director General		
Association of Canadian Pension Management	2004/11/25	25
Scott Perkin, President		
Stephen Bigsby,Executive Director		
Canadian Association of Mutual Insurance Companies		
Normand Lafrenière, President		
Canadian Bankers Association		
Raymond Protti, President and Chief Executive Officer		
Kelly Shaughnessy, Vice-President, Banking Operations		
Canadian Co-operative Association		
Dave Sitaram, President		
Jean-Yves Lord, Executive Director		

Associations and Individuals	Date	Meeting
Certified General Accountants' Association of Canada	2004/11/25	25
Everett Colby, Chair, FCGA		
Carole Presseault, Assistant Vice-President, Government & Regulatory Affairs		
Certified Management Accountants of Canada		
David Fletcher, Vice-President, Public Affairs		
Michael Tinkler, Chairman of Audit Committee, Member of the Board of Directors		
Credit Union Central of Canada		
Jack Smit, Chairperson, Board of Directors		
Wayne Nygren, Chair, Legislative Affairs Committee		
Investment Dealers Association of Canada		
Joe Oliver, President and Chief Executive Officer		
Investment Funds Institute of Canada		
Thomas Hockin, President and CEO		
Jamie Golombek, Vice-President, Taxation and Estate Planning		
Multi Employer Benefit Plan Council of Canada		
Peter Landry, Consultant		
Registered Education Savings Plan Dealers Association of Canada		
Paul Renaud, Chairman		
Tax Executives Institute, Inc.		
David Penney, General Director, Taxes and Customs, General Motors of Canada Limited		
Jeffery Rasmussen, Tax Counsel		
VenGrowth		
Jay Heller, General Partner		
Canadian Advanced Technology Alliance	2004/11/25	26
David Paterson, National Director		
Canadian Council of Professional Engineers		
Marie Lemay, Chief Executive Officer		
Canadian Diabetes Association		
Christine Flammer, Associate Director, Office of Public Policy & Government Relations		
Karen Philp, Director, Policy and Government Relations		
Canadian Mental Health Association		
Penelope Marrett, Chief Executive Officer		
Robert Campbell, Vice-President, National Board		
Canadian Professional Sales Association		
Terry Ruffell, President		

Associations and Individuals	Date	Meeting
Canadian Taxpayers Federation	2004/11/25	26
John Williamson, Federal Director		
Chronic Disease Prevention Alliance of Canada		
Bonnie Hostrawser, Executive Director		
Patricia Pelton, Steering Committee		
Council for Health Research in Canada		
Deborah Gordon-El-Bihbety, President and Chief Executive Officer		
Heart & Stroke Foundation of Canada		
Cleve Myers, Chair		
Stephen Samis, Director, Health Policy		
Information Technology Association of Canada		
Bernard Courtois, President & CEO		
Multiple Sclerosis Society of Canada		
Deanna Groetzinger, Vice-President, Communications		
Ottawa Centre for Research and Innovation		
Jeffrey Dale, President & CEO		
Blair Patacairk, Director Investment, Marketing Media, Government Relations, Ottawa Global Marketing		
Paramedic Association of Canada & Ambulance Paramedics of British Columbia		
Ernie Mothus, Advanced Care Paramedic, Chairperson PSO		
Pierre Poirier, Deputy Chief Ottawa EMS, CEO of the Paramedic Association of Canada		
Space Industry Executives		
Magued Iskander, Vice-President & General Manager		
John Keating, Chief Executive Officer, COM-DEV		
Toronto Board of Trade		
Robert Hutchison, Vice-Chair and Honourary Treasurer of the Toronto Board of Trade		
Cecil Bradley, Director of Policy		

A copy of the relevant Minutes of Proceedings *(Meetings No. 6, 9 to 26 and 29 to 34)* is tabled.

Respectfully submitted,

Massimo Pacetti, Member of Parliament
Saint-Léonard / Saint-Michel
Chair

SUPPLEMENTARY OPINION OF CONSERVATIVE PARTY OF CANADA

December 14, 2004

The House of Commons Standing Committee on Finance heard from a wide range of Canadians who presented their considered thoughts on the policies they felt should be in the 2005 Federal Budget. We are impressed with the commitment among Canadians to build a strong Canada where our quality of life is among the best in the world.

The Conservative Party of Canada (CPC) supports the majority of recommendations from this Committee. Nevertheless, our rationale for delivering a Supplementary Opinion is that the Liberal government simply refuses to listen and to implement the changes that Canadians need. This Committee's report, is simply more of the same, a broken record of observations that can be seen in virtually every previous report.

To correct this sad state of affairs, we want to emphasize the following perspectives on the items we would like to see in the 2005 Budget to help Canadians sustain and build upon their high quality of life:

- Encouraging investment in Canada's productive capacity
- Reducing corporate, capital and payroll taxes
- Streamlining the regulatory environment
- Vigorously reducing the national debt to reduce interest charges
- Cutting federal spending to sustainable levels
- Encouraging education and training
- Promoting and stimulating affordable housing development

The world around us is changing dramatically and Canada has to be better prepared to deal with the new realities. We have seen the Canadian dollar soar to new highs, not because our productivity has sharply increased, but because the prices of our raw materials have risen. China is a growing force, not only as a consumer of our raw materials, but also as a competitor in manufacturing and as a magnet for international investment. Canada is not prepared to deal with this situation, and the urgency is building. Finally, the United States is heading toward serious economic difficulties as reflected in its fiscal and trade deficits—the resolution of which can only hurt Canada.

