SECTION B

PUBLIC FINANCE

CHAPTER I

THE CANADIAN ECONOMY AND PUBLIC FINANCE

The Commission, in accordance with its terms of reference, has devised and recommends the fiscal plan which, in its opinion, "will best effect a balanced relationship between the financial powers and the obligations and functions of each governing body, and conduce to a more efficient, independent and economical discharge of governmental responsibilities in Canada".[1] This plan is based on the historical, economic and financial analysis of the Dominion contained in Book I of this Report. It is an attempt to make the division of financial powers and responsibilities of governments conform to the basic economic structure and social needs of the country.

The Canadian economy is made up of a number of diverse and highly specialized areas. Partly as a result of the specialized character of the resources and industries of the individual regions, and partly as a result of national policies, these regions are closely related and integrated and are, to an important extent, dependent on each other. But although these regions may be economically complementary, and the existence of each vital to the welfare of the others, it does not follow that the income resulting from their joint effort is evenly distributed. On the contrary, it is a distinguishing feature of the Canadian economy, which has particular significance for public finance, that a very large proportion of the surplus—and taxable—income of the country is concentrated in a few specially favoured areas. (We use the term surplus income to comprise income derived from the ownership of scarce resources and the occupation of monopoly positions, and all other income in excess of that necessary for bare subsistence.)

This state of affairs did not exist in 1867. As recounted in Book I, the new Dominion's transportation policies and railway, canal and harbour construction, its immigration and land settlement policies, its trade, tariff and industrial policies, its banking and monetary policies—all of which we may for convenience call national economic policies —established a framework within which the young country grew. The great expansion in population, trade, and industry that came with the wheat boom both marked the success of these national economic policies and established them more firmly. Canada was knit more closely together and the different regions became more dependent on each other. The Maritime Provinces failed to share to the full extent in the wheat boom prosperity and accompanying integration, but in general the country had become committed to a transcontinental economic organization from which no part could detach itself and prosper in isolation.

The War and the post-War boom introduced many new and complex elements in what had previously been a broad simple pattern. The national war effort, the national railway commitments, and the great growth in all governmental, corporate, and private debts, increased the fixed overhead costs of the country tremendously, and thus created new rigidities and increased the fluctuations of surplus income in the country as a whole, and even more so in the different regions. Their economies became not only much more interdependent and complex, but in many respects much more delicate and vulnerable. Not only had overhead costs of Canadian industry and government grown much larger and more rigid, but the income of large areas became more and more dependent on specialized export activities and the huge initial investment connected with them. In addition to the Prairie wheat exports, which were still of dominant importance, mine, forest, and electro-products from Northern Ontario and Quebec, and from British Columbia, and automobiles and accessories from Southern Ontario created new regions which were basically dependent on international trade and often on limited, highly fluctuating, and uncontrollable markets. In connection with these developments (and the growing use of the automobile) was a huge capital investment which stimulated and maintained a high tempo of economic activity throughout most of the country. One result was a very substantial increase in real income, bringing with it a change in consumption habits and distribution of expenditures which drew a larger proportion of our productive forces into vulnerable luxury and

[1] Order in Council appointing the Commission.

service trades, subject to extreme and prolonged fluctuations, and which introduced new rigidities and obstacles to rapid adjustment.

In the thirties the vulnerability of the whole economy to uncontrollable external factors, as well as certain internal maladjustments and weaknesses, brought great distress. The former lifeblood of the whole system—the circulation of the wheat exporter's dollar—was choked off at the very source. As the system slowed down, depression burdens were very unevenly and haphazardly distributed. At the same time overhead costs and accompanying rigidities increased, and intensified the maldistribution of income. Monetary policy was not directed, during the early years of the depression, to alleviate the burden or distribute it more evenly. Tariff policy, directed to maintain employment in some regions, threw a greater burden on the primary producers. Great efforts were made to adjust the regional economies to a local base, and there was a natural rise of local vested interests and local protectionism.

The Maritime Provinces have relied in recent years on an ambitious program of public works. Quebec has attempted to meet a particularly serious unemployment problem by back-to-the-land and colonization plans directed to secure greater self-sufficiency, and by extensive public works. Ontario was fortunate in finding a new frontier and a new stimulus in its own northern mines, and this has done much to compensate for the loss of western markets and to relieve Ontario in some measure from dependence on the traditional transcontinental economy. The Prairie Provinces bore the full brunt of the collapse of the system, with no assistance from national policies in the early years of the depression, and with the added strain of an unprecedented series of crop failures. But there proved to be a limit even to the primary producers' capacity to absorb punishment, and in recent years relatively large transfers within the federal fiscal system, direct assistance to wheat producers, and involuntary write-offs by eastern creditors of western debts have redistributed a part of the burden. British Columbia, after heavy losses in both Prairie and external markets, greatly increased its volume of exports and eventually emerged into a period of relative prosperity which has left it, like Ontario, somewhat inclined to regard the terms of its partnership in the transcontinental economy as unfavourable because of its potential liabilities.

There have thus emerged in Canada chronically distressed areas (especially those which have no alternative to wheat production) and chronically distressed classes, especially unskilled labour. With the breakdown of integrating forces some regions seem to have been left outside the organized national economy and to have become more and more dependent on specialized activities and on assistance from the Federal Government; the national income has substantially decreased and the surplus national income, i.e., the margin over subsistence cost, has suffered a proportionately greater decline; the national income is more unevenly distributed (both between regions and between classes) and the disparity in the distribution of surplus income is, of course, even greater.

We must exercise caution in projecting these tendencies into the future as the results of past attempts at prophecy have shown. The present tendencies *may* continue and any sane policy must take them into account. But there may be an abrupt change and any comprehensive plans for the future should be of the most flexible character. Pressures will vary, and shift from one industry, area, or class to another. However, one positive conclusion stands out: the situation is so serious that conflicts of policy between Dominion and provinces or between province and province have become a luxury which Canada cannot afford, and the sterility of policy which chronic conflict is apt to engender may be an even greater evil than conflict itself. Fiscal policies which have profound effects on the magnitude and distribution of the national income must be in a single hand and responsibility for action or inaction must be assigned with unmistakable clarity.

The implications for public finance of the economic and social changes which have occurred in Canada are of far-reaching importance. As a result of the transcontinental economy which was deliberately built up, with its notable concentrations of surplus income, and later as a result of the disintegration of this economy, no logical relationship exists between the local income of any province and the constitutional powers and responsibilities of the government of that province. In fact, the great expansion in organized social services which has developed makes the existing relationship contrary to all common sense. Expenditures almost automatically increase when income falls and revenues decline. The harder any particular area is hit, and the more impoverished its people, the greater are the burdens which that area must carry. Even if it were possible to revert to the localized economies of 1867, it would be unjust to do so, for national partnerships cannot be dissolved when one of the partners finds the association onerous. The constitutional division of taxing powers, applied to the existing regional distribution of taxable income, has produced surpluses in some provincial budgets, and in others deficits which have inevitably been reflected in reductions of those community services which Canadians have come to look on as the minimum which their governments should supply. As a result Canadian citizens in some provinces are receiving educational, health and other social services much inferior to those in other provinces and (quite apart from any question of governmental extravagance or the provision of unusually costly services) Canadian citizens in some provinces are required to contribute a much larger portion of their income to the government of the province than those in other provinces. Provincial ability to borrow, and the fortunes of investors in provincial securities have fluctuated widely, erratically, and sometimes disastrously. Businesses operating on a national scale are hampered by increasing special (and in some cases discriminatory) impositions and regulations. The possibility of off-setting the impact of world-wide disturbances and depressions on the Canadian economy by financial and monetary policies has been virtually annihilated by the lack of co-ordination in governmental policies. In brief, the present distribution of public finance powers both sabotages any effective action to increase the national income and actually depresses that income.

Another unfortunate result (noted in our analysis of the public finance system)[2] of the present distribution of financial powers is the incentive to rely on taxes on costs instead of taxes on surpluses. By taxes on costs we may include not only direct taxes on business imposed without reference to the net incomes of the business owners, but also consumption taxes (including property taxes on residential and commercial buildings) which affect costs of living, wages, and eventually all costs of production. Consequently, many resources which would be used at lower production cost levels must be left idle, and the tendency to increase taxes on costs during times of depression greatly weakens Canadian competitive power abroad, and increases rigidities and difficulties of adjustment at home. The effect of this pressure on marginal enterprises, on the general level of economic activity, and on the national income cannot be calculated. But now that 30 per cent of the national income is collected by governments and spent by them (either by redistribution in the form of pensions, relief and interest payments, or in payment of the costs of government services) any avoidable waste or inefficiency in the process is serious.

The Commission has consequently attempted in its financial proposals to provide both for a more equitable distribution of governmental burdens and of social service benefits throughout Canada and to make possible a revenue system and a general fiscal policy designed to stimulate rather than to depress the national income.

A comparison of the fiscal position of the provinces and an account of their fortunes during the depression will be found in Book I.[3] It is important to note that some of the provinces are quite unable to meet their obligations and at the same time to provide the social and educational services which Canadians have come to look upon as essentials. Such a situation cannot leave the other provinces unconcerned. The investors in other provinces will suffer in the case of public or private insolvency among their neighbours. The producers in other provinces will suffer if markets are destroyed. Migrants must be admitted from depressed provinces, and it is not merely a nuisance and an expense but a positive danger to the more prosperous provinces if these migrants are illiterate or diseased or undernourished. Nor is the danger of competition from substandard labour in a distressed province a peril which can be disregarded. More important than all these considerations taken together is the danger to national unity if the citizens of distressed provinces come to feel that their interests are completely disregarded by their more prosperous neighbours, and that those who have been their full partners in better times now tell them they must get along as best they can and accept inferior educational and social services. The Commission's proposals will inevitably place on the shoulders of taxpayers in the more prosperous provinces heavier burdens than those which they bear to-day, but these burdens will not be so heavy as those which they will have to bear, directly from increased taxation and indirectly through restriction of the national income, if present conditions continue.

Following, and supporting, the proposals of Plan I is a chapter dealing with the three taxes which are affected by the Commission's recommendations. It shows that the tax allocation recommendations of the Commission are not only

[2] See Book I, Chap. VII.

[3] See Chaps. VI and VII.

desirable on general considerations, but also stand on their merits in each individual case.

Expenditures can be briefly analyzed as they have been considered in greater detail in other parts of this Report.[4] In considering the relative fiscal needs of provincial governments, we are mainly concerned with a few divisions of their expenditures: on education; on social services; on development. It is of national interest that no provincial government should be unduly cramped in any one of these respects. Education is basic to the quality of Canadian citizens of the future and it is highly undesirable that marked disparities in the financial resources available for education should exist as between Canadian provinces. Social services, like education, cannot be subjected to marked disparities without serious reactions on the general welfare and on national unity. An appropriate developmental policy is required in each province, and the only standard which can fairly be applied is the policy of the province itself over a period of time.

It is also necessary to devote a short chapter to the discussion of federal and provincial debts showing the close inter-relation of borrowing with developmental expenditures, with the maintenance of employment, with general monetary and fiscal policy, and with the control of the foreign exchange value of the Canadian dollar. The importance of borrowing policy, and of the ultimate effects and incidence of government indebtedness, indicates the desirability of a uniform policy based on co-operation between governments which are prepared to seek a common objective by similar action. Municipal debts form a separate problem, although a sharp line cannot always be drawn between provincial and municipal indebtedness. Municipal debts (including debts of all subordinate agencies such as school boards) are considered in a separate chapter.[5]

As striking as the economic interdependence of Canadian provinces, is their political, social, and cultural individuality. The Commission's recommendations are based, in accordance with its terms of reference, on the economic and financial analysis which it has made. But the Commission appreciates the existence of many non-economic and non-fiscal factors, and its recommendations are not those which might have been made for a more homogeneous country. No allocation of jurisdiction, over education and social services for example, would be satisfactory which did not take full account of the strong existing loyalties to provincial traditions and institutions. The Commission's Plan seeks to ensure to every province a real and not an illusory autonomy by guaranteeing to it, free from conditions or control, the revenues necessary to perform those functions which relate closely to its social and cultural development.

