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Chair

Mr. Rob Merrifield

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● (1535)

[*English*]

The Chair (Mr. Rob Merrifield (Yellowhead, CPC)): Our witnesses today are by teleconference, and we have enough members here to begin today's study. It's pursuant to Standing Order 108(2), a study on the structure of Canada's federal revenue-raising system.

I want to thank our witnesses for being here through teleconference. This is the first time we've actually had the opportunity to watch you dialogue. This is kind of new technology for the committee. I certainly appreciate you both being here.

From the University of Calgary we have Professor Jack Mintz, from the school of policy studies.

Which one is Jack?

Prof. Jack Mintz (Professor, School of Policy Studies, University of Calgary): I'm here. I'm in Toronto right now.

The Chair: Excellent.

From Vancouver, the University of British Columbia, we have Kevin Milligan.

We want to thank both of you for taking the time to contribute to our study and to be with us today. We'll yield you the floor in order, and then move into a question-and-answer period.

We'll start with you, Jack. The floor is yours for your presentation. Thank you.

Prof. Jack Mintz: Thank you very much. It is a pleasure to come back to the House of Commons finance committee. I have been involved many times in various sessions over the past number of years.

I find the question-and-answer period particularly useful, and I am sure useful to the members. I am going to be as brief as possible about several things, to leave more time for discussion with the committee.

Let me, first of all, start by saying that since 2000 a considerable effort has been made in Canada to reduce the impact of taxes on investment and savings that are critical to ensuring that Canadians can enjoy economic growth and provide resources for their retirement as our population ages. Both Liberal and Conservative governments have achieved much in the past eight years.

Federal-provincial general corporate income tax rates have been cut from 43% in the year 2000 to 32% today and will be further reduced, to 28%, by 2012.

Capital taxes have been or are being phased out. In this, I am referring to both federal and provincial capital taxes. The federal one has already been phased out.

Capital cost allowances are being matched better to economic depreciation, although some tax preferences have been scaled back and others enhanced.

Income taxes have been reformed to remove the tax penalty on savings, for example by broadening contribution limits for RRSPs and pension savings and introducing the new tax-free savings account, which I thought was a terrific idea, in the last budget.

However tax reform is a process that continually reacts to new changes. Given the state of the U.S. economy and global imbalances and the continued concerns over productivity, Canada should keep moving the agenda forward.

Tax issues that should get some attention are the following.

First, while Canada has made tremendous strides in reducing business taxes, personal income taxes should be reformed, especially to remove high rates induced by high marginal tax rates and clawbacks of income-tested benefits and credits. It might make sense to cut down the number of tax brackets to three—15%, 20%, and 25%, as examples. We should also consider that various approaches can be taken for removing clawbacks, based on RSP asset sales, or by pooling benefits to reduce overlapping clawback rates.

Second, Canada should consider the demographic trends, which in the long run are quite important in terms of labour shortages, even though in the next couple of years we will be challenged by a contracting U.S. economy.

The separation of employment insurance into a separate fund, which the last budget has introduced, I think gives opportunities to rethink EI reform to put it more on an insurance basis. Employment insurance provides important insurance to help people cope with job loss, but also gives them an opportunity to adjust to new jobs, and that is where retraining programs could be useful.

It should also be changed to reduce contribution rates on businesses that do not lay off workers as much. This has been referred to as experience rating and is used quite well in worker compensation programs at the provincial level. In the case of unemployment insurance worldwide, the United States has practised experience rating for many years now.

Third, Canada should look at the tax treatment of small businesses, which undermines growth and job creation. Incentives such as the lifetime capital gains exemption and the small business deduction tend to impose a penalty on growth, since incentives are lost above a threshold or when the small business becomes public. Instead, small business incentives should be developed to improve growth prospects, such as the U.S. half capital gains tax reduction for investors holding initial public share offerings, for a certain number of years.

Fourth, the federal government could encourage provincial tax reforms by providing a grant for those provinces that undertake sales tax reforms through adopting a value-added tax similar to the GST. This was done more than ten years ago for the Atlantic provinces, and it would be good if Ontario, British Columbia, Saskatchewan, Manitoba, and Prince Edward Island all fixed up their antiquated sales tax systems, which are distortionary and less elastic with growth in the economy.

Fifth, many of the above proposals suggested will cost money at a time of a slowing economy. The finance minister would like to avoid deficits and should do so, and to help pay for tax reforms, the federal fuel excise tax should be converted into a true broad-based environmental tax that would be comprehensive and affect all regions of the economy in a fair and neutral manner. The revenues could be used to reduce corporate and personal income tax as well as being used to support investments to new technologies needed by businesses to deal with environmental costs.

And that, sir, is what I would like to mention as the main issues that I want to cover today.

The Chair: Thank you very much for that.

We'll now move on to Kevin Milligan, assistant professor, economics department, the University of British Columbia. Mr. Milligan, the floor is yours.

Mr. Kevin Milligan (Assistant Professor, Economics Department, University of British Columbia): Thank you very much, and thank you for the invitation to speak to the committee.

I'm pleased that the committee has a really broad mandate, because while details are important, it's also useful to maintain a focus on the long-term target, which is a tax system that raises revenue in the most efficient and equitable way possible.

I'm going to start my presentation with five quick suggestions and then move on to a broader proposal.

First, on the GST, strong efforts should be made to harmonize the GST with provincial retail sales taxes in provinces that have not done so. Evidence strongly suggests that business investment would grow.

Second, on capital gains, the proposal to allow deferral of capital gains needs really careful consideration. As the income trust experience has shown us, problems can arise when one type of capital income is taxed differently from other types.

Third, the extension of boutique tax credits for expenditures such as sports and transit passes should stop. While these might be popular in some circles, I don't think they're a good tax policy.

Fourth, I urge you to consider a role for environmental taxation. Environmental taxes are supported by a very broad spectrum of economists. The recent initiatives of the government here in British Columbia in this area should provide some encouragement to our federal politicians in this area.

Fifth and finally, I would like to address the issue of deductibility for registered education savings plans. I understand that legislatively this has been killed. Good. As tax policy, this idea of RESP deductibility is folly, and as education policy, it is farce.

While I believe all five of these items deserve careful consideration, I'm going to defer further comment on them until the time allocated for questions. I'm very happy to speak in more detail about those. But for the rest of my time, I'd like to talk about more fundamental reform that could be considered.

The income tax system that we have today in Canada was built on the recommendations of the royal commission on taxation from the 1960s, commonly referred to as the Carter commission. The backbone of the Carter commission was the idea that income from all sources should be treated equivalently. Whether it's a capital gain, earned income, social benefits, scholarship income, it should all go in the same pot. Economists call this comprehensive income taxation, but it's often distilled down to the phrase “a buck is a buck”.

In theory, there are two principal merits to this type of system. First, there's a sense of equity embedded within it. No matter what is the source of one's economic power, it is treated equally. Second, in theory, it can generate efficiency gains because it avoids preferential treatment of certain types of income, so there's no incentive for individuals to rearrange their affairs and decisions in order to channel their incomes through preferred income categories.

Whatever the merits in theory, the complexity of implementing such a system has proven difficult, especially with respect to capital income. Moreover, the greater mobility of capital that has arisen since the 1960s brings into question whether the Carter framework still resonates with Canada's needs in 2008.

An alternative is available. One alternative is referred to as the “dual income tax”. A dual income tax combines a progressive schedule for the taxation of labour with a separate flat schedule for capital income. Corporate income, capital gains, interest, and dividend income could all be taxed at the exact same rate.

A dual income tax has been in place in Sweden and other Nordic countries since the early 1990s. Aspects of this system are also in place in Belgium, Ireland, the Netherlands, the United States, and elsewhere.

What are the advantages of a dual income tax system? I see three. First is simplification. The complex rules for the taxation of capital income create vast administrative challenges as inventive accountants and lawyers find ways to avoid taxation. By taxing all capital income at the same rate, much of this waste can be avoided.

Second is neutrality. A primary goal for tax policy is to avoid changing decisions about how and when to invest. By taxing all capital income in a simple and equal way, neutrality in investment decisions can be achieved.

Finally, it allows some freedom in the setting of the tax rate on capital income from concerns about equity. With comprehensive income taxation, any attempt to make Canada more attractive as a location for investment dollars by lowering tax rates runs into the problem that tax rates on labour income must be lowered as well. By separating the taxation of labour income from that of capital income, an appropriate rate for each can be chosen.