The Record is Really Not that Good

A few basic statistics back up our contention that the now is the time for major change—that more of the same is not good enough—that Canadians deserve better. First, during the past forty years Canada's GDP per worker has remained little changed compared with that in United States—it remains stuck at about 85 per cent of the U.S. level.[i]

For a nation that has endured numerous innovation, competitiveness and productivity enhancing attempts from Liberal governments, we have precious little to show for it. Canada remains where it was some 40 years ago. *"Lest any Canadian think that the productivity gap is irrelevant, it more than accounts for the income gap of $6,078 per Canadian."*[ii] Surely we can do better—having a family of four with some $24,000 a year less income to spend than they would have in the United States is nothing to celebrate.

Furthermore, unemployment rates in Canada are stuck well above those in United States. This has persisted for a quarter century. Whereas once, back in the early 1970s, Canadian and U.S. unemployment rates were the same, or ours were even lower, they are now locked in a gap that should be unacceptable to all Canadians.[iii]

It is obvious that doing the same thing over and over will not give us better results. This is why we believe that bold, new initiatives are needed to turn the situation around. It is not good enough just to be critical, which is why we are presenting viable options in this Supplementary Report. There are a number of areas that we want to highlight as being crucial to improve our productivity and guarantee the quality of life Canadians deserve.

The Drivers of High Living Standards

- **Investment in Productive Capacity**

Throughout the hearings we heard that productive investment in Canada is lagging and that a number of key factors are the main culprits. Taxation levels affect the willingness of investors to build new industrial capacity in Canada. If taxation is too high and investment too low, the competitive abilities of Canadians can not be unleashed. Countries like Australia and Ireland have shown the way and are benefiting from large gains in productive investment—why can't Canada do the same?

We are not getting our share of foreign direct investment and in fact we have been experiencing a net outflow. Sadly, Canadians see better opportunities elsewhere and, equally, there is little prospect of reversing this trend unless major change to tax policy affecting the Canadian business investment environment is brought forward in Budget 2005. We have made this point many times before and are frustrated with the timid proposals coming from this government.

- **Taxation Remains too High**

We heard from many presenters that corporate tax rates remain too high and are impairing investment that could improve our productivity and employment rates. The CPC position is that more emphasis on tax reduction, especially those taxes that are well-known job killers, is a must.

First, as the Auditor General has noted, the government continues to flout its own policy about balancing the EI Account, now some $46 billion in surplus. *"In our view, Parliament did not intend for the Account to accumulate a surplus beyond what could reasonably be spent for employment insurance purposes* . . . "[iv] This government simply refuses to respect the intent of the *Employment Insurance Act*. The CPC wants it to eliminate the $2.0 billion surplus in the EI Account estimated for 2005. The Chief Actuary's Outlook shows that the three cent cut in premiums for 2005 to $1.95 is still some 10.8 per cent higher than the breakeven rate of $1.76.[v] This government should stop overcharging Canadians!

Second, we want the capital tax eliminated in 2005 and are glad the Committee sees this as a priority. The best we could get this Committee to agree upon was to *"review"* the timetable for its elimination. This tax is universally deemed to be a job killer and has no place in the Canadian tax system. It should be gone before the planned termination date of 2007.

Third, we note that the evidence is clear that the effective large business tax rate in Canada remains well above that in United States. *"Canada's effective tax rate on capital (*corporate income, capital and sales taxes on capital purchases*) of 31.5 per cent in 2004 is substantially higher than that in the United States, where it is 20.1 percent"*.[vi] We cannot afford this situation and we want the Government of Canada to stop telling Canadians that our corporate tax rates are competitive with those in United States—this is simply not true. We must insist that the effective tax rate be considered in tax reform and are pleased that the Committee sees the merit in our perspective.

If the U.S. administration goes forward with further tax cuts, the situation will be even worse. Countries like Ireland and Australia have moved aggressively on corporate tax cutting, and their corporate tax revenues have risen because investment in those countries is so much more attractive that even with lower rates, tax revenues rise. We don't think Canadians should have to put up with another decade of lost opportunities.

- **The Regulatory Environment Needs Streamlining**

The CPC has no doubt that Canada has the potential to do better. We want cumbersome regulations removed, and improvement in the efficiency of those that are necessary to ensure the safety of Canadians. We want action on implementing the recommendations of the External Advisory Committee on Smart Regulation.

As for securities regulation, we have heard for years that having 13 jurisdictions governing securities is simply out of touch with the needs of a modern economy. Consequently, we applaud the Committee for recognizing the need for a *"national securities regulator scheme"*. Unfortunately, the federal government has failed to show leadership and has little credibility with the provinces on this issue. Nevertheless, we are hopeful that this will be resolved by June 2005, the timeframe recommended by the Committee. Canada cannot continue to be the only industrialized country without a national regulator and expect to ensure the vitality of its capital markets.

- **The Interest on the National Debt is Too High**

Perhaps most troublesome about this government is its unwillingness to allow proper debate about the uses of surpluses and their size. The Committee has taken steps to correct this by proposing regular updates to the estimate of the fiscal balance. The Conservative Party of Canada believes this is critical and in the public interest—after all, it is Canadians' money. We are nevertheless disappointed that the Committee did not emphasize this point, preferring to be silent on the need for a more transparent process that enables Canadians to debate the use of surpluses or to deal with looming deficits.