In the final chapter of the financial section possible alternatives are discussed, however, and Plan II is presented, which indicates what the position would be, and the probable adjustments which would have to be made, if none of the transfers recommended in Plan I were made with the exception of the assumption by the Dominion of relief for employables as recommended in the chapter on Social Services. A comparison is made of the two Plans, which is largely the same thing as a comparison of Plan I with perpetuation of the present system.

[4] See Book I, Chap. VII.

[5] Chap. VII this section.

CHAPTER II

PLAN I

The financial recommendations of the Commission, which we term Plan I, may now be summarized. They are developed in greater detail in following chapters.

The Commission's recommendations with regard to the burdens of government are concerned with social services and debt service. The social service recommendations contemplate the assumption by the Dominion of the full cost of unemployment relief for employables;[1] and, through National Adjustment Grants, provision for at least average Canadian standards for all other social services in all provinces.

It is not a simple matter to estimate the financial changes which will result from the assumption by the Dominion of the cost of unemployment relief. For the purposes of our calculations, we have assumed that the Dominion will provide for the maintenance of the unemployed on the scales adopted by the provinces and that the provinces will not undertake relief works of any sort. Should the Dominion choose to resort to relief works, either directly or by subsidizing works which the provinces will then execute as part of their developmental programs, the cost to the Dominion would be greater than under our assumption but no additional charge will be imposed on the provinces. In short, the provinces will have no further costs in connection with unemployment. In calculating the effect on the Dominion budget we have assumed that the Dominion will provide for the unemployed by direct relief. This is assumed simply for purposes of illustration, since it is necessary to establish some common yardstick, and it is not a recommendation of policy. These assumptions neglect any expenditures which the provinces may choose to make in rehabilitating or training the unemployed classed as unemployables, as these expenditures are included under our estimate of an appropriate per capita expenditure for social services in general.

As regards the remaining social services, the Commission has discussed several fields in which expansion appears likely. For instance, the Commission has considered the possibility of expansion in public health services to provide medical services and hospitalization for those who cannot afford to pay their cost. But under Plan I, no special allowance in either Dominion or provincial estimates has been made for any such *new* expenditures. Rather, an attempt has been made to frame a plan which is sufficiently elastic to meet new situations as they may develop without undue strain on any section or class of the country.

The Commission recommends that all provincial debts (including both direct obligations and those guaranteed by provinces)* should be assumed by the Dominion, and that the provinces should pay to the authority charged with the administration of these debts a fixed annual sum equal to the interest received by each province on its investments (or paid directly by subsidiary bodies) in the most recent appropriate fiscal year. This recommendation is based on a number of considerations. In the first place Dominion and provincial credit have become to some extent interlocked. In the second, no important change can be made in the burdens of government and the revenue sources available to governments without taking into account the position of bondholders who have purchased securities on the basis of existing arrangements. In the third place, it is easier for the Dominion than for individual provinces to obtain the economies incidental to the conversion of these debts to lower interest rates as they mature. A portion of the provincial debt is deadweight debt which represents either developmental expenditure or borrowing to meet relief costs. It is not practicable to break down the debt in such a way as to apportion it between investment and extravagance. If the debt were left in provincial hands it would be difficult and most unrealistic to make an estimate of the fiscal needs of each province which would allow as a legitimate need the debt charges which did not represent undue extravagance and not to provide for charges on that portion of the

[1] See p. 24.

* The special position of the debt of certain Quebec hospitals and other charitable and educational institutions for which interest and amortization is provided by subsidies from the provincial government is discussed at p. 124.

debt which did represent undue extravagance. The difficulty of breaking down the debt is extreme in the case of debt incurred in recent years for relief works. Finally, if under our proposals some provinces may appear to benefit more than others, it should be noted that the recommendations for debt assumption must not be considered in isolation but as an integral part of a general rearrangement, which must be examined as a whole before their equity can be determined.

Municipal debts are, in the main, a separate problem, but the municipal situation in Quebec is unique. As noted in Book I[4] local governments in the Province of Quebec have borne a much larger share of joint provincial-municipal functions and expenditures than in other provinces. This has, of course, been reflected in the relative position between provincial and municipal debts. Provincial net debt service in Quebec in 1937 was but 23 per cent of the combined provincial-municipal net debt service, as compared with an average of 58 per cent in the other eight provinces. Consequently, in order to compensate for this special factor and give equality of treatment, the Commission recommends that the Dominion assume *either* net provincial debt service, *or* 40 per cent of the combined net provincial and municipal debt service, whichever is the larger. Application of the 40 per cent formula would affect any province in which municipal debt greatly exceeded provincial debt. In practice Quebec alone is affected.

It is unnecessary at this stage to enter into detail as to the technique of the debt transfer recommended. It would have to take place as at a fixed date—we might suggest December 31, 1939. (All provincial debt incurred after that date would be charged against the province concerned, i.e., the Dominion would assume it but the province would pay interest on it to the Dominion.) An agency would have to be set up for the technical management of the debt. This would be solely an administrative matter and would presumably be combined with the technical management of the Dominion's present debt. This agency would presumably offer new Dominion bonds in exchange for the outstanding provincial bonds. There are two possible methods by which this could be done. Either provincial bonds might be replaced by Dominion bonds of like interest rates and like maturities; or provincial bonds might all be made callable (at par, or at the best selling price between say, January 1, 1939, and December 31, 1939, whichever was the higher), and refunded by the Dominion when advantageous to do so. If the first course is followed, and if we assume the possibility of refunding maturities at an average rate of $3\frac{1}{4}$ per cent, there would be a progressive reduction in interest charges which would reach \$5 million annually by 1944, and \$9 million by 1949. If the second course is followed, and if we assume the possibility of refunding all bonds at an average rate of $3\frac{1}{4}$ per cent, wherever this would result in any appreciable saving under the callable provisions suggested, an immediate reduction in interest charges[5] of \$7·8 million would result. (The bonds affected would be the higher coupon issues of the four Western Provinces.) The reductions in interest charges noted are, of course, gross figures, and no allowance is made for reduced government investment and sinking fund earnings, and lower tax yields; in other words, the net saving to governments would be appreciably less.

The procedure to be adopted is, the Commission thinks, solely a matter of government policy. If provincial bonds are replaced by Dominion bonds of like terms and interest rates, fortuitous profits will accrue to some holders. A special capital gains tax, or a transfer tax on the first sale, although it presents many practical difficulties, would appear appropriate and equitable in such circumstances. The monetary cost of strictly honouring the letter of the contract is not large, but it will produce unearned profits for a favoured few. However, both proposals would result in some fortuitous profits, and to make the bonds immediately callable, on the terms suggested, would involve violating the contract, with possible repercussions on Canadian credit, for comparatively negligible temporary savings.

The debt agency would receive from each province an annual payment equal to the interest which that province received from its investments (including security portfolios, wholly-owned utilities, advances to commercially operated departments, and all other interest or profit-earning assets), and the interest which boards and commissions, financed by securities guaranteed by the province, paid directly in the latest appropriate fiscal year period. This payment would be a fixed one unless special arrangements were made to amortize it. The Dominion would pay annually to the agency the balance necessary to meet total interest charges. Thus, the Dominion would bear the total cost (including exchange premiums) of servicing all provincial debt which was not directly self-supporting during an agreed on fiscal period, and provinces would be bound to pay over a sum equal to their interest receipts during the same

[4] Chap. VIII.

[5] Assuming payment on Alberta bonds at full interest rates.

period. If provincial investments and utilities increased their returns, this would be a clear gain to the provincial governments concerned; if, on the other hand, earnings fell the province would have to make up the difference (between the fixed payment to the debt agency and the province's interest receipts) from general taxation.

The provinces would no longer have to provide sinking funds. The Dominion would presumably do so as part of its general policy with respect to its total debt. In our review of the Dominion fiscal position we note how a sliding scale of sinking fund payments in prosperous years combined with deficit financing in depression years would contribute to smoothing out the business cycle.

Under this Plan, future direct and guaranteed borrowings by provincial governments and all their subsidiaries, including all local and municipal governing bodies and their subsidiaries, would be required to be payable, as to principal and interest, in lawful money of Canada only, unless special exceptions were made, as presumably would be done, for example, in the case of normal municipal refunding, by the Dominion Government on the recommendation of the Finance Commission. If a province wished to have the debt charges on new borrowings included in calculations for any future adjustment grant revisions, it would have to submit its loan proposal to whatever body was agreed on as appropriate for that purpose. In the event of approval by such a body (which would take account of all the circumstances including the credit position of the Dominion), the debt charges would be considered part of the expenditure of the province for purposes of calculating National Adjustment Grants. In any other circumstances the borrowing would be on the sole credit of the province, and the debt charges would have to be met entirely by the province, and excluded in calculations of National Adjustment Grants.

The responsibilities recommended to be transferred to the Dominion may be briefly recapitulated. It is recommended that relief for unemployed employables, and net provincial debt service (or 40 per cent of the combined net provincial and municipal debt service if larger) be assumed by the Dominion, and that all provincial governments be put in a financial position, by National Adjustment Grants from the Dominion, to supply education and welfare services, equivalent in quality (although not necessarily in cost) to the national average, and to maintain developmental expenditures at their individual 1928-31 averages.

Every one would agree that the Dominion can assume these new burdens and responsibilities only if its revenues are correspondingly increased. Consequently, the Commission recommends that the transfers of responsibilities as summarized above be made conditional on provinces (and municipalities) withdrawing entirely from the personal income tax, corporation tax, and succession duty fields, and agreeing to the cancellation of all existing subsidies from the Dominion. A single qualification is the recommendation that a portion of the corporation tax collected from mining and oil-producing companies be returned by the Dominion to the governments of the provinces in which the mine or oil well is located. The tax allocation recommendations of the Commission are discussed in Chapter III.

The Commission's proposals for future intergovernmental transfers, to replace the chaotic and illogical subsidy system now existing, and to provide for balanced budgets and average standards of services in every province, are simply:—

(1) a National Adjustment Grant for certain provinces as recommended;
(2) an emergency grant if made necessary by some abnormal conditions.

The Commission recommends that the National Adjustment Grants, as initially calculated, be irreducible.

It is recommended that the National Adjustment Grant be subject to review by an independent advisory commission every five years, and that this commission would recommend to the Dominion an increase in the adjustment grant whenever a provincial government established that it could not supply Canadian average standards of service and balance its budget without taxation (provincial and municipal) appreciably exceeding the national average in relation to income. (The increase, as distinct from the original adjustment grant, would not be irreducible, but would be subject to review every five years.)

This advisory body, which we may for convenience call the Finance Commission, would of course only have power to make recommendations to the Dominion Government, but it would play a most important role in the recommended new structure of Dominion-provincial relations. In addition to making a periodical review of National Adjustment Grants, the Finance Commission would also be the appropriate body to examine and report on claims for emergency grants whenever circumstances necessitated this, and presumably on the application of a province for any loan the service of which it desired to have included as part of its budget in calculating its National Adjustment Grant. The emergency grant—unlike the irreducible National Adjustment Grants—would be made for a year at a time only, and reduced or suspended as soon as conditions justified it. Provinces receiving emergency grants would, during the same period, by simply maintaining existing tax rates, and in consequence of the abnormal fall in the incomes of their citizens be automatically imposing heavier taxation on their citizens than the national average in relation to income. If any special conditions were thought desirable they could be recommended by the Finance Commission, and the emergency grant made conditional on their implementation.