● (1540)

Let me close by giving you two concrete examples of how a dual income tax system could make the Canadian tax system better. First, consider the income trust episode. At its root, the problem originated in the lopsided treatment of interest income compared to corporate dividend income. The recent changes to the dividend tax credit and corporate tax rates have restored some of the balance for now. But under a dual income tax such a problem couldn't occur, because all types of capital income are automatically going to be treated equally. This might well put an army of tax accountants and tax lawyers out of work, as it renders the search for tax advantage less fruitful, but that's a good thing for our economy, because we can put those minds to more productive use.

For the second concrete example, consider income inequality. In work with my colleagues David Green and Marc Frenette, of Statistics Canada , we have documented a sharp increase in pre-tax and transfer income inequality since 1980 in Canada. The greatest source of this continued increase in income inequality is from labour income. The labour earnings of the highly paid are increasing very quickly. But taxing these big earners at higher rates is difficult, because it means we will also increase the tax on capital income and potentially scare away investment.

So a dual income tax can solve this problem by freeing the tax system to continue to tax labour incomes progressively, without having the fear of scaring away capital investment. Of course a dual income tax would raise several problems in implementation. Potential difficulties might arise in the treatment of the self-employed, pensions and savings, federal-provincial concerns, and various international tax issues, to name just a few. I admit that today I don’t have the answers for all those problems, but I do know that the potential gains of a dual income tax for Canada make it worth while to consider such a change. If it is good enough for a progressive, small, open resource-based economy like Sweden, it might be good enough for Canada. I therefore advocate serious study of a dual income tax.

Thank you for your time and attention. I'm happy to answer your questions.

● (1545)

The Chair: Thank you both for your presentations.

We'll now move to the question-and-answer session. We'll start with Mr. McKay, for seven minutes. The floor is yours.

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

Thank you both for your presentation.

I have three questions, the first to Professor Milligan. I found your suggestion of dual income very intriguing and on the face of it a rather attractive idea. The working premise is that you can make a distinction between capital income and labour income. The sanctity of the idea, if you will, rests on that distinction.

In the latter part of your paper you talk about the problem with the self-employed but also with those who are in the upper margins, say basketball players and CEOs and individuals of that nature, who have enormous economic clout in the marketplace.

If capital is taxed at a flat rate and income is taxed at a progressive rate, at the intersection of rates is where the labour income will want to become capital income. So I'd be interested in your thoughts as to how you would curb that rather obvious and potentially excessive abuse of those who are probably the most privileged in our society.

Mr. Kevin Milligan: Thank you for the question. It's a good one, because that's exactly where some of the problems with dual income tax arise.

First, on the self-employment problem, the issue there is to try to separate what's a return to capital and what's a return to the labour of the self-employed. Right from the early days of this kind of dual income tax in the Nordic countries, that's always been a contentious issue. I know that in Norway they have developed a pretty innovative way of trying to deal with this. The broader point I'd like to make is that we wouldn't have to start from a blank piece of paper; we could learn a lot from how things have gone in the Nordic countries.

The second point about potentially high-income individuals—basketball players, hockey players, highly compensated executives, who might have some ability through paying their accountant to do some tricks of transmitting some of their labour income into capital income—is a valid concern. The question, though, is whether you can design a system that can limit that kind of substitutability.

That is the exact right question to ask. I think a good study of the dual income tax would take a look at the experience of the Nordic countries and how they've tried to quell those problems.

Hon. John McKay: Professor Mintz, in your second point, with respect to EI, you think that the transfer to the fund is a good idea, and then you talk about the potential of experience rating.

As I understand it, a lot of companies and essentially their employees.... I guess the entire system functions on the assumption that EI premiums will be paid but not be drawn by the vast majority of workers. And yet wouldn't your suggestion of experience rating exacerbate that problem? Because the companies that lay off employees, say the forestry sector or currently the manufacturing sector, are the ones that hire and lay off and hire and lay off—GM being a classic example. Presumably their experience rating would be higher and therefore their premiums rating would be higher, whereas the banks—to pick on them again—such as the Bank of Nova Scotia, continuously hire and very seldom lay off employees or draw on the EI system.

Wouldn't that effectively create a more expensive system for seasonal and more marginal industries and therefore almost be a disincentive for those companies to get back into manufacturing or forestry, as the case may be?

● (1550)

Prof. Jack Mintz: First of all, tomorrow is the tenth anniversary of the report of the technical committee on business taxation, which did recommend experience rating, and it was recommended on an individual firm basis.

Let me say first of all that Statistics Canada has done a number of studies, and while it's true that in some industries you have a higher incidence of layoffs, there's actually quite a differential experience across companies, even within the same industry. Therefore, in my view, experience rating—if we ever move in this direction—should really be done on an individual firm basis and not on an industry basis, which is an alternative approach.

With respect to compliance costs, this approach is often remarked to be more expensive, perhaps, but in some of the studies I've seen for the United States, the cost of complying with the unemployment insurance system, even with experience rating in some states, like Washington, is actually less than what we have in Canada. So I think we must ask some questions about what we are actually doing here in Canada, in terms of the administrative and compliance costs of running the system.

I would agree that there could be some additional expense, but then we have to remember the economic benefits associated here, because, effectively, EI is being used as a way of really helping companies to avoid making their own payments to keep individuals available to them when they're laid off, and then to bring back those individuals at a later time.

Really, what we're doing now is that we're imposing a significant tax on many sectors in the economy, including service companies. You mentioned banks, but you didn't mention a lot of the small companies that really have very little experience with unemployment and yet are paying very high premiums too.

The studies have actually shown that you could reduce unemployment rates by almost a percentage point if you did introduce at least some, or partial, experience rating for the EI system. That's why many economists are actually very favourable to the concept of experience rating, because it would have some significant economic benefit, especially at a time when we're worried about labour shortages.

I must say that one of the things that would need to be addressed is the way we handle regional benefits under the employment insurance system, which is particularly important for the Atlantic region.

The Chair: Thank you very much.

Monsieur Laforest.

[*Translation*]

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

Good morning. My question is addressed to both of you; you could answer it in turn.

I expected that you could talk to us about some ratio. The day before yesterday, we looked at the proportionate amounts in the aggregate revenues of the Government of Canada... There is some sort of ratio between income tax and consumer taxes. I may be wrong, but I believe that you have not talked about this.

In terms of our study, this is still a concern. Should we at some point increase consumer taxes in Canada in order to decrease income taxes so that at the end of the day the revenues remain the same? This is another aspect of our study.

There are some aberrations within the fiscal system. During the same presentation, we have seen that couples, individuals or single-parent families earning between $35,000 and $40,000 were not really being encouraged to earn an additional amount of $5,000 because then they would only keep $1,500 of that money. One must admit that it is a problem. We will have to correct this eventually.

I would like to hear you both on this.

● (1555)

[*English*]

Mr. Kevin Milligan: I could start, if that's okay with Jack.

The Chair: Go ahead.

Mr. Kevin Milligan: I'm going to pick up on the last thing that Monsieur Laforest said, which is about child benefits and the marginal tax rates that are faced by families in middle income ranges as they earn a bit more income. This is something that Professor Mintz mentioned in his presentation as well.

I think it is really important to consider how our child benefit system functions right now. We have a plethora of child benefits, certain parts of which overlap with each other. There's the new working income tax benefit, the national child benefit supplement, provincial national child benefit payments, the Canada child tax benefit, and the GST tax credit, which is paid to families as well. All of these things, as you earn more money, are reduced.

Having five different messy acronyms for child benefit programs seems to me like not the ideal way to proceed. Having a more universal approach to our child benefit system would allow our tax system to be more transparent in exactly what those tax rates are that are charged to families so that we could focus better on improving the system.

Prof. Jack Mintz: Let me add a number of comments.

First of all, to me, putting a lot of weight on what's consumption versus income taxes could be a bit of an exercise, because under the income tax today, there are elements of what you would call "consumption taxation". That's because we have brought in provisions that allow people to avoid paying tax on their savings income, or effectively, in the case of the RRSPs and pensions plans, you're able to deduct your contributions from the income base. In other words, you deduct your savings, so you're only paying tax on your consumption at that point. Then, when you withdraw your money from the RRSP account or receive your pension, you're being taxed on your consumption.

With the introduction of the tax-free savings account, that's another way, actually, of doing consumption taxation. Of course, our tax treatment of housing in Canada is very much based on a consumption system. You don't get a deduction for the contributions, but you don't pay any tax on the imputed rental income you get by owning the house and renting it to yourself, or capital gains taxes on the ownership of that house. Therefore, all these elements, once you take them into account, are equivalent to an RRSP-type system, as long as you have similar tax rates over time when doing the treatment of this type of asset.

