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—
Chair

Mr. Brian Pallister

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•(1100)

[Translation]

The Chair (Mr. Brian Pallister (Portage—Lisgar, CPC)): Pursuant to the order of reference of Tuesday, May 15, 2007, we are studying Bill C-52, An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007.

[English]

Good morning to our witnesses. Thank you for being here this morning as we continue our discussions on the budget bill, Bill C-52.

You've been asked to keep your presentations to five minutes to allow time for questions from committee members.

We will commence with the Coalition of Canadian Energy Trusts. John Dielwart is here.

Five minutes to you, John.

Mr. John Dielwart (Chief Executive Officer, ARC Energy Trust, Coalition of Canadian Energy Trusts): Thank you very much, and thank you for the opportunity to present our views.

When the Conservatives broke their promise not to tax trusts, it came as a total surprise to millions of hard-working Canadians, and it will have severe negative economic impacts for all of them. The government continues to ignore their concerns and has advanced its broken promise into Budget 2007.

Our coalition has made every attempt to understand how the government arrived at their tax leakage calculation. This committee's previous investigation into the trust decision has revealed that the government has intentionally prevented this information from coming to light. In the absence of such information, Canadians have no alternative but to believe the government's decision was ill-informed and not well thought out.

In December 2006 we presented a detailed, comprehensive report of the importance of energy trusts in the Canadian oil and gas industry. We have yet to receive a response from the Department of Finance. Their failure to engage in consultation on our report indicates to us that the government has chosen to ignore the concrete facts presented by companies that are generating billions of dollars of wealth and employing thousands of Canadian taxpayers.

We believe our position is beyond dispute and that energy trusts should be allowed to continue to exist as they were prior to the so-called tax fairness plan. In our last presentation to this committee, we provided copies of this report.

You have previously heard testimony from government-selected witnesses, and ironically, many of them believe there is a role within Canada's capital markets for energy trusts. Let me highlight some of their comments.

Dominic D'Alessandro noted that real estate and royalty-producing assets such as energy trusts are the businesses that the current tax regime was designed for. He said that energy trusts have a strong case for exemption. We agree.

David Dodge said, "on balance, income trusts make capital markets somewhat more complete and somewhat more efficient". He went on to say, "the income structure may be very appropriate where firms need only to manage existing assets efficiently". That is exactly the energy trust role in maximizing production from Canada's mature oil- and gas-producing assets.

Jeffrey Olin, by inference, declared that there are businesses suited for the trust sector. We believe this is the case for energy trusts.

Kevin Dancey said, "trusts have a role to play in rounding out Canada's capital markets". We agree.

The government has heard these inconvenient truths from their very own expert witnesses that they presented to this committee. These individuals say that trusts, and particularly energy trusts, have a role to play in Canadian capital markets. Contrary to this advice, the government's proposed tax measures will see trusts disappear from capital markets in Canada. We have repeatedly stated that eliminating energy trusts will reduce production and reduce government revenues.

There is an increasing threat of foreign takeover of trusts. Foreign corporations are not focused on maximizing production from conventional western Canada oil properties. This has been the domain of the energy trusts. The increased cost of capital imposed by this tax will alter the economics of these mature properties, leading to reduced ultimate recoveries of Canada's oil and gas resources.

It has been only six months since the government made this ill-considered announcement; nevertheless, our sector has already seen changes. Energy MLPs have made overtures to acquire some of our member companies, and others have been looking seriously at moving mind and management of their organizations to the U.S. The revenue losses to the government will be significant relative to retaining the status quo of the energy trust sector.

Another impact of the October 31 announcement is that Canada's credibility in foreign markets has been significantly eroded. We are no longer looked at in the same positive way by foreign investors. At a time of increasing globalization, this is a severe black mark on our nation's reputation. We expected better from our government.

You heard our position regarding this government's decision to break its promise on tax trusts from my colleague, Gord Kerr, on February 1. Let me conclude by restating our position.

Energy trusts do not cause tax leakage. Taxes are not avoided; they are transferred to the unitholder. Energy trusts enhance energy productivity. U.S. energy trusts in the form of the MLPs and LLCs not only exist but are expanding rapidly.

Canadian junior oil and gas companies are struggling today due to the materially reduced access to capital resulting from the trust tax announcement. The increased costs of capital imposed on the energy sector have negatively impacted the economics of important projects, including those targeting carbon dioxide capture and storage.

We believe it is only reasonable that the Minister of Finance revisit the issue of Canada's energy trusts, just as he did to fix a mistake he made on foreign interest deductibility for Canada's corporations. Individual Canadians deserve the same treatment afforded these large corporations.

In conclusion, I would say, as we have said before, that it is never too late to get it right, not just for energy trusts and its investors but for all Canadians.

Thank you, Mr. Chairman.

• (1105)

The Chair: Thank you, Mr. Dielwart.

We'll continue with the David Suzuki Foundation. Bill Wareham is here. Bill, you have five minutes.

Mr. Bill Wareham (Acting Director, David Suzuki Foundation): Thank you, and good morning, honourable members of the committee. I appreciate being invited to present to you today.

I'm the marine conservation program director for the David Suzuki Foundation. I have a BSc in science and a master of business administration degree. I've worked for about 20 years for various environmental non-government organizations on various environmental policy issues. Over the last three years I've focused specifically on marine conservation and fisheries policy issues.

Today I'd like to present my views on Canada's efforts and performance in the field of ocean and coastal conservation and management, highlight some of the values in our oceans that I believe are at risk because of the current federal budget allocations, and suggest where I believe Canada should be investing more federal money to meet some of our international commitments.

With over 40% of our national jurisdiction in marine environments, and with the significant contribution that ocean-related activities make to our economy, I believe that Canada is currently significantly under-investing in the health and future of the well-being of our oceans and coastal environments.

Canada has made many international commitments to protect and manage our oceans in a manner that maintains the function of marine ecosystems. In 1992 we signed the United Nations Convention on Biological Diversity. Article 8 of that convention clearly states the mandate for the parties to the convention: to establish a system of marine protected areas; to regulate and manage biological resources for the conservation of diversity, both inside and outside of protected areas; and to promote the protection of ecosystems and natural habitats to maintain viable populations of species.

Canada also has commitments under the Migratory Birds Convention Act and our own Oceans Act, in which, under subsection 35(2) of the act, it directs the Minister of Fisheries and Oceans "to lead and coordinate the development and implementation of a national system of marine protected areas on behalf of the Government of Canada".

In 2002, in an attempt to realize the Oceans Act mandate, Canada developed an ocean strategy. This strategy laid out a plan on how to realize some of these international commitments and our domestic mandate. Sadly, Canada is failing to meet its commitments. Other nations, including the United States, Australia, and New Zealand, which also made commitments to ocean strategies at about the same time Canada did in 1997, have moved far ahead of us in planning, protecting, and managing the biological resources within their economic zones.

How badly are we doing? As of 2006, Canada had protected 0.12% of our exclusive economic zone. It is not my view that Canada lacks the ability to reach our objectives; rather, there's a lack of political will and a serious lack of investment that's required to do the job professionally and in a manner that would maintain Canada's reputation as a world leader in stewardship, conservation, and sustainable practices. This critical view is not only mine. It was presented in 2005, when the Canadian Commissioner of the Environment and Sustainable Development issued a very detailed report highlighting that Canada had failed to meet the ocean strategy objectives and its mandate under the Oceans Act.

The commissioner identified the lack of inter-agency coordination and collaboration and a lack of adequate funding as the primary hurdles for progress on this file. Now, almost two years later, we have not only failed to make progress, but we are sliding backwards. We have no integrated management plans in place in our oceans. We have no new marine protected areas. We have declining budgets for science and research in oceans. And we have less funding in DFO's ocean management budget than we had two years ago.

How many years will Canadians have to hear that we have failed to meet our international commitments, failed to invest in the conservation and management of our oceans, and failed to establish a governance structure that maintains the benefits Canadians realize from our oceans?

The oceans are important to Canadians. Over 20% of our population lives in coastal cities and communities. And 98,000 people work in fisheries and processing jobs. Canada has over 11,000 ocean-oriented businesses with fisheries landings worth over \$2 billion to the Canadian economy and seafood exports of over \$5.4 billion. Recreational fishing in southern British Columbia alone is worth \$500 million. And DFO estimated in 2006 that the overall economic activity was worth \$23 billion.

Not all this economic activity is sustainable. It's increasing. The non-traditional things like aquaculture, oil and gas, and tourism are escalating on an ever-increasing scale. The threats we face from climate change are exacerbating the problem.

I'm very concerned that there is a \$105 million decline in the budget at DFO in the next year, and there's only \$18 million allocated over the next two years for conservation.

• (1110)

We believe that a much greater investment must be made, and we're asking for more than \$100 million per year to be allocated to engage the integrated management planning process and related work necessary to actually complete the designation of marine protected areas and to move to an ecosystem-based approach to management of our oceans.

Thank you very much for hearing my comments today.

The Chair: Thank you very much, sir.

We'll continue with Living Oceans Society representative Kate Willis.

Madam Willis, you have five minutes.

Ms. Kate Willis (Campaign Manager, Marine Planning and Protected Areas Campaign Manager, Living Oceans Society):

Thank you for inviting me to appear before the finance committee. My remarks today will focus on the implications of the lack of dedicated funding in Budget 2007 to integrated oceans management. I will be commenting on two key areas: why the amounts allocated towards oceans health and protection in Budget 2007 are grossly inadequate and the repercussions this lack of funding will likely have on progress that has already been made in the regions. Our written submission contains additional details. Unfortunately, due to the short notice to appear before you, we were unable to get a brief translated prior to our appearance, but French and English copies will be sent following our appearance today.

I work as the marine planning and protected areas campaign manager for Living Oceans Society, a non-profit research and public education organization based in British Columbia that is committed to conserving marine biological diversity in order to ensure a healthy ocean and healthy coastal communities. Prior to my position at Living Oceans Society, I worked for the U.S. Government at the National Oceanic & Atmospheric Administration in Washington, D. C., in their office of international affairs. In my position there, I attended several meetings at the United Nations and abroad, debating and discussing the dire situation of our world's oceans and the immediate need for more action to protect them from habitat degradation, overfishing, and loss of biodiversity.

While at these meetings I was always impressed by the Canadian delegations. They spoke of advancements in their legislation and governance bodies over the past 10 years: the passage of the Oceans Act; the development of Canada's oceans strategy; and, most recently, the development of Canada's oceans action plan in 2005. I was therefore optimistic and encouraged by Canada's international reputation when I moved to British Columbia. It is now just over a year later, and although I remain optimistic—it is a part of my nature—I must admit, I was very disappointed when I saw the 2007 budget.

Of the \$4.5 billion dedicated in Budget 2007 to clean our air and water, reduce greenhouse gases, combat climate change, and protect our natural environment, only \$19 million was allocated to help clean and protect our oceans and support greater water pollution prevention, surveillance, and enforcement along Canada's coast. Nineteen million dollars may sound like a lot of money to many people, but when you consider the extent of our coasts, all 243,000 kilometres of them, it's a drop in the bucket. Split evenly between the five major ocean regions over the next two years, this amounts to approximately \$1.9 million per region per year. To expect any region, no matter how effective it is, to clean and protect our oceans with that amount of support is setting them up for failure.

In 2005, approximately \$28 million was allocated towards the first phase of Canada's oceans action plan. Portions of that funding were directed at integrated oceans management, which considers both the conservation and protection of our ecosystems, while at the same time providing opportunities to create wealth in oceans-related economies and communities. It is Canada's opportunity and a common sense approach to shift from single species management, uncoordinated decision-making, and poor management of unsustainable industries to establish marine-planning processes that will ensure that our oceans resources are sustained for generations to come.

There was progress between 2005 and 2007. Several agencies within the Government of Canada started to undertake the difficult task of integrated oceans management. In B.C., the Pacific North Coast Integrated Management Area, or what we fondly call PNCIMA, was identified as a priority area. It's a huge area. It's about 88,000 square kilometres. If you're not from there, it's about the size of one New Brunswick and two Prince Edward Islands. So it's a really large area. It's an area of high ecological, social, and economic importance to British Columbia, and it contains some of the richest marine life in Canada. It's a spectacular and beautiful place, and there are approximately 72,000 people in the region who depend on it for their livelihood, recreation, and employment.

Notable indicators of progress made towards starting a planning process in British Columbia include a tripartite commitment from the federal and provincial governments and first nations to work collaboratively on planning in the PNCIMA. This is profound. In British Columbia, there has historically been a rift between our provincial government and Fisheries and Oceans Canada. To have them working together, in particular on a government-to-government level with first nations, is quite remarkable, and it's an opportunity that we need to take advantage of and to continue fostering.

I'm therefore here today to express our extreme disappointment that no funds were allocated toward integrated oceans management in Budget 2007. I would like to see the government show new leadership on oceans management in Canada and to put the resources and the political commitment behind managing our oceans and getting these marine planning processes under way.

Our oceans are important for all Canadians, no matter how you look at them, in terms of health and quality of life, in terms of economics, and in terms of the environment. Therefore, oceans management is not just for the people who live on the coast; it's for all Canadians. It's critically important, it's something that must be done, and \$1.9 million over two years is not going to do it.

• (1115)

Thank you very much for the time and the opportunity to present before you.

The Chair: Thank you very much, Ms. Willis.

We'll continue with the Canadian Vehicle Manufacturers' Association. Mark Nantais is here.

Over to you, sir, for five minutes.

Mr. Mark Nantais (President, Canadian Vehicle Manufacturers' Association): Thank you, Mr. Chairman.

CVMA membership includes DaimlerChrysler, Ford, General Motors, and International Truck and Engine Corporation. Our members account for roughly 70% of all vehicles assembled in Canada, 55% of the vehicles sold, and over 85% of all the automotive investment in Canada.

As an association, we've been very supportive of several aspects of the 2007 budget. We have been particularly supportive of items including the promotion of ethanol production as a fuel, increased funding for infrastructure and borders, the accelerated capital cost allowance, and efforts to enhance the SR and ED tax credit system. But on the other hand, we, along with many others, have been very

vocal in opposition, both publicly and privately to the government, to the ecoAUTO green levy program and its very perverse and unintended consequences for manufacturers and consumers that will yield no environmental benefit.

The ecoAUTO rebate green levy program, for all intents and purposes, is what we call a feebate program, so I will refer to it as a feebate program. This measure constitutes in my mind the single most significant intrusion into and disruption of the functioning of the competitive automotive marketplace that not only will fail in its objectives, like every other program similar in nature, but has also created huge inequities between manufacturers. In reality, it disproportionately only benefits the sale of one vehicle, which is produced offshore, not an advanced technology vehicle, and it only benefits one manufacturer. It has created very severe and unintended consequences at a time when the industry is in a very fragile state, and it will actually retard environmental progress. The timing could not be worse for our industry. On top of that, the policy will actually diminish the effectiveness of the support the government has already announced itself for the accelerated retirement of older vehicles, which is a much better approach that will yield real environmental benefits.