The consequence of many years of deficits still plagues Canada. The public debt stands at $501.5 billion and interest costs are $35.8 billion annually. Without such a heavy debt load, we could be spending this amount on social programs or reducing taxes. Imagine how we could improve the competitiveness of Canada and our quality of life if we didn't have to tax ourselves so heavily to pay for past misdeeds!

The CPC is disappointed that the Committee can bring itself only to support the current rate of debt-to-GDP reduction. We have been arguing for a more rapid reduction in the level of debt, not just in the debt to GDP ratio which has recently declined mainly because of the growth in GDP. But this government continues to spend and shows no sign of being more prudent about the future as so many speakers demanded in our Committee Hearings.

- **Federal Spending is Rising Far Too Rapidly**

The federal spending record of the past three years is very discouraging for those who want to ensure Canada remains on a sound fiscal footing. There is an entrenched culture of spending in Ottawa. The growth in non-interest spending has been 5.7 per cent a year from 2001 through 2004. As revenue grew by only 0.8 per cent over the same period, this trend is obviously unsustainable.

In this regard the CPC is very concerned that the current expenditure review is simply not going to deliver the goods. This endeavor is supposed to find billions in spending cuts, but these are cuts from what—levels of spending that would otherwise have occurred or from current levels of spending?

We are frustrated! At best, the Committee *"hopes"* that $3 billion will be found and maybe even *"surpassed",* but we have absolutely no way of actually knowing if this will happen and no evidence was brought before the Committee that would make us believers. The growth in non-interest spending is simply too rapid and we want to see, in Budget 2005, a clear statement that this will stop. The priority must shift from spending taxpayers' money to expenditure cutting and tax reduction.

- **Education & Training**

The federal government continues to have a limited role in the support of education in Canada. While we are committed to respecting provincial jurisdiction in this area, we feel the federal government can do far more to promote education in our country.

Specifically, we want to see Budget 2005 contain initiatives to expand the tuition grant program for students of modest means who want to attend post-secondary educational programs. We heard a great deal about the problems faced by students from low-income families. To help them further, we also want to see federal income taxes removed from bursaries and scholarships.

- **Promoting and Stimulating Affordable Housing Should be a Priority**

The difficulties of our cities have received much attention over the past few years and the Liberal response has been to reduce the GST charged to municipalities and promises of a portion of the federal excise tax on gasoline. The CPC supports these initiatives, but we are also concerned about the lack of attention to the supply of affordable housing.

The Committee speaks of another federal *"review"* of housing policy—but, we have had enough reviews to know how to proceed. Two initiatives should appear in Budget 2005, one relating to tax policy as it affects housing supply, and the other to regulation.

First, *". . . it is clear that a reasonable tax regime will bring investors back into new rental housing production and . . . will keep owners of existing rental buildings in business."* [vii] The current federal tax policy works against the construction of affordable rental accommodation and this policy is especially harsh on smaller landlords.

This government continues to ignore simple solutions to the real difficulties faced by poorer Canadians in accessing rental housing. While the CMHC is researching issues related to building and fire codes for secondary suites, action is what is needed or the ongoing shortage of affordable housing will remain. This is simply wrong-headed policy and we want it changed in Budget 2005. "*Secondary suites in single-family homes provide one of the most cost-effective ways of providing affordable rental housing. . . yet many of these suites are technically illegal"*[viii].

In Conclusion

The Conservative Party of Canada understands that our living standard is not simply reflected in high income. It is also, however, not guaranteed. Opportunities to develop one's potential are what we seek when we talk of a high quality of life.

Canadians should not have to settle for another round of lost opportunities. The true value of these pre-budget consultations lies in the ability of the Finance Committee to change policies that will lead to improvements in these areas. Unless bold measures are taken, Canada will continue sleepwalking toward mediocrity.

Standing Committee on Finance
Monte Solberg, M.P., Finance Critic
Charlie Penson, M.P., Vice-Chair, Standing Committee on Finance
Rona Ambrose, M.P., Intergovernmental Affairs Critic
Brian Pallister, M.P., National Revenue Critic

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[i] The Centre for the Study of Living Standards, *Aggregate Income and Productivity Trends: Canada vs. United States,* (Ottawa, October 2004) Table 7.

[ii] The Conference Board of Canada, *Performance and Potential 2004-05,* (Ottawa, 2004), p. 60.

[iii] Ibid, The Centre for the Study of Living Standards, (Ottawa, October 2004), Table 8, 9.

[iv] 2004 Report of the Auditor General of Canada, (Ottawa, November 2004), Chapter 8.3.

[v] Human Resources and Social Development Canada, *Chief Actuary's Outlook on the Employment Insurance Account for 2005* (October, 2004).

[vi] Duanjie Chen and Jack Mintz, *The 2004 Business Tax Outlook: Lowering Business Taxes Would Spur Investment*, C.D. Howe Institute, Toronto, 2004. p. 3.

[vii] Canadian Home Builders' Association, *Anticipating the Future, Pre-Budget Submission*, (Ottawa, September 2004), p. 4

[viii] Canadian Real Estate Association, *Pre-Budget Submission*, (Ottawa, September 2004), p. 3.

LIBERAL DISSENTING OPINION

A minority Parliament presents challenges for each of the parties involved, as well as individual Members of Parliament. While the report presented by the Finance Committee does represent the completed work of the Committee, we, the Liberal Members of the Standing Committee on Finance feel that it is important to have a clear, Liberal position on the record.