As a result, many Canadians actually are on what's called a "consumption-based system" under the income tax, because all their assets are being held in either owner-occupied housing or in RRSP pension accounts, and they now have available to them the tax-free savings account. Effectively, to the extent that everything is in those kinds of assets and they do not pay any tax on their return on savings, they are really being treated as one would have as a consumption tax under the personal income tax.

There are other ways that I think you can bring in consumption taxes and increase the weight. Clearly, one of them is to encourage provincial sales tax reform, to eliminate the retail sales taxes in favour of value-added taxes. Currently, retail sales taxes collect about one third of the revenues on businesses' intermediate and capital good inputs, and that actually has an impact on their competitiveness.

If we move to a value-added tax, which has now been adopted in more than 150 countries around the world today, and of course we have it at the federal level with the GST, and we have the Quebec sales tax in Quebec and the harmonized sales tax in—

● (1600)

[*Translation*]

Mr. Jean-Yves Laforest: I am sorry to interrupt you.

You talked earlier about the adjustment, about an experience rating refund for corporations that do not lay-off workers. You were saying that corporations that do not make any lay-offs should benefit from a better rating. Is this counter-productive for the system itself? Does this go against some form of universality for the system?

[*English*]

The Chair: Who would like to take that? Our time is up, but I'll allow a very short answer from each of you, if you'd like.

Prof. Jack Mintz: Okay, I'll be very brief on that.

First of all, there is a principle with insurance that if you don't have the issue of what's called "moral hazard"—where people will take undue risks, including deciding to take more unemployment—you would like to have full insurance, and you could make an argument for a no experience rating in that case, because all the unemployment is due to cyclical changes.

On the other hand, if the system of insurance encourages people to take more layoffs than they normally would—and of course businesses may actually participate in that as well.... For example, I know of teachers at private schools who only have a one-year contract and then go on unemployment insurance over the summer. That allows them basically to collect insurance, and that saves the private school from having to pay higher salaries as a result.

If you get those situations, you could argue for partial experience rating—not full experience rating, but partial—with the idea that those businesses that tend to have a higher layoff experience would end up paying more. So they would try to avoid some of the actions they take that lead to layoffs when it's not just a matter of cyclical effects.

The Chair: All right. Thank you very much.

We'll move to Mr. Dykstra.

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

Just to start out, I know that both you gentlemen have a broad depth of understanding of the issues we're challenged with here and are trying to work through. I guess my only request would be that you shorten your answers just a bit. That might allow us to get a few more questions in, if that is possible. I mean that with the greatest respect, of course.

One of the questions I had, Kevin, was on your approach. I guess I'm trying to get a handle on the direction most of you who have appeared before the committee have taken with respect to income tax versus consumption tax. It seems, from all your perspectives, that you would prefer a consumption tax to an income tax .

I wouldn't mind getting your comments on that very quickly. The reason I note it, especially with you, is that in the opening of your presentation you talked about the fact that you're not a big supporter of boutique tax credits.

Clarify this for me, because I may not see this as you're seeing it. You're supportive of a consumption tax, but you're not supportive of a consumption tax credit. I do not see the two as mutually exclusive. In fact, I see them very much working hand in glove with each other.

Mr. Kevin Milligan: Sure. Let me address that briefly.

There are a couple of issues I have with what I refer to as the boutique tax credits. One is that you're eroding the tax base. The government is giving you credits and costing revenue in that way, which means that the tax base is getting smaller. In order to raise the same amount of revenue, rates must go higher.

The general preference, which I think many of the people in front of the committee have likely expressed, is a system that has low rates but a broad base. So that's where part of the concern comes in.

The other part of the concern ties in with the other part of your question. With these kinds of tax credits, the difference between that and more general consumption taxation is that you're picking and choosing which types of expenditure are eligible for these tax credits, whereas with the general consumption tax, it's neutral across different types of expenditure.

As an example, for the fitness tax credit, I remember reading last year a presentation by the representative from the Federation of Canadian Archers, who was worried that archery wasn't going to be considered to be enough of a physical activity to qualify for the fitness tax credit.

So you have meetings and lots of interest about how you define where you're going to draw the line and what's enough fitness. My point is that you're picking and choosing what's good for kids and what's not. I'm not sure if archery is good or bad for kids, but I'm pretty sure that having a system that treats archery the same as the chess club the same as hockey is actually a pretty good system.

● (1605)

Mr. Rick Dykstra: That may be the case. I guess the reason I question it is because your preference is to move away from that, yet your fourth point basically urges us to do exactly what you're suggesting we not do, and that is focus on a tax on the environment. I hear what you're saying, but am I wrong in saying that it's a bit of an inconsistent argument you're making?

Mr. Kevin Milligan: I think there is something to what you say. Let me try to defend it this way. The question is how broad a target you're trying to hit. When you try to have a credit for something that is very narrow, you create the incentive to shift things around and you have the difficulty of defining what's in and what's out.

So my preference in greater environmental taxation would be having a very broad base for environmental taxation. As Professor Mintz mentioned, something that is very broad-based, that is neutral across jurisdictions, would be the best way to go.

Mr. Rick Dykstra: Thanks.

Jack, go ahead. I have a question for you, but if you want, do a quick summary.

Prof. Jack Mintz: Okay. I have just one very quick point.

I agree with Kevin's comments about selected, targeted tax credits, but there are some tax credits that are very important, and in fact aren't wrong to do, in my view. One of them is the GST tax credit. The whole concept of that was to make the GST progressive so that low-income people wouldn't pay as much. So I think there's a good argument for that credit, and I don't think one should detract from it.

On the other hand, when you get into various targeted credits.... For example, Quebec had a special tax holiday for high-tech companies in two Internet towers in Montreal. That created very significant distortions, but it was ultimately eroded by high rental prices charged for the two Internet towers. So that kind of very targeted thing often doesn't accomplish what you're really hoping to achieve.

Mr. Rick Dykstra: To that end, maybe this expands a little on your point that I'm intrigued by, and that is, the whole concept of encouraging provincial tax reforms by providing a grant for those provinces that undertake sales tax reforms. Could you expand on that a little? The point I'm trying to determine is that we're taking the same approach. We're not necessarily dealing with income tax or tax on corporate gains, but in fact we're moving to a system through which we're trying to encourage provinces to do something that perhaps they should be doing anyway, without our encouragement.

Prof. Jack Mintz: I think that's a valid point.

First of all, we have a bit of history. Back in 1997 the federal government gave a billion dollars to New Brunswick and Nova Scotia and Newfoundland and Labrador to harmonize their sales taxes with the federal GST and to eliminate the provincial tax. This was a grant to offset revenue losses that were going to rise because the retail sales tax rates were quite high and the federal government wanted them to go to an 8% rate.

I think today you can make a case that a similar type of grant should be provided to other provinces, as was done ten years ago, in part because that would really help improve the system and allow better growth, which the federal government will make up for in terms of getting their own higher taxes, especially when you get some of the very large provinces, particularly Ontario, to move towards a value-added tax.

● (1610)

The Chair: Thank you very much.

Mr. Christopherson.

Mr. David Christopherson (Hamilton Centre, NDP): Thank you, Chair.

Thank you, professors, both of you. I appreciate your taking the time.

Professor Mintz, I believe it was you who raised the experience rating, and that was fine until you got to the part where you made reference to Ontario's WSIB. That caused me to generate this question. The experience rating at WSIB right now is a nightmare. In fact there was just an acknowledgement by Steve Mahoney, a former member of this place—and I served with him in the Ontario legislature—who is the chair and who has acknowledged that the whole system is just a nightmare. There are companies that are finding it cheaper to have employees who are injured sit in the lunchroom and pay them their wages rather than have them make a claim because a claim affects this rating. The downside for the workers is that without a claim going in, if they have a problem down the road, particularly as they get older and the problem becomes a debilitating injury or illness, for that matter, they're out of luck.

There is more money paid out—unless it has changed since I was there, which is going on five years ago—in experience-rating benefits than there were benefits to injured workers. So I'm just trying to understand how, given that experience in Ontario, you're seeing it as a real plus nationally. Maybe you can help clarify that for me.

Prof. Jack Mintz: First of all, there's no system or policy in the world that doesn't have some effects that you don't like, and of course the question is how you deal with that. I won't comment about Ontario because I don't know enough about the actual way the experience rating is put in. I do know that, for example, in New Brunswick, when they introduced experience rating—and this was Frank McKenna who did this back in the 1980s—it had a tremendous impact in encouraging growth in the service sector, in call centres, for example, because premiums were very sharply reduced for service companies that had very little layoff or worker compensation experience. Therefore it really did achieve a much more efficient system, and you'll find that people in New Brunswick, from what I understand, are really quite happy with the experience-rating system that operates there.