The intent of this feebate policy is to persuade consumers away from larger, less fuel-efficient vehicles towards smaller, more fuel-efficient vehicles. In theory, perhaps; in reality, not, definitely not. While improved new vehicle fuel economy is an important factor, the debate is and should be shifted to that of fuel consumption as a function of how and how far we drive our vehicles. In addition, we need to focus on greenhouse gas emission reductions, which means, yes, small, more fuel-efficient vehicles have their place. But in today's automotive technology world, we can deliver, in some instances, greater greenhouse gas reductions in larger vehicles equipped with technologies that, for instance, run on renewable fuels such as ethanol at 85%, particularly when it's derived from cellulosity processes. So contrary to popular opinion, big is no longer always bad. We must avoid being too myopic in our approach, but rather look to a broad range of technologies now available to address personal transportation's contribution to greenhouse gas reductions.

If we look at today's market realities in Canada, Canadians already purchase small, fuel-efficient vehicles in much greater quantities, especially in comparison to the United States. This is particularly due to lower disposable incomes and higher operating costs, including the price of gasoline. According to Dennis DesRosiers Automotive Consulting, as well as being backed up by a lot of supporting data, Canada's auto market is already optimized toward more fuel-efficient vehicles, with very limited opportunity to shift consumers between vehicle segments.

Let me tell you why this policy is fundamentally flawed.

Number one, it damages domestic automakers: \$67 million worth of levies is placed on domestics. That's 80% of all the levies that will be collected. Transfers of \$47 million benefit one company—that is 75% for one vehicle, and it is, as I said, produced offshore.

Number two, it damages the Canadian economy segment, that is the economy segment of vehicles. The \$1,000 rebate for one vehicle, which makes up half of all rebates, undermines other dealers' and manufacturers' abilities to sell equally beneficial subcompacts competitively on the same basis.

Disincentive to Canadian green technology is another one.

Dangerous trade-offs: we are trading off the ability to put safety on vehicles, and it creates a possibility of actually putting vehicles on the market that are less safe in order to be competitive.

It hurts urban and rural families. It impacts segment choices. In other words, it does not promote people shifting from a larger segment to a smaller segment.

More older vehicles on the road: it tends to delay fleet turnover; therefore, you delay environmental benefit. It also allows, perversely, incentives for vehicles that do not meet the same smog-related standards in 2007, and it has an unreasonable cost-per-tonne reduction. There are several and many different implementation realities that are also problematic.

So, Mr. Chairman, many studies into it now suggest that this program will not deliver any environmental benefit.

• (1120)

We have a plan, as an auto industry. We'll be announcing that plan, and over the next several weeks there will be an ad campaign to address that.

I'd be glad to answer any questions you may have.

The Chair: Thank you very much, sir.

We'll conclude our presentations now with Paul Hobson, who is here as an individual. Mr. Hobson, over to you for five minutes.

Professor Paul Hobson (Department of Economics, Acadia University, As an Individual): Thank you, Mr. Chair.

Let me briefly introduce myself. I've been a professor of economics for 29 years. For 25 of those years, I have studied equalization and associated aspects of federal-provincial fiscal relations. I have been working on this particular file ever since the budget came down. I've done some very detailed analysis of what is being proposed here. I'm still revising my results as I better understand what is proposed in Bill C-52.

My presentation today will focus solely on fiscal equalization payments to the provinces and associated changes to the offshore accords. The bill also makes important changes to the determination of territorial formula financing payments, as well as to the growth and distribution of the Canada social transfer and the eventual distribution of the Canada health transfer. These matters would require a separate presentation.

The bulk of Bill C-52 lays out, in terms of the text, the terms of the new equalization program applicable to the provinces. Associated changes to the Federal-Provincial Fiscal Arrangements

Act are in clause 64, pages 64 to 83. In addition, clauses 80 to 86, pages 93 to 103, lay out the associated changes to the Canada-Newfoundland Atlantic Accord Implementation Act and the Nova Scotia and Newfoundland and Labrador Additional Fiscal Equalization Offset Payments Act. My point is, getting your head around all this is a huge undertaking.

Proposed section 3.1—this is in clause 80—specifies amounts for fiscal equalization payments to the provinces for 2007-08. What people need to understand is that these amounts are derived from application of the formula described in the subsequent proposed section 3.2. There are, in fact, three formulae at work in generating those numbers. One involves the O'Brien formula coming out of the expert panel. One involves a variant on that formula, with zero inclusion of natural resource revenues, and the third involves effectively a continuation of the status quo on option to Newfoundland and Labrador and to Nova Scotia.

If you go into the details of these—that's where the numbers come from—in particular how these numbers will be generated in future years, that's proposed section 3.2. Paragraph 3.2(1)(a) is the O'Brien formula. Paragraph 3.2(1)(b) is the zero inclusion of natural resources formula. And that is only part of what is being undertaken.

Proposed section 3.3 makes important transitional provisions for British Columbia with regard to the calculation of revenues derived from property taxes. There has been very little study of what the implications of those provisions are.

Proposed section 3.4 introduces the new cap on equalization, the so-called fiscal capacity cap, designed to ensure that equalization payments do not raise a province's total fiscal capacity above that of any non-receiving province. Where that does occur, equalization will be reduced. Indeed, it can be eliminated as a result of exceeding the cap.

Proposed section 3.5 provides definitions of terms and bases. There is a lot of important material in there that people are still getting their heads around. It explains the process, the three-year moving average lag of two years that will generate the data on equalization, but also the changes in how bases are being measured for purposes of determining equalization. Very little study has been made of that aspect either.

Proposed section 3.6 is very important. It makes special provision for Nova Scotia and for Newfoundland and Labrador, allowing them the option of continuing under the fixed framework indefinitely and, indeed, specifying an annual 3.5% growth rate in the aggregate equalization pot. Either province can, at its option at any time in the future, including during this year if it wishes, opt into the new program. That is specified in proposed section 3.7.

•(1125)

Beyond 2007-08, Nova Scotia and Newfoundland and Labrador will have to make choices. For 2007-08, the choices are obvious, and what choices are made in this particular year are not irrevocable. However, they will be irrevocable in subsequent years if either province opts into the new program. I would simply make the point that the analysis I've been involved in would suggest, from Nova Scotia's point of view, that remaining within the fixed framework indefinitely into the future would likely be its most preferred option, notwithstanding the fact that it might involve taking slightly reduced benefits in the 2008-09 fiscal year.

The Chair: Thank you. We appreciate your comments, and I'm sure you will be able to work in some more material in responses to questions.

Mr. McKay, seven minutes.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Mr. Chair. I just want to take a minute of silence for Professor Hobson. Anybody who has studied equalization for 25 years has nothing but my sympathy.

Voices: Oh, oh!

Hon. John McKay: It's hard to imagine how one document, Bill C-52, could offend more people. Literally, *a mari usque ad mare usque ad mare*, from sea to sea to sea, to the industrial heartland of the nation out to Alberta, where, if you will, it's part of our new economy.

But I wanted to focus on Mr. Dielwart in my brief time. We had a presentation here yesterday and the presenter talked about the unintended negative consequences of this move with respect to the income trust fiasco. I don't generally go to paranoia, but I'm just wondering whether it was unintended or if this was a move intended to destroy the sector, because some of the consequences of the decision were blindingly obvious.

It would be blindingly obvious that this would give a boost to the growth of MLPs in the U.S. It would be blindingly obvious with experience in hand that it had potential to destroy billions of dollars worth of investment. It was blindingly obvious that it would tilt the playing field in favour of private equity, etc., and we see that rolling out literally in waves.

I know your group was talking to the previous government about energy trusts as a unique entity needing to be left alone, if you will, and it would be blindingly obvious that there are going to be a bunch of takeovers.

So I disagree with yesterday's presenter that it is unintended; these consequences were readily predictable and possibly even intended. So I want you, Mr. Dielwart, to tell this committee what's unique about energy trusts that they need a carve-out.

•(1130)

Mr. John Dielwart: Thank you very much. First and foremost, I'd like to address the issue of was it or was it not intended. I don't think there's any question from anyone who looks at this policy that this policy was intended to eliminate trusts from the Canadian economy. Based on the government's own tax leakage numbers, which we have repeatedly disputed, a 3.5% tax would have dealt with it. We

got 31.5%, so I would agree with you that there was an overt measure here to eliminate the trust sector.

We in the energy trust sector have been saying from the beginning that we are different, and that has caused a lot of people to raise their eyebrows, but we remind this committee that energy trusts were created in the late eighties with specific rules from the Department of Finance. This structure was intended for these assets for very good reasons.

The maturing base in the costs of capital advantage that has been created by this entity is allowing us to more fully develop Canada's energy resources. We have repatriated tens of billions of dollars of assets from foreign ownership, and those foreign corporations are interested in one thing and one thing only today, and that's the oil sands. They are neglecting conventional production, which is the bread and butter of small-town Alberta, and we fail to understand how this government could look at the energy trust sector in any way but to say that this is a beneficial component of the economy.

The 20% of Canada's production that we represent would diminish significantly under the cost of capital changes that will occur as a result of this policy. So we have asked ourselves many, many times, why would the government do this? It's clear it doesn't understand our industry. It's clear we have not done a good enough job explaining what we do. We defy anyone to take a hard look at the report we presented to this committee and to the Department of Finance six months ago now and not conclude there's a very important role for energy trusts to play.

Hon. John McKay: You can readily see how a finance minister from central Canada maybe just doesn't get it, but presumably a prime minister from Alberta should get it.

So why are energy trusts just going to disappear, and what has been the effect on the market for you? The TSX has been on a tear lately and has lifted all boats, but the trust sector has lagged the TSX since October 31. Explain to the committee how that has played out for your particular sector.

Mr. John Dielwart: It specifically addresses some questions that came from the chair yesterday about the fact that valuations are back up. I'll give you our example. We're one of the larger top performing trusts. We traded in the \$28 to \$29 range on October 31. We currently trade in the \$21 to \$23 range—a 20% to 25% hit. We have not cut distributions. Our programs continue to work well. So while the broad sector is up, we're down by 20% to 25%, and that's not going away.

Our cost of capital has gone up by 20% to 25%. Our access to capital has gone down—our ability to fund the projects that are necessary. I remind this committee that energy trusts are at the forefront of carbon capture and storage. I can tell you that on October 31, the economics of every CO₂ sequestration project we have changed—and our company has been at the forefront of that with several projects. They came into question. The probability of those projects proceeding on the same basis as they would have before has changed dramatically.

•(1135)

[Translation]

The Chair: Thank you, sir.

Mr. Crête is next.

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

Mr. Nantais, you spoke to us about the ecoAUTO program. We all recognize that environmental matters require a major effort, particularly in regard to greenhouse gases, and that action is required across all sectors.

But you briefly spoke about what you see as the negative consequences of the current version of ecoAUTO. I know that a review is planned for 2008. I would like to know what changes you would like to suggest so that the program meets its objectives, but also does so in a way that is more effective for your industry in general.

[English]

Mr. Mark Nantais: Thank you very much, Mr. Crête.

Because this program is so flawed, our recommendation is that it be eliminated, that steps be taken to essentially phase out this program as quickly as possible. But in the meantime, make adjustments to the playing field between manufacturers and provide certainties to manufacturers for the 2008 model year.

This program was introduced without any warning or consultation with industry, yet it's almost three months later and the wheels have already come off the cart. Administratively, these programs are complex and don't work.

On recommending more appropriate action, we suggest following through on a broader integrated plan that involves the smog-related standards that have already been adopted—the most stringent smog-related standards in the world. We should follow through with our voluntary agreement to reduce greenhouse gas emissions by 5.3 million tonnes in 2010. We should now look beyond that with more stringent fuel economy standards that the Prime Minister has announced he will do in 2011. Those standards, in our view, should continue to capitalize on and benefit from the integrated approach that our industry has taken since 1965 and harmonize ourselves with the very stringent reformed CAFE standards that are forthcoming in the United States.

We recommend that we take the broad comprehensive plan to integrate fuels with greater diversification of fuels, that we integrate the whole notion of green fleet zones, where government fleets and commercial fleets can adopt many of these vehicles that we already have on the market that run on renewable fuels, like 85% ethanol or biodiesel.

We should help consumers, not with a program like the auto eco-rebate or the green levy program, but with an incentive to actually help offset the premiums attached to some of these very sophisticated advanced technologies.

We should also look to driver behaviour. This is not so much a fuel economy debate as a fuel consumption debate, and it's a nuance that is very important. Our ability to reduce greenhouse gas emissions really depends on how we use our vehicles and how far we drive a vehicle. The amount of greenhouse gas emissions we all emit when we drive a vehicle is directly proportionate to the amount of gasoline consumed.

That is what we would recommend, Mr. Crête.

[Translation]

Mr. Paul Crête: I have somewhat of a conflict of interest because I myself drive a subcompact. The program certainly targets very small vehicles through a criterion that means that, in practical terms, there is only one choice. Would it not be helpful, for the second generation of the program in 2008-2009, if the integrated plan you spoke of allowed the purchase of a family vehicle, a minivan or any other kind of vehicle as long as their results are good in the future?

Purchasers of large cars will not necessarily embrace smaller ones, but some activities are perhaps not sufficiently covered by the current policy. I mentioned the family car, but I could also be talking about the need, in a rural constituency like mine, for such and such a type of work vehicle.

Would a future approach be to reduce fuel consumption rather than just favouring one specific make of vehicle?

• (1140)

[English]

Mr. Mark Nantais: In many respects, you're absolutely correct. The program, as it now stands, does penalize people who have legitimate needs for particular vehicles; in many respects, people who are in rural parts of this country have specific utility needs, so again there's a fairness issue there.

Although this program has been touted as a revenue-neutral program, it's not. In fact, it's like any other feebate program: it's a tax. That's really where other things come out. There's a \$55 million net gain, if you will, in revenue by virtue of this program.

All literature suggests, whether it's the National Round Table on the Environment and the Economy, the Ontario government, the British Columbia government—Other independent studies in the United States clearly show that these programs do not work, but if we are able to remove the program and provide a look at a whole broad range of advanced technology vehicles and help consumers afford them—

We have and continue to have an affordability challenge in this country simply because of lower personal disposable income and higher operating costs and so forth, so the market is actually already optimized to a smaller, more fuel-efficient fleet, and the data shows this as well. People really don't buy much beyond their needs, except in the high-end luxury vehicle segment, and that's where there's a great deal of price inelasticity, where it doesn't matter; because of their affluence, they'll continue to buy the vehicle that they do purchase.