The Government should be commended for the significant action that has been taken since the Parliament began. The successful conclusion of two federal-provincial agreements — one on Healthcare and one on Equalization — must be viewed as significant progress made on issues of great importance to Canadians.

But the task is far from complete. It is time to take the Canadian economy to the next level. To do so requires the acknowledgement that a balanced approach is needed, and that the strength of our economy is inextricably linked with the overall health of our nation. Therefore, the proper balance must be struck between the need for encouraging sustainable development, strengthening our social foundations, recognizing the unique challenges faced by women, and ensuring a competitive yet equitable tax system, all while addressing the need to continue reducing the debt.

With this in mind, we wish to highlight the following as attractive ideas that merit serious consideration by the Minister of Finance in his budget preparation.

Sustainable Development:

Today, it is well established that our economic prosperity cannot be accurately measured without giving proper regard to how our policies and practices affect the environment in which we live. We must therefore take steps to promote economic activity through the prism of sustainable development. Towards this end, the Liberal Members of the Standing Committee on Finance believe that in the next Budget, it is essential that the Minister of Finance reflect the environmental concerns expressed to us by the witnesses and Canadians. In particular, we recommend the following:

a) **Allowing full deductibility of Brownfield remediation expenses for income tax purposes to level the playing field with Greenfield sites.**

b) **Reviewing the Capital Cost Allowance system immediately with a view to having the system reflect the useful life of an asset. In particular, the Minister should accelerate the schedule for equipment that produces energy and/or expand the class of assets eligible for accelerated depreciation. Those technologies which show demonstrable environmental attractiveness should receive priority**

c) **Providing the proper incentives to help achieve our Kyoto goals and encourage cleaner engines by:**

   - **Aggressively bringing Capital Cost Allowances for transportation equipment in line with comparable U.S. rates**
   - **Creating some form of incentive in the form of a credit, a deduction, or GST relief /rebate for the purchase of hybrid motor vehicles**

d) **Committing adequate annual funding to a Strong Ocean's Strategy**

e) **Instituting enhancements to the Wind Power Production Incentive (WPPI)**

f) **Creating a Green Power Production Incentive (GPPI), by extending support to all green power technologies (small hydro, biomass, ocean energy facilities) at the same level as WPPI, i.e. (1 cent per kWh)**

g) **Renewing and enhancing the FCM Green Municipal Fund and Green Municipal Investment Fund**

Social Foundations:

It is important that the Government take steps to ensure that all Canadian residents have the tools necessary to be contributing members of society. The Liberal Members of the Standing Committee on Finance therefore recommend the following:

a) **Announcing at the earliest opportunity, along with interested provincial/territorial governments, initiatives to reduce child poverty. These initiatives should include a national, accessible, affordable, high-quality, publicly regulated, not-for-profit child care system**

b) **Increasing the CCTB, provided that no province be permitted to claw back the relief**

c) **Ensuring a fair and equitable Immigration system by:**

   - **Increasing the resources of the Department of Citizenship and Immigration**
   - **Improving programs for settlement and integration**
   - **Establishing a clear process for assessing immigrants' skills soon after their arrival in Canada. Any additional course or language training needed to meet Canadian standards or qualify for employment should be provided immediately**

- ❖ **Implementing a program to help facilitate access to employment and break down possible systemic barriers**

- ❖ **Providing sensitization programs for employers**

d) **Combating the problem of obesity in children and adults due to bad diet and inactivity by:**

- ❖ **Creating a 10 year preventative health plan that would include: bold warnings (like those on cigarette packages) on food that is bad for you, encouraging active transportation (walking) and active living**

Women

Too many women in Canada still face the problems of lower pay, poverty and violence. Also, homelessness and under housing is more severe for women than men. Women who are visible minorities face even more problems due to lower income or unemployment related to racism. The Liberal Members of the Standing Committee on Finance call on the Government to undertake the following:

a) **Implementing government-wide, gender-based analysis in policy development, starting with Budget 2005**

b) **Increasing funding for emergency shelters for women and their children who have experienced domestic violence**

c) **Re-establishing the Advisory Council on the Status of Women Canada, and appointing a Deputy Minister for the Department**

d) **Enhancing the National Crime Prevention Program in order to help prevent domestic violence**

e) **Addressing the shortage of affordable housing in partnership with the provinces and territories. The goal to be achieved is that housing costs should represent no more than 30% of net income**

f) **Developing programs to assist women in need with skills training, education and employment**

Tax Fairness:

A tax system that: takes into account the various needs of individuals and businesses, does not unfairly burden the less unfortunate in society, and encourages investment, is essential to a vibrant economy. The Liberal Members of the Standing

Committee on Finance therefore recommend that the Minister of Finance address many of the inequities in the taxation system by undertaking the following**:**

a) **Increasing the GST tax credit for those with modest incomes**

b) **Increasing each bracket by a declining amount as the brackets increase**

c) **Instituting a deduction or credit for up to $500 for employment-related expenses**

d) **Amending the *Income Tax Act* to ensure that paramedics are considered to be public safety workers for purposes of unreduced early retirement benefits**

e) **Implementing a system of deductions or credits for those families that incur adoption expenses above a threshold of $5,000 providing that fees paid to professionals and others not comprise more than 25% of the claim**

f) **Increasing the medical expense tax credit from $5,000 to $10,000**

g) **Implementing the section of the Report of the Standing Committee on Finance Committee on Small Business Tax Measures dealing with Excise Tax on jewellery.**

h) **Considering the elimination of the tax on scholarships up to the sum of $10,000 per year**