I do know that Alberta has gone to individual firm experience rating, and I'm not aware that there have been significant problems, although I know that there have been issues over deficits, which is another type of difficulty that one gets with government-owned enterprises, but that's an issue they've had to deal with over time.

Mr. David Christopherson: Yes, well, certainly unfunded liabilities remain an ongoing problem in Ontario.

I also want to pick up where Rick left off, or at least touch the same issue, in terms of the boutique taxes. I was equally surprised, Professor, to hear that you are opposed to them. I listened to your answer, and I understood it from both a revenue and an efficiency point of view, but I didn't quite understand how that trumps what the attempt is, without commenting on this particular tax; that is, the whole notion that if you want to use the tax system to affect behaviour in a positive way for the nation without acting like big brother, this is one of the means. So I still need a little help understanding why the efficiency of it is more important than the social goal, if you will.

Mr. Kevin Milligan: I'll take that one. Thank you for the question.

You're right in saying that one way to affect outcomes they might want to see is through the tax system. Taxes can affect people's decisions and are one way to get things done, but taxes aren't the only way to get things done. You can also spend money out of the budget directly on the expenditure side of the budget, rather than doing it through the credit side, the tax side.

My argument is perhaps a bit subtle.

Certain types of things might be better done on the tax side—for example, those affecting equity concerns that are raised by the GST through the GST tax credit, as Professor Mintz mentioned. Other things might be better done on the expenditure side. Take the example of the fitness tax credit. To go further on that, an issue with the tax credit approach is that an awful lot of families don't have taxable returns at all. They don't see any benefit at all from a fitness tax credit, so if you're trying to focus, say, on lower-income families, they're not going to see any benefit from that at all. On the other side, some kind of expenditure program that helped local community centres or something like that would be something you could perhaps use to improve the outcomes for all families.

It comes down perhaps to a case-by-case basis, but in general the broader the measure is, the less likely it is that you're going to have to worry about these kinds of small distortions and changes we've alluded to.

● (1615)

Mr. David Christopherson: Okay. I'm still not sure I'm convinced, but I hear your argument.

I have one more question, Chair, if I have time.

On the dual income tax, one of the things we're seeing over the last 30 to 40 years is that more of the overall revenue for the country is coming from personal income tax and less from the corporate side. In fact, over the last.... Obviously you're the professors, and you'll correct me if I'm wrong, but over that time period there's been a dramatic shift away from having the majority of it come from the corporate side. The personal income tax has long surpassed that now.

I won't get into the politics of what current governments are doing, but when you suggest this system, can you give me some assurance it would go toward rebalancing that, or do you not see the rebalancing coming? Are you prepared to defend that it's right for so much of our revenue to be coming from personal income tax rather than from the corporate side, which is the reverse of what it was as early as the 1960s?

You can tell I'm getting old.

Thank you.

Mr. Kevin Milligan: Let me address that with a brief point.

One thing that's really interesting is that there has been a rise in income inequality in Canada over the past 25 years, but a lot of that is driven not by changes in capital income but by changes in earned income. People at the very top of the wage distribution of earned income have done very well over the last 20 years. People even at the 90th percentile of the earnings distribution have actually been pretty flat over the last 20 years; it's really the top 1% who have done very well.

My point about the dual income tax is that if you're really concerned about equity and this inequality problem, this approach might allow you to address it through a system that allows you to separate out the capital income side from the earned income side, because the earned income is actually the source of the greatest growth in inequality.

Mr. David Christopherson: Very good. Thank you both very much.

Thank you, Chair.

The Chair: Thank you very much.

Mr. Pacetti is next.

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.): Thank you, Mr. Chair.

Thank you to the witnesses for appearing.

Professor Milligan, I think you touched upon the reason that we're here.

I think we're seeing a shift. You can look at what the Nordic countries are doing in terms of shifting away from corporate taxes and going towards wage or personal income taxes. Another prime example is Ireland.

I'm not sure I understand why that's happening. What is the benefit of taxing what you've lumped all together and called capital? Whether it's capital gains, dividends, or interest, what are we trying to accomplish with that? You would attract capital, but what would that do in turn for the country as a whole?

Mr. Kevin Milligan: There are two or three points.

For the country as a whole, if you want to have more business investment—better investment, better job creation—one way to do it is to make sure Canada is an attractive location for investment dollars. One way to do that is to make sure we have a competitive taxation regime for capital income.

The second thing, about why I'm lumping together capital gains and other types of capital income—

Mr. Massimo Pacetti: Professor, let's focus on that.

If somebody brings in capital, what does it generate for the country? Does it make a foreign investor richer because he's not paying taxes here? Should we put some conditions that would require capital investment to create jobs? It seems like an open invitation to come and invest your money here, and if we decide to change the rates, you can go elsewhere tomorrow.

Mr. Kevin Milligan: So the argument is that for people who have dollars to invest in lots of different countries around the world, one of the key things they're going to look at is the after-tax rate of return on those investments. The more amenable the Canadian choice is to them, the more likely they are to invest. What does that do for us? That means we get new plants opening up, we get new technologies being developed, and we have good-paying jobs that are going to come out of the greater corporate investment.

Mr. Massimo Pacetti: Okay, but is that actually happening?

● (1620)

Prof. Jack Mintz: Could I...?

Mr. Massimo Pacetti: I just want to.... Then I'm going to go to you, Jack.

Is that actually happening? Are we just attracting people to put money in term deposits, and the banks are increasing the amount of reserves they have? Or are there actual jobs being created when we do reduce the corporate taxes, when we do reduce the capital rates, when we do reduce dividend income? Are there studies out there? The great example is Ireland. That's the reason we're here. Are there studies out there? Is the proof in the pudding? Is it really something we should be looking at and recommending? Because, that's the purpose of this study. I believe it is, but I have nothing on which to base my decision.

What we're seeing, if we look at the forestry sector, is that, yes, businesses are putting huge amounts of money into a factory. We saw it in Quebec with the automobile sector where they were given tonnes of money. They put in two automobile factories in the span of three or four years, and once the grants ran out—I don't even think they waited for that—the plants closed down. In the forestry sector, the dollar turns and they're gone the next day. So can we really rely on these? Should there be more conditions or heavier conditions?

Prof. Jack Mintz: Could I comment on that?

Mr. Kevin Milligan: Sure, I'll defer to Jack.

Prof. Jack Mintz: First of all, let me say that I think the question is wrong in the first place, and the reason it's wrong is that corporations don't pay tax. It's going to be either shareholders who get lower after-tax returns, or it's going to be workers who are not going to get as high wages.

The reason I raise that is that in today's global world, the one thing that corporate taxes don't do any more is get shifted back onto shareholders. The reason is that if you impose high corporate income taxes and it lowers the profits that are going to be paid to shareholders or to investors, then they'll take their money and go elsewhere around the world. So in the end, the corporation has to pay the same after-tax rate of return to shareholders as it would with or without corporate taxes.

Right now I'll get to some important studies that have recently come out. But what we have seen in the past number of years is that there is a growing body of evidence that corporate tax reductions actually do generate more and higher wages paid to workers.

A recent study done by Mike Devereux at Oxford University—quite a good one with a colleague—looked at the incidence of corporate income taxes in Europe and I think particularly in Britain. This was one of the first studies that had been done in quite a long time. He found that in the short run, if corporate taxes are reduced by $1, then wages increase by 50¢, and in the long run they increase by over 100%. The reason he got over 100% is that companies would invest in new technologies and that would increase the productivity of workers and then that would allow them to pay more wages to their workers. Or they would be able to reduce prices, and that would have the impact of increasing the purchasing power of wages.

Mr. Massimo Pacetti: Did studies look at other things—for example, standard of living? When I say "standard of living", I mean the fact that post-secondary education is not as expensive and neither is health care or medicare. Are those factors also taken into consideration or is it just corporate taxes? What does a corporation look at?

Prof. Jack Mintz: They were just looking at the corporate tax. As you might know, there's work that I personally have done in which I have tried to actually look at what's called the "fiscal burden" on businesses. It's a way of trying to aggregate up different taxes on different inputs—labour and capital—but also take into account various subsidies, like health care subsidies and education subsidies, etc., that could impact the fiscal burden on the cost of producing goods and services. I've done that for Canada and for Ontario particularly.

Let me just very quickly add that there's been a recent study that was done by Ken McKenzie, at the University of Calgary, with a colleague. They looked at these effective tax rates on the cost of doing business in Canada; they looked at inter-provincial differences. He found that those provinces that had lower effective tax rates on costs would actually end up having more companies operating in that jurisdiction.