Clearly, with all these things going on and with gasoline prices being the way they are, we are moving to more fuel-efficient vehicles, but if we take on the wrong policy—policies like this one, which can actually retard environmental improvement and retard fleet turnover—not only do we lose out on the smog-related benefits, but we lose out on the greenhouse-gas-related benefits.

The third one we lose out on is vehicle safety benefits. For every old vehicle that's taken off the road—There are over a million 1987 and older vehicles on our roads, each emitting 37 times more than a new vehicle in terms of smog-causing emissions. These new vehicles are equipped with some of the most advanced safety systems that exist, and there's data to show that if we were able to turn over the fleet overnight—we can't do that, of course, but if we could—we would see as much as a 50% reduction in fatalities on our roads. So the whole key here is policies that support fleet turnover.

The Chair: We'll continue now with Mr. Del Mastro.

Thank you, sir.

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

I'm going to continue with Mr. Nantais.

Mr. Nantais, as you know—or as you may not know—I've been around cars since I was 14 years old. I started washing cars, and worked in parts departments, worked as a mechanic, and worked in various dealerships. I've worked every capacity in a dealership. I've sat on Suzuki Canada's dealer advisory board. I've sat on the CADA industry relations board. I have a lot of experience around the auto industry. And we've also been, amongst other things, an emissions test and repair facility since 1999.

When I first heard about the program announced in the budget, I was very suspicious, to be perfectly honest with you. I'd had experience with things like the air conditioner tax, the federal air excise tax that was brought in during the eighties, the provincial gas taxes that have been brought out, and they really didn't curb consumer appeal or demand. They didn't drive anything. They didn't really do anything except create a new tax.

That said, I think there are a couple of things we need to recognize about the direction of the auto industry over the last number of years. It's been in complete contravention of the direction in which we know, inherently, we need to go as a society.

As we talk about reducing greenhouse gas emissions—and I know the former government talked a lot about it, especially since 1997. What we actually did was we started building cars that were less and less fuel efficient. When I signed on in 1997 with the manufacturer that I represent, we had a car that got 58 miles per gallon. Our best car on gas for fuel economy now is 42 miles per gallon. Why? Well, because we kept on driving up horsepower numbers. We were feeding what people wanted.

I understand, because the auto industry is in the business of giving people what they want. That's what they compete on, creating appeal. Showroom appeal really sells cars. But ultimately the government has a separate responsibility, and that is to tell people that showroom appeal is important, but we really have to bring this back because greenhouse gas emissions continue to go up.

I applaud the vehicle manufacturers, believe me. I will tell you, from the point of view of an emissions test facility, that smog-causing pollutants in vehicles are down dramatically. People need to know how much cleaner today's cars run and the technologies they've developed, the safety technologies that are going into cars, the investments the manufacturers have made to make cars better in

every conceivable way. And I applaud the vehicle manufacturers for that.

I also applaud you for the opening remarks you made with respect to the very positive things that are in the budget for the vehicle manufacturers, such as the accelerated capital cost allowance and other issues we put into the budget that assist the industry.

I did want to quote something here, and I want to get your remarks on it. This comes from a *Toronto Star* article of May 2:

The Canadian auto industry has smashed its sales record for April with a boost from the federal government's rebate program for fuel-efficient vehicles.

Sales and leases of new cars and light trucks jumped 9%, or almost 14,000, to 168,984 vehicles last month from the same period last year—

The big increase in Impala business fuelled a turnaround at General Motors of Canada Ltd. last month after significant monthly declines. GM's light vehicle sales jumped almost 16 per cent, or more than 6,000, to 44,651 despite two less selling days than April 2006.

Industry watchers said Ottawa's new program in March's federal budget contributed to the strong gain.

Dennis DesRosiers also said, "Since the Canadian consumer primarily buys small fuel-efficient vehicles, this incentive helped propel the market to its best April on record."

Now, I recognize what you're saying—except that the government did make some very significant concessions in the new announcement. We excluded minivans because we know families need space. We excluded pickup trucks because we know workers need trucks. We've really taken a look at the program and asked how we can make it work best. We've also made very significant concessions for vehicles that will run on E85, flex-fuel vehicles. We see that result.

You made the point that big is no longer bad. We agree with you. That's why we put the money on Impala, and we'll see how the Impala does. There are other E85 vehicles that are doing very well. We're not telling everybody that they have to drive a small car. We're just telling them they need to drive a better car.

I'd love to get your comment on that.

• (1145)

Mr. Mark Nantais: You raise a lot of issues, and important ones. When you look at one-month sales like that, you really have to start looking into the longer trend. Clearly the rebate program, for instance, has shown that yes, for one vehicle in particular, again the one that I was referring to, it has generated huge volume sales increases. It's the same with the E85, obviously. It would generate that. But the perversity comes into the fact that you have other manufacturers who might just be on the other side of the arbitrary threshold that was chosen. Our objections, and they're supported by a great deal of literature out there, show that ultimately these programs do not work, and it's very difficult to either determine or even demonstrate that people actually shift from either a smaller vehicle to a larger vehicle to a smaller vehicle.

What we're saying is when you have basically the on-road fleet accounting for only 12.5% of greenhouse gas emissions in Canada in total and new vehicles accounting for only 1% of that, and feebate programs and any regulation only address the new vehicle market, it doesn't make a whole lot of sense. If we were able to take this broader integrated approach that we speak about, we could make a great deal more progress without the perversities, without the inequities, without the unfairness that is imposed on manufacturers and ultimately consumers. That's what we're saying here.

While I think the intent may have been to actually generate or create a greater level of visibility on the issue and environmental benefit, I think in the end you will find that won't be the case. You will not be able to attribute any success to the program, particularly when you complicate things by increasing gasoline prices. All of the literature shows and a lot of economists will clearly show you that what really matters here, what really does make a difference, is that people respond to gasoline prices, fuel prices.

We still operate, even despite increases in gasoline in Canada, in a relatively low energy cost environment. Any other countries around the world that have high gasoline prices and so forth clearly have a smaller, more fuel-efficient fleet. All we're saying is we don't think this is the right thing to do. We would like to see it eliminated, and we would like to work with the government on how we can bring forward a more integrated plan that will actually yield greater benefits in terms of transportation and GHG emissions.

• (1150)

The Chair: Thank you, sir.

We'll continue with Madam Wasylycia-Leis for seven minutes.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): Thank you, Mr. Chair.

Let me just pick up on the last point, because in fact I don't see any sign that the Conservatives are going to voluntarily move to delete this section of the bill. Is there a way we can fix up the proposal in Bill C-52? I'm wondering if it would help to add the words—somehow get the sense across that we want to only give the incentive when we're talking about domestically produced cars. Would that be of merit, at least in terms of domestic production and jobs and industry in this country?

Mr. Mark Nantais: There's no good angle on this thing in terms of fixing it, in our mind. If we were to perhaps limit that rebate or

that incentive to only domestically produced vehicles, then I would suggest it could raise some trade-related issues. It could be seen as a non-tariff barrier to trade, for instance. That's one angle.

This is a program, and again I come back to the literature that exists out there, that has a very high cost for very little return and has a great imposition in the competitive marketplace when in fact companies are competing more fiercely than ever before. Free market competition like that, I would suggest, works far better than trying to enter into the market and manipulate it, particularly when, again, the data shows that Canadians are already making some very prudent decisions about the vehicles they purchase.

Ms. Judy Wasylycia-Leis: I hear what you say, but I may not agree with that. I wouldn't mind hearing from the David Suzuki Foundation or from the Living Oceans Society and having their views on this. In fact, I think the only way we're going to really get a handle on it and get ahead of the game in terms of the future of the planet is by market intervention.

I'm more concerned right now in terms of your presentation from the point of view of Canadian investment. I think we should at least have some agreement around what this will do to discourage investment in the country, what it will do in terms of increasing import purchases, what it will do in terms of Canadian jobs, and what it will do in terms of making Canadian-built vehicles more expensive. I'm looking for a way to apply this model in a way that encourages the economy and is meaningful.

Let me ask both Bill and Kate about this issue of how you intervened to get, or how you achieved, progress in terms of the environment, and then let me get to the question about the Living Oceans Society and marine protected sites.

Mr. Bill Wareham: The bigger issue is around incentives. I'm going to defer this at some level to some specialists we have at the Suzuki Foundation on this file. I'll be happy to provide the committee with some more details on it in writing.

Incentive is key in this. Unfortunately, other manufacturers took the lead on developing hybrid vehicles and these kinds of things. If we're going to develop a range of alternative technologies, we're looking at incentives.

This program, in our view, is providing a great level of awareness, the discussion. The fact that this program is out there has so many people talking; here are alternatives; there's a way to do this differently; we need to reduce things. It's as much an education, awareness-raising thing, which I hope can lead to some of the other changes.

I don't disagree with Mark on some of the things that should be considered as well, and some of the issues that have to be dealt with, but we believe a program is necessary to drive incentive and change within industry in Canada, and that the Canadian public is looking for this and I think would welcome some significant shifts in industry in Canada to mirror some of the other manufacturers.

Ms. Judy Wasylycia-Leis: Thank you. Let me ask Kate for her views on this.

As well, I would like you to take the opportunity to tell us by how much we're missing the boat, so to speak, in terms of dealing with dead oceans or near-dead oceans.

You said you asked for the minimum, \$600 million, just to work on protected marine sites. Is that right?

• (1155)

Ms. Kate Willis: It's more than that; \$600 million, in our mind, would actually comprehensively cover an integrated management planning process for the five ocean areas that have been identified in the oceans action plan.

Ms. Judy Wasylycia-Leis: And this budget only provides what?

Ms. Kate Willis: It provides \$19 million, with no funds identified toward integrated management. That \$19 million is supposed to cover pollution prevention, establishment of marine protected areas, enforcement and surveillance, and anything else in terms of protection.

Ms. Judy Wasylycia-Leis: So it's minuscule. We always say a drop in the bucket, but this is more like a droplet in the ocean.

Ms. Kate Willis: It is; it's a drop in the proverbial ocean.

Ms. Judy Wasylycia-Leis: Or a teardrop; it makes you want to cry.

I'd like you to express what will happen as a result of not having some more intervention.

Ms. Kate Willis: I can give a really good example. I was just in an area of British Columbia called Rivers Inlet, which is a small coastal community in the central coast of British Columbia. This is a community that once had 6 million salmon running in its inlet. It had an oolichan fishery, which is crucial to the first nations in the region. That salmon fishery is gone; it has been closed down completely. The oolichan didn't come back last year.

There's a sports fishing industry there. As Bill mentioned, sports fishing in British Columbia contributes \$500 million to the economy. They felt a hit last year.

So we are starting to see the effects of mismanagement of our oceans resources. We're at a point now where we're increasing industry, we have increases of shipping, we have increases in cruise traffic, we have increases in port terminals. All of these things are good for the economic growth of British Columbia, but that kind of increase is only going to contribute to the questions of sustainability.

At this point, with the direction it's going, there's no management. There are absolutely no plans for how we are going to deal with these increases in addition to fishing pressures and the needs of coastal communities.

As far as we're concerned, we're going down a very slippery slope toward a point where we are not going to be able to handle the conflicts in a productive way, and I think we're fairly close.

Ms. Judy Wasylycia-Leis: Thank you.

The Chair: Thank you very much, Madam.

We'll continue with Monsieur Thibault.

[*Translation*]

You have five minutes, sir.

Hon. Robert Thibault (West Nova, Lib.): Thank you, Mr. Chair.

[*English*]

I want to thank all the panellists for participating, especially Mr. Hobson, who was on the same trip I was coming from Nova Scotia.

Mr. Hobson, you've done a lot of studying on the Canada-Nova Scotia accord, and I've read some bits that came out in local papers. In your analysis, what is the cost to the Nova Scotia treasury of this broken promise regarding the Canada-Nova Scotia accord?

Prof. Paul Hobson: Well, the number that has appeared in the media is approximately \$1 billion—some \$950 million to be exact, based on the data I'm using.

What that number represents is the impact of the fiscal capacity cap on Nova Scotia over the period effectively between now and 2013-14. What that \$1 billion more or less represents is a complete clawback of the benefits under the additional offsets payment act.

The point in putting that number out was simply to have people understand that there are issues of important principle here with regard to adhering to the accords, but that these are also issues of significant financial import to the province.

Hon. Robert Thibault: The province has come up with similar figures, very close, I think, to what you have. The figures I've seen coming out from them were only for the first term of the accord of 2012, but the accord was renewable for another eight years, to 2020. Have you been able to do the analysis of those additional eight years?

Prof. Paul Hobson: Yes, we have been able to work these things through. Indeed, the billion-dollar estimate takes it right through until 2019-20.

Hon. Robert Thibault: Is that under the assumption of only the existing production fields in Nova Scotia?

Prof. Paul Hobson: That's correct. We've not incorporated the possibility of Deep Panuke coming on stream, but should it come on stream in the timeframe involved, the revenue flow to the province would be relatively small, given the way royalty arrangements work. So it should not dramatically affect the results.

Hon. Robert Thibault: In the case of the rumoured subamendment or subagreement that we're hearing about, the rumour is that rather than having just one year to play Russian roulette, the premier will be able to take until 2012 to make that decision about going with a new equalization formula or maintaining the equalization payment. Have you been able to do the analysis of each year? Has anybody done an analysis of what would happen if it changed at any time?

• (1200)

Prof. Paul Hobson: That's exactly the kind of analysis that I've been undertaking for Nova Scotia, that my colleague, Dr. Locke, at Memorial has been undertaking for Newfoundland and Labrador. Rumours are just rumours, so I don't want to comment on them. I doubt very much that the option will be that a province can move back and forth between a fixed framework and the new arrangements. I don't think that is in the cards in the long term.

What I would suggest, however, is that given that the decisions that have to be made for 2007-08 are in fact straightforward decisions, given the numbers that have been presented to provinces, the issues going forward should perhaps be better studied prior to being locked into budget legislation. So what I would suggest would be the implementation of a task force picking up on the work of the expert panel but now extending to the proposals that are contained in Bill C-52 that would provide greater insight into the actual effects of these proposals. They are not well understood by those of us in the academic community, as far as I can tell, nor are they understood very well by others in the policy community.

Hon. Robert Thibault: Ms. Willis, I was involved in the listing of the Race Rocks, and the opening of the hydro vents and the Gully, and I remember the very difficult consultation process with the fisheries and with other users on these issues. If we looked at one of these proposed MPAs, the future ones, if we looked at Race Rocks, how far would \$1.9 million get you, on just one of them—not the 15 under consideration, but just one?