The constitution of the Finance Commission would be determined by the Dominion Government, which it is to advise. The necessity for continuity of policy, experience and intimate knowledge of the problem, and political independence is obvious. We are also keenly aware of the need for further economic and financial research along the lines which we have attempted to develop, for continuation and improvement of the economic and financial statistics which we have gathered, and for refinement and development of technique in measuring the relative financial positions of governments and making equitable inter-governmental adjustments in the future. These functions will require a small, but highly competent, permanent research staff and secretariat. Such a body, which would become a clearing house for economic, financial, and administrative information relevant to Dominion-provincial relations and public finance policy, should be able to perform many valuable services for Canadian governments. It might make special investigations and reports on the request of individual governments. It might, if it were so desired by the Dominion-Provincial Conference, meet a long-felt need and act as secretariat for that body. No more, of course, can be done at this stage than suggest the possible scope of usefulness of such a body; much will depend on the use which governments will choose to make of it, and on the quality of the personnel, but there can be no question of the very great and desirable benefits which might be achieved.

It should be made clear that while the adjustment grant proposed is designed to enable a province to provide adequate services (at the average Canadian standard) without excessive taxation (on the average Canadian basis) the freedom of action of a province is in no way impaired. If a province chooses to provide inferior services and impose lower taxation it is free to do so, or it may provide better services than the average if its people are willing to be taxed accordingly, or it may, for example, starve its roads and improve its education, or starve its education and improve its roads—exactly as it may do today. But no provincial government will be free from the pressure of the opinion of its own people and if, when it applies for an increased adjustment grant on the basis of need, it has to produce figures which indicate that although it might, without specially heavy taxation, have provided better education but did not do so, it has, of course, to justify this to its own voters.

The following chapter shows the effect on provincial budgets of the tax, expenditure and debt transfers recommended, and the adjustment grants which would be necessary. After testing various years and averages of various combinations of years, the Commission has adopted the year 1937 (i.e., the fiscal year of each province which is nearest to that calendar year) as the most satisfactory base, but an attempt has been made to note, and to make adjustments for, any features which might be considered abnormal in that year. To test this calculation, summaries of the effect on provincial budgets have been made, based on the average of the actual results in 1936 and 1937 (and 1938 where available), and the budget estimates of 1938 and 1939. It should be clear that these years have been chosen simply as the most satisfactory for purposes of illustration, and there is no suggestion that the settlement would in an way be retroactive. These were "recovery" years, and consequently show the operation of the plan as less favourable to the provinces and municipalities, and more favourable to the Dominion, than would be the case in depression years. On the other hand, if recovery continues and assumes the proportions of a boom, the advantages to some provinces and municipalities would not be as great as potentially possible under the present system (although the Plan provides against any loss), but the burden on the Dominion Government (and Dominion taxpayers) would be substantially reduced. Conversely, any serious economic recession would greatly enhance the benefits to provincial and municipal governments, and impose a heavier load on the Dominion. In Tables 21-30 in Book III complete details of the effect of the Plan on each government's budget are given for individual years.

Before examining how these main provisions of the Plan will apply to individual provinces and computing the adjustment grants which have to be paid, a few general comments may be made which apply to all provinces.

Under Plan I the financial position of every provincial government, without exception, will be improved, although in varying degree. More important, the financial future and security of every provincial government will be guaranteed. Each province will be left with, relatively speaking, a remarkably stable revenue. A large part of the revenue of some will consist of a fixed cash payment from the Dominion. The taxes with highly variable yields will have been transferred to the Dominion. Those with fairly constant yields will remain. (The chief exceptions are the public domain revenues and the mining tax rebate in some provinces, and the profits from the sale of liquor.) It is implicit in the Plan, but should be clearly stated, that the Dominion will respect the tax fields left to the provinces. Adjustments in the joint Dominion-provincial-municipal tax structure will undoubtedly be necessary and desirable from time to time. But the Dominion can no longer consider itself a free and independent agent to take unilateral action to this end when it pleases. The essence of the Plan is to leave provinces and municipalities with adequate, stable revenues, and this would clearly be defeated if the Dominion should extend its taxation into fields already occupied by the provinces or on objects jointly taxed without making satisfactory compensatory adjustments. Such action would violate the whole spirit of the arrangement. It would also necessitate a general increase in adjustment grants. It is the Commission's view that these transfers should be kept to a minimum, and the taxation and expenditure allocations recommended in Plan I so provide.

The provinces will have no fixed charges in the technical sense, although, of course, many current expenditures are not in fact controllable. However, the worst of the uncontrollable social service costs will have disappeared as the Dominion will bear the cost of unemployment relief for employables, and the provinces and municipalities will not be confronted with this burden at a time when their revenues are declining. Any chronic inability to maintain average standards will be met by a National Adjustment Grant, and any sudden blow by an emergency grant.

Every province will know that if there is widespread prosperity in which, however, it does not share, there will be a tendency for its adjustment grant to increase for two reasons: the prosperous provinces will tend to expand their social services and so raise the national average; the provincial and municipal taxation in the prosperous provinces will become a decreasing proportion of the income of their people and a lower Canadian standard will thus be set as regards weight of taxation.

In estimating the expenditures on social services and in considering the weight of taxation it has been necessary to treat each province and its municipalities as a unit since the separation of functions between provincial and municipal governments is not uniform in Canada. It is probable that in every province some sort of readjustment of the financial relations between province and municipalities would follow the implementation of the Plan. This would not only do something to mitigate the burden on real estate, but would, if wisely carried out, remove fiscal injustices as between different municipalities in the same province. The savings to municipalities from the Commission's recommendations amount, on the 1937 basis, to slightly more than $20 million, or 8 per cent of the total real property tax. This saving, of course, is not evenly distributed, but goes largely to a few specially distressed areas. This calculation makes no allowance for any redistribution of education and welfare burdens, and possible assumption of larger shares of their joint cost by provincial governments which are put in a better financial position.

The immediate effect of Plan I on Dominion finances would be adverse, since in some degree provincial finances would have been improved at the expense of those of the Dominion. In the long run there should be certain compensations from two sources: lower net debt charges as refunding at lower interest rates becomes practicable, and a drop in the out-of-pocket cost of unemployment. Moreover, the Dominion would be in a better position than the Dominion and the provinces are today to get maximum revenue from income taxes and succession duties with minimum cost and sacrifice to the taxpayers.

In some cases the taxpayers in a province would pay more and in some cases less under the proposed Plan. Roughly speaking income taxpayers would pay more in those provinces which have no provincial income tax, and less in a province with an exceptionally high provincial income tax. The net immediate fiscal advantage of the Plan to the people of a province should be assessed by taking account of these losses and gains as well as of the gains (there are no losses) of the combined provincial and local governments in that province.

An important advantage of Plan I which cannot, however, be shown statistically is that provincial and municipal governments will be put in a financial position which will make it unnecessary for them to resort to sales taxes and other nuisance or extraordinary levies. The province (and even more so, the municipality) is not a desirable unit for sales tax purposes from the point of view of efficient administration, and resort to this tax has the very dangerous and undesirable feature of erecting miniature tariff walls throughout Canada.

Before proceeding to examine in detail the effect which the adoption of Plan I would have on the finances of each province and on those of the Dominion it will be convenient to recapitulate the main features of the plan.

1. Relief to the Provinces

The Dominion would relieve the provinces (and the municipalities) of the whole burden of relief for the employable unemployed and their dependents.

The Dominion would assume the whole of the provincial (but not the municipal) debts, and would in effect bear the deadweight cost of this debt, as it would collect from the provinces no more than the return which they receive today from their revenue producing assets. The provinces would thus have no further provisions to make for sinking funds.

In the case of Quebec, where the provincial debt is an unusually low proportion of combined provincial and municipal debt, the Dominion would assume 40 per cent of the net, or deadweight, cost of combined provincial and municipal debt service.

2. Withdrawal by the Provinces from certain Tax Fields

The provinces would cease to use the following forms of taxation: the personal income tax; taxes on corporations or corporate income which would not be imposed on individuals or partnerships; and succession duties.

3. Surrender of Subsidies

The provinces would surrender all existing subsidies.

4. Remaining Provincial Revenue Sources

The Dominion, while retaining its unlimited taxing powers, would recognize an obligation to respect the remaining revenue sources of the provinces.

In addition the Dominion would pay annually to each province a sum equal to the tax which that province would have received had it collected from mining and oil producing companies 10 per cent of the net income which was derived from mining, smelting, and refining of ores and oils produced in the province.

5. New Provincial Revenue Sources

The Dominion would pay annually a National Adjustment Grant to certain provinces. The amount of the grant (which will be computed in the following pages) would be such as to enable each province (including its municipalities), without resort to heavier taxation than the Canadian average, to provide adequate social, educational and developmental services. The weight of taxation is estimated by comparing the provincial and municipal taxation with the total income of the province. The test of adequacy of social and educational services is found in the Canadian average for these services. The adequacy of developmental services is tested by what the province itself has done in years which may be considered normal.

The original adjustment grants would be irreducible. Increases would be granted (on the advice of the proposed Finance Commission) at appropriate intervals if they were needed, in order to enable a province to perform its functions adequately without exceptionally heavy taxation.

In addition to the National Adjustment Grants payable to some provinces the Dominion would pay an Emergency Grant to a province in which abnormally bad conditions prevailed. Such a grant would be made for a year at a time, reduced as soon as possible, and eliminated as soon as possible.

6. Future Borrowing

Future provincial and municipal borrowing would have to be in lawful money of Canada.

Future provincial borrowing might be either (*a*) as today on the sole credit of the province, in which case the debt charges could not be counted as part of the financial need of the province if it applied for a National Adjustment Grant (if it were not receiving one) or for an increase in its grant; or (*b*) on the credit of Canada, if the proposed Finance Commission is asked to approve it, and after reviewing all the circumstances does so.

7. Freedom of Provinces

No control of provincial expenditures is contemplated. Every province would be quite free to improve its services, by specially heavy taxation, or to have specially light taxation by reducing its services, or to develop some services in excess of the Canadian average at the expense of others which would remain below it.

1. The Province of Prince Edward Island

In reviewing the economic and financial position of Prince Edward Island in Book I[6] we noted the difficulty of making comparisons which are not misleading between its statistical position and those of other provinces. Both on a per capita basis, and in relation to total income, the Province appears to be in a very favourable position respecting debt and taxation. The debt is small in part because the chief transportation problem of the Island—communication with the mainland—has been the concern of the Dominion since the Province entered Confederation, and in part because the lack of public domain has limited the need for costly developmental expenditures. Owing to its small and compact area the Province has been able to get along without the elaborate and expensive arrangements for local government which have been necessary in other provinces. There are none of the problems and high costs which accompany urbanization. But these advantages have been accompanied by corresponding disadvantages. The revenue from public domain has been negligible. The governmental unit is so small that, in spite of low salary scales and economy in administration, and of the virtual absence of municipal governments, the overhead costs of the bare framework for legislation, administration, justice and education have been relatively high. The per capita income of the people is low, and is in large part an income in kind, while the cash proportion fluctuates widely because it depends on the markets for a few specialized products. The taxable income is consequently low and variable. This difficulty is enhanced by the absence of urban or corporate concentration of wealth, and therefore of the small proportion which net or "surplus" income bears to the gross income of the people. Prince Edward Island does not gain greatly by the assumption of unemployment relief by the Dominion (which the Commission recommends), for, in spite of the cessation of emigration in the thirties, unemployment has not been a serious problem in the Island. This was the result of two circumstances: the strength of family responsibility in the economic life of the Island and the possibility of enforcing it, and the government's highway modernization program which absorbed surplus labour. The cost of the public works program has, however, approximately doubled the outstanding debt of the Province during the thirties and, if the Dominion assumes the burden of unemployment relief, the Province will be relieved in future of the cost of relief works which have been charged to capital account. Finally, it must be remembered that the sources of revenue which (under the Plan) the Province would surrender to the Dominion are, for the reasons given above, not very productive in Prince Edward Island.