● (1625)

The Chair: Thank you very much.

Mr. Crête.

[*Translation*]

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

My question is for Mr. Milligan.

You told us about the dual taxation system, that is income taxes and capital taxes. You gave the example of Sweden. Could you tell us in more details why, in your view, this could be relevant in Canada? We in Canada have an enormous neighbour, namely the United States, while the situation is different in Sweden. Please give us some more indications as to the results and the feasibility of such a system in Canada.

[*English*]

Mr. Kevin Milligan: Thank you for the question.

I will pick up the last point that you made first. I think you're right that there might be some differences in a place like Canada, where there's a lot more bilateral investment with a larger partner, than in Sweden, where it's more of a multilateral, within-Europe situation, but it's not necessarily the case that that makes it harder to think of why a dual income tax would be good. The reason is that in a case like Canada it might even be more likely to be the case that capital flows freely across the border because we're in the NAFTA agreement with the United States, and the more freely capital flows, as Professor Mintz was just saying, the less likely it is that capital income taxes will actually be borne by those who are investing in the country. In other words, what you're going to do when you're taxing capital income is you're just going to decrease the amount of investment in a world where capital flows very freely.

So part of what the dual income tax is trying to do is to recognize that fact, that capital is flowing freely, and to design a tax system that accounts for the fact that by taxing capital income more heavily, we're not actually doing ourselves any favour. For the most part, what we'll be doing is just scaring investment across the border.

[*Translation*]

Mr. Paul Crête: Does the Swedish model succeed indirectly in obtaining a better return not in terms of creation but rather distribution of wealth? Does this model have an impact on distribution of wealth? Centrist governments and even rightist governments have been elected in Sweden. However, it has been a social democratic model for a long time and it remains so.

Do you have an idea of the impact this model has on the distribution of wealth, on social programs? How does it compare to the model that we are applying here?

[*English*]

Mr. Kevin Milligan: Thank you for the question.

I haven't seen a study of Sweden in particular, but I was just reviewing a study of Finland, which also has a dual income tax system, and it found that there was a gain for those who were heavy recipients of capital income within Finland and also some slight gains on the employment side as well. But one difficulty in making comparisons of the social changes that have happened through the 1990s, as Finland and Sweden made these tax changes, is that many different things were changing. So as we see the progression of these societies, it's hard to be sure what exactly was caused by this tax reform and what wasn't. In Finland, in any case, there was no evidence from the study that there was a great change in the distribution of wealth.

[*Translation*]

Mr. Paul Crête: Thank you.

Mr. Mintz, you talked about an independent employment insurance account. That is an interesting idea. I don't know whether you know that model, but in Denmark, employment insurance does not work the same way as it does here, since they are not waiting for the people to be out of the system to offer them training and reintegrating them within the system. Here, we begin to train people once they have lost their job. In a context of globalization, it is not a very efficient way to proceed.

I understand that in Denmark, there is an employment insurance system that enables workers to have access to training within the system. Moreover, when they are laid off, they benefit from a security lasting up to two or three years. They in turn make a commitment to receive some training.

Have you examined this aspect in the context of a potentially adequate employment insurance system?

[*English*]

Prof. Jack Mintz: The short answer is no. I'm not aware of the Danish reforms in detail. All I do know is that Denmark, unlike many other European countries, has avoided the use of payroll taxes to fund all social security and health and other expenditures. What people have found is that actually the Danish labour market is much more flexible compared to other European countries, and part of that is attributed to the payroll tax, but I think maybe some of these other factors are playing a hand as well.

● (1630)

The Chair: Thank you very much.

Mr. Del Mastro.

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

Thank you, witnesses, for appearing before us today.

Professor Mintz, one of the things I've been talking about a lot, and something I've been studying and working on, is the harmonized sales tax or value-added tax and the benefits of transitioning toward that. I note that it's one of the points in your presentation today.

We've had some discussion here before the committee, which I happen to agree with, that it's often not a matter of the tax rate even, but where you're generating the tax revenue dollars from. So where you're applying it would often determine how you're positioning your economy productivity-wise and whether you're optimizing your tax system.

I do know our government has put in place some incentives for harmonization of taxes, and one of the things we keep coming back to is that we should come up with perhaps a larger subsidy, or create an impetus for that to occur. But one of the things I don't really understand is why this change can't be made revenue-neutral for the provinces. Why can't they transition to a value-added tax without taking an enormous economic hit, especially considering that most tax revenues in the provinces are generated—as with the federal government—by personal income taxes, not through value-added taxes or corporate taxes? It would seem to me that this transition could be made, with the exception of administrative changes, fairly revenue neutral for the provinces.

Prof. Jack Mintz: First of all, I think you're right that it can be revenue neutral. In fact, there's going to be a paper coming out on Ontario value-added taxation, which I've done with a couple of colleagues at the University of Toronto, where we've gone into this in detail.

First of all, let me say that if Ontario converted its retail sales tax into a value-added tax, whether fully harmonized with the GST, or maybe with some deviations from the GST, like the Quebec sales tax, it could levy the tax rate at about 8% without losing revenue—but it wouldn't gain any revenue either.

There is one virtue, though, which is what we found out. Retail sales taxes in Ontario have only grown 3% per year in nominal terms—not when inflation is taken out—over the past five or six years, while value-added tax collections in Ontario of the federal GST have actually been more buoyant with the economy and have actually increased 5% per year. In a sense, Ontario is hurting itself by maintaining a retail sales tax that actually is not growing very well with the economy, and that's because of the way it operates.

Now, there are some things that Ontario—

Mr. Dean Del Mastro: Could I just ask you to expand to the next step?

If most of Ontario's taxes, as with most governments, are generated by personal income taxes, reducing the marginal effective tax rate by eliminating retail sales tax on investment into industry should relate to more employment, and certainly more investment, which would also lead to higher personal income tax revenue for the provinces. So it would seem to me that it would really marginalize or negate any potential loss from the transition to a retail sales tax.

Is that not accurate?

Prof. Jack Mintz: It's not quite accurate. In the work we've done, using the FOCUS model of the University of Toronto, we did take into account the investment impacts, which would be positive and actually help to generate more revenue in the future. There is also a more immediate impact, different from the longer-run impact, that would have to be taken into account.

But overall, I think there's a very strong case to be made for Ontario—and I'm sure this would also apply to the other four provinces—to move towards a value-added tax, even from the point of view of the government getting a better and growing source of revenue.

● (1635)

Mr. Dean Del Mastro: Thank you.

Professor Milligan, I want to come back briefly to what I guess we've been tied up about—that is, your comment about boutique tax credits, that environmental taxes are good and boutique tax credits bad. But then you expanded on that a little bit and said that one of the other things that could be done is spending money, versus creating a tax credit to encourage a behaviour.

As a Conservative, I actually look at it the other way. If I look at public transit, for example, I would rather encourage people to ride public transit and have the transit system become economic, and actually be able to provide for itself, than the other way, which is to pour money into a system and have a whole bunch of empty buses with nobody riding in them.

Do you see how that might be a better approach—which is where the government has gone with it?

Mr. Kevin Milligan: Yes, I can see it, although it depends maybe upon what city you're in. In Vancouver, the problem is getting on a bus; the problem isn't empty buses going around, I can tell you for sure.

In general, the argument I was trying to make is that on the spending side it is possible to perhaps be more targeted than on the tax credit side. As I mentioned with the fitness tax credit, a lot of people riding buses are students. Students quite often don't have taxable returns, and they won't see the benefit of this tax credit. Maybe these are people we want to encourage to take the bus more, rather than to drive and park at the university. That's one of the issues I'd like to raise.

Mr. Dean Del Mastro: Obviously, the goal of it is not to give tax credits, necessarily. We want to reward the people who are currently using transit through that system—and this is only an example—but secondly, we want to create an incentive for people who aren't using transit, and those probably aren't, generally speaking, students.

The Chair: That will be the last. We'll move on now.

Mr. Bagnell.

Hon. Larry Bagnell (Yukon, Lib.): Thank you.

Thank you both for coming.

I have just one question, then I'll let my colleagues.... They have more questions.

Just to change stream a little bit, do you have any comments on regional development and how the system can be used in that respect? There have been suggestions occasionally over the years that one way would be to have different tax rates, for instance, in depressed regions. Do you have any comments on that? If not that, then how would we deal with those depressed regions, because it is in our constitution that we're trying to get everyone up to the same level of prosperity and equal services, etc., which are provided by taxes.