Ms. Kate Willis: I would have to go back and do a real financial analysis to give you a truly accurate answer, but off the top of my head, I'll say it would not get you very far. When you look at what needs to go into designating a marine protected area, you have multiple sectors that have a stake in the area, most notably fishermen. You have tourism operators. You have stewardship groups. You have industry. You have to decide what areas you're going to keep open and what areas you're going to keep closed.

In order to do that in a really meaningful, transparent way, you need to make sure that you have a process in place that adequately addresses the needs of all stakeholders. In order to do that effectively, I would say it's a process that can take up to two to three years to ensure that you get representation from people. Particularly in a province such as British Columbia, you need to fly people from all sorts of different areas, so \$1.9 million would go very quickly.

I want to just clarify that this \$1.9 million that was allocated wasn't just for establishing marine protected areas. It was also for surveillance and enforcement. It was also for pollution prevention and abatement in addition to establishing marine protected areas. So the reality is, I would say, it is impossible to do all of those things with \$1.9 million. It's setting someone up for failure to give them that.

[*Translation*]

The Chair: Thank you.

Mr. St-Cyr, you have five minutes.

Mr. Thierry St-Cyr (Jeanne-Le Ber, BQ): Thank you very much.

I would like to follow up the discussion with Mr. Nantais. I would like to understand his argument better.

Perhaps I misunderstood, but it seems to me that there is something contradictory in your remarks. On the one hand, you say that the policy will have a negative impact on Canadian industry because people will want to buy other products, and, on the other hand, you say that the policy will not have an effect on the environment because people will not change their purchasing habits. It has to be one or the other: either the policy will have no impact on consumption habits and the industry, or it will have an impact on the industry because consumption habits will have changed.

What is your view?

[*English*]

Mr. Mark Nantais: I don't think there's a contradiction. And perhaps I did not articulate the position well enough for you.

But all the data show—and I can particularly cite data from Ontario, for instance, showing that when they introduced their tax for fuel conservation, it retarded new vehicle sales by upwards of 3%. And, by the way, Ontario will get hit with that, plus this.

The key thing here in terms of environmental benefit is turning the fleet over. While we may see an increase in sales of one smaller vehicle, for instance, that may receive a feebate, other vehicles will receive a penalty.

So there are several factors that come into play. It does get complicated, but clearly when you delay the fleet turnover, you delay environmental benefit. When you tax the vehicles that are primarily the ones we produce here in Canada, they too get hit with a penalty. And it's not just my member companies, but it's other manufacturers here in Canada as well who produce larger vehicles.

But to the extent that people delay their purchase of a new vehicle because of that tax—again, fleet turnover is delayed, and there is no environmental benefit—they will go elsewhere to get a vehicle, or a nearly new vehicle, that meets their needs. This means they could go to the United States to get a vehicle. Generally, the United States has an unlimited supply of nearly new vehicles, and in many instances, because of the different nature of their vehicle fleet, those vehicles are less fuel efficient, meaning again there is no environmental benefit.

The impact of that, of course, is that to the extent we produce some of those vehicles in Canada, we will produce and sell fewer of them.

We're in a situation now where there is overcapacity globally and in North America, and we will decide to produce vehicles where we can do it the most effective way. If we have a plant that's underutilized in Canada, we'll go elsewhere. Capital is extremely fluid now. We will go offshore to produce vehicles. We are the most open market in Canada. We will produce vehicles offshore and bring them into Canada.

So it does come back down to whether this is a hostile regulatory environment in Canada. The levy side of it presents a real obstacle to creating the most positive business plan or business case you can make to bring new investment into Canada. This is where the negative implications occur.

• (1205)

[Translation]

Mr. Thierry St-Cyr: How is it that the vehicles made by the Canadian producers and manufacturers in your association do not meet the program standards? Is it going to encourage manufacturers to build vehicles that do meet the standards, and thereby allow them to take advantage of the rebates and make more sales?

[English]

Mr. Mark Nantais: Actually, all vehicle manufacturers have some vehicles that meet the rebate program. All vehicle manufacturers have some vehicles that receive a penalty under the program. So it's not a question of whether we have and they don't, or they do and we don't.

[Translation]

Mr. Thierry St-Cyr: You told us several times that only one met the criteria. Is it one, or several?

[English]

Mr. Mark Nantais: What I have said is that one vehicle receives almost three-quarters of the rebates—one vehicle. It's not an advanced technology vehicle. It's not a vehicle produced in Canada, but one brought in from offshore.

You have another vehicle that directly competes with that vehicle. And by the way, they're both made by recent entrants to Canada in manufacturing. One vehicle sits on the other side of the line and doesn't get the rebate. Yet there is a huge discrepancy in the sales of those vehicles. And the other vehicle, vehicle B, if I can call it that, is one where the company is very concerned that they can no longer compete on a level playing field, to the point where they are actually thinking of taking off vehicle safety equipment in order to be competitive.

That's the perversity of the program, which, in my mind, is not a right thing.

[Translation]

The Chair: Thank you very much, sir.

Mr. Wallace, you have five minutes.

[English]

Mr. Mike Wallace (Burlington, CPC): Thank you very much.

Thank you to the panellists for coming today. I only have a couple of questions.

I do appreciate the panellists from the area of water quality and the environment, in terms of the oceans. To be fair, we, including myself, did have a number of requests and ideas that we'd like to see in the budget. Obviously, it didn't all get in there. We saw hundreds and hundreds of people last year, and they all had a request. I don't think anybody, or very few, didn't want money for something.

I am very supportive of the national water strategy. It may be just a beginning. It may not meet your needs, but from my particular area it certainly does, on the Great Lakes. It is a start. I will continue to pursue those issues. Also, I was recently nominated for a marine caucus piece, and I might take some interest in what those issues are related to industry.

I do appreciate you coming.

I do have one question to begin with for the professor from Nova Scotia. We based our results, basically, on the O'Brien report, who I don't think was hired under the Conservatives but rather under the Liberals to do the math. Based on the numbers that I have, there actually is a difference, and I believe they've gone with the new formula, I'm pretty positive of that, for this year, and then there's a decision to be made, which I think was referred to earlier.

Could you explain to me where O'Brien was wrong in his formula, compared to what you have in your formula?

• (1210)

Prof. Paul Hobson: First of all, let me say I don't have a different formula. I'm not here advocating anything. All I want to say is that Bill C-52 goes well beyond O'Brien. The O'Brien formula is part of it, but there are three formulas at work in the proposals in clause 80 of Bill C-52. O'Brien did not recommend the continuation of the status quo. O'Brien did not recommend a formula in which there's zero inclusion of natural resource revenues, and yet these are all parts of the proposals.

O'Brien had nothing to say about the offshore accords, and yet there are major changes in the language of the offshore accords, in how calculations will be made. That was not part of O'Brien. So I don't think we can hide behind O'Brien.

Mr. Mike Wallace: I'm not hiding behind the O'Brien report. In fact, I think the O'Brien report was a lot stronger in those areas, in terms of offshore accords, and that we had made a commitment that we were going to honour them if that was the choice of the provinces, and that's why they got added. I think we're doing more for those areas of Canada than what the O'Brien report would have reported. If we had gone by it very strictly, if the finance department had gone strictly by it, the option likely would not have been there.

I think you're absolutely right, we're not hiding behind it. Actually we're improving on it. I appreciate that piece.

In all your work in your 25 years of doing equalization, what have you done to recommend to the province that they become a have province and not require equalization anymore?

Prof. Paul Hobson: I'm not in the business of making recommendations to the province.

Let me just make the point that in a situation where you have wide disparities of natural resource revenues across provinces, there will always be provinces that are have and provinces that are have not.

Mr. Mike Wallace: My next question is for my acquaintance from the automotive area. It's nice to see you again. The numbers you quoted, are they based on current sales with no actual change? I think you said it was an overall uptake of \$55 million; I forget what the number was that you mentioned earlier. Is that with the status quo based on last year's sales, or where do you get that figure from?

Mr. Mark Nantais: It's based on 2006 annualized sales.

Mr. Mike Wallace: So there's no change to the actual sales. So whatever cars I sold of whatever make last year, it would be the same this year.

Mr. Mark Nantais: That's the assumption. We don't have the data to project outward.

Mr. Mike Wallace: This is along the lines of Mr. St-Cyr's question—and I'm not sure if we discussed this before or not, but I think we have. You're convinced that the incentive program will not get people to buy more of the cars on the list. I think there are cars that are manufactured in Canada on the list. I'm not saying there couldn't be more, and I think, to be frank with you, that there are likely some adjustments that could be made over time to help improve that piece. It's difficult to argue that there'll be no change—

That's five minutes?

The Chair: I think so, yes. Five minutes and four seconds. *Merçi.*

Mr. Dielwart, I have just a quick question for you. One of your colleagues in the trust sector pointed out an issue of concern to him yesterday, and I just wanted to get your views on this. This was in terms of not having a road map for future reorganizational possibilities set out in the tax act. He said section 82, perhaps, of the tax act.

Mr. John Dielwart: Section 85, I believe.

The Chair: Section 85, thank you.

Do you share that concern? Is that something that you suggest work has to be done on?

Mr. John Dielwart: Absolutely. If the ultimate conclusion is that we must be forced to become corporations, then there has to be a tax-

effective mechanism to do that without penalizing all of our investors on what we would view as an arbitrary forced conversion.

So there are very clear issues on what are the rules going to be for us to morph into whatever we have to become, all the while saying that the industry should be left in its current form, of course.

• (1215)

The Chair: Certainly. Thank you, sir.

We are going to go with three more questioners. In an effort to get them all in, I'll just say Mr. McCallum, three minutes.

Hon. John McCallum (Markham—Unionville, Lib.): Three minutes. Why not five minutes?

The Chair: Because I want to start the next panel on time and we also have to break for lunch. So I am going to end up giving you about three minutes for lunch, if I go three minutes, or no time. This is an effort to get one of your colleagues in, by the way, Mr. McCallum, so we'll go with three minutes and some ten seconds.

Hon. John McCallum: One question for Mr. Nantais.

I've heard that the Minister of Transport says the program belongs to the Minister of Finance and the Minister of Finance says the contrary. Do you know who's in charge of this program?

Mr. Mark Nantais: I can only tell you what I know or believe to be the case, which is that ultimately, as it relates to this program and the accelerated retirement of older vehicle program, it is in the hands of Minister Cannon and Transport Canada.

Hon. John McCallum: Thank you.

To Mr. Dielwart, it is difficult to understand the rationale for deliberately setting out to destroy energy trusts. I think you've already testified that that is your belief. One can think of a number of players who might have influenced the decision. I know we're getting into speculation, but it could be CEOs, some of whom compete with income trusts, it could be finance department officials, it could be the PMO, or it could simply be a minister out of his depth.

Do you have any idea of what ultimately led to this policy in terms of pressures on the government?

Mr. John Dielwart: It's our view, and of course we don't have firm knowledge, but if you listen to some of the government's own witnesses, people like the Governor of the Bank of Canada, they are suggesting that the model was being extended to areas outside of where it was originally intended. I don't think there's any question there was significant lobbying by CEOs who did not want to become trusts.

As a CEO of a trust you are more accountable to your unit holders than you ever are in a corporate form, and many people like spending the corporation's money in the way they see fit.

I believe the energy trust got captured in the nuclear blast—as you so rightly described the way they have taken an approach to this sector—and that the energy trust sector is perfectly suited for where it is. That's the view we are getting from people like David Dodge, from Dominic D'Alessandro, and from Kevin Dancy. So we are at a loss to understand why we are wrapped up in here, particularly since the government has stated that they acted on energy trusts because these did not exist in other jurisdictions, and that is patently untrue. Not only do they exist, they are growing at a rate that is going to dwarf what's happening in Canada.

The Chair: *Merci.* We'll continue with Mr. Dykstra.

Mr. Rick Dykstra (St. Catharines, CPC): Thank you, Mr. Chair.

I just want to follow that up. I read page after page, yesterday, today, and over the last month, John, about the comments and the doom and the gloom of the industry and where it's not going to be in five or ten years. And then page after page, report after report, not just on front pages, not just in political editorials, but in the finance sections of the newspapers, whether it be an economist at the bank, whether it be from individuals who are experts in the area, say that we have an industry that is strong, we have an industry that is one of the most competitive in the world and is going to be able to compete.

Are you saying your industry is finished because of this one issue?

Mr. John Dielwart: What we're saying is that the ability to optimize Canada's energy resources for all Canadians has taken a significant hit. If you took the opportunity to review our report, you would see that the maturing western Canadian basin has significant cost issues, and any time you increase the costs of capital in any business, it alters their ability to execute certain types of projects. Those projects include conventional optimization projects and they include carbon capture and storage projects.

We're not saying our industry is going to disappear; what we're saying is we're going to be forced into a corporate model that is not conducive to the nature of the basin today, and we'll be forced to do what all the other corporations are doing: pursuing different strategies that are not for the benefit of small-town Alberta, not for the benefit of Canadians as a whole, and certainly not for the benefit of individual Canadians who are being denied the opportunity to invest in something that's very important to their future.

•(1220)

Mr. Rick Dykstra: You made the point very clearly that you're now going to have to compete as the rest of corporate Canada does. Is there not some form of fairness when it comes to competitiveness, when it comes to corporate Canada, and when it comes to making sure all of us pay our fair share and pull the weight we're supposed to, to make sure we stay together as a country?

Mr. John Dielwart: First of all, we're paying more than our fair share. There's no scenario under which you can look at the statistics and see that Canadian individual unitholders are not paying their fair share, so this whole notion of not paying their fair share is just false.

Mr. Rick Dykstra: All right, John, thanks. I'm sorry I have to interrupt you there; I don't have much time and I wanted to ask one other question.

Paul, you said you weren't in the business of making recommendations but in the business of studying. I look at what's in this budget for the province of Nova Scotia and I hear that it's not enough. When I look at \$1.3 billion under the new equalization system, \$130 million in offshore core offsets, and \$639 million under the Canada health transfer, I see good things for Nova Scotia.

You've said you don't want to make recommendations, but if keeping the accord is something that's going to benefit Nova Scotia, according to you, then why don't they just keep the accord and not enter into the new deal, even though there are a lot of advantages that sit within this budget itself?

Prof. Paul Hobson: That is a very good point, and it may well be the decision the province makes. For 2008-09 it may well be that they forgo some benefits under the current recommendations with the new program, but going forward it may well be that they're much better off staying within the fixed framework. The question is whether, over the long term, three different equalization programs will be sustainable.

Mr. Rick Dykstra: Over the longer term, when you look in the past in terms of equalization, haven't we been having these same arguments as a country since 1867? Isn't this at least a step in the right direction to try to make it more consistent?

Prof. Paul Hobson: It is a worthwhile discussion, and I think it needs further study.