Miscellaneous:

Finally, there were a few other issues that the Liberal Members of the Finance Committee believed were important to bring to the Minister of Finance's attention. We recommend the following:

a) **Immediately raising the RRSP and CPP foreign content limits**

b) **Accelerating RRSP limits**

c) **Amending the *Employment Insurance Act* to introduce a Yearly Basic Exemption in the amount of $3,000**

d) **Encouraging entrepreneurs to turn successful research into successful businesses through the creation of an Office of Commercialization, as well as enhancing investment in research and development, while also creating more coordination across government programs and, most importantly,**

coherence between programs and the work being done by the federal granting councils and arms-length foundations.

e) **Implementing changes to the current Port regulations:**

- ❖ **Reviewing the current charge on gross revenues of Canada Port Authorities with a view to decreasing it or stipulating that the stipend be used for future development of the National Ports System**

- ❖ **Reviewing section 25 of the Act for a possible amendment to allow CPA's access to federal funding for infrastructure**

All of which is respectfully submitted.

Liberal Members of the Standing Committee on Finance

DISSENTING OPINION OF THE BLOC QUÉBÉCOIS

The Bloc Québécois cannot fully support the recommendations of the report on the pre-budget consultations of the Standing Committee on Finance. A number of recommendations quite simply encroach upon provincial areas of jurisdiction, such as health, education and fighting poverty. And the report recommends once again as it did ten years ago that a Canadian securities commission be created, which is completely unacceptable to Quebec. Some important and fundamental elements are omitted from the Committee's report. By providing this dissenting opinion, we wish to correct these omissions and highlight the real priorities of Quebeckers and Canadians.

1. FISCAL IMBALANCE

Many people consider that the fiscal imbalance must be addressed by a new division of fiscal responsibilities. Fiscal rebalancing would give the Government of Quebec and that of the other provinces autonomous, stable and predictable revenue that is essential for sound management and for maintaining a balanced budget without compromising the federal government's balanced budget.

2. SOCIAL PROGRAMS AND EDUCATION

The witnesses we consulted would like the federal government to increase its contribution to social programs and education to 25% of the cost of these systems. In addition, students would like to see certain tax measures, such as tax exempt status for scholarships and other more specific measures.

3. EMPLOYMENT INSURANCE, PARENTAL LEAVE AND OTHER MEASURES

The proposals we heard during the hearings are consistent with the conclusions of the unanimous report tabled in May 2001 by the Standing Committee on Human Resources Development, as well as the latest work by unions, the Coalition des Sans-Chemises [Coalition of the Shirtless] and the Bloc Québécois (eligibility starting at 360 hours for everyone, maximum duration of benefits 50 weeks). Moreover, the were calls for the creation of a separate employment insurance fund, the abolition of the clause discriminating against newcomers, the establishment of a new POWA, delivering on the promise to transfer the parental leave amounts to Quebec and finally tax cuts for persons with low and moderate incomes.

4. SOCIAL HOUSING AND DAYCARE

The federal government should allocate 1% of its expenditures to the construction of social housing, which would amount to close to $2 billion per year. The surpluses posted by CMHC could go toward this investment. Moreover, with respect to daycare, the various groups called upon the federal government to unconditionally transfer to Quebec the amounts set out in its national daycare program and to correct the injustice to Quebec with respect to the loss of tax credits and tax deductions for Quebec parents. The GST on diapers should also be eliminated to help families.

5. SENIORS

The various groups that spoke out during the tour called upon the federal government to intensify its efforts to ensure that seniors receive their share of the guaranteed income supplement and any retroactive amounts that some of them are entitled to. There are also calls to completely index old age pensions and the guaranteed income supplement to the cost of living, and to review them in consideration of the low income cutoff.

6. CULTURE

The various arts groups called for the cancellation of cuts and reinvestment in the budgets of various organizations such as the Canada Council for the Arts, Telefilm Canada, the Canada Television Fund, and the Canadian Broadcasting Corporation. The Committee report reflects these issues, but omits an important recommendation from the publishing world to eliminate the GST on books.

7. AGRICULTURE

There are calls for reinvestment in agriculture in accordance with Quebec's areas of jurisdiction and programs until the price of agricultural products returns to a level that would allow farmers to make a decent living. Similarly, there are calls for tax measures and incentives, the return of land in Mirabel and federal participation in setting a price floor and in purchasing a slaughterhouse for culled cows.

8. REGIONAL DEVELOPMENT

The stakeholders we consulted demanded that the federal government increase funding to the regions and transfer the Quebec budget of Economic Development Canada to the Government of Quebec. Moreover, stakeholders are calling upon the federal government to introduce a clause requiring programs to be tailored to the specific rural regions of Quebec. There are also calls for universal telephone and high-speed Internet access, as well as support for the airline and shipping industries.

9. DEVELOPMENT OF INDUSTRY

The various groups we met during the tour would like to see a substantial increase in federal investment in Technology Partnerships Canada. A number of stakeholders also suggested a loan guarantee program, better support to the lumber industry, sectoral policies for the shipping and airline industries and proactive measures to attract international investors and experts in the pharmaceutical sector.