Prof. Jack Mintz: Several years ago I gave a major speech on regional development programs in Canada and went into a lot of the literature about what people have found around the world with them. There was a comment made by the World Bank that just about every regional development program that was ever tried didn't work, in the sense of really doing anything.

But there were two things I found that were quite effective in trying to improve more depressed regions. One of them was to link them better with the urban areas in terms of both communication and transportation networks. That allowed people more easily to trade from the outlying regions with the major urban centres. It was found in Europe and in a number of other studies that these things did tend to work.

The other type of regional development effort that was successful was getting over jurisdictional boundaries, and in particular, when you get to smaller regions, enabling a sharing of the costs of major expenditures by getting several communities to share the costs rather than each, let's say, building their own centres. If you could get some economies of scale and efficiencies that way, that actually succeeded.

I was quite surprised that one of the jurisdictions was a Canadian jurisdiction that actually put some significant effort in that direction. That was Alberta. With its regional development policies, it was trying to get smaller towns to share resources more, so that they could have better facilities available to them.

None of these things is on the tax side, and so I think maybe we have to go back to trying to recognize what we are trying to achieve and how best to achieve it. I think those are interesting directions to think about anyway.

Hon. Larry Bagnell: Are there any other...?

Mr. Milligan?

The Chair: If he has any more comments, he may go ahead.

Go ahead, Mr. Milligan.

● (1640)

Mr. Kevin Milligan: No, I'm fine.

Hon. Larry Bagnell: He doesn't want to say anything.

The Chair: Okay, that's fine.

Yes, you have a minute or two.

Hon. John McKay: All right. Well, I may have to go into another round, but....

It's pretty obvious at this stage that, one way or another, governments have to price carbon. It's easy to say and extremely difficult to apply.

It's also obvious that we are under-taxing consumption vis-à-vis other G-7 comparators. I was wondering whether the tax pricing of carbon would be easiest as, if you will, a consumption tax, both at a manufacturing stage, but also at an ultimate consumption stage for import purposes.

Prof. Jack Mintz: Let me first of all say that this kind of proposal really was made ten years ago by the technical committee on business taxation, which I chaired. I was appointed by Paul Martin when he was Minister of Finance.

In fact, we recommended taking the federal fuel excise tax, which really lost its rationale.... It was introduced in 1975 to reduce imports of oil. That's really irrelevant today. There's a question of why it even exists at the federal level, since the federal government really doesn't fund highways and roads, as the provinces do, and one could argue that it's a user-related tax. Can't the federal government do something better with that tax? We recommended at that time a broadening of the federal fuel excise tax into a tax either on energy or on toxins. It would effectively take into account these things.

Today I presented a paper and gave a speech at the Economic Club of Toronto. In that presentation Nancy Olewiler and I developed in more detail some of these arguments, taking up the report's recommendation from ten years ago. We looked at what would happen if you kept the gasoline tax at 10¢ and then decided to apply a broad-based environmental tax on other fuels. It could be on carbon; it could be on sulphur and NOXs or on some combination of these things. That's a choice that could be made, but we worked through the carbon case because it actually was easiest in terms of the data.

A tax of 10¢ a litre, which is currently existing under the federal excise tax, is equivalent to a carbon tax of $42 per tonne. If you apply $42 on everything else, what would happen in our calculations is that instead of raising $5.1 billion under the federal fuel excise tax, one could raise $17 billion under a full-blown carbon tax that would be based on consumption. In other words, you try to exempt exports and tax imports, although there's a very significant problem in trying to do that beyond the fuel combustion stage.

The reason is that if you bring in a toy from China, it may not just include lead; it will include carbon, but it may not be carbon in China, because it could have been assembled from components produced all over the world, including the United States and Canada. Then you want to know the price of carbon in all different parts of the world in measuring that carbon and everything else. Putting tariffs on manufactured goods would really be quite a challenge, but as we've seen with the B.C. carbon tax, it is possible to consider that.

I think there is some room at the federal level to take a restructuring of the existing federal excise tax and maybe use it for a better purpose than simply grabbing revenue.

The Chair: Thank you very much.

We'll now move to Mr. Wallace.

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

Thank you, professors, for being here.

I'm going to start with Mr. Mintz. Your first recommendation was to go to three tax brackets instead of four, which I believe we have now. Do you have any comment on changing the thresholds at which they apply—the income you have to earn before they start to take effect?

Prof. Jack Mintz: I think that if you did do that, you would want to recast the thresholds. I have to admit that I haven't done the calculations, and of course all of it would depend on the amount by which you want to reduce personal tax.

As I said in my comments, if you did bring in a restructuring of the federal fuel excise tax that raised a bunch of revenue, and some of it was used for reducing personal income taxes, then I wouldn't mind seeing a reconfiguration of the personal tax. Perhaps it could go down to three rates. It would mean recasting the thresholds, which could go up. It depends on how much revenue one wants to—

● (1645)

Mr. Mike Wallace: When I look at your four or five points here, you haven't done an overall calculation of whether this is revenue neutral for the government or any of that type of analysis, then.

Prof. Jack Mintz: No. You have to work out all the details. I don't have a Department of Finance to do that for me; I'm just one person.

Mr. Mike Wallace: No problem.

Your third point I haven't seen before. I'm not sure I agree with you.

We've provided an incentive for a small business owner to get a lifetime capital gains exemption of, I think, $400,000 now. If I read you correctly, you're recommending that we get rid of that exemption completely, because once you've made over $400,000, you start paying tax on it, so it's a disincentive after that point, based on what I'm reading here.

Could you explain to me what the better system is? I don't understand it at this point.

Prof. Jack Mintz: I was very brief in my comments. But first of all, the lifetime capital gains exemption is available for anyone who owns Canadian-controlled private corporate shares.

In fact there are many large companies that have restructured themselves so they might create a private management company, in which the managers—who could be people quite wealthy, actually—end up claiming the lifetime capital gains exemption for their shares, because it's a Canadian-controlled private corporation, when they sell off their shares within that private corporation.

But the problem that I have with the lifetime capital gains exemption is that it only is available for private corporate shares. So if you become public, you can crystallize and fully claim your exemption, but effectively, sometimes if you haven't built up enough capital gains yet, then you may want to keep the company private.

What I'm suggesting is that I think we need to start thinking about incentives for small businesses that would allow them to grow. An example I was always struck with was in the United States when they gave a half capital gains tax treatment for investors holding initial public offerings of small companies, and small companies were defined as up to $60 million in assets, the last time I looked at the rules. There was a study done at Harvard that indicated that investors actually got about half the benefits of that and the company got half the benefits in terms of a lower cost of capital. But it was interesting, as it was an incentive to actually encourage companies to go public, as opposed to what I see as an incentive to keep small.

Mr. Mike Wallace: Either economist can answer the next couple of questions—hopefully, both.

In this country, as you know, the capital gain in your own personal home can grow and grow and you never pay tax on it when you sell it. In the United States, I know there's a minimum under which you can do that and then you can write off your interest, and so on and so forth.

Do you have any suggestions on any changes to that, or do you like the Canadian system over the American system?

Prof. Jack Mintz: The Canadian system is much better. It's equivalent to what I called an expenditure tax treatment for housing, just like RSPs and the tax-free savings account that's just been introduced by the government. I think we have exactly the right system for the treatment of housing. I wouldn't change it one iota.

Mr. Mike Wallace: Professor Milligan, do you have any—

Mr. Kevin Milligan: I'll just echo that.

I notice that one big difference between Canada and the U.S. is the lack of deductibility for mortgage interest. I think we made the right choice in Canada.

In the U.S., there was a commission last year that recommended ways to try to remove that tax preference. Once created, it's very difficult to remove, and they found that in the U.S.

I think we're much better off in Canada with that.

Mr. Mike Wallace: As my final question, of the items that you've recommended to us, is there one, each, that you particularly would like to emphasize for us? We can't do everything, of course. Is there one that you'd recommend as a top priority among your suggestions?

● (1650)

Mr. Kevin Milligan: I'll go first with the easy one. It's the retail sales tax and the GST thing. There are precedents for how to do it within Canada, and I think there are big gains to be had for doing so.

Mr. Mike Wallace: Professor.

Prof. Jack Mintz: My first choice is the very first bullet point on the personal tax. I think we need to start paying more attention to reducing personal income taxes in Canada. It may require a shift toward consumption taxes in various ways, including an environmental tax, being a form of a consumption tax.

The Chair: Thank you very much.

Mr. Pacetti.

Mr. Massimo Pacetti: Thanks.

Just to get back to a question I think Mr. Wallace was asking you, Professor Mintz, do you believe that we should be giving incentives for individuals investing in small business or that there should be no incentive at all and everybody should be treated equally?