The Chair: Thank you very much, Mr. Dykstra. We'll conclude with Mr. Pacetti.

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.): Thank you, Mr. Chairman. Again we save the best for the last.

I have just two quick questions. Mr. Dielwart, in your sector, what is your viewpoint? I understand the finance minister wanted to get rid of the income trusts, but he's being inconsistent by allowing the real estate sector to continue to survive. I would understand if he'd put a moratorium and said there would be no more conversions, for example, for the financial sector or the telecom sector, but that's not what happened. What is your viewpoint there? Why did they allow the real estate sector to continue to survive, while the energy sector is very apparently affected by all this?

Mr. John Dielwart: Certainly we're at a loss to understand how we have not been included under the same basis that the real estate investment trusts were, because it was for real estate and resource properties that the whole structure was originally set up.

What the government stated in their backgrounder was that REITs exist elsewhere; therefore, they need to be exempt. Energy trusts do not exist elsewhere; therefore, we need to get rid of them.

Mr. Massimo Pacetti: “Elsewhere” means where?

Mr. John Dielwart: They exist in the U.S., Australia, and elsewhere. The fact is that the U.S. has an active flow-through entity model very much like this, and they are patterning it in the upstream resource sector on the success of the Canadian—

Mr. Massimo Pacetti: Is there a hidden agenda? Is there a reason that...?

Mr. John Dielwart: It is difficult to understand what the agenda is, because they will not discuss it with us. As we try to consult with them and try to offer them feedback on their reasons for acting, they will not engage. Is there a hidden agenda? I don't know, but we certainly don't know what the agenda is.

Mr. Massimo Pacetti: Thank you.

Mr. Nantais, on the whole feebate program, is there another solution that could be useful to your industry? For example, I'm thinking about taking some of the money and using it to take old cars off the market. Is that a solution, or are there other solutions that we're not thinking of?

Mr. Mark Nantais: I agree. One solution is to get the older, higher-polluting vehicles off the road. In fact, what has been announced actually detracts from one of the other options the government announced, which is the accelerated retirement of older vehicles program. So you basically have one program detracting from another.

We submit that the \$30 million that was put aside for the early retirement of vehicles program is actually extremely underfunded. We'd be better off putting more money into that program, but also looking into fuel diversification, like ethanol from cellulosic processes ultimately, and getting more distribution out there.

They've done the right thing by adding more to the production side of renewable fuels like ethanol. But we're coming up short on the distribution side of it—on getting more stations out there, like in the United States. Brazil has been doing it for years, and Sweden is doing it now. We're falling way behind compared to some of these other countries and what they're doing in renewable fuels and their distribution. So we could make more progress going that route.

• (1225)

The Chair: Thank you very much to all our witnesses. It was a very interesting panel and we appreciate your participation.

We'll invite the second panel to gradually make their way to the front. We'll suspend briefly for some lunch.

• _____ (Pause) _____

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• (1240)

The Chair: We will reconvene.

Thank you to our witnesses for their patience in allowing the committee members to get that sustenance they need to probe deeper into the pros and cons of this year's budget. Thank you for being here.

Perhaps you were here earlier, so I will just outline quickly. I know you've been given a mere five minutes to make your opening remarks, but then we'll move to questions from committee members. I do appreciate you being here, and thank you on behalf of the finance committee for doing so.

We'll begin with Richard Jock, who is here from the Assembly of First Nations.

Richard, welcome. Five minutes to you.

Mr. Richard Jock (Chief Executive Officer, Assembly of First Nations): Thank you.

It's the submission of the Assembly of First Nations that the Government of Canada has missed an important opportunity with this budget. We feel that, to a large extent, our efforts to see the concerns of first nations addressed and to implement a first nations plan for creating opportunity remain unanswered.

It is further our point of view that without a comprehensive plan to tackle the comprehensive issues facing first nations, this leaves first nations governments and first nations peoples managing desperate situations. Therefore, we urge the committee to recommend significant amendments to Bill C-52 to reflect these urgent concerns, and we summarize our recommendations as follows.

Funding growth must be commensurate with other jurisdictions. By our estimation, this is 6.6% through equalization and CHT and CST payments to provinces, and it ranges up to 10% for the territories.

Secondly, any new legislation must recognize its financial impact on communities and be funded sustainably with reference to inflation and population growth, as well as other pertinent cost drivers.

Thirdly, discriminatory funding practices must end, and specifically I refer to the fact that within the Department of Indian Affairs' budget the provinces are paid at the provincial rates for such things as tuition agreements in the area of education, and similarly, in child and family services, which leaves comparatively less money within those same budgets for first nations to run their own services. This, in our view, is highly discriminatory.

A second example of such discriminatory practice is in terms of pension and benefit plans for band council employees. We feel that those must meet the standards of other jurisdictions and be transferrable and comparable if we're to retain and recruit capable staff. For example, many such plans are done as sort of wraparound plans, which take into consideration such things as non-insured health benefits, which then simply drive up government costs in other areas.

The fourth point is that the federal government must create a real planning basis for funding, and to do so we feel it's extremely important that with first nations there be the establishment of performance standards, which includes funding to meet those standards.

We also feel that an important part of this, again with first nations, is to look at structural changes to the machinery of government to address some of the inherent conflicts of interest that currently exist and to bring then much more independence and fairness into the fiscal relationships. This was also referred to in the RCAP report, where it talks about setting up a department that would be in charge of policy interests and a separate department that would be in charge of service delivery.

We are pleased to see that this government is renewing and expanding programs in two areas where first nations are leading the way in creating solutions for themselves and their future. Those are the aboriginal justice strategy and the aboriginal skills and employment partnership initiatives. However, these two programs and an investment in the maritime fisheries, much as those are very much needed, are not really an overall comprehensive plan.

The total investment in Bill C-52 for the next two fiscal years, then, is just under \$60 million, for an average of \$30 million a year.

Also in the budget we've seen reference to \$300 million for market-based housing, which does deal with part of the continuum of need for housing. However, it should be noted that this was part of last year's budget announcement, and we feel that further investments in terms of social housing and other elements of that housing continuum are also necessary.

I refer you to the PowerPoint presentation that was distributed to you before the meeting, which summarizes the Canada cost drivers study, which was completed by the Department of Indian Affairs last year.

• (1245)

We feel the study was prompted by some of our own research in the area. I would say that to a large degree our view is that the study is based on correct figures, but our analysis is that it potentially understates some of the real circumstances.

In terms of overall approach, though, it's important to state that beyond those critical investments, we do feel it's important to address some of those historic gaps in well-being, to invest in those, but also at the same time to seek structural change. We've put forward a comprehensive plan to do that, which we'd be happy to discuss with you.

The Chair: Thank you very much, sir.

We'll continue with Diane Urquhart, who is here as an individual. Welcome again to committee, and five minutes to you.

Mrs. Dianne Urquhart (Independent Consulting Analyst, As an Individual): Good afternoon.

There is no need to alter the income trust tax amendment in Bill C-52 based on any developments that have occurred since October 31, 2006, when the new income trust tax was announced. The only action that's now required is for the Canada Revenue Agency to make an announcement that it plans to use the general anti-avoidance rule and the thin capitalization rules in the current Income Tax Act to ensure that all acquirers of income trusts will be forced to pay Canadian business taxes. This must be done so that individual investors are treated fairly compared to pension funds, private equity funds, corporations, and U.S. master limited partnerships. I'll speak on that in a moment. I want to review some of the developments since I was last here.

First of all, the income trust tax damage was relatively small upon announcement. The average capital loss in the 14 days post-announcement was 14%, or \$24 billion. The capital loss as of last night is now negative 3%, or \$5 billion. While income trusts have rallied from their worst prices, they have, as indicated earlier this morning, underperformed the common stock market, which rallied 15% since October 31.

Income trusts are underperforming corporations in the market because they're bringing out the overvaluation that was contained in the market prior to the announcement of the tax. Without access to the new financings, distributions have become less sustainable. The Ponzi structure of paying the excess distribution is not working anymore. Income trusts are now brought to a level playing field with corporations. That was the objective of the tax and that is what the impact is in the marketplace.

Another development since I was last here is that on April 26, 2007, the National Pensioners and Senior Citizens Federation, the United Senior Citizens of Ontario, and the Small Investor Protection Association made a joint call for a criminal investigation by the Royal Canadian Mounted Police and the Ontario Provincial Police on the deceptive cash yields in the marketing materials used by the investment banks to sell income trusts to seniors. I'm here also as a spokesperson today on behalf of those three associations that supported the income trust tax. We have one million senior members throughout all the provinces of Canada.

While there has been some recovery of income trusts in the market as a result of extremely buoyant stock market conditions, there are still 50 business income trusts that are down more than 20% from their public offering prices in the last six and a half years. This group has had an average loss of 50%, representing \$8 billion of capital losses for seniors and other retail investors.

The income trust tax was not responsible for the cause of this decline. It was due to the deceptive cash yields that proved not to be sustainable. We now have close to one-third of the business income trust market that has suspended its distributions or has made significant cuts. The latest ones—XS Cargo, Drive Products, Precision Drilling, Primary Energy Recycling—slashed distributions in the past couple of months. It's when these distributions get suspended and slashed that we get the catastrophic losses for seniors that are the subject of the call for the criminal investigation.

Now I'd like to turn back to taxes. There have been 25 acquisitions of business income trusts. Most of those have indeed occurred since October 31, but acquisitions were clearly anticipated since the new income trust tax would result in the phase-out of most income trusts by 2011. There are only two ways to phase out income trusts: you either get acquired or you decide to convert back to corporations.

The Canadian Association of Income Trust Investors, the federal Liberal Party, and several tax lawyers and financial analysts are saying that the acquired income trusts will not be paying Canada any taxes. This clearly cannot be the case. U.S. master limited partnerships are said to be the most promising acquirers of the Canadian energy trusts, with the intent again not to pay any Canadian taxes.

The objective of the vocal income trusters is to have us rescind the income trust tax that is before this committee today. This is not the answer for fair treatment of individual investors who've just had a tax advantage removed. We can't turn around and give that tax advantage to foreigners and to pension funds. The answer is fair treatment—for Revenue Canada to announce that it will enforce the general anti-avoidance rule in section 245 of the Income Tax Act and the thin capitalization rule in subsection 18(4) of the Income Tax Act.

• (1250)

The fair tax policy is that Canadian business is not to be permitted to operate with artificially high debt loads and interest rates for the purpose of stripping profits and paying no business taxes. Similarly, the energy trusts cannot be permitted to use artificially structured royalty agreements for the purpose of stripping profits and paying no business taxes. All Canadian businesses must pay business taxes, regardless of who owns them: public investors, pension funds, or any foreigners in the market.

The Chair: Thank you for your presentation.

We continue with James Morand, as an individual. Welcome, sir. It's over to you. Five minutes is yours.

Mr. James G. Morand (Partner, McCarthy Tétrault, As an Individual): Thank you.

Just by way of background, I'm a tax lawyer with McCarthy Tétrault, and I practise quite a bit in this area of income funds.

I am here to talk about some technical deficiencies in the current draft legislation. I'm here not to debate whether or not it should go ahead but to instead point out some deficiencies on the assumption that it is going ahead. These deficiencies have been raised with officials in the Department of Finance in detailed submissions, but we thought it worthwhile to bring them to your attention also.

The first relates to the fact that the way the draft legislation is crafted, although it's ostensibly aimed at publicly traded partnerships or trusts, it will similarly apply to trusts or partnerships whose equity is not publicly traded but that have debt that is publicly traded. The reason is that the definition of security and investment in the draft legislation causes the scope of the legislation to be so broad as to capture those types of trusts. That seems to be at odds with the announcements of the minister in the backgrounder when the legislation was released, because the minister indicated then that the legislation was aimed at large public trusts and he talked about the equity being publicly traded.

We think a legislative amendment is necessary in order to carve out debt that is publicly traded where it's not convertible to equity and where the trust or the partnership is not a publicly listed trust or partnership.

A similar problem exists where, in the context of a partnership, you have a partner who has a greater than 50% interest in the partnership, or, in the context of a trust, you have a beneficiary who has a greater than 50% interest. If either of those entities has debt that is publicly traded, you run into the same problem. The underlying partnership or trust is considered to be a SIF and is subject to these rules, although, again, that wasn't the announced scope of the rules. It was aimed at trusts or partnerships whose equity was publicly traded. So we think the rules need to be carved back so they don't capture these types of situations.

It is quite common to have private partnerships or trusts that have parent entities, parent corporations, for example, that carry on business through the partnership in conjunction with a third party. That corporation would go into the public market and issue debt. Because it has issued debt, although it has a private partnership underneath, that partnership gets caught in these rules. Whether it is intended or not, I don't know, but that is the scope of the rules as drafted, and we think they need to be amended.

The next theory I'd like to turn to relates to the normal growth guidelines that were issued on December 15. Those guidelines allow new issues of equity to be made and not considered normal growth if they're used to replace debt that was existing on October 31. But the rules, as contemplated, seem to require a tracing. At least, this is the interpretation being offered by officials in the Department of Finance in discussions we've had with them. The actual guidelines don't say anything about the tracing, but that's the interpretation. They force greater costs and inefficiencies by requiring a SIF that has a debt outstanding on October 31 to use new equity to replace that debt, because it could then turn around and issue new debt, and that wouldn't cause it to be offside. So you could circumvent that restriction by doing a series of transactions. It seems that instead of requiring this tracing concept, it would make more sense to eliminate the tracing concept and just allow a new issue of equity that was equal to the amount of debt outstanding on October 31.

• (1255)

The last couple of points I want to raise are these.

The normal growth guidelines are incorporated by reference into the draft legislation. They're not drafted with the precision of legislation at all; they're very broadly drafted. If they're going to exist in this form, I suggest they be drafted with much more detail so that people will know what's intended. Right now there's no precision to the rules.

On a related point, in the first session, Mr. Chair, you indicated that someone had requested a rollover for subsequent conversions. We endorse that. The existing tax rules don't provide for it, and should provide for it, if these rules are going to be implemented.

The Chair: Thank you very much for your presentation.

We conclude now with Armine Yalnizyan.

There are five minutes to you, Madam.

Ms. Armine Yalnizyan (Director of Research, Community Social Planning Council of Toronto , As an Individual): Thank you, Mr. Chair.

Yes, context is everything, so I want to talk about my context. I come from the Social Planning Council of Toronto. It serves the residents of the sixth biggest governmental jurisdiction in the country: 2.5 million people. We deal with about 1,400 agencies that provide human services to residents, that cover hundreds of thousands of residents every day, and that touch literally the lives of all citizens in Toronto.

We're funded by the City of Toronto and the United Way, if you're wondering where our money comes from.

Context is everything for you. You folks are dealing with the daily cut and thrust of politics. The two big contextual issues in which you discuss Bill C-52 are these.