The financial credits and debits to the provincial and local governments in Prince Edward Island under Plan I, before provision for any National Adjustment Grant, may be summarized as follows, taking the year 1937 as an example:—

EFFECT OF GENERAL PROVISIONS OF PLAN I ON PRINCE EDWARD ISLAND (1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$ 221,000	Taxes transferred to the Dominion	$ 244,000
Relief to employables assumed by Dominion	21,000	Former subsidies	657,000
Savings on tax collection costs	10,000		$ 901,000
	$ 252,000		
Sinking funds	208,000		
Relief works charged to capital account	288,000		
	$ 748,000		
Deterioration in financial position of provincial government before considering the need for a National Adjustment Grant	**153,000**		
	$ 901,000		

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 30,000		
Municipal relief works	34,000		
	$ 64,000	**Gain** to local governments	**$ 64,000**

[6] Chap. VII.

This summary shows that, in respect of 1937, the application of the general provisions of Plan I to Prince Edward Island would impair the financial position of the Province by $153,000 and improve that of the local governments by $64,000. It remains to consider whether the figures for 1937 are a safe guide for future years, and whether the position of Prince Edward Island makes a National Adjustment Grant necessary.

The taxes transferable to the Dominion under Plan I were the largest on record in 1937 but some further expansion was expected. (On the other hand these taxes would yield less if there is no longer any incentive to organize holding companies in the Province to avoid taxation elsewhere—as provided in the Commission's corporation tax recommendations.) The net burden of debt service was expected to increase and would have offset the estimated increase in the transferred taxes. The sources of revenue which would remain with the Province are peculiarly stable since they comprise gasoline, automobile and land taxes, while the two items most subject to fluctuation, viz., public domain revenue and revenue from liquor control, are of negligible importance as compared with those of other provinces.

The desirability of an adjustment grant rests on the need for balancing the provincial budget on current account and for increasing expenditures on education, welfare services and development so as to provide services not markedly inferior to those in other provinces, without Prince Edward Island being compelled to resort to heavier taxation than imposed elsewhere in Canada.

The Commission estimates that an annual increase in the expenditures on education and public welfare (principally on the latter) of $200,000 to $250,000 would suffice to achieve substantial real equality with other Canadian provinces. The dollar expenditure per capita for these purposes would still be much lower than it is elsewhere, i.e., much lower than the statistical average for Canada, but the Commission has taken account of the various factors which tend to make these services relatively less costly in Prince Edward Island where lower salaries are possible because of the lower earnings in alternative occupations, and where the proportion of rural to urban population is relatively high.

The Commission therefore recommends an annual National Adjustment Grant of $750,000 for Prince Edward Island.

The relatively small scale of local government in Prince Edward Island and the relatively small amount of relief expenditures[7] make the direct effects of the Commission's recommendations on municipalities in Prince Edward Island of less importance than in other provinces. It should also be added that accurate statistics, particularly on the division of employables and unemployables, are not obtainable, and the Commission's estimates are only approximate. Nevertheless, it would appear that direct relief to employables during the thirties has cost municipalities about 5 per cent of their budget, and provision of relief works another 5 per cent. In addition to these savings (which would approximately balance municipal budgets) there are possible indirect benefits, which will emerge from the fact that the Provincial Government will have been put in a position to bear a larger share of education and welfare costs.

If the Commission's recommendations are implemented the Provincial Government will have at its disposal a remarkably reliable revenue, and will find that its expenditures are, at least in the technical sense, almost entirely controllable. Before the new expenditures for which the adjustment grant would make provision are undertaken, the budget of the Province would appear in round figures as follows (based on the 1936-39 average):—

BUDGETARY POSITION OF PRINCE EDWARD ISLAND UNDER PLAN I
(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$ 680,000	Expenditures	$1,170,000
National Adjustment Grant	750,000	**Surplus***	**260,000**
	$1,430,000		$1,430,000

* Surplus available for expansion of public welfare, education, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

[7] In the four years 1934-37, on direct relief and relief works (excluding any direct Dominion expenditures):

	$000
Dominion contributions were	1,000
Provincial expenditures (on current account and capital account) were	1,326
and Municipal expenditures (on current and capital account) were	222
	2,548

2. The Province of Nova Scotia

Nova Scotia's finances in recent years have been dominated by the large public works program of the Provincial Government, and as noted, this program has also had a profound influence on the Province's economy.[8] Important considerations for our present purpose are consequently the extent to which the current statistics of Nova Scotia public finance are influenced by the capital program, and what the position is likely to be, under the present system, when this program is completed. It would seem clear that the somewhat better than average relative position of the Nova Scotia economy in recent years (and the consequent buoyancy of governmental revenues) has been due in large measure to the Government's large capital expenditures, and these expenditures have also done much to reduce the cost of relief. Even if the new capital equipment fulfils all expectations and not only strengthens the economy generally but proves self-supporting, there will still be a drastic adjustment necessary when the stimulus of new construction passes. Attention is drawn to this because under the terms recommended in the Commission's Plan the strain of this adjustment would be borne by the Dominion, and not, as at present, largely by the Province. It is impossible, of course, to estimate this in monetary terms, but it is necessary to point out that the current public finance statistics contain elements of serious instability, and understate the advantages of the Plan to Nova Scotia.

At present Nova Scotia is making a determined effort to overcome certain deep-seated and chronic economic disabilities. It is the purpose of our Plan to make such a policy possible, wherever it would appear desirable, without requiring undue reductions in other services of government, undue sacrifices by provincial taxpayers, or threats to the solvency of the particular unit.

The financial credits and debits to the provincial and local governments under the general provisions of our Plan, and before provision for any National Adjustment Grant, may be summarized as follows, based on the year 1937:—

EFFECT OF GENERAL PROVISIONS OF PLAN I ON NOVA SCOTIA (1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$2,616,000	Taxes transferred to Dominion	$1,426,000
Relief to employables assumed by Dominion	236,000	Former subsidies	1,953,000
Savings on tax collection costs	65,000		
			$3,379,000
	$2,917,000		
Sinking fund	285,000	**Improvement** in financial position before consideration of the need for a National Adjustment Grant	**996,000**
Relief works charged to capital account	1,173,000		
	$4,375,000		$4,375,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 172,000	Surrender of income taxes	$ 47,000
Municipal relief works	69,000	**Gain** to local governments	**194,000**
	$ 241,000		$ 241,000

The effect of the Plan would, therefore, be to improve the financial position of the Provincial Government by $996,000 (owing to freedom from the need for borrowing for relief works) and that of the local governments by $194,000. It is then necessary to consider whether or not the Province should receive a National Adjustment Grant, if it is to have a balanced budget and provide services at the Canadian average.

Education and welfare expenditures in Nova Scotia have increased during the thirties in relation to those of other provinces but are still materially below the national per capita average. Even when allowance has been made for somewhat lower costs,

[8] See Book I, Chap. VII and VIII.

for less urbanization, and a more self-sufficient family economy than are to be found in most of the other provinces, the Commission estimates that $600,000 a year more would have to be spent by provincial and local governments to put educational[9] and social services on approximate real equality with those in other parts of Canada. On the other hand the expenditures on development and on highways have exceeded the Commission's estimate of minimum requirements by an average of about $100,000 annually in recent years.[10]

The Commission, however, has given consideration to the special circumstances and problems of the Nova Scotia economy, and to the frugality of its general administration, and in its adjustment grant recommendation of $800,000 has chosen the higher rather than the lower of possible figures.

The Commission estimates that Nova Scotia's remaining provincial and municipal taxation, in relation to income, is below the national average by an amount in excess of that necessary to bring Nova Scotia's expenditures on education and public welfare fully up to the per capita dollar average of Canada. (Nova Scotia has at present no personal income tax, and our proposals would, therefore, require larger contributions from Dominion income taxpayers there.)

Provision is thus made for the recommended expansion in education and welfare expenditures, and for a small surplus. In addition there would seem good reason to expect moderate expansion in the next few years in provincial revenues, particularly in automobile and gasoline taxation as a result of the improved highways.

The net debt service, of which the Province would be relieved, is at present increasing at the rate of $200,000 a year.[11] Relief expenditures, in large part owing to the highway program, have been relatively low, but the contingent liability in this connection is important.

Local governments have benefited substantially from the Provincial Government's highway program in recent years, and their share of direct relief (to employables) and relief works has fallen from a 1931-35 average of $600,000 to about $200,000. Offsetting the improvement which would result from Dominion assumption of this burden, and the indirect benefits which might result from increased provincial expenditures on education and public welfare, is the $45,000 to $50,000 in municipal income taxes which would be cancelled by municipalities under the Plan. This would only affect the city of Sydney significantly, and the Provincial Government would be in a position to make any adjustment which would appear equitable under the circumstances.

At present, Nova Scotia municipalities enjoy, as a whole, a small surplus. Application of the Commission's recommendation would result in a direct saving to them of from 2 per cent to 7 per cent of their expenditures, depending on the extent of unemployment.

The Provincial Government's budget, before giving effect to any increases in education and welfare expenditures, for which the adjustment grant makes provision, would (on the basis of 1936-39 figures) be approximately as follows:—

BUDGETARY POSITION OF NOVA SCOTIA UNDER PLAN I

(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$6,900,000	Expenditures	$6,900,000
National Adjustment Grant	800,000	**Surplus***	**800,000**
	$7,700,000		$7,700,000

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

[9] "Even with the Provincial aid, however, the salaries [of rural school teachers] are low—the equivalent of $10.31 per week if spread over the whole year—and it cannot be expected that the Province will have a highly trained and serious group of rural school teachers so long as salaries remain at the present level." Brief of N.S., p. 130.

[10] It is not the Commission's intention to criticize these expenditures, but simply to note them as essential constituent parts in any calculation of adjustment grants. A province may distribute its expenditures in any way it likes, and the best policy at any one time will depend on the individual circumstances, but it is not entitled to draw on the national purse to support certain undernourished services if it spends with more than average liberality on some other services. It may be highly desirable to emphasize these alternative services, but in fairness to the rest of Canada it should be done either by somewhat greater than average severity of taxation or by somewhat greater than average economy on other services.

[11] Excluding sinking funds, for which an increase of $174,000 is budgeted in 1939 over 1937.

3. The Province of New Brunswick

New Brunswick shares with Nova Scotia the unhappy distinction of the longest unfavourable economic history of any Canadian province. The inferior character of many of the Province's resources, and transportation and marketing difficulties, have retarded economic progress and created chronically impoverished areas and distressed industries. From time to time since the opening of the century the Provincial Government has attempted, by developmental and public works programs, to improve conditions and alleviate distress, and has done so on a much larger scale in the last five years. Earlier efforts proved disappointing, and left the Province burdened with unproductive debt. It is too early to appraise the results of the present program, but the proportion of provincial revenues absorbed by net debt service has become serious. In spite of marked improvement in these revenues in the last three years, the tax basis is still relatively narrow and vulnerable.

An ambitious highway construction program (which produced the extraordinarily high figure of approximately 10 per cent of the income of the people in 1937 and 1938) has dominated both the recent financial and economic history of the Province. It has stimulated general activity, absorbed virtually all the unemployed, swollen government revenues,—and added 30 per cent to the net debt service in two years. As in Nova Scotia, but on a relatively larger scale, the termination of the program is likely to be followed, unless some alternative stimulus appears, by a period of widespread unemployment, distress, failure of business firms, reduced purchasing power, and pressure on profits and wages. For this reason, the calculated gains from the provisions of the Commission's recommendations, striking as they are in the case of New Brunswick, greatly underrate the potential benefits.