Prof. Jack Mintz: We need more current studies, but past studies have shown that actually many small businesses are created but then they don't grow in employment growth. Only a few do. In fact the last study that was done, which was almost ten years ago, had shown that only 12% of small business companies actually grow.

As we know, many people have used the small business tax treatment, really, as a way of trying to reduce taxes and they've incorporated themselves, as opposed to really going ahead and growing.

What I'm trying to say is that I don't think our system has worked well. I think we need to rethink our incentives for small business. I'm not arguing against trying to have some incentives; I think we should, but I think we need to rethink what we're doing.

Mr. Massimo Pacetti: But would the solution be—and this what I'm trying to reconcile between you and Professor Milligan—to lower the income tax on capital income, whether it be capital gains, dividends, or interest, just lumping them all together and reducing the tax on that? Would that solve it? Or would there still have to be something for a small business owner? The small business owner will need to have some type of incentive to take a chance on opening up a business.

Prof. Jack Mintz: Right. First of all, one thing I would disagree with Professor Milligan on is that, even if you try to lump capital gains and dividends and interest together, you're not going to simplify the system. First of all, capital gains are only taxed on a realized basis, when people actually sell assets. That already creates an important differentiation, and a lot of tax law is built on trying to cope with that differentiation from other sources of income.

Also, for dividends, and in the case of capital gains too, we know that if a company is paying corporate income taxes, it's actually reducing its value and in fact the capital gains and the dividends. The reason we've had dividend tax credits, especially for small firms, and lower capital gains taxes on shares has been as a way of trying to recognize that the income the owner gets has already been subject to one layer of tax, and that's at the corporate level. So you're going to have those kinds of differentiations.

In the case of small business, I think there is an issue of building a company and of people having sufficiently low costs of capital to grow their company. Taxes, especially capital gains taxes, can impede risk-taking, because governments are there to share the gain, but they don't necessarily share the loss entirely, although we've tried to deal with that in the tax system.

But because we don't have a perfect system of capital income taxation—we will never get there—sometimes you have to do some offsetting incentives. That's where I think we need to rethink this, but what I'd like to do is rethink incentives by which we can actually encourage growth and not have very high marginal tax rates, such that if a company grows, then they're facing much higher levels of taxes on their income, should they grow.

It's very similar to low-income people trying to—

Mr. Massimo Pacetti: Would a gradual type of rate perhaps be a better solution than just going from the small business rate of 13% and jumping directly to 22%?

Prof. Jack Mintz: That is one thing that could be considered. As I mentioned, I'm going to be doing some work in this area. I think there may be some really interesting incentives one could think about. Right now I'm not exactly sure what to recommend, but I like this U.S. incentive, because it's a good example of something that can be done that encourages growth.

Mr. Massimo Pacetti: When the small business deduction was at $200,000, everything I ever read coming out of accounting firms was that you had to bonus down to $200,000. Now that it's at $400,000, they're suggesting bonusing down to $400,000. There are still corporations that should be at much higher levels, but they're all bonusing down, just for tax purposes. That doesn't make sense; you're not going to grow a company by doing that. You'll do it in the short term, but not in the long term. I agree that it's a disincentive.

Do I have—

● (1655)

The Chair: Your time is pretty well gone.

Mr. Massimo Pacetti: Okay, I'll go for another round.

The Chair: Thank you very much.

Mr. Menzies.

Mr. Ted Menzies (Macleod, CPC): Thank you to our witnesses here with us today.

Thank goodness we have BlackBerries. I just got a note about the Manitoba budget, and I see that they have also cut their capital tax. That's encouraging. We're hoping to see that happen all across the country.

I have a couple of things. You have both talked about a fuel excise tax, a carbon tax, or an environmental tax. I just wonder, blue-skying here, how, if we ever decided that was going to take place, we would make it fair. My colleague across the table from Toronto, who seems to think it's a no-brainer, doesn't have quite the travel challenges, the distance challenges that many of our rural residents have in this country.

I'm not sure how we would do this to make it fair and equitable. It would drive up costs, if every item of food that is shipped to the city has this extra cost added to it as well. I think it's going to impact everybody. How on earth would we do it fairly would be my first question.

Mr. Kevin Milligan: Let me jump in briefly.

Can I start for a bit, Jack, and then I'll pass it over to you?

Mr. Ted Menzies: Yes, go ahead.

Mr. Kevin Milligan: In B.C. I can say that has been a concern of late. There have been some concerns raised by people around the Prince George area in northern B.C. for this exact reason. They're concerned about the fact that they have to drive around more than perhaps I do in Vancouver. It was not considered carefully enough.

What you saw in the B.C. budget was an offsetting change in the income tax system and also some other changes that tried to take into account exactly these kinds of concerns. One reason I'm glad the committee has a broad mandate is that you can perhaps trade off some of these things and adjust one part of the tax system for efficiency and another part to improve equity.

Mr. Ted Menzies: If I can jump in here, I'd like to hear Jack comment on this as well. For the production of food, for example, there are huge amounts of investment in fuel—fuel into fertilizer, fuel into all of the products that go into providing food for this country. How do we deal with that as well?

Prof. Jack Mintz: Well, first of all, I would endorse Kevin's comment. It's a question of what you do with the revenues in terms of some of the offsets. You are correct, also, to lay out that, as we've seen with ethanol, when you make major changes in policies, it could have impacts on prices and all sorts of things, and we need to understand that.

With respect to my comment about restructuring the federal fuel excise tax, it's already an existing tax, and you can restructure it in all sorts of different ways, including, for example, reducing the gas tax to let's say 5¢, and then bringing in a broad-based environmental tax that would apply to natural gas and coal products as well as other petroleum products that are not subject to the environmental tax.

I've calculated, in the case of a carbon tax, that if you have a 5¢ tax on gasoline—so you're cutting the gas tax by 5¢ and then applying the carbon equivalent—in effect the federal government would actually still raise about $2 billion to $3 billion. Of course it also means that you have a much smaller tax, and of course the ramifications of that in trying to deal with all the offsets and some of the issues are much less. It also gives you an opportunity to see how the tax operates, because I don't think any of these tax reform proposals should ever be brought in such that you have huge changes at one time. We have to see how they work, how they impact on the economy, including prices that are going to be affecting people.

Mr. Ted Menzies: Well, I'm sure you know that I'm not going to be out promoting in the riding of Macleod, just south of Calgary, a carbon tax as of yet. I think we're a long, long way from that.

I have one quick question, if I could.

● (1700)

Hon. John McKay: That is the land of the dinosaurs.

Mr. Ted Menzies: That's why we have oil and gas, because it was the land of the dinosaurs.

We had a witness here on Monday who very strongly advocated an inheritance tax, and I still haven't quite got over it. I would like your comments on that.

Prof. Jack Mintz: Kevin may have some comments.

First of all, we have deemed realization in capital gains at death in Canada, and of course if you have any RSP assets left over, that's going to be subject to tax as well, at death. A lot of people have to do estate planning around that.

I forget the current numbers that are being raised by that, but it's a very significant level of tax. If we brought in an inheritance tax, a transfer tax—and frankly I'm not really in favour of it myself, because I think the deemed realization does a lot of the trick—no country except for a couple will apply both deemed realization and inheritance taxes at the same point. Someone dies and then the government's going to come along with two different taxes. That would make very little sense. What you do with one hand you'll end up giving up with the other.

Mr. Kevin Milligan: I'll just reiterate that. Taxing estates is something legitimate to discuss. People are going to have different opinions on that, but that discussion should be made in the context of realizing that we have deemed realization at death, which, as Jack said, goes part of the way there.

Mr. Ted Menzies: Thank you.

The Chair: That's very good. I encourage the NDP to bring that up in the next platform again.

Mr. McKay.

Mr. David Christopherson: Yes, for all the working people worrying about losing their millions.

Hon. John McKay: Alberta clearly is the land of the dinosaurs.

Going back to this notion that in the real world we still will have to price carbon, regardless of the MPs from Alberta, Professor Mintz, you seem to have gone from pricing carbon by way of an excise tax on gasoline, then to spreading it on forms of fuel, and now you seem to be on to other forms of carbon sequestration, whether it's in a manufactured good or something of that nature. Is that correct in terms of the transitions of your thinking?

Prof. Jack Mintz: What I'm suggesting is first of all that the value of doing a tax, as opposed to let's say the cap and trade system or a regulation that says “You must reduce emissions by a certain amount”, is that it gives certainty to businesses about what the price is and allows them, if you've not put the price too high and it will still give them incentive, to look at new technologies that could be adopted to reduce carbon.