In the last few days there is the remarkable development in Quebec, where a minority government might fall because it's promising to deliver on its promise to cut taxes, because members of Quebec society feel the need for that money to be used to provide health and education is perhaps the more important imperative. That's quite a remarkable development in our political discourse of the last few years.

The second very important political moment for you is this discussion of mergers and acquisitions and foreign takeovers, which is not just an issue of foreign ownership but more an issue of increasing concentration of our corporate resources. This is a theme I'll touch on in a moment.

Our context for discussing Bill C-52 has several features. First of all, the economy is hotter than it's been in 40 years. All the fundamentals are right. Our government at the federal level has run 10 back-to-back fiscal surpluses, a feat that has not been paralleled by any other nation on the surface of the planet. We are literally rolling in money. That's quite a remarkable contextual moment.

Secondly, we are facing the biggest retirement of the labour force of any industrialized nation on the planet. No other nation had as big a baby boom as Canada had. We have been sleepwalking towards this event with no national training strategy. Whereas our governments mandate access to health and education, there is no

national strategy to deal with what is about to hit those services, which are considered basic by every Canadian who lives here.

Thirdly, inequality is a growing issue globally: between nations, within nations, within your ridings. There's not one of you who sits here who doesn't know of stories of how inequality—not just growing poverty, but growing prosperity—happens cheek by jowl in your riding, rural or urban, and what the impact of that is on your constituencies and between households.

I would love the opportunity to address any one of your caucuses about the issue of inequality as the other inconvenient truth of our era: that it is unsustainable in Canada. It is growing at a faster rate than it has in the 30 years we have data for it, at a time when precisely economic conditions are ripe for its reversal. And it is happening with a face, a place, and a race—some of those comments that Mr. Jock has referred to. This is completely unacceptable for a country with our prosperity.

We have just returned to the rate of child poverty that unanimously your colleagues in 1989 stood up in Parliament and said was unacceptable. Child poverty had to be eliminated when it was at the 11.7% mark in 1989, and now we should be cheering that it has returned to that after 10 years of economic prosperity.

I would say to you this is not about just poverty, and it's also not about just income, when the rich set the markets for housing, and when we are dealing with a global diaspora because we're not dealing with training but are importing our solution. We're welcoming people into the three major immigrant basements, plus Calgary and Edmonton, where there are housing shortages already, where the rich set the prices for housing markets, where our bankers and our economists tell us that over the course of the next 20 years housing prices are going to double. There's not one economist or banker who will tell you that incomes are going to double.

This is not a poverty issue, though poverty is the worst part of it. We are sitting on a potentially huge problem, when the majority of Canadians are feeling increasingly economically insecure at a time of huge prosperity.

I won't go into the other parts I wanted to touch on. But I want to say that I think you have three revenue-neutral options for adjusting your budget to address some of these realities.

First, you should reconsider the tax cuts promised last year. The second 1% of GST reduction—that one point of GST reduction—should go to where the real fiscal imbalance now lies.

You've done an amazing job of starting the discussion on where the fiscal imbalances are and how to redress them. I think it's very important for you to recognize that the real vertical fiscal imbalance is with the cities: \$60 billion to \$120 billion of infrastructure deficit that we know of, which is hard infrastructure deficit, primarily occurs in the cities, and they have no capacity to raise the funds for this. The federal government should be playing a role there.

•(1300)

Secondly, you have introduced significant changes to the CST. We are repeating exactly what we did with the CHST and the separation of the CHT, and so on. It's time to separate out those elements of the CST and introduce clear objectives as to what these pots of money are for. This government is the value-for-money government. It's the accountability government. Show us where the money is going and what we're getting for it.

I think we have some precedents in the way we got the four pillars of child care negotiated prior to that. We can separate out the CST so we are clear on what we are sending money to the provinces to achieve, and it surely can't be just to produce tax cuts for their citizens.

Thirdly—can I just make one more point?

The Chair: No, but you can work it into a response to one of the questions, and I invite you to do that.

Thank you for your presentation. You crammed a lot of very good points into a brief time.

Ms. Armine Yalnizyan: Thank you very much.

The Chair: Mr. McCallum, we'll begin with you. You have six minutes, sir.

Hon. John McCallum: Thank you, Mr. Chair, and thank you very much to all the witnesses.

I'd like to begin with Ms. Urquhart and make a couple of comments and then ask a question.

First of all, I can't really understand why the government measures created a level playing field. I would say it tilted the playing field deliberately in such a way as to destroy income trusts, and witness after witness has confirmed that point. While it's true that a 31.5% tax rate equalizes statutory rates, the critical point is that the average corporation pays far less than that, so it's not truly equalizing.

Secondly, you seem to criticize the argument that you specifically connect to the Liberal Party that the acquired entities won't pay much tax when they're acquired by a combination of public pension plans and private equity outfits that load up on private debt. I don't think you deny that they won't pay much tax under existing rules, but you're proposing to change the rules, to change to the thin capitalization rules so that they won't be allowed to load up on debt anymore. But under existing rules, we are claiming that in many cases they'll pay little tax, partly because public pension plans pay no tax in the immediate and partly because there are these devices, by loading up on debt, so that private equity firms of the kind that are likely to acquire BCE will pay little tax.

I don't disagree with you that maybe CCRA should alter the rules to limit the degree to which they can load up on debt, but that's kind of a separate issue. I agree with you on that.

I guess that brings me to my question, because this is reminiscent of our discussion of that old issue on which the government has backed down: interest deductibility. The experts who came to talk to us a few weeks ago were unanimously of the view that the real source of abuse in the interest deductibility issue had nothing to do with double dipping and had everything to do with so-called debt

dumping, where corporations load up on debt, deduct the interest on that debt, and thereby avoid taxes.

Would you agree with me, first, that this thin capitalization is also applicable to the interest deductibility issue, and secondly, that in the absence of such changes we are right that, in many cases, little tax will be received by the government by these acquisitions?

•(1305)

Mrs. Dianne Urquhart: No, I do not agree.

First of all, just to review income trusts, the way in which no business taxes were paid was primarily through each of the income trusts, which is itself a legal structure, having a corporate subsidiary. In the corporate subsidiary, that is where you have virtually—

Hon. John McCallum: I'm asking you about the—

Mrs. Dianne Urquhart: No, I have to answer the question. Do I have time?

Hon. John McCallum: I don't have much time.

I want to ask the question about these new acquisitions. Our contention is that in many cases little tax will be paid. My question is whether you agree with that or not.

Mrs. Dianne Urquhart: No, I do not agree with that.

The current thin capitalization rules apply to non-arm's-length debt, so the master limited partnerships and the U.S. foreign equity who come in to buy an income trust and who do not raise additional debt from third-party lenders expect to pay no business taxes because they expect the treatment of that corporate, non-arm's-length debt in the subsidiary not to be subject to thin capitalization rules.

If the federal government announces that it intends to apply the thin capitalization rules, then that debt, artificially high, non-arm's-length debt, will not be permitted to exist, and if it does, it will be ignored and it will be treated as not interest that is deductible.

Hon. John McCallum: Thank you. So basically we agree—

Mrs. Dianne Urquhart: No.

Hon. John McCallum: —because you're saying that if they don't change these rules, they won't—

Mrs. Dianne Urquhart: No, I disagree. They have the rules today to stop the acquirers of income trusts from having interest deductibility for the purpose of stripping out profits from the underlying—

Hon. John McCallum: But they're not enforcing the rules.

Mrs. Dianne Urquhart: Well, they have the means to do so, and my demand today is to have an announcement from Carol Skelton, the Minister of National Revenue, of her intent to use the rules.

Germany just did a study and they found that the German multinationals—

Hon. John McCallum: Okay, I'll have to stop you there. Thank you.

I want to turn to another witness, because we agree. It doesn't sound as if we do, but the problem, you're saying, is that they're not enforcing existing rules and that these companies are getting away without paying much in taxes, and if we did enforce the rules, they would pay some taxes and that would be a good idea. But I'm not asking you to answer that.

Ms. Yalnizyan, I want to turn to cities. I like what you said about cities and agree with you that they tend to be the neglected level of government. I think that under the Paul Martin government we started to move towards a gas tax and other revenue sources being transferred to cities. It's my opinion that the current government is not enamoured of this; it's of the view that cities are basically the creatures of the provinces.

So I'd like to ask you to comment on what you think would be the next step in terms of helping the fiscal situation of municipalities, not just cities, I should say.

•(1310)

The Chair: Unfortunately, you only have a very brief time to give a response.

Ms. Armine Yalnizyan: May I just say that what cities need—and you all probably know this story—is money for capital costs to maintain existing public infrastructure, as well as to expand it, in jurisdictions that are growing. So capital costs are distinctive from operating costs. And cities also require some growth source of revenue. They do not have any growth source of revenue, and it is incumbent upon senior levels of government to negotiate something, because most Canadians live in municipalities, not in rural settings, and 50% of Canadians live in the biggest urban centres.

If we're going to continue with our immigration policy, we have to have a system of financing the way people live in this country, a system that responds—

The Chair: Ms. Yalnizyan, your time is well past.

Just for clarification, you said they don't have a growth source of revenue, yet I understand that local municipalities essentially receive a share of the growth in tax revenues coming from property taxation in their region, or some percentage of that from the provincial level.

And you alluded in your presentation to the prospective doubling of real estate values, so wouldn't that in a sense be a growth form of revenue that would be available to cities?

Ms. Armine Yalnizyan: Indeed, it would, sir, if market value assessment had no problems with income affordability. You've probably heard of people in your own riding who are elderly and house rich and cash poor, who are very, very concerned—

The Chair: Yes, of course, but we're talking about revenue here—

Ms. Armine Yalnizyan: Well, it's not politically sustainable to sustain it on a property tax system. When I talk about growth revenue, sir, I'm talking about revenue that grows according to both population and the economy, whether it's through the consumption side or the income side, whether individual income taxes or corporate income taxes.

You need some growth source of revenue. The economy largely expands. There are very short periods of time when it recedes. The housing market is absolutely the inappropriate way to finance both

social and physical needs, and it is really time for the federal government to step up to the plate and take part in rebuilding our nation, as it did from 1948 to 1970.

[*Translation*]

The Chair: Thank you, madam.

Mr. Crête, you have six minutes.

Mr. Paul Crête: Thank you, Mr. Chair.

Ms. Urquhart, at the beginning of your presentation, you said that we did not need to amend the bill in order to correct the problem of trusts. You mentioned a rule in the Income Tax Act that could be applied to prevent tax avoidance.

Could you explain that idea a little more for us, please?

[*English*]

Mrs. Dianne Urquhart: First of all, section 245 of the Income Tax Act is the general anti-avoidance rule. If you make an attempted avoidance transaction that is for the purpose of only getting a tax benefit, and if it's determined that the transaction is abusive, then the Canada Revenue Agency is able to force you to pay a tax notwithstanding the attempted transaction. In this case, it's the non-arm's-length debt in the corporate subsidiary of the income trust that CRA can go in and say, "We don't permit you to have this high level of debt, we don't permit you to use a 15% interest rate", just as an example. The thin capitalization rule, if it's used in conjunction with that, which is section 18.4...you are limited to having two times the debt relative to the equity in a non-arm's-length debt transaction.

The consequence is that they're forced to have that 2:1 ratio, and they don't get the interest deduction that is presently in existence, even in the case of a private income trust. The tax advisers are telling the foreign acquirers to come to the country because this new income trust tax legislation for you today applies to publicly traded. They're saying that if you come in and acquire this and make it private, you'll get the same ability to use the high non-arm's-length debt and get a full interest deduction for that.

I'm saying Canada Revenue Agency can say to that foreign private equity buyer or to that master limited partnership, "You're not allowed to do that. We're going to use these sections of the act and force you to not have such a deduction and have profits"—they're not all stripped out—"and you'll pay taxes to the Canadian government." It would be grossly unfair not to apply that GAAR section and thin capitalization rule after having just removed the tax advantage for individual Canadians.

It's also essential, in my opinion, in the debate of hollowing out of Canadian corporations and income trusts, that we not have a tax advantage in this country that draws all those billions of floating capital in the world to our market because we're a tax haven for them. We stop ourselves being a tax haven by using this thin cap rule in the non-arm's-length step. They can do it for the royalties in the anti-trust as well. GAAR would apply to the artificially high royalty agreements within the energy trust.

•(1315)

[Translation]

Mr. Paul Crête: Ms. Yalnizyan, you mentioned the issue of fiscal imbalance. All across Canada, we can see that this question has only been dealt with in financial terms. Corrective measures have not been applied to the tax system, perhaps by transferring tax points, or things of that nature. You also mentioned the surpluses that have been built up over several years, but that situation could change.

What permanent changes would allow us to meet more realistic objectives, such as the war on poverty, or the lack of economic security that you mentioned?

[English]

Ms. Armine Yalnizyan: It's a wonderful question, and thank you for the opportunity to address it.

I think there is a real risk that we are going to have the surplus disappear. I think this government's goal is to cut the problem off at the source and make the surplus disappear. Two budgets ago the lion's share of the surplus went to tax cuts. This time, about \$7 billion of a \$35 billion bag over the next three years went to tax cuts and \$15.2 billion went to debt reduction. I submit to you, the \$22 billion this government has paid down in debt reduction over the last two years could be used to make a down payment on the \$60 billion to \$120 billion infrastructure deficit. It is absolute, utter folly to be paying down debt at this stage in our country's history when we have made such progress on debt-to-GDP reduction and it will continue to come down because of growth in the economy when we are facing such infrastructure deficit.

This is the time to roll over debt that is coming up, when you have a 40-year low rate in terms of interest rates. You are able to lever capitalization at a rate that no subsidiary level of government can do. This is the time when we need to get the money to invest. Instead, this government, and the preceding government, put a lot of emphasis on debt reduction as a way of soaking up the surplus. In fact, this government's call to do the tax-back guarantee, that any reduction in debt charges, because of debt paydown, go to further tax cuts, strikes me as a squandered opportunity to rebuild, not only the nation but—it's not even nation-building; it's what every citizen needs in every corner of the country, whether you live in Quebec or in the Northwest Territories. You need access to housing, you need access to roads, you need access to utilities and clean water. These are fundamentals.

It raises the question, what is the federal government there to guarantee? In what sense are we all Canadians, from coast to coast to coast, where we can rely on certain basics? It strikes me, just from a purely hard infrastructure point of view, that this is a squandered opportunity. From some of the evocative things that you're talking

about, like fighting poverty, we know poverty isn't about income. We know poverty is about access to opportunity.

Thank you.

[Translation]

The Chair: Ms. Ablonczy is next.

Ms. Ablonczy, you have six minutes.