Apart from consideration of any National Adjustment Grant, the general principles of our Plan would, if applied to New Brunswick in 1937, produce the following results:—

EFFECT OF GENERAL PROVISIONS OF PLAN I ON NEW BRUNSWICK

(1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$2,784,000	Taxes transferred to Dominion	$ 904,000
Relief to employables assumed by Dominion	28,000	Former subsidies	1,567,000
Savings on tax collection costs	37,000		
			$2,471,000
	$2,849,000		
Sinking funds	323,000	**Improvement** in financial position before considering the need for a National Adjustment Grant	**1,315,000**
Relief works charged to capital account	614,000		
	$3,786,000		$3,786,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 74,000	Surrender of Saint John income sur-tax	$ 129,000
Municipal relief works	15,000		
	$ 89,000		
Loss to local governments	**40,000**		
	$ 129,000		

The improvement in the financial position of the Province for the year would thus be $1,315,000. On the other hand, the position of local governments (assuming that except in Saint John their "income" taxes are not true income taxes and would not have to be discontinued)[12] would be impaired by $40,000. There would, therefore, have to be some financial readjustment between the Province and some at least of its municipalities.

In spite of the substantial net improvement indicated in the financial position of the Provincial Government, New Brunswick would still require an adjustment grant. New Brunswick (Province and municipalities) is at present spending little more than half what the Commission estimates would be necessary to bring its education and public welfare services to the real (although not dollar) national per capita average. The explanation of this is found in New Brunswick's lack of taxable capacity, and in the heavy drain of its unproductive debt burden. Consequently, although New Brunswick would gain, in round figures, some $1,300,000 under the general provisions of the Plan, the Commission recommends an annual National Adjustment Grant of $1,500,000. This is chiefly to make provision for increased expenditure on education and public welfare (in approximately equal parts) but some allowance has also been made for a moderate expansion in public domain and developmental expenditures. Although the adjustment proposed would not permit New Brunswick to extend its educational and public welfare services to the statistical Canadian average, the Commission believes that its recommendations provide for approximate real equality, and notes that its calculations (which are admittedly most tentative and approximate) show New Brunswick to be undertaxed in relation to the Canadian average, by more than enough to make up the statistical gap should its citizens so wish. (As in Nova Scotia, there is at present no provincial personal income tax, and implementation of our recommendations would lead to an increased, although in no sense an unjust, burden on the wealthier citizens.)

The resulting surplus, which is expected to provide for expanded educational, welfare, and to a small extent, developmental services, is large in relation to total current expenditures, but not in relation to New Brunswick's needs if the Government of that Province is to be put in a position to supply the average Canadian standard of social services and education to its citizens. The Commission does not believe that any attempt to direct or control the expenditure of this surplus is necessary, desirable, or compatible with provincial autonomy.

The Provincial Government's budget, before giving effect to any increases in current expenditures on education, welfare, or developmental services, would (on the basis of 1936-39 figures) be approximately as follows:—

BUDGETARY POSITION OF NEW BRUNSWICK UNDER PLAN I

(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$5,100,000	Expenditures	$4,350,000
National Adjustment Grant	1,500,000	**Surplus***	**2,250,000**
	$6,600,000		$6,600,000

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

[12] Municipal taxation in general in New Brunswick is governed by The Rates and Taxes Act (R.S.N.B. (1927), c. 190) which applies to all parishes, cities, and towns in the Province unless (as is often the case) they are governed by some other law. By this Act one-sixth of the sum to be raised is levied as a uniform poll tax on males of full age, and the remainder is levied uniformally on assessable property (real and personal) and income.

Great variations exist in methods of assessment, and frequently an arbitrary income value is set which is far less than the actual income. Exemptions allowed also vary, and in some cases women workers are assessed and in others not. After considering the characteristics of this tax and its administration, its place in the New Brunswick municipal revenue system, and the New Brunswick municipal revenue system in relation to those in other provinces, the Commission believes it more accurate to treat it as roughly the equivalent of a property tax. It has also some characteristics of a poll tax. This does not apply to the Saint John income surtax, which imposes a graduated tax (rising from 1 per cent to 3 per cent) on income as defined for Dominion taxation, and is unquestionably a real income tax which would be suspended under Plan I.

4. The Province of Quebec

Quebec consists of a number of regional economies of unique diversity.[13] The great commercial entrepôt and financial centre of Montreal, which lives by handling and processing the goods which flow through it, is at once both completely dependent on the national transcontinental economy, and one of its main pillars. Surrounding Montreal is a tributary agricultural, industrial, and resort area integrated, through Montreal, with the national economy. North of the St. Lawrence are a dozen huge modern mass production units, with small tributary areas, depending entirely on world metal and forest product markets. In the Lower St. Lawrence basin and on the northern frontier are several sub-marginal areas existing on a pioneer basis of self-sufficiency. Every phase of the Canadian economy is represented, and virtually every period of Canada's economic history. But bridging the centuries and economic extremes is a remarkable homogeneity of traditions, ideals, and culture, which often obscures the vital differences in economic interests. All these factors are reflected, to some extent, in Quebec's financial history and present financial position.

The economic changes of the twenties, which brought increasing specialization, industrial concentration, and urbanization, proceeded without governmental assistance or interference, and brought prosperity. The depression of the thirties, however, proved the structure a very vulnerable one and made necessary government intervention on a hitherto unknown scale. Defensive action in the form of relief and public welfare, and constructive action in the form of colonization, agricultural aid, highway construction, and development of resources, put a tremendous financial strain on Quebec governments and institutions just at a time when their revenues were dwindling and their whole economic basis was in jeopardy.

The Provincial Government's financial position is only a part of the picture. To an extent unparalleled in other provinces, religious bodies have supported welfare and educational services. Local governments have also carried an exceptionally large proportion of combined provincial-municipal responsibilities, and under depression conditions, have been strained nearly to the breaking point.

The role of religious institutions in Quebec requires special mention for financial reasons, because these bodies have habitually provided educational and welfare services which in other provinces have been for the most part the responsibility of the state. This fact makes comparisons with other provinces particularly difficult, and from some of the submissions made before the Commission it would appear that there are frequent misapprehensions as to the efforts being directed towards educational and welfare services in Quebec. Unfortunately, accurate statistics of the monetary equivalent of the contribution of the Church are not available; for example, most of the personnel are paid only nominal salaries. To allow for this factor the Commission has assumed that the contributions of religious institutions and the fees paid by pupils and other beneficiaries have brought education and welfare expenditures in Quebec to the national average. In view of other direct estimates of this contribution[14] the assumption does not appear unreasonable, although the amount involved is very large. In the absence of any precise statistics this is the only procedure open, since it would be absurd to suggest that the educational and welfare services in Quebec are inferior to those in other provinces to the extent to which the expenditure of public funds in Quebec falls below the per capita expenditure in other provinces.

Quebec is the only province in which the municipal debt substantially exceeds the provincial debt. This is a reflection of the past delegation of materially greater responsibilities to local governments than in other provinces. This delegation has also, of course, been an important factor in explaining the smallness of the per capita debt of the Quebec Provincial Government in relation to other provincial governments. As we have noted (p. ..), it was necessary to give weight to this special factor in our financial proposals, and consequently, in order to establish approximate uniformity of treatment between all provinces, the Commission has recommended that the Dominion assume the larger of either the net debt service of the Provincial Government or 40 per cent of the total net debt service of Provincial and municipal governments. The latter formula would apply only in the case of Quebec, but would in that case be very important, for in addition to relieving the Provincial Government of its total net debt service, Quebec municipalities would save approximately $5 million a year in interest and $2 million a year in sinking fund payments.

Apart from consideration of any adjustment grants, the general principles of the Plan would, if applied to Quebec in 1937, produce the following results:—

---

[13] Book I, Chap. VII.

[14] See Appendix 5—Esdras Minville, *Labour Legislation and Social Services in the Province of Quebec.*

EFFECT OF GENERAL PROVISIONS OF PLAN I ON QUEBEC

(1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$ 6,868,000	Taxes transferred to Dominion	$18,662,000
Relief to employables assumed by Dominion	11,454,000	Former subsidies	2,592,000
Savings on tax collection costs	626,000		
	$18,948,000		$21,254,000
Sinking funds	3,155,000	**Improvement** in financial position before considering the need for a National Adjustment Grant	**2,235,000**
Relief works charged to capital account	1,386,000		
	$23,489,000		$23,489,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 7,829,000	Income taxes surrendered	$ 1,694,000
Debt interest transferred	4,975,000	**Gain** to local governments	**12,967,000**
Sinking fund payments transferred	1,857,000		
	$14,661,000		$14,661,000

It remains to consider whether the figures for 1937 are a sound basis on which to calculate the effect of the Plan on the Province and its municipalities, and whether or not Quebec should receive a National Adjustment Grant. It should be noted, to begin with, that as Plan I contemplates a single personal income tax at uniform rates throughout Canada, taxpayers living in Quebec would pay a much heavier income tax than at present (although residents of the Montreal metropolitan area would be relieved of the municipal income tax). The same thing is true of other provinces which have no provincial income tax but the amounts involved are small in comparison with that in Quebec.

In the case of Quebec the taxes which would be transferred under the Commission's recommendation are succession duties and corporation taxes, since no personal income tax is now levied by the Province. Succession duties, which fluctuate greatly, yielded less than $3 million in 1933/34 and more than $11 million (an all-time peak) in 1937/38. The changes in rate account for but a fraction of this variation. The selection of the peak year for the purpose of calculation shows the loss of revenue to Quebec at its maximum and the improvement in the financial position of Quebec as shown in the foregoing table is correspondingly reduced. Corporation taxes are expected to yield $2 million more in 1939/40 than in 1937/38 as a result of an increase in rates. It should be noted, however, that the Commission's mining tax apportionment proposal would give Quebec a substantial, and in all probability a rapidly expanding, revenue from that source. It should further be noted, in weighing the debits and credits of the proposed transfers, that Quebec's net debt service will increase about $2.2 million from 1937 to 1939. The cost of unemployment relief may be expected to vary from year to year, but our economic analysis indicates that it will be more persistent in Quebec than in most other provinces.

The purpose of a National Adjustment Grant in the case of Quebec would not be to improve educational and social services, since we have, for reasons given above, assumed that these are maintained at the Canadian average. The purpose would be to balance the Quebec budget, which is at present running a serious deficit, without forcing the Province to increase the burden of its taxation. This, as a proportion of the income of the people, already exceeds the Canadian average. An effect of the adjustment grant recommended would be to make it possible to maintain developmental expenditures at nearly their present level. The annual National Adjustment Grant which the

Commission recommends is $8 million. This is about the average of the provincial deficits for the last few years, and under Plan I the expenditures of which the Province (as distinct from its municipalities) will be relieved are roughly equivalent to the yield, at present rates, of the taxes which it will relinquish.

Provincial revenues and expenditures have expanded notably in recent years, and 1936-39 is consequently not a completely satisfactory base to illustrate the operation of the Plan. Based on the actual returns for 1938/39, and the estimates for 1939/40, the budget under Plan I would appear in round figures as follows:—

BUDGETARY POSITION OF QUEBEC UNDER PLAN I

(On the basis 1938-39 figures)

Cr.		*Dr.*	
Provincial revenues	$39,800,000	Expenditures	$46,800,000
National Adjustment Grant	8,000,000	**Surplus***	**1,000,000**
	$47,800,000		$47,800,000

* Surplus available for expansion of developmental expenditures and for reduction of taxation.