You then have the value of using the revenues—to the extent it raises revenue, which I'm suggesting, in terms of this restructuring of the federal fuel excise tax—in part to help fund tax credits for many businesses that are going to take on costly technologies in order to reduce carbon, of which carbon storage and capture is certainly going to be one.

Hon. John McKay: I think you're right. I think, actually, business is simply saying to itself, “Let's just get on with this.” In talking to other economists and business people, they're simply saying, “We're ready for carbon to be priced; just give us certainty about the system.”

One other question comes from an unusual suggestion, but one that was made to me. Economists generally say payroll tax is bad and consumption tax is good. That's rather crude, for economists, but it's as much certainty as you ever get out of economists. The suggestion to me was that we completely eliminate premiums for EI and fund that revenue loss by an increase in GST.

Can I have a quick reaction on that?

Mr. Kevin Milligan: I'll start with a quick reaction. I like the approach that's been followed recently of taking EI off-budget and making it a self-funded program, which would be harder to do if it were funded through the GST.

Prof. Jack Mintz: I agree with that as well. I wouldn't like to use the GST for that purpose.

Hon. John McKay: All right, but in general terms most economists seem to think that payroll taxes are a bad thing, so if in fact you were looking to simplify the system to take tax away from labour, if you will, you'd have to fund it from something. It may not be the linkage between the GST and EI, but would the elimination of payroll taxes be a good thing, as a point of economic principle?

● (1705)

Prof. Jack Mintz: I wouldn't want to see the EI payroll tax being eliminated, because I think it really is tied to what's being provided—unless you change the benefits of the EI system so that it then goes beyond what workers receive.

There are payroll taxes that I think should be eliminated, such as provincial payroll taxes that are general ones. But then you would have to find a replacement revenue for that.

You might want to look, potentially, at some changes in other areas of the tax system where payroll taxes are used to make sure they're done appropriately.

Most of the payroll taxes we have in Canada are funding benefits that go to workers, and I think that tie between the two is very important. What I would like not to see is payroll taxes that are really not tied to benefits, because that's when I think you end up getting distortions in labour markets induced by that means.

Hon. John McKay: Thank you.

Mr. Kevin Milligan: I'd echo that. When payroll taxes are really tied closely to the benefit that's received through them, that tie can make a big difference in how the benefit affects people's behaviour. When I have Canada Pension Plan premiums deducted from my paycheque, I realize that I'll get a benefit from that later in life.

Also, if that weren't there, I might have to pay a bigger pension plan premium to my employer. So in a certain sense I'm buying something with it. It's not just going into a pot to Ottawa; I'm buying a pension with it. The greater is that tie from premium to service, the more efficient the payroll tax can be.

Hon. John McKay: Mr. Chair, could I ask that we instruct the clerk to obtain Professor Mintz's paper and speech?

The Chair: Sure—if that's okay, Professor Mintz?

Prof. Jack Mintz: I'm sorry, the paper and what?

The Chair: Professor Mintz, the request was to obtain your speech and your paper, if that's all right.

Hon. John McKay: I mean the one you gave today at the Economic Club of Toronto.

Prof. Jack Mintz: Oh, okay.

You can get the paper. It's released today on the website. I did not write the speech.

The Chair: Okay. Those usually are the best kind.

I want to thank you both for coming in. Oh, there is one more quick question.

Go ahead, Mr. Pacetti, please.

Mr. Massimo Pacetti: I've asked this question before and I think John was alluding to it, but it was a little bit contradictory, Professor Mintz, so that's why I want to ask it.

There's no doubt the government needs *x* dollars to run the government, to provide the services. Whether it's $200 billion or $300 billion doesn't really matter. We talked about the idea that payroll taxes should go for certain benefits; we talked about unemployment perhaps going for benefits. At what point should they no longer go for benefits?

The airport taxes came out a couple of years ago. All of a sudden it was a tax grab, and the government got addicted to it. Probably the same amount of money was not invested in security for airports, but they seem to have just generated endless amounts of revenue.

I'm using that example because it was brought to light, but you brought up another example with the excise tax. Should governments be all over the place? In a sense you say the excise tax should go into general revenues, but then you turn around and say that perhaps the excise tax should come down—that we should introduce a carbon tax and that some of that money should go back to the people who are paying it. At what point should we do that for personal taxes? What should we do in terms of corporate taxes?

The question is, when should we be using dedicated tax, and when should we skim a little bit off the top to really get the taxpayers for whatever we can?

Prof. Jack Mintz: I'm certainly not going to profess that you should skim the taxpayers as much as possible, but with respect to the environmental tax and the question of what you do with the revenues, I'm suggesting it should be very similar to what B.C. did. I would highly recommend that the revenues be used to reduce taxes and not go into government spending.

Certainly there are people who are going to have a different view on that, partly because the emissions issue, I think, is going to be particularly concentrated in two parts of Canada, Ontario and Alberta. Through the tax reductions and the way that you could do the offsets, I think you could do it in a way that would be regionally neutral as well, because otherwise this tax could end up creating major transfers among the regions, which could be highly problematic in a political sense.

I'm not saying the money should be dedicated. That's different. Dedicated taxes are like the Canada Pension Plan: the money is hived off and put into a special fund, and then the benefits come from that fund. If the EI system ends up being a separate fund, and money goes into that fund and then funds those benefits, then that actually becomes a dedicated payroll tax. In a sense the EI payroll tax was not as dedicated before, because it went into general revenues and—

● (1710)

Mr. Massimo Pacetti: I understand, but I'd like to know what your opinion is. Should the government lean towards collecting money and using it for benefits? Should it be doing more with CPP, EI, the airport security tax? Should it be doing more funds like that, or should everything go into a pot? That's the short end of the question.

Prof. Jack Mintz: I see your point.

I always worry about too much rigidity in budgeting. I worry that if you create a lot of dedicated funds and everything else, you do create that problem.

In the case of the CPP, I think it was quite wise to put it in a special fund, because there were federal-provincial aspects associated with that. I think there could be a case for EI if you really wanted to run it more like an insurance fund, just like workers' compensation programs at the provincial level, but I'm not sure I would like to start seeing a whole bunch of funds created for everything else. At that point I would be cautionary, just as your question suggests.

Mr. Massimo Pacetti: Okay, great.

Professor Milligan, would you like to comment?

Mr. Kevin Milligan: I defer. That was fine.

The Chair: Thank you.

We want to thank both of you, Professors Milligan and Mintz, for lending your time. It was a very interesting discussion, as was reflected by the number of questions from the committee. Thank you very much for joining us today and contributing to our study. Thank you.

Before we adjourn, we do have a budget in front of us that we have to pass prior to getting witnesses in here tomorrow, so I would entertain a motion to accept that budget.

Mr. McKay moves the motion.

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

The Chair: There is one other issue, which is that it appears Bill C-50 is going to pass the House. It will likely be here next week. My suggestion to the committee would be to put Wednesday's meeting off to do Bill C-50.

Mr. Massimo Pacetti: What are we dealing with next week?

The Chair: That would be the last one of your motions.

Mr. Massimo Pacetti: What is on Monday?

The Chair: Monday—

The Clerk of the Committee (Mr. Jean-François Pagé): Monday we have OECD on taxation.

The Chair: Yes, we have it all lined up for taxation.

Mr. Massimo Pacetti: What is Wednesday?

The Clerk: Wednesday is OSFI.

The Chair: Okay, it's his motion. Who cares?

Mr. Massimo Pacetti: No, it's just that it took him forever to come.

The Chair: Then we are ready for clause-by-clause by Wednesday.

Mr. Massimo Pacetti: Do you want the list of witnesses for Monday?

The Chair: Witnesses? I would suggest if you insist on witnesses, get them in quickly, because clause-by-clause will happen very quickly. By Wednesday we will be on Bill C-50.

Mr. Massimo Pacetti: I just have amendments.

Hon. John McKay: What is the commitment on asset-backed commercial paper? We meet on that tomorrow.

The Chair: That's right, tomorrow morning, and then we'll wait until after the vote until we wade into that arena again.

Hon. John McKay: I'll defer to John on whether he wants any more hearings after tomorrow.

The Chair: Okay, fair enough.

Paul.

[*Translation*]

Mr. Paul Crête: Regarding Bill C-50, will we hear experts from the department next Wednesday?

[*English*]

The Chair: Yes, that's what we'll start with.

[*Translation*]

Mr. Paul Crête: There will be experts from the Department of Finance, but will there be as well some officials from the Department of Citizenship and Immigration?

[*English*]

The Chair: I'll bring all the officials in if you promise to pass it in five minutes like the last one. That's my commitment.

The meeting is adjourned.

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