[English]

Ms. Diane Ablonczy (Calgary—Nose Hill, CPC): Thank you, Mr. Chairman.

We appreciate the panellists and all of you who have made presentations.

I would like to point out for the City of Toronto that this government, in the recent budget, put fully \$39 billion toward addressing the fiscal balance to make sure that provinces such as Ontario have considerably more cash to fund services. That included, of course, making sure that per capita payments for things such as education and health care and all of these things were now equal across the country. Before, Ontario citizens did not receive the same money per capita as some of the other provinces.

In addition to the \$39 billion, this government put \$33 billion towards infrastructure, which you were talking about.

That's a heck of a lot of money, and some of it is going to go to Toronto. So I think this passionate concern that somehow these important issues are being neglected is simply not logical. The \$39 billion plus \$33 billion plus all the other transfers to provinces makes I think an enormous list. I don't want to do that list, because I have another question, but I think we need a little perspective here. Yes, you can always complain, but \$39 billion plus \$33 billion is not small change. I hardly think these important issues are being neglected.

I want to address a question to Mr. Jock, because in addition to the concerns we've heard from the City of Toronto, I know all Canadians are concerned about conditions for aboriginals. I'm particularly and specifically interested, as a former teacher, in the matter of education.

You know the old saying, "knowledge is power"—power to participate, power to get a good job, power to build a strong future. In this budget there was more money for aboriginal education, and those moneys keep continuing, but I'm specifically interested in the programs, which I know you're aware of, that target this whole area to ensure that aboriginal youth get the education they need.

I think it would be helpful if you discussed with the committee what is being done there and where you see these programs going, specifically in education.

• (1320)

Mr. Richard Jock: Thank you. That's an excellent question.

There are two aspects to the education element. One is that there are marginal increases that go to education. As I indicated, there's a 2% cap on funding in general.

What happens, and I'll use Alberta as a particular example, is that when the CHST and other transfers are increased and the province as well is able to invest more in education, the average cost of education increases.

For first nations in Alberta, say the situation is that on the reserve there's a school up to grade 8 and that what is expected out of their budget is that they provide for the tuition agreements for the students who would go to the local city or municipality to high school. Those amounts that go for the students in the high school are paid at the provincial average, which grows at a much faster rate than the 2%, which leaves a smaller amount—and proportionately smaller as time goes on, as those increases continue—for those elementary interests that are of course foundational and of prime importance.

What we are engaged in is a process of developing both standards and a costing formula with the department that we think will yield substantial results if implemented. I think that's what—

Ms. Diane Ablonczy: I think those are very important figures to know and to have in mind. I appreciate that.

I wish I had more time for everybody, but I had a question for Mr. Morand.

You brought out some technical drafting difficulties very specifically. We appreciate that, because people who work within this area all the time sometimes know these issues better than we do.

I'm curious about the response you had when you brought these forward to officials. Do you expect they'll be addressed, or are you bringing them to committee because you don't think they're going to be addressed? What's the situation?

Mr. James G. Morand: We've received no commitment from the officials that they will be addressed, and that's why we're before the committee—to ensure that the issues don't get lost in the shuffle.

Ms. Diane Ablonczy: I think that's important, and we appreciate that.

Thank you, everyone.

[*Translation*]

The Chair: Thank you, madam.

[*English*]

Speaking of mouthfuls, we continue with Madam Wasylycia-Leis.

Some hon. members: Oh, oh!

Ms. Judy Wasylycia-Leis: All right. I'm going to talk fast, so get ready. I have three questions; I'm going to get a question each for Dianne, Richard, and Armine, and I'm going to do it in 30 seconds. You'll each have a minute and a half to answer, starting now.

Dianne, first of all, I want to say that I don't think there's any similarity between you and the Liberal Party, which has hitched its wagon to the income trust lobby and which has in fact engaged in a

smear campaign against anyone who believes that we should level the playing field in this regard. In fact, they both seem to suggest this weird notion that this is going to trigger a chain reaction; it's going to lead to new foreign owners who don't pay any taxes—this, of course, despite the fact that 11 of the largest energy trusts already are 50% foreign-owned.

Anyway, what is your answer to that? How can Canada be saved without removing the tax?

• (1325)

Mrs. Dianne Urquhart: Well, first of all, apply GAAR and apply the thin capitalization rules. I'd like to note that in the United States the IRS did apply its anti-avoidance rules against the Canadian income trusts that owned American businesses, so we don't have to be worried about needing to have reciprocity. They taxed us, we tax them; that's the way it works. We both have thin capitalization rules and intercorporate pricing rules to prevent artificial transactions and pricing for the purpose of avoiding tax in our respective countries.

The other point I would note is that a German Institute for Federalism and Intergovernmental Relations study released in August 2006 found that 75% of the OECD countries have thin capitalization rules in place today for non-arm's-length debt transactions within corporations owned by multinationals. They concluded in interviewing the German multinationals that those multinationals use significantly less debt leverage in the country that has the thin capitalization rule, the consequence of which being they pay taxes to those foreign governments.

Thin capitalization rules work; that's why 75% of the countries have them. There's no excuse for Canada not to execute its thin capitalization rules in order to be competitive with the world. They exercise those tax obligations in their countries, so it's reciprocal for us to do the same. We will protect our government tax revenue base for all the various services that we've had a number of speakers seek to get better funding for.

Ms. Judy Wasylycia-Leis: Thank you very much.

Richard Jock, many people said after the budget came down that the most glaring omission in the budget was its focus on aboriginal peoples—that it was a slap in the face to our first nations, Métis, and Inuit communities, that promises were made about clean drinking water, but there was nothing in it. Housing is a disaster, and there are third world country conditions.

If we don't find a way to significantly redress these concerns, what would be the impact in terms of human conditions and also in terms of...? We're hearing about protests and blockades. What will be the real outcome of all this?

Mr. Richard Jock: There are two aspects to this. One is that part of it responds to the point made about the situation of Canada as a baby boomer country.

I think first nations represent an important element of the future. The education system, with its need for investment, I would say, would be a critical investment. Among our post-secondary students, who are very interested in further education and training, we have a situation in which we estimate about 10,000 are not able to access post-secondary education funding through the department because of the funding limitations.

I would say in fact that government is at risk in such things as child welfare, where, in effect, by insufficiently funding it, government could be liable for knowingly underfunding these kinds of services.

Having housing fall farther behind is simply a human tragedy in the making.

But the other element is that in order to respond to the crises that come up, and you alluded to some of those crises, the department is forced to reallocate from within to deal with those crises. This simply delays what needs to be done in other communities. It becomes a whole process of problems and reallocation and not really dealing with the issue.

The only comment I can make on the other issue is that what's needed is hope and a plan for the future as a way to deal with it, as opposed to not dealing with it and the current circumstances.

Ms. Judy Wasylcia-Leis: Thank you very much.

Armine, first of all, I'd like to hear point number three. You mentioned the GST and the CST. What's point number three?

Secondly, with respect to this pattern of the present government and the last government putting all their extra money against the debt —

• (1330)

The Chair: There are twenty seconds left.

Ms. Judy Wasylcia-Leis: —what would you do with \$100 billion that is a cumulative result of these governments not dealing with problems we have?

Ms. Armine Yalnizyan: Ms. Ablonczy referred to the \$33 billion going to infrastructure. I would suggest making sure that money goes to infrastructure. When you have it levered over P3s, we're paying more. As taxpayers, we are paying more for the privilege of having the private sector lever that money for us.

Also, the period of time over which the \$33 billion is being spent is a much longer time horizon than that of the \$22 billion we've dumped into debt reduction over the last two years.

And that was my point number three: infrastructure. You've made an important start in this past budget to address infrastructure issues, but you're doing it cheek by jowl with having the sale of public assets on your agenda, which is mind-boggling. That's point number one.

Number two is the tax-back option for every dollar we get back in debt charges. Don't give me my money back as a debt charge; please

reinvest it. This is a crazy way to guarantee citizens anything. This is a revenue-neutral option for you that actually puts money where it belongs, in the bricks and mortar that build this country.

The Chair: Merci, Madame.

We continue now to the second round.

Mr. McKay, you have three minutes.

Hon. John McKay: Three minutes.

Mr. Morand, it seems to me the argument that's been put forward here this afternoon is that the Minister of Finance has really screwed up; the rules don't contemplate that he's going to get absolutely no revenue out of this, and one of the reasons is that companies are going to load up with debt, and therefore the Minister of Revenue has to issue a notice saying, "You'd better enforce those GAAR rules and you'd better enforce those thin capitalization rules."

Have you ever heard of the general anti-avoidance rules being applied to situations such as this?

Mr. James G. Morand: The thin capitalization rules as currently drafted don't apply to trusts, so there'd be nothing for GAAR to apply to. GAAR is nothing more than another section in the Income Tax Act, and its application is in the context of the Income Tax Act and whether or not there's an abuse of the Income Tax Act.

The thin cap rules are drafted and specifically do not apply to trusts. So in my view, GAAR would not apply to impose the application of the thin cap rules to existing income funds, as currently drafted.

If an amendment to the thin cap rules were made, then it's a different story. But as currently drafted, there's nothing for GAAR to apply to.

Hon. John McKay: I wanted to bring you back to your presentation with respect to ordinary partnerships.

I think you actually make an interesting point that there is some enthusiasm to get this legislation through, and therefore the rules haven't been well thought out. Just as an example, would your law partnership be potentially caught up in something of this nature?

Mr. James G. Morand: No.

Hon. John McKay: Is that because it's private?

Mr. James G. Morand: It's for a number of reasons. The law partnership is restricted; the members are restricted to lawyers. You don't have the situation of a public corporation, or a corporation or entity with public debt, that is a member of the—

Hon. John McKay: Okay, I have chosen a poor example, but give me an example of an ordinary partnership that in your view is unintentionally caught up by this kind of poor drafting.

Mr. James G. Morand: Sure. Assume you have a private corporation, so its equity is not publicly traded. It is a private corporation with equity not traded. It has a greater than 50% interest in a partnership; there are other partners, and they're going to develop a specific property, a resource property. It really doesn't matter what the focus of the business is. That corporation issues debt in the public market and then uses that debt to finance its investment in the partnership. Again, it's not a partnership whose equity is publicly traded.

Based on the current drafting, that partnership becomes a SIFT and is treated as a corporation and is subject to these rules. Although, as you may know, partnerships are not taxable themselves, all their income gets allocated out to the partners and is taxed in the partners' hands, so what you're doing is imposing a level of corporate tax on the partnership, even though all of the income of the partnership would be allocated out to the partners, and in this case one of the partners is a corporation that is going to be taxed anyhow.

•(1335)

Hon. John McKay: You had another point with respect to rollovers. There's a transition period of four years here—

Mr. James G. Morand: Right.

Hon. John McKay: Why is it so important to be very clear right now about the rollover rules?

Mr. James G. Morand: It's because it's affecting the decision-making that's taking place now as to what they're going to do on the SIFTs, because right now there is no rollover rule. There have been positive noises made by officials at the department that a rollover rule will be implemented, but there's no commitment for it, and we've been told it's not a priority.

Hon. John McKay: It's not a priority?

[*Translation*]

The Chair: Mr. Morand, thank you very much.

[*English*]

I'll just venture in here a bit.

Madam Urquhart, you raised a number of points in your presentation. The one that stuck with me was the fact that the income trusts have largely recovered the so-called losses, the theoretical losses, that occurred following the announcement by the finance minister.

You said minus 3% relative to that value, and then you went on to say that the values have lagged the TSE. What did the values of the income trust index do in the six months prior to that announcement vis-à-vis the TSE index?

Mrs. Dianne Urquhart: I don't know that factually, but I believe the average annual for the prior three years was approximately 20%, so I'm going to guess it's 10%. It would have been a substantial return because there had been such a flow of billions of dollars of the retail market into the income trust area. Since close to half of the income trusts are energy and the energy price was escalating, there was outstanding performance prior to that.

The Chair: To just restate that yield, did you say that in the three years prior, there would have been a 20% average annually?

Mrs. Dianne Urquhart: I think the average annual for the prior three years was approximately 20%, so they had become overvalued.

The Chair: It's 60%. Okay. Just to be clear, if I held them for three years prior to October 31 of last year, I would have made 20%, plus compounding, each year for the previous three years. If I held them to now, I would have a net yield of something over 60%, minus the 3% you say, so I would have made 57% if I held them for three years and six months. The only way I'd lose money on them would be by selling them the day after the announcement was made, and this would be ridiculous for anyone with basic investment knowledge.

Mrs. Dianne Urquhart: But if you bought them just prior and you sold them just after, you had a loss.

I would like to note that our call for a criminal investigation was made because there are 50 names that are down 20%. Someone who was not properly diversified or who unfortunately had a high proportion of what we call the struggling business income trusts could have catastrophic losses. A number of people did present to this committee indicating that they had done so, and we say that wasn't the—

The Chair: Yes, exactly. That's a concern. I'm sure any member of our committee who had any bit of objectivity would have been touched by the stories told to us by some of the investors who came here, but all, without exception, were overweighted in income trusts, and that speaks to the industry's advice somewhat as well.

The other point that's being made, and you alluded to it a little bit, is the foreign takeover issue, this fear that we'll push all these income trusts into the hands of evil foreigners. I'm curious as to whether that was happening in the six months prior to the announcement.

Mrs. Dianne Urquhart: I think we had a few acquisitions prior. I think that if the master limited partnerships are entitled to come here and buy income trusts and not pay business taxes as a result of the belief of a tax advisor such as James, who is sitting next to me, that they're not going to be able to apply the thin cap rules to the corporate subsidiaries, then you will have the master limited partnerships coming up here and buying the income trusts. That's because essentially you've taken a tax advantage away from individual Canadians and given it to the owners of the master limited partnerships in the United States, so they'll be a premium bidder. That's why it's urgent that this matter be addressed.

If you are concerned about being fair to individuals who have a tax advantage removed, then you must not give the tax advantage to foreigners, and if James Morand is saying that GAAR and thin cap can apply, then you've got to make an adjustment to this income trust tax package; you've got to take the publicly traded out so that it's very clear that it applies.

I'm not a tax expert who gets paid for tax advice, but that's probably a good thing because I don't have a commercial interest in this. It's still my opinion that the thin cap rules very clearly apply to corporate subsidiaries. While they might not apply to income trusts, virtually all income trusts have a corporate subsidiary, so what I'm saying is see through the income trust and have CRA apply that thin cap rule and the GAAR to the corporate subsidiaries.

The Chair: Thank you. You've been clear on that point.

We'll continue now with Monsieur St-Cyr.

• (1340)

[Translation]

Mr. St-Cyr, you have four minutes.