There is also the saving in relief costs, interest and sinking funds to municipalities—on the 1937 basis of about $13 million. The municipal benefits also provide, to some extent, direct relief to the Provincial Government, since its financial position is affected by the difficulties of the chief municipalities. How the saving on debt service should be apportioned among them is, of course, a matter to be determined by the Provincial Government. But it may be assumed that a large proportion of the saving would accrue to the benefit of Montreal, and it is possible that advantage might be taken of this opportunity for a thorough reorganization of the finances of the metropolitan area.[15] Statistically the effect of the proposed relief would be to reduce municipal expenditure in Quebec by about 15 per cent. This would convert the present over-all deficits into comfortable surpluses, greatly improve the credit situation, and permit a measure of tax reduction. This reduction is particularly desirable as our calculations indicate that existing provincial and municipal taxation in Quebec is substantially above the Canadian average. Under the present system, on the other hand, taxation would have to be increased still more above the national average to wipe out the chronic deficit. Reduction will give provincial and municipal revenues an elasticity and potential reserve lacking at present.

[15] See Section B, Chap. VIII.

5. The Province of Ontario

Two causes combine to make Ontario the wealthiest province in Canada. Added to the rich agricultural lands and favourable climate of Western Ontario, the timber and mineral resources of Northern Ontario, the manufacturing advantages in her power and transportation facilities and proximity to the industrial heart of the United States, is the strategic and dominating position Ontario occupies in the whole Canadian economy.[16] But just as Ontario's natural advantages, combined with national policies, have made it the industrial and financial centre of the Dominion, and the logical concentration point for the profits and fortunes of the outlying regions, they have linked Ontario's fortunes closely to those of every section of the country, and have made it sensitive and vulnerable to regional disasters and bankruptcies outside its borders. Ontario cannot fail to share in prosperity elsewhere in the Dominion, nor can it remain unaffected by regional impoverishment in any part of the Dominion. But the gains and the losses to the people of the Province do not offset each other as they fall on different groups. Anything which stabilizes conditions in Canada and which makes it possible for other provincial governments to maintain the level of their services even in times of depression will be of great benefit to the people of Ontario and to the financial stability of the Province. The citizens of that Province, who pay nearly half the federal taxes, and who pay twice as much to the Dominion as to the Provincial Government, have a very direct and immediate interest in seeing Dominion and provincial finances put on a rational and business-like basis. They are vitally concerned in maintaining the solvency of other provinces, for the drastic and arbitrary readjustments which would become necessary in the case of widespread insolvency would cause far more harm to them, because of effects on their investments and their markets, than any preventive measures are likely to cost them. The Commission's recommendations which are designed to ensure the solvency and stability of the finances of all provinces are, therefore, of enormous importance to Ontario and to its citizens and must be considered with an eye to the possible alternatives. One of the alternatives—the present system, modified by Dominion assumption of relief for unemployed employables,—will be described in detail in a later chapter as Plan II. In comparison, Plan I will appear as the more attractive way for Ontario to meet the financial risks inherent in its position as the keystone of the Canadian economy. The direct benefits to Ontario governments which the Commission's recommendations would produce are important, but might not in themselves justify such sweeping changes as are proposed. The case for Plan I as it affects Ontario must rest on the much more basic and important benefits which industries, taxpayers, and investors in Ontario will gain from nation-wide improvement.

Under Plan I the financial credits and debits to the provincial and local governments may be summarized as follows, based on the year 1937:—

EFFECT OF GENERAL PROVISIONS OF PLAN I ON ONTARIO
(1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$18,539,000	Taxes transferred to Dominion	$28,932,000
Relief to employables assumed by Dominion	8,347,000	Former subsidies	2,941,000
Savings on tax collection costs	1,099,000		
			$31,873,000
	$27,985,000		
Subsidies to municipalities discontinued	2,921,000	**Improvement** in financial position before considering need for a National Adjustment Grant	**5,326,000**
Sinking funds discontinued	1,041,000		
Relief works charged to capital account	5,252,000		
	$37,199,000		$37,199,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 5,209,000	Provincial subsidy	$ 2,921,000
Municipal relief works	100,000	**Gain** to local governments	**2,388,000**
	$ 5,309,000		$ 5,309,000

[16] See Book I, Chap. VII.

In 1937 the Plan would, therefore, have improved the financial position of the Provincial Government by $5,326,000 and that of the municipalities by $2,388,000. These improvements, of course, in large part result from burdens imposed on the Dominion and therefore ultimately on Dominion taxpayers.

It is naturally very difficult to say whether or not the year 1937 can be considered as a good guide to conditions in later years. But a number of the relevant factors may be examined. The yield of succession duties (one of the taxes to be given up by the Province) was exceptionally high in 1937 when it was at an all-time peak of $20,214,000, exceeding the last ten year average by some $8 million and the estimates for 1939/40 by more than $3 million. Thus the sacrifices to be made by the Ontario Government are to some extent exaggerated by use of the 1937 figures. Moreover, the benefits resulting from Dominion assumption of net interest charges are understated as the Ontario budgetary estimates provide for an increase of $2 million in this item by 1939/40. The mining tax rebate to the Ontario Government is a rapidly growing sum (although, of course, it will at times fluctuate sharply, and will eventually decline), and it is a substantially larger proportion of total mining taxation than the Provincial Government now receives. On the other hand, it is possible that the figures for unemployment relief are higher for 1937 than they will be in future years, and if this optimistic conjecture were realized the benefit to Ontario governments from the application of Plan I might be reduced, might disappear entirely, or might even in prosperous years be converted into a loss. But just as benefits to Ontario would come in the main from the pockets of Dominion taxpayers, and as to nearly half their amount from the pockets of taxpayers resident in Ontario, so any loss which Ontario might appear to sustain in a prosperous year would take the form of a benefit to Dominion taxpayers, nearly half of which would accrue to taxpayers resident in Ontario. In contrast with this optimistic forecast we can consider the year 1933, in which relief expenditures were high and revenues lagged. In that year the application of Plan I would have improved provincial finances in Ontario by $15 million and municipal finances by $4 million. It thus appears that the effect of Plan I, as regards Ontario alone, would be to ensure it against the worst calamities of bad years at the cost of some sacrifice in exceptionally good years. This "compulsory insurance", if we may so designate it, is a low price to pay to safeguard the financial stability of all the Canadian provinces and the autonomy which is closely linked with that stability.

Analysis of the budgetary position of the provincial and municipal governments which would result from the operation of Plan I makes it clear that Ontario does not require a National Adjustment Grant. The per capita expenditures on education and social welfare in that Province are about 10 per cent above the Canadian statistical average. Even after allowance has been made for the higher costs in Ontario than in some other provinces there seems no doubt that the quality of the services is well above that of those provided by most other provinces. This high standard can be maintained under Plan I, as it is now, by taxation which is less burdensome than that which is imposed by other provinces. There is no suggestion that Ontario should not continue to provide these services but there is also clearly no claim for national assistance to maintain these standards.

Municipal governments would lose the provincial subsidy, originally paid in lieu of income tax, of some $3 million, but would be relieved of relief costs which in 1937 were somewhat more than $5 million. The net gain is accordingly small—something less than 2 per cent of municipal budgets. However, the financial position of Ontario municipalities, as a whole, is now outstandingly the strongest in Canada, and the transfer of responsibility for unemployment would remove the one constant threat to the financial security of the industrial centres.

The provincial budget, based on the 1936-39 average, would be approximately as follows under Plan I:—

BUDGETARY POSITION OF ONTARIO UNDER PLAN I

(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$57,300,000	Expenditures	$52,600,000
		Surplus*	**4,700,000**
			$57,300,000

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

6. The Province of Manitoba

It is perhaps not generally realized how far Manitoba has moved from the pioneer prairie economy stage. The production of wheat, and the handling of wheat produced in Manitoba and Saskatchewan, together with ancillary industries are still the major activity of the Province. But the period of dynamic expansion and construction which was long associated with the developing wheat industry has definitely passed. The economy has suddenly become static and adjustments have had to be made. Added to the shock of this major reorientation was the sequence of droughts and disastrously low prices which reduced prairie agricultural income from the 1928 peak of $435 million to a 1930-37 average of $80 million. That these blows were not completely overwhelming is evidence not only of the tremendous capacity of the primary industry to absorb punishment, but also of the existence of new elements of strength and diversification and of a more mature and firmly established economy than had been generally realized. Winnipeg, which is the metropolitan centre of Saskatchewan as well as of Manitoba, was hit terrifically hard, but what taxable income did exist in the area was concentrated there, and was garnered by the Government of Manitoba. (In fact, the Manitoba 2 per cent special income tax, paid largely by Winnipeg, was the heaviest income tax on low income groups in North America.)†

Bumper crops in Manitoba and somewhat improved prices in 1937 and 1938 have substantially eased the strain, but the Saskatchewan *débâcle* prevented any real recovery. Winnipeg's position in relation to Saskatchewan, which had proven so advantageous during the period of expansion and prosperity, contained serious elements of liability during the depression. The unemployed naturally gravitated to Winnipeg, and the burden of maintaining the governmental and commercial overhead fell largely on that City. The City's own finances were thus under a double strain, and only the very strong position in which it entered the depression and the healthy financial condition of its utilities enabled it to carry on.[17]

Apart from consideration of a National Adjustment Grant, the general principles of Plan I would, if applied to Manitoba in 1937, produce the following results:—

EFFECT OF GENERAL PROVISIONS OF PLAN I ON MANITOBA

(1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$3,701,000	Taxes transferred to Dominion	$4,731,000
Relief to employables assumed by Dominion	2,584,000	Former subsidies	1,703,000
Savings on tax collection costs	202,000		*750,000
	$6,487,000		$7,184,000
		Improvement in financial position before considering the need for a National Adjustment Grant	1,000
Sinking funds	378,000		
Relief works charged to capital account	320,000		
	$7,185,000		$7,185,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$2,050,000		
Municipal relief works	407,000		
	$2,457,000	**Gain** to local governments	$2,457,000

* Special grant following Bank of Canada investigation.

[17] For extended account of the City's difficulties see Ex. 19, Brief of City of Winnipeg, Ev. pp. 905-48.

† Reduced to one per cent in 1938.

It remains to examine the general level of educational, welfare, and developmental services, and to determine whether Manitoba requires an adjustment grant. Manitoba's expenditures on these services have been progressively reduced, in relation to the rest of the country, since the twenties; combined provincial and municipal expenditures have fallen from 7 per cent more than the national average in the twenties to 9 per cent below it today.[18] To provide services up to the national average would require approximately $1,100,000 more a year. (In Manitoba, as in the other Western Provinces, the lack of endowed universities throws a somewhat heavier burden on current public expenditures than is the case in Eastern Provinces.) Manitoba has also reduced highway expenditures by some $200,000 (annual average 1936-39) below the 1928-31 average. (Owing to the transfer of natural resources to the Province in 1930 comparisons of developmental expenditures cannot be made.) Consequently, for these purposes, and to meet the deficit which would still remain under the general provisions of Plan I, the Commission recommends an annual National Adjustment Grant of $2,100,000.