10. IMMIGRATION

The various groups we met during the tour are seeking significant improvements in Immigration Canada's efficiency in processing refugee claims and an additional transfer of $100 million per year to support Quebec's intake and integration efforts, as well as the establishment of the refugee appeals section as soon as possible.

11. INFRASTRUCTURE AND TRANSPORTATION

The various groups we met during the tour called on the federal government to significantly increase its contributions to municipal, strategic and rural infrastructure programs, and to make these contributions recurring, while respecting Quebec's areas of jurisdiction. A number of people would like to see the federal gas tax that is to be transferred to the municipalities go through the Government of Quebec, which would then negotiate the allocation criteria with the municipalities. Moreover, there are calls for a bill to make public transit passes tax deductible and questions about the appropriateness of making parking fees deductible, as this only encourages people to use personal vehicles.

12. INTERNATIONAL AID

The stakeholders we consulted were unanimous in demanding that the federal government implement a plan in 2005 in order to achieve the UN target of spending 7% of GDP on international aid by 2015.

13. CONTROL OF OPERATING EXPENDITURES

The various stakeholders all agreed that the federal government should strive to eliminate needless and inappropriate operating expenditures, most of which are in provincial areas of jurisdiction.

14. SUPPORT FOR EVENTS

The various stakeholders we consulted called upon the federal government to create a new support program that it would manage, without third-party input, as was the case with the communication agencies. It was also agreed that the government should establish very specific criteria and rigorous monitoring to prevent another sponsorship scandal.

15. AMENDMENT OF THE INCOME TAX ACT

The paramedics' association of Canada called for the government to amend the *Income Tax Act* so that paramedics would be deemed public safety workers for the purposes of unreduced early retirement benefits. Moreover, the government should examine all health and public safety professions in order to determine what other groups might be eligible.

For further details about these demands as regards the next budget, please refer to the brief tabled by the Bloc Québécois to the Standing Committee on Finance in November 2004.

NDP DISSENTING OPINION TO THE FINANCE COMMITTEE REPORT ON THE PRE-BUDGET CONSULTATION 2005

JUDY WASYLYCIA-LEIS, M.P.

This fall, more than 200 individuals and organizations presented their views to the Finance Committee regarding the 2005 federal budget. The government's decision to call Parliament back later than usual compressed the timeframe for this year's hearings and many groups were called upon to prepare their presentations on short notice. Despite this, witnesses responded with insightful and informative presentations. Regrettably, there are a significant number of initiatives reflecting the concerns of a substantial number of Canadians that are not reflected in the Committee report. New Democrats feel that this advice is important for the government to consider in charting Canada's economic course in its next budget and accordingly submits this minority report.

Stop fudging and denying debate about the numbers

This year's pre-budget consultations followed on the heels of yet another grossly mis-estimated budget surplus announcement. In 2003-04, the Liberal government had forecast a budget surplus of $1.9 billion. The actual surplus total announced in October was $9.1 billion – an error of 379 percent. This alone is cause for concern, but even more troubling is that it is part of a consistent pattern of budget forecasting gaffs. Over the last ten fiscal years, it has been in error an average of 203.9% a year amounting to a total of $86 billion.

Clearly this is not accidental. Using the government's own data, the Alternative Federal Budget has pinpointed the actual surplus numbers with consistent accuracy over the years. Since 1999, the AFB has been off by a total of $0.8 billion, while the government has been off by $43.4 billion. Surpluses represent money that could and should have been designated for Canadians' priorities through budgets debated in Parliament. Instead, billions of dollars have been routed to Liberal priorities such as accelerated debt reduction with no debate whatsoever.

Canadians and the NDP believe in balanced budgets and fiscal responsibility, but by continually presenting numbers that bear little relation to fact, the government is effectively precluding debate among citizens about the choices we can make. We need not choose between fiscal responsibility and investments in key environmental, social and economic areas since our fiscal capacity allows both this investment and a continued reduction in the debt-to-GDP ratio. Yet this urgently required debate is being denied as a result of chronically inaccurate budget forecasts.

In his Fall Economic Update, Finance Minister Goodale continued the numbers game by projecting a surplus of $5.9 billion, then, under questioning at Finance Committee, acknowledged that he had not included the government's arbitrary $3 billion contingency amount. His real surplus projection: $8.9 billion. Mysteriously, the surplus disappears in years two and three of Goodale's forecast, despite his claims that this is a structural surplus that should be expected to recur.

Canadians find this manipulation of numbers and lack of transparency and accountability unacceptable and disturbing, particularly in light of the Liberals' recent history with the sponsorship scandal.

So does the NDP. And we have suggested a solution:

Recommendation: That the government take immediate steps to create an independent budgeting office, responsible to Parliament, to present the most accurate fiscal projection data on an ongoing basis for use in budgeting and other economic planning.

Restore Budgeting Balance

Canadians are concerned not only with the government's inability to forecast the amount of the surplus, but also with what it has been doing with the surplus funds. The origin of these surplus funds, let us remember, was in Canadians severe belt tightening in the years of Martin budget cuts. Despite his rhetoric and promises, the fiscal capacity of Canadians was not re-invested in environmental, social or other priorities, but in massive tax reductions and aggressive debt repayment.

In 1997, the Liberal government promised Canadians that it would divide any surpluses on a 50:50 basis: half for increased program spending and half to be divided between tax cuts and debt reduction. Like other Liberal promises, they have not delivered. An analysis of surplus spending since 1997-98 reveals that only 22 percent has gone to program spending and an overwhelming 78 percent has been spent on debt reduction and tax cuts.