Mr. Thierry St-Cyr: Continuing with the question of the value of income trusts, I would like to say that the Bloc Québécois has been asking for a moratorium on this for a long time. We are reasonably happy with the measures that have been taken, even though we think that the transition period could have been longer.

I have a question on the inflation in the share values of income trusts that we noticed in the years before the announcement. Is there reason to believe that the Conservative Party's promise to never tax income trusts helped to inflate their value even more? After all, potential investors saw these trusts as a very tempting investment vehicle, because the government of the day was promising never to touch them.

[English]

Mrs. Dianne Urquhart: The business income trusts and the energy trusts were about 50% overvalued prior to the announcement. I've estimated that taxes are about 10%, so the promise not to take a tax would have kept them 10% above where they should have been—but there was another 40% overvalue, in my opinion, as a result of the deceptive cash yields. This was cash that was paid out that was not earned, cash that was needed to sustain the business by replacing the depleting reserves in the energy trusts and replacing and maintaining the plants.

Primary Energy Recycling just cut its distribution by a third. They didn't have a dollar set aside for maintenance. Guess what? What was the reason for needing to cut the distribution? Major maintenance was required in one of the five plants for energy recycling for electrical generation. That was a clear case to show the distribution was far too high, and the price was far too high, and it was sold that way to seniors in the Canadian market by an American businessman who couldn't raise the money in his own market.

[Translation]

Mr. Thierry St-Cyr: Fine.

You mentioned current rules preventing tax avoidance, and the way in which the Canada Revenue Agency could use them, for income trusts or for other reasons. During our hearings, we have also talked about double-dipping.

To prevent double-dipping, could the agency use its anti-avoidance rules, which prohibit a structure being set up simply in order to pay less tax and with no real commercial validity?

[English]

Mrs. Dianne Urquhart: I'm not experienced enough or expert enough to make a comment in the area of application of GAAR to double dipping, but in the case of the interest deductibility for third-party debt raised to fund foreign acquisitions, the GAAR and the thin cap rules apply to non-arm's-length debt.

If a company is levered up because the banks are willing to give them 99% debt—and banks of the world do not give 99% debt—basically, in the income trust situation, it's the non-arm's-length debt that enables the avoidance of tax. It's on that basis that I say GAAR and thin cap rules apply, because it's clearly non-arm's-length debt, whereas in the case of interest deductibility, it was actually seen to be a problem for the Canadian banks because they wanted the ability to provide billions of dollars to Canadian corporations so that they could take the proceeds of that to acquire foreign operations.

[Translation]

The Chair: Mr. St-Cyr, perhaps Mr. Morand could give you an answer.

[English]

Mr. James G. Morand: I can add a little colour for you. The GAAR rule generally would not apply in circumstances of the double dipping. There's nothing offensive that's happening from a Canadian tax perspective; there's a single deduction of interest that's occurring in Canada. What seems to be offensive to people is another deduction for interest occurring in another jurisdiction, and GAAR would have no application there.

[Translation]

The Chair: Thank you very much, sir.

We will continue with Mr. Dykstra.

[English]

Mr. Rick Dykstra: Merci.

Armine, one of the early comments in the presentation you made was about the potential for home values to double in the next 20 years. I want to make sure that your comment then was that salaries will not increase to the same extent. Is that correct?

Ms. Armine Yalnizyan: What I said was that several reports out now by the major banks are saying the prices in real estate markets across Canada are predicted to go up by 20%; there is no banker or economist out there who has said incomes are going to double.

• (1345)

Mr. Rick Dykstra: I did a quick check. In the last generation, in fact, the per capita household income has increased by 104%.

Ms. Armine Yalnizyan: What's your timeframe, sir?

Mr. Rick Dykstra: It's over the last 20 years, from 1987 to 2007.

Ms. Armine Yalnizyan: I would love to see the study you are referring to, because I've just done an analysis of inflation-adjusted growth in household incomes, particularly among families raising kids, and saw no such evidence from 1976 to 2004. Indeed, the average did go up, but the average is driven by most of those gains being concentrated in the top 10% of families raising children; the distribution is such that the bottom half of the distribution of families raising children stagnated or fell, and that's after taxes.

Mr. Rick Dykstra: I think we've tried to address that issue in the last two budgets, in the sense that 850,000 people in this country no longer pay federal income tax. I do understand your point when you speak to the fact that when the 10% or 20% of incomes at the higher end go up, percentage-wise, they obviously go up a lot more than the lower end.

One of the things you have to address from a government perspective, as far as we're concerned, is to make sure that folks who are at the lower end of the income scale receive credits that apply to them to allow them to do the types of things they need to do on a daily and yearly basis to support their families, and if they're paying tax and shouldn't be, to make sure we remove them from the tax rolls. When you move 855,000 people from the tax rolls, I think that states a lot.

When you talk about the debt that we pay down, in a sense a lot of the interest that we use and a lot of the debt we pay down is money that we don't have to pay interest on. I think what we've done is responsible in terms of ensuring that we apply the money that we have and the revenue that's generated to the most vulnerable, and by that I mean those who shouldn't be paying income tax and those in low-income families that need assistance.

You didn't address this in your comments. I do want to ask a couple of folks some other questions, but I do think that needs to be taken into account when you prepare your presentations.

Ms. Armine Yalnizyan: May I respond, Mr. Chair—

Mr. Rick Dykstra: Dianne, I did have a question about the points you were making.

We had Mr. Dielwart up prior to you. I did ask him about that, and he's here, but I wouldn't mind getting your comments. One of the comments he made was about the risk we put the energy trusts in when we implement what we're doing. I wonder if you could comment a little on that potential.

Mrs. Dianne Urquhart: I'm not sure I understood.

Is this the issue of needing a lower cost of capital in order to exploit the energy assets in the western basin?

Mr. Rick Dykstra: Right.

Mrs. Dianne Urquhart: My feeling is that if oil is at \$64, up from \$25 just a short two to three years ago, and we need to have a Canadian government subsidy in order to create a lower cost of capital.... When I say it was overvalued, the flip side of that is a lower cost of capital; if you have a high price, then you have a low cost of capital. He's saying he cannot run his business unless he has a subsidized cost of capital. I'm saying I just don't believe it.

Mr. Rick Dykstra: James, one of the points you made that I found intriguing was your last point, which was that the structure of

some of the sentencing was too broad and did not cover specific areas.

The Chair: Merci, Monsieur. We'll have to learn more about that intriguing point later.

Monsieur Thibault is next.

Hon. Robert Thibault: Madam Urquhart, you referred—and I've heard this a few times—to some people being enticed into investing on an unrealistic return in companies or trusts that eventually can't meet their commitments and can't replace their assets. That is a concern, but don't we have that same problem in the normal equities market on the TSE? I've got friends who got burned on what they were buying. They were thinking Nortel was an absolute blue-chip corporation.

Mrs. Dianne Urquhart: The difference is the nature of the buyer. We're talking about a product that was said to be designed for seniors whose objectives were preservation of capital and income for the purpose of meeting their household expenses.

Hon. Robert Thibault: Didn't we see that in the vast majority of trusts where that was reasonably carried out; where the payments were made and the preservation of capital was maintained until the announcement of a 31% tax by the Minister of Finance?

Mrs. Dianne Urquhart: No. Already, in a strong economic period with no new taxes needing to be paid, close to one-third of the business income trusts have suspended or massively slashed their distribution. That has nothing to do with income trust tax.

They had to slash because they were set too high. Then when there was a hiccup in the business, or simply when management determined it was time to do replacement of assets and they couldn't get new financing, they were forced to do a cut. In some cases the banks themselves allowed this degree of leverage and high distribution to occur at the beginning so they could get the product out the door at a premium price and get the maximum fees out of it. They were the ones that said, "Okay, now that you've reached your covenants you need to cut." The minute they cut.... Too many of them have occurred. We think at least half the business income trust market will go there.

● (1350)

Hon. Robert Thibault: We think that, but we know there was a collapse in the value of those trusts when the finance minister made the announcement. We know there was encouragement and enticement of seniors to invest, beyond what would have been reasonable in a balanced portfolio, by the promise of the Prime Minister to not tax them. We know those things. We know there are problems.

There are always some shysters, but we also know that the Governor of the Bank of Canada told us here that while there were problems in some sectors in governance, and in some cases it wasn't a proper vehicle, for some sectors like energy it was a proper vehicle for REITs. The Minister of Finance agreed with that.

When you give your figures on the index, you forget to mention that the REITs are included and there have been transfers of funds into those REITs. There has been an increase in investments in those because they are still permitted to do an income distribution. The capital market, the investment market, is looking for income distribution, so they normally go there.

My final question, if I have any time left, is to Mr. Jock. You mentioned the Atlantic fisheries investment, and I am pleased that it continues to be there. But when there was that whole Marshall decision and adjustment package, part of that money was for economic investment in those communities on the Atlantic coast.

I've had an opportunity to visit a lot of those communities to see the positive things they have done and the change within those communities to a "can do" attitude. I see business investments and thousands of jobs created where very few jobs existed before.

Can that experience be repeated? Did the Kelowna accord give us that chance, and is there still a chance to repeat that experience in less favoured communities?

The Chair: You have 30 seconds to respond.

Mr. Richard Jock: I think that's an excellent example of where government investment can be replicated and multiplied in terms of impact. I would invite you to talk with John Paul of the Atlantic Policy Forum, because they generated a study that looked at the sustainable jobs that came out of the investment in Marshall.

I would say that your observations are well-grounded in clear evidence. I think that's one of the reasons we're pleased that this plan was continued to a degree, although I understand it's not at the same level as its initial investment.

Kelowna was a step. It only began to look at economic development. A challenge and a way forward is to look at economic development in terms of creating opportunity; looking at the potential for first nations people to become part of these new opportunities as both companies and individuals who can contribute to the labour market.

The Chair: I'm sorry to move on, but we must.

Mr. Del Mastro.

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

Mrs. Urquhart, I just want to make something clear. Mr. McCallum made the point that you and he are of a common mind on income trusts, but I think you are quite diametrically opposed.

Would you comment briefly on the Liberal income trust proposal?

Mrs. Dianne Urquhart: The 10% refundable income trust tax proposal is basically the status quo, except as it applies to Americans. It requires that new business taxes be collected from the American owners. All current deferred tax accounts and taxable accounts will pay 10% but will get it refunded, so essentially they're not going to be paying taxes. In my opinion, the consequence is that it will reinvigorate the income trust market of Canada.

As well, he has indicated there is a process for getting exemptions. Any time there is an authority given to a government to enable exemptions, they're almost always granted, so there will not be a binding termination of new conversions in what is proposed.

Because I feel that the Canadian government should not have a tax advantage to invest...for our seniors, our most precious seniors, who can't make up for losses to go into an investment product that is ill-conceived and unsuitable for their purposes, then I do not support the 10% refundable tax plan. It retains a very substantial tax advantage for seniors to invest in income trusts within their tax deferred accounts.

• (1355)

Mr. Dean Del Mastro: Thank you.

Just briefly, I know they work very closely with an organization called CAITI. Have you received any threats or acts of intimidation for your stand?

Mrs. Dianne Urquhart: I get a lot of e-mail, just as I think many people around this room get e-mail. I find it offensive to be called names. I don't think people in political life, or people such as me, who are experts and work pro bono for a serious cause in the community, deserve to get that kind of treatment. I suspect it is not endorsed by the association, but there has been a very aggressive and very personal campaign.

The Chair: Welcome to the world of politics, Dianne.

Before we conclude with Mr. Pacetti, I want to congratulate the members of this committee for their conduct in dealing with this particular bill, in contrast to some of our colleagues who have unfortunately been part of less efficiently conducted committees. Each of you deserves to be congratulated for the way in which you've handled this very contentious and very important piece of legislation. I offer my sincere and favourable comments for the way you've handled yourselves.

We'll conclude with Mr. Pacetti now, for three minutes.

Mr. Massimo Pacetti: Thank you again. You saved the best for last.

I have two quick questions, and one is for Mr. Jock.

If the present government had respected the Kelowna Accord, would that have solved some of the issues you've raised today?

Mr. Richard Jock: I think it would have dealt with the issue of hope, which is one of the fundamental elements that is needed at this time.

Mr. Massimo Pacetti: Then it was a missed opportunity by the present government. Okay.

Mr. Morand, just quickly, I have a couple of technical questions. If you have U.S. corporations buying up some of these trust funds and turning them into private income trusts, would they still be exempt from the present rules?

Mr. James G. Morand: They would not be subject to the present rules unless the U.S. corporation had publicly traded debt. Based on the very first point I raised in my introductory comments, the rules as crafted would apply to a private trust if its parent had public debt.

Mr. Massimo Pacetti: So if a foreign or even a pension plan kept the income trust in the same form it is today, except they privatize it, why would they load it up with debt?

Mr. James G. Morand: A pension plan would not... But it's not a matter of loading up the trust with debt; it is whether the shareholder has debt. It's not debt at the trust level that's the—

Mr. Massimo Pacetti: So the money from the trust would flow tax free.

Mr. James G. Morand: The trust is a flow-through vehicle regardless of whether it's public—

Mr. Massimo Pacetti: But under the new formula it would have to pay tax.

Mr. James G. Morand: It would.

Mr. Massimo Pacetti: Wouldn't it be subject to the new rules? The money would continue—

Mr. James G. Morand: It would not be subject to the new rules if its equity is no longer publicly traded, subject to the few exceptions I described at the outset.

Mr. Massimo Pacetti: So the real reason most of these income trusts are being taken private is because there's a benefit. They continue to survive in their present form, and that's what we're seeing.

Mr. James G. Morand: I won't speculate as to the motivation for why they're being taken private, but the flow-through nature of any trust would—

Mr. Massimo Pacetti: There's also the fact that they're undervalued, of course.

Thank you.

The Chair: Let the record show that Mr. Pacetti doesn't determine the value of anything on the market.

Some hon. members: Oh, oh!

The Chair: Thank you very much to our witnesses. We have benefited as a committee, and this has been a most interesting panel. We appreciate your being here.

I have two quick points for my colleagues. Although it is not required, if you have amendments, I would very much recommend you have them in to the clerk's office by the end of the business day.

An hon. member: Today?

The Chair: It isn't a requirement, but it would really facilitate the operation of our meeting tomorrow.

Second, we will move to clause-by-clause tomorrow, and you will receive a notice that the meeting will be from 3:30 to 5:30. However, we have by previous agreement said that we could take until 11:59 tomorrow night. If it is your wish, we will do that.

We have a notice of motion from Mr. McCallum that he wants dealt with. I will try to accommodate him, unless, by some strange coincidence, some of you wish to—and this would be most unfortunate—filibuster the operations of the committee tomorrow until midnight, in which case there will not be time to deal with Mr. McCallum's resolution.

Again, thank you all very much for being here.

The meeting is adjourned.

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