To summarize the effect of the Commission's proposals, the financial position of Manitoba's municipalities would be improved by some $2 to 2½ million a year, converting current deficits of about $1¼ million into surpluses of equal amount. The Province of Manitoba would be left with current expenditures on the basis of present budgets of $9 million a year (of which nearly 60 per cent would be on education and welfare, and 20 per cent on highways and development), revenues from local sources of $8 million, and an adjustment grant of $2,100,000. The largest items in the remaining provincial revenues would be gasoline taxes, liquor control profits, and automobile licences; these, and the other remaining taxes, are relatively stable with the notable exception of liquor control profits, which fell $1 million from 1930 to 1933 and have since recovered three-quarters of the loss. Recurrence of such a fluctuation would be serious (although *total* liquor control profits are less than the deficit under the present system, in the 1939 budget estimates) but the recommended transfer of taxes to the Dominion, and their establishment at a uniform level, would materially reduce the income taxes paid by Manitoba citizens, and would presumably provide the Provincial Government with reserves of taxable capacity in case of emergency. The redistribution of taxes recommended by the Commission would transform Manitoba from one of the most heavily taxed areas in the Dominion, as at present, to one with approximate average level of taxation in relation to normal income.

Under the terms of Plan I, and before the new expenditures for which the adjustment grant would provide, the provincial budget would appear as follows (based on the 1936-39 average):—

BUDGETARY POSITION OF MANITOBA UNDER PLAN I

(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$ 8,200,000	Expenditures	$ 9,000,000
National Adjustment Grant	2,100,000	**Surplus***	**1,300,000**
	$10,300,000		$10,300,000

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

[18] For condition of education, social services, etc., in the Province, see Ex. 6, Brief of Man. Pt. VI.

7. The Province of Saskatchewan

The people of Saskatchewan have suffered a reduction in income during the last decade which has probably been unparalleled in peace-time in any other civilized country. Net agricultural income averaging some $200 million a year in the late twenties fell to an actual negative amount in 1931 and 1932, and was only about one-tenth of that average in 1937. Total provincial income (after including federal relief payments in the province) fell in the thirties by more than half, and in the worst years by two-thirds of the 1926-29 annual dollar average.[19]

The impact of this blow on government revenues has, of course, been coupled with new demands for government assistance on an unprecedented scale. There not only existed the problem of maintaining, on occasion, more than half the population, but also the problem of supplying the major industry's raw material and operating costs in order to keep it in production. The contingent liability of such a highly specialized economy, dependent for prosperity on a combination of two major uncontrollable factors—crop yields (in a hazardous climate) and world marketing conditions (in a speculative trade)—was brought home with shattering force. Unlike more diversified and self-sufficient economies that could, in a pinch, live in some fashion on their own resources, the operating costs of the industry, the fixed charges of the industry, and the very subsistence of the population had to be met in cash.

There was no possibility of financing the new responsibilities from current local revenues. Fixed charges and cash operating costs had virtually wiped out the net income of the major industry, and no concentrations of past income and wealth remained in the Province in liquid or taxable form. Rural municipal tax collections, for example, fell from $18 million in 1929/30 to $4,300,000 in 1937/38. There was also no possibility of borrowing the necessary money from commercial sources, since the altered outlook for Saskatchewan's main product, the growing scepticism of Saskatchewan's ability to recover its productive power, and the growing burden of debt and agitation for drastic debt reduction measures, shook Saskatchewan's credit. Yet Saskatchewan had been, in many ways, the mainspring of the transcontinental economy, and it was recognized as a national necessity, as well as a national duty, to maintain the industry, people, and organization of the area. Dominion relief on a very large scale and, for a while, Dominion assistance to provincial financing served as a stop gap.

But the experience of Saskatchewan illustrates the weaknesses in the present division of financial and constitutional powers and responsibilities in Canada, and our inability to grapple effectively with any such emergency within the framework of the existing system. It should not be suggested that the Commission's recommendations are based on the abnormal conditions which have prevailed in Saskatchewan—in fact, as noted subsequently, certain special assistance is necessary in the case of Saskatchewan in addition to the general provisions of Plan I. But the position of Saskatchewan does serve as an extreme and vivid example of the vulnerability and impotence of the present system in the face of unfavourable regional developments; of the arbitrary, inefficient, and wasteful extra-constitutional transfers and palliatives which must be resorted to in desperation; and of the crying need for adjustments in the present public financial system to bring it more in line with the modern Canadian economy and world conditions.

Apart from consideration of any adjustment grant, the general principles of Plan I would, if applied to Saskatchewan in 1937, produce the following results:—

[19] See Appendix 4—*National Income.*

EFFECT OF GENERAL PROVISIONS OF PLAN I ON SASKATCHEWAN

(1937 Base)

PROVINCIAL GOVERNMENT

Cr.		*Dr.*	
Net debt service assumed by Dominion	$ 6,083,000	Taxes transferred to the Dominion	$ 1,553,000
Relief to employables assumed by Dominion	9,776,000	Former subsidies	2,120,000
Savings on tax collection costs	72,000		*3,500,000
	$15,931,000		$ 7,173,000
		Improvement in financial position before considering need for a National Adjustment Grant	8,786,000
Sinking funds	28,000		
	$15,959,000		$15,959,000

LOCAL GOVERNMENTS

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 500,000	**Gain** to local governments	$ 500,000

* Special grant following Bank of Canada investigation.

The 1937 figures (i.e. fiscal year 1937/38) cannot be taken as normal in Saskatchewan. On the one hand, a very large portion of the relief expenditures[20] is only nominally provincial; as in previous depression years these expenditures were made on provincial account, but were financed by Dominion loans, many of which have already been written off. (The interest on the remainder is capitalized annually.)

On the other hand, Saskatchewan revenues and expenditures in that year reflected the abnormal crop conditions. The Government was running at a huge deficit in spite of the most severe retrenchment of education, welfare, developmental and general government expenditures. Total provincial and municipal expenditures on education, for example, were cut 40 per cent from 1930 to 1937. The average salary for rural teachers (male, First Class) fell from $1,160 in 1930 to $512 in 1936,[21] and in many cases the reduced salary was paid largely in the form of notes which could only be cashed at a heavy discount. The Commission has accordingly attempted to estimate the budgetary position of Saskatchewan under "normal" conditions, and to make special allowance for abnormal crop failure conditions.

The Commission's estimate of Saskatchewan's budgetary position, on the basis of reasonable economic expectations in the near future, shows that Saskatchewan needs a fixed annual adjustment grant (supplementary to the general transfers recommended under Plan I) of $1,750,000 a year. Such a payment, however, combined with the improvement in the Government's fiscal position under the general terms of Plan I, would not provide for maintenance of services at the national average under existing circumstances. Education, welfare, and development expenditures in Saskatchewan have been cut to a level which not only prevents the maintenance of reasonable standards in Saskatchewan but threatens standards throughout Canada.[22] For example, there is lack of hospital-bed accommodation for about one-third of the serious mental cases. Inferior standards of education and public health services have insidious but extremely injurious effects on both the area immediately concerned and the rest of the country. Particularly in time of depression, when personnel affected by disproportionate wage cuts cannot

[20] The cost of relief to be transferred to the Dominion includes, in this case, a certain amount of agricultural relief as well as relief for employables. It was thought more realistic in the case of Saskatchewan to show as transferred to the Dominion that portion of agricultural relief which the Dominion did in fact assume.

[21] Ex. 62, Brief of the Saskatchewan Teachers' Federation.

[22] For account of reduction in services see Ex. 34, Brief of Sask., pp. 273ff.

readily shift, and when individuals as well as the community continue running to some extent on accumulated reserves and along traditional lines, standards may be maintained. But over any long period of time the quality of the service adjusts itself to the new economic level. This process makes certain superficial financial savings to the governments and taxpayers concerned, but leads to economic loss and wastage, human suffering, and ultimately, serious impairment of provincial autonomy and national strength.

To meet the special circumstances of Saskatchewan the Commission accordingly recommends, in addition to the National Adjustment Grant, an emergency grant. For purposes of illustration only, the figure suggested for 1937 is $4 million; for 1938 $4 million; and for 1939, on the basis of budget estimates, $2 million. As has been explained, the emergency grant would not be irreducible, but would be subject to annual review, and under normal conditions should disappear entirely.

The improvement in the Government's fiscal position, which would result from the general provisions of Plan I, together with the Adjustment Grant and the emergency grant (a total of $14½ million in 1937) would leave the Provincial Government, on the basis of current expenditures which have been pared to the bone, with a surplus of $2,693,000 in 1937. This is approximately the amount which the Commission estimates to be required to restore Saskatchewan's education, welfare, and development expenditures—not to their former level—to the national average. (The dollar average in the case of Saskatchewan is taken as approximately the real average.) The gain to Saskatchewan municipalities from Dominion assumption of relief for employables is $500,000—obviously an inadequate sum under the special circumstances of 1937. But by putting the Provincial Government in a position to make good the deficiencies in the chief municipal responsibilities—education and welfare expenditures—the Commission believes that provision has been made for alleviating the worst effects of such disastrous years, and for putting municipal finances on a stable basis over an average cycle.

It should be added that the level of provincial and municipal taxation in Saskatchewan, after giving effect to the Commission's proposals, would be above the national average in relation to income during such abnormal depression years as we have been considering, but that it should be at the national average when provincial income rises to figures which would permit discontinuance of the emergency grant.

In a province where government revenues fluctuate only less extremely than the provincial income, the future budgetary position of Saskatchewan under the Commission's proposals cannot be set forth with the same degree of approximation as in other provinces. The emergency grant is designed, of course, to meet the more violent of these fluctuations and introduce a greater degree of flexibility in the operation of the Plan.

Because of this special feature in the case of Saskatchewan, the effect of the implementation of the Commission's recommendations on the provincial budget, before increasing expenditures to bring services up to the national average, may be best illustrated by the individual years from 1936 to 1939, rather than by an average.

BUDGETARY POSITION OF SASKATCHEWAN UNDER PLAN I

	1936	1937	1938	1939
	$000	$000	$000	$000
Provincial Revenues	10,050	9,700	11,150	12,500
National Adjustment Grant	1,750	1,750	1,750	1,750
Emergency Grant	1,500	4,000	4,000	2,000
Total	13,300	15,450	16,900	16,250
Expenditures	11,000	12,800	14,300	13,300
*Surplus	2,300	2,650	2,600	2,950

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

8. The Province of Alberta

Alberta contains both the last important undeveloped agricultural frontier of Canada, and a varied assortment of resources, and these give the Province a broader and more diversified economic base and a more promising outlook than the other Prairie Provinces. Fluctuations in agricultural income have been extreme, although consistently better crop yields have made them less so than in Saskatchewan, and their effect on the total provincial income has been tempered to some extent in recent years by oil, mining, construction, and industrial development. Alberta is still in the stage when, under normal conditions, one would expect large scale capital investment and rapid expansion. These expectations have been defeated in recent years by drought and low prices, and by political factors.

Because of the possibilities which exist to increase income and welfare generally in Alberta if new capital investment is made, it is of common concern to re-establish Alberta's credit and to provide conditions which will inspire investors with confidence.

Whether default was necessary or not at the time it occurred is of less importance at the moment than the fact that it now exists. To escape from the impasse which it has produced requires more than a technical financial operation; it requires recognition of certain basic economic disabilities and of maldistribution of important governmental powers and responsibilities. The losses to investors, the prevention of desirable economic expansion through lack of credit, and the damage done to the credit of other Canadian governments will only be compensated for if the lessons to be drawn from this experience are applied in practical form to prevent its recurrence.

Plan I proposes the assumption of Alberta's debt, including all unpaid interest, on the same terms as for every other province. (It should be noted in passing that had Alberta paid full interest, Dominion advances to Alberta for relief would have been increased by about an equal amount, so that this proposal does not put any greater burden on the Dominion than would have been the case had Alberta paid full interest throughout.)