Without any public debate, the Liberal government has spent $61 billion toward its priority of accelerating debt reduction. It claims it had no choice — despite its own past practices and an unequivocal statement by the Auditor General of Canada denying that the surplus for the year must automatically go to pay down the debt. In her 2002 Report, Sheila Fraser wrote: "There is neither any law nor accounting rule that requires this. Following the terrorist attacks in the US, the federal government abandoned economic prudence altogether and reduced the contingency reserve to $1.5 billion."

The Liberal goal is to reduce the debt-to-GDP ratio to an artificial target of 25 per cent of GDP. In contrast, real and pressing targets on pollution reduction or poverty alleviation have never been met by this government — and targets for education, child care and housing construction are not even made — and it is unreflective of Canadians' priorities to constantly strive for artificial fiscal targets while neglecting action on other fronts. New Democrats are pleased Canada is the only G-8 country in surplus, and recognize our debt is going down at a rate far faster than the remainder of the industrialized world. We are alarmed, however, that Canada is at the bottom of the pack in meeting our Kyoto commitments, are the only G-8 country without a national housing program and are far behind on child care, education and other key social issues.

To further their accelerated debt obsession, the Liberals have in recent budgets adopted a practice of building into their budgets a $3 billion 'contingency' amount. Again, this $3 billion decision has been adopted without any public debate on the appropriateness of the amount or the practice itself. Given this government's history of underestimating their revenues and falling short on expenses, the justification for a contingency fund is weak.

Recommendation: That the government provide Parliament an opportunity to decide on the allocation of any budget surplus.

Recommendation: That the government provide Parliament an opportunity to debate the practice and amount of contingency and prudence allocations in its budgeting framework.

Canadians are finding increasingly that their priorities are not being addressed

Canadians are bombarded with government messages about how well the economy is doing, yet they look around and see a different picture: Their household debt has increased by 38 percent since 1989, food bank use has increased by 8.5 per cent in the last year, and the gap continues to grow between the upper and lower rungs of the income ladder. They see youth unemployment at over 13 percent, but no federal action to relieve high tuition across the country. There is a housing shortage, but not a comprehensive housing strategy. They know Canada signed on to Kyoto, but reports keep showing we are moving in the wrong direction to reduce pollution. A 'watershed' health accord was signed, but their drug costs and out-of-pocket payments keep rising. The Bank of Canada Governor says our economy is at capacity, but unemployment is stuck over seven percent and 40 percent of the jobless can't access benefits.

Canadians know the government can do better. And they know that speeding up debt repayment and more corporate tax cuts are not the answer. We have obligations to future generations, to be certain, and leaving a fiscally responsible legacy behind is one of them. But New Democrats also believe future generations benefit from a sustainable planet and more accessible education, yet pollution and tuition continue to go up as our debt continues to go down. After a decade of beating every fiscal goal set and missing every environmental goal promised, it is time for a more balanced view, and one better in keeping with Canadians' priorities.

Repeatedly, witnesses maintained that there is no public craving for more tax cuts except in corporate boardrooms. Any personal income tax review that results from the Committee's report should follow the principle that any cuts should be targeted specifically — and solely — to Canadians with low incomes. New Democrats do not support the Finance Minister's musings about new corporate tax reductions.

The Committee's report provides for the review or elimination of several corporate taxes. The NDP supports measures to enhance Canadian productivity and attract investment, but corporate income tax cuts are the wrong way to go about it. As the Liberal government demonstrated in the March budget, Canadian corporate income tax rates are already competitive with the United States' if not, in some cases, lower. To enhance Canadian productivity, we should be spending budget surpluses on the infrastructure needs, education and skills acquisition that make Canada competitive internationally.

Since the fall of 2001, corporate pre-tax profits have grown 49 per cent. Indeed, as a percentage of GDP, corporate profits are running at almost 14 per cent — a record high level. At the same time, however, corporate reinvestment of that profit back into building the economy is at a record low. Further blanket cuts to corporate taxes would not serve the purpose of economic growth for which they are intended. Even so, the demand for more corporate tax cuts continues unabated, made all the more cynical by the billions of dollars in uncollected corporate taxes that remain on the books.

Investing in Canadians:

New Democrats believe that Canadians' needs can be met — and met within a balanced budget. We also know that in order to do so, we need a government with a strategic investment vision to build a strong, sustainable and inclusive domestic economy. And we know that in building such an economy, we can no longer afford to ignore — as the Liberal government has — the social and environmental deficit from past Liberal budget cuts.

Federal program spending as a percentage of GDP is 11.6 percent — hovering at a 40 year low. It is even down from 12.1 percent in 1997-98 when we began running surpluses and well below our long-range average of 15.5 percent. When inflation and population increases are factored in, government program spending in real per capita terms since 1999 has only risen by 3.9 per cent per year, much of it only offsetting previous reductions.

The Alternative Federal Budget, and now an increasing number of private sector forecasters, are predicting continued surpluses in the years ahead. The AFB forecasts roughly $24 billion in surplus over the next three years alone. These anticipated surpluses provide the government an opportunity to provide needed stability in program funding. Yet Recommendation #2 in the Committee's report to restrict program spending growth to the rate of growth in the nominal GDP effectively eliminates the possibility of any significant progress toward restoring balance to our budgeting through strategic increases to program spending. This utterly ignores the economic imbalance created by this government and condemns Canadians to live with a lower social and economic horizon.

Our budget priorities aim at building a strong economy for all, not just the wealthy few, and reflect the concerns of witnesses from many sectors who appeared before the Committee.

Recommendations:

Invest in Education:

Initiate a national tuition reduction strategy with the provinces to tie lower tuition fees to increased federal transfers designated separately for post-secondary education.

Phase out the Millennium Scholarship Fund and replace it with a system of needs-based grants.

Establish a national training strategy to actively support lifelong learning and literacy.

Invest in a Sustainable Environment:

Put Canada on track to sustainability within a generation, with a focus on renewable energy technology available today; mandatory vehicle emissions; large-scale and largely revenue-neutral energy efficiency projects and an east-west power grid to reduce dependence on fossil fuels.

Invest in Municipalities and Infrastructure

Ensure that all municipalities receive a 50 percent share of the federal fuel tax and a full refund of their GST payment.

Make employer-funded transit benefits tax-exempt.

Re-start a national housing program with one percent of total program spending devoted to affordable housing.

Require the Canada Mortgage and Housing Corporation to use its profits to fund low-interest mortgages for affordable housing instead of turning the money over to the government's general revenues.

Help deliver clean water and safe roads through a national infrastructure program, delivered in the public sector.

Invest in Children:

Establish a pan-Canadian, publicly-funded, universally accessible, not-for-profit, regulated child care and early learning system grounded in legislation to quickly move to cover children up to age 12.

Increase the Child Tax Benefit to $4,900 and open the benefit to include those who don't pay income tax.

Implement a comprehensive strategy to eliminate child poverty, including affordable housing construction and EI reform.

Invest in Health:

Initiate a national bulk-buying program in cooperation with the provinces and territories for prescription drugs to reduce drug costs

Establish a national system of public, non-profit home care

Save costs and inefficiencies in health care delivery by ensuring that any new health care initiatives remain within the public, not-for-profit domain and not public-private partnerships.

Increase direct federal health funding to First Nations communities to ensure access to services with an emphasis on delivery within or close to the community.

Invest in Employment:

Lower the work time to qualify for Employment Insurance benefits to 360 hours.

Establish the EI fund as a separate trust fund so that it is no longer classified as general revenue and used to supplement other government expenditures.

Introduce a pro-active industrial development strategy to protect jobs and reduce unemployment.

Invest in Aboriginal Communities:

Make Aboriginal communities priorities in new housing and infrastructure programs.

Settle land claims expeditiously through an independent land claims process to foster economic development in First Nations communities.

Develop a national strategy to address the needs of urban Aboriginal people.

Gender Equality:

An issue of major significance missing in the Committee report is any reference to a gender analysis of budget material, despite recommendations to the contrary from a *significant number of witnesses. The Committee was told that Canada has failed to live up to the commitments it made as a signatory of the Beijing Platform for Action, and that despite unprecedented wealth and prosperity in the last ten years, significant advancement has not been made in the cause of gender equality. The New Democratic Party concurs with this demand.*

A responsive federal budget will respond to the needs of other sectors of Canadian society as well as those highlighted here. While the Committee report recommendations on the long-promised comprehensive disability agenda and funding for cultural institutions are positive, it fell short in a number of critical areas: stopping the claw back the Guaranteed Income Supplement; increasing the pace to reach our overseas assistance budget target of 0.7% of GDP, enabling co-operatives and their members to capture capital losses without having to resort to limited partnerships; and addressing the serious pressures on the family farm and the agricultural sector generally.

These proposals reflect the day-to-day budgetary concerns of the many Canadians searching for ongoing economic security and leadership from their government as they raise their children, educate themselves for the future, seek decent jobs or stretch their pension dollars in retirement. Far from being a drain on the economy, they potentially form an integral part of a strategic investment strategy to build a strong, sustainable domestic economy to carry us forward in the 21st century.

New Democrats believe that a truly prudent government should seriously consider these viable options in developing its budget for the fiscal year 2005-2006.

MINUTES OF PROCEEDINGS

Monday, December 13, 2004
(*Meeting No. 34*)

The Standing Committee on Finance met *in camera* at 11:16 a.m. this day, in Room 308 West Block, the Chair, Massimo Pacetti, presiding.

Members of the Committee present: Rona Ambrose, Don H. Bell, Guy Côté, Charles Hubbard, John McKay, Maria Minna, Massimo Pacetti, Brian Pallister, Charlie Penson and Judy Wasylycia-Leis.

Acting Members present: Gary Carr for John McKay, Claude Drouin for Charles Hubbard and Réal Lapierre for Yvan Loubier.

In attendance: Parliamentary Information and Research Service: June Dewetering, principal; Alexandre Laurin, analyst.

Pursuant to Standing Order 83.1, the Committee resumed its pre-budget consultations 2004.

The Committee resumed consideration of a draft report.

At 12:49 p.m., the sitting was suspended.

At 1:10 p.m., the sitting resumed.

It was agreed on division, — That the draft report be adopted, as amended, as the Third Report of the Committee.

It was agreed, — That the Chair, analysts and clerks be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the Report.

It was agreed, — That the Chair be instructed to present the Third Report of the Committee to the House.

It was agreed, — That the Committee prints 1500 copies of the report in English and 1000 copies in French.

At 2:03 p.m., the Committee adjourned to the call of the Chair.

Richard Dupuis
Clerk of the Committee