Apart from consideration of a National Adjustment Grant, the general principles of Plan I would, if applied to Alberta in 1937, produce the following results:—

EFFECT OF GENERAL PROVISIONS OF PLAN I ON ALBERTA

(1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion (at full interest rate)	$6,959,000	Taxes transferred to the Dominion	$3,739,000
Relief to employables assumed by Dominion	1,540,000	Former subsidies	1,776,000
Savings on tax collection costs	165,000		$5,515,000
	$8,664,000	**Improvement** in financial position assuming full interest paid	**$3,609,000**
Sinking funds	......	Interest not paid was	3,400,000
Relief works charged to capital account	460,000	**Net Improvement**	**209,000**
	$9,124,000		$9,124,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 995,000		
Municipal share of relief works	97,000		
	$1,092,000	**Gain** to local governments	**$1,092,000**

It should be noted that in the year 1937 succession duties were $1 million higher than normal, and no provision was made for sinking funds (formerly $700,000 to $750,000). Adjustment for these items would, of course, increase the financial advantage to the Provincial Government shown as resulting from Plan I.

The transfers recommended above leave the provincial and local governments of Alberta in a comfortable financial position. The Provincial Government's clear surplus would be about $2½ million. Municipalities, which had a small surplus in 1937, would have a surplus of $1½ million, or roughly 7½ per cent of their expenditures.

Provincial highway expenditures are now at the approximate 1928-31 average level. Provincial and municipal expenditures on education and public welfare are still, taken together, slightly in excess of the Canadian average, but less so than in pre-depression years. When, in addition to these considerations, account is taken of the large surplus which the general provisions of Plan I would now provide, and the rapid expansion in oil production now taking place (which will be immediately reflected in provincial revenues by the operation of the Commission's mining tax rebate proposal), it is clear that Alberta would not require any adjustment grant. Following the transfers recommended by the Commission, it would be possible to restore Alberta's education and welfare services to pre-depression levels, which were approximately 10 per cent more than the national average, and at the same time substantially reduce taxation, which the Commission's calculations show to be somewhat higher than the national average.

Of greater importance than the immediate monetary gain would be the clearing up of the present credit situation which is both hampering Alberta's economic progress and producing arbitrary and inequitable losses to investors in Alberta securities. The benefits of such a development would not be limited to Alberta alone, but the whole country would gain from the stimulus of renewed expansion and prosperity in Alberta.

Implementation of the Commission's recommendations would produce a provincial budget, based on 1936-39 figures, approximately as follows:—

BUDGETARY POSITION OF ALBERTA UNDER PLAN I

(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$13,100,000	Expenditures	$10,900,000
		Surplus*	**2,200,000**
			$13,100,000

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

9. The Province of British Columbia

British Columbia presents the most striking contrast in Canada of huge barren areas and extraordinarily rich resources. Although greatly affected by Canadian tariff, railway, and other economic policies, it has not been absorbed as a completely integral part of the Canadian economic system. But unlike the Maritimes, which have also been more affected by than made a part of the Canadian economic system, British Columbia has been able, on the strength of its own resources, to establish a high income and standard of living for its people. This income is based on the exploitation of a few specialized products, dependent on external (and in a few cases, Prairie) markets, and hence is highly vulnerable and subject to wide fluctuations.[23] The coincidence of a number of favourable factors in the twenties—the opening of the Panama Canal, low shipping rates, the development of electro-metallurgical technique—stimulated extremely rapid development and a very high rate of capital investment. It cannot be assumed that such a favourable series of circumstances will be repeated, and with no new worlds to conquer the exceptional stimulus from the great capital investment program and rapid frontier expansion of the twenties will be missing. Sufficient virgin resources of higher than average quality still remain to give British Columbia a favourable competitive margin at present, and ability to absorb market and price fluctuations without undue distress. But it is easy to foresee the disappearance of this differential advantage, and even of some of the resources, which will then expose British Columbia to much more severe shocks and adjustments.[24] Even the metropolitan area of Vancouver, and the large wholesale, shipping, and servicing trade which has developed, are dependent to an unusual extent on external and uncontrollable factors. Vancouver's tributary area is largely determined by ocean freight rates, and an increase in those rates to profitable levels will greatly circumscribe the hinterland which finds it profitable to trade through western rather than eastern or southern ports.

There are important public finance implications in an economy with the special strengths and weaknesses of British Columbia. That the strengths are present, and the weaknesses still largely potential, should not be allowed to obscure these implications. Overhead government costs that are easily borne from the surplus of above-average resources and a huge capital investment program, may prove crushing when only average resources remain and new investment tapers off. Services and a standard of living established and financed by treating capital depletion as current income will be subject to extreme pressure when the first phase of exploitation passes. Major economic and social adjustments will be necessary (and will require money and co-ordinated planning) unless large population groups are to be allowed to sink to chronically depressed if not subsistence levels. British Columbia should, for years to come, have a per capita income higher than average, but it will also be a more variable and vulnerable one. It is only reasonable to expect that new and alternative resources will be developed as some of the present ones are exhausted, and there are, in addition, important permanent assets. But in no other province are the problems of depreciation and depletion as important to the provincial economy and public finance.

The Commission's recommendations in Plan I provide insurance against deterioration of governmental services below the national average when British Columbia, having lost its differential advantages in resources and transportation, may encounter serious blows in world markets. Apart from consideration of any adjustment grant, the general principles of Plan I would, if applied to British Columbia in 1937, produce the following results:—

[23] For extended account of provincial economy see Ex. 172, Brief of B.C., Pt. VI.

[24] The Province contended in evidence before the Commission that its present prosperity was due in part to the exploitation of "wasting or wastable assets", see Brief, pp. 181*ff*.

EFFECT OF GENERAL PROVISIONS OF PLAN I ON BRITISH COLUMBIA

(1937 Base)

Provincial Government

Cr.		*Dr.*	
Net debt service assumed by Dominion	$ 6,540,000	Taxes transferred to Dominion	$ 8,278,000
Relief to employables assumed by Dominion	3,408,000	Former subsidies (including interim grant)	1,625,000
Savings on tax collection costs	415,000		
			$ 9,903,000
	$10,363,000		
		Improvement in financial position before consideration of need for a National Adjustment Grant	**2,648,000**
Sinking funds	853,000		
Relief works charged to capital account	1,335,000		
	$12,551,000		$12,551,000

Local Governments

Cr.		*Dr.*	
Relief to employables assumed by Dominion	$ 749,000		
Municipal share of relief works	11,000		
	$ 760,000	**Gain** to local governments	$ **760,000**

The net effect of the foregoing transfers is favourable to British Columbia governments. (This is true in spite of the fact that selection of the relatively prosperous year 1937 considerably understates the monetary advantages of the Plan to the Provincial Government. In most other years the Provincial Government would gain—and the Dominion Government would lose— substantially more). The transfers are even more favourable to British Columbia taxpayers, since they would involve the transfer of taxes which are now considerably above the national average to the Dominion Government, and consequently their adjustment to uniform national rates, and would leave taxes (provincial and municipal) which approximated the national average in relation to income. On the basis of 1936, 1937 and 1938 results, and 1939 budget estimates, the Provincial Government would be left with a surplus, as follows:—

BUDGETARY POSITION OF BRITISH COLUMBIA UNDER PLAN I

(On the basis 1936-39 figures)

Cr.		*Dr.*	
Provincial revenues	$20,000,000	Expenditures	$19,100,000
		Surplus*	**900,000**
			$20,000,000

* Surplus available for expansion of education, welfare, and developmental expenditures, directly or through municipal subsidies, and for reduction of taxation.

British Columbia municipalities, although benefiting by some $750,000, would be left with a small cash deficit on the basis of 1937 figures alone, but with a small surplus on the average of recent years.

In reviewing British Columbia's expenditures on education and welfare, however, we note that they are (1936-39 basis) $3,300,000, or 23 per cent more than the Province's expenditures would be at the national average. The Commission believes that there are certain factors which tend to make the unit dollar cost of education and welfare higher than the national average for the same quality of service. But after having made full allowance for these factors, the Commission concludes that British Columbia is providing a higher real standard of service than the average. On the other hand, British Columbia developmental expenditures are some $640,000 annually below the 1928-31 provincial average and this enforced retrenchment has undoubtedly impaired desirable conservation measures.[25] It will be noted that the surplus which the Commission's recommendations would yield the Province would be more than enough to make up this deficiency.

British Columbia evidently does not require a National Adjustment Grant at the present time. Following implementation of the Commission's recommendations it would be possible to maintain the present above average standard of social services; and bring up development and conservation expenditures to pre-depression levels on the basis of provincial taxation which would be slightly lower than the Canadian average. In addition, British Columbia taxpayers would save between $4 and $5 million owing to the fact that present provincial rates are much higher than national rates would have to be on the transferred taxes.

It must be noted, however, that some 10 per cent of British Columbia's remaining revenue will consist of the mining tax rebate based on profits which fluctuate widely; e.g., in the ratio of 1:7 from 1933 to 1937. This is merely indicative of the great relative importance of that volatile industry in British Columbia, and present provincial revenues are even more vulnerable to decline in income from mining. But to an extent unparalleled in any other province, except possibly Ontario, provincial services are now, and would, under the Commission's recommendations, still be to some degree dependent on a highly fluctuating and eventually disappearing source of revenue. Ideally, revenue from wasting assets should be treated as capital, or should at least be used to develop new resources. In view of the uncertainties of British Columbia's future, inherent in its economy, the chief merit of the Commission's recommendations is the assurance of means to maintain at least average Canadian standards in the event of either a sudden blow to the primary exporting industries or the depletion of the best of the natural resources.

[25] Expenditures on forest fire protection were cut from a 1930 peak of $908,000 to $89,000 in 1933, and now (1936-9) average $425,000.

It is obvious that if the tax and expenditure transfers which the Commission recommends improve the financial position of every provincial government (including their municipal governments), on balance, the Dominion Government will lose. It is true that some of the improvement in provincial finances would result from clear savings in the costs of tax collection, and not from increased burdens on the Dominion. (We are here considering only the direct savings to the governments concerned. Of much greater importance would be the savings to business in tax compliance costs, and the elimination of inequitable double and triple taxation on organized business and on individuals.) But even after allowing for all the economies in government expenditures made possible by the Plan, the Dominion Government would lose nearly $40 million a year (on the basis of the 1936-39 average) before making any allowance for amortization of the provincial (and Quebec municipal) debt to be assumed. Prospective savings on debt refunding would be achieved, if present interest rates continue, as high coupon provincial bonds mature. (On the other hand, the Dominion would be accepting the very important contingent liabilities of a rise in interest rates, and of an exchange premium on bonds payable in foreign currencies—liabilities which are much more properly those of the Dominion, because of its control of monetary and foreign exchange policies, than of the provinces.) The Plan also makes possible substantial economies in unemployment relief costs. Dominion responsibility will permit, and in fact will force, an attack on the problem on a national scale, and co-ordination of taxation, borrowing, and monetary policies, industrial and agricultural subsidies and protection, public works programs, vocational training, and labour transfer facilities. In such co-ordination, and by using business-like and effective methods, lie some of the major potential economies. A national attack on the unemployment problem will involve larger direct government expenditures under certain conditions, but will also make it possible to avoid much of the waste which now results from governments working at cross purposes, and from lack of clear delimitation of responsibility. Even more important, national responsibility and a constructive program should remove the pressures on the national income inherent in the present system and stimulate its increase, thus reducing the relative burden and proportionate cost of relief. To these advantages should be added the improved prospects for the unemployed.

To offset the immediate cost of the Plan the Dominion would have exclusive control of three basic modern instruments of taxation, and would be in a position to develop a taxation system which would produce the necessary revenues with much less burden to the economy, and with much greater equity as between individual taxpayers, and groups of taxpayers living in different regions.[26]

The first result of the recommended transfers would be to establish uniform income, corporation and succession duty taxes. In this process, Maritime and Quebec taxpayers would pay more, and Manitoba and British Columbia taxpayers less than at present. Presumably the next step would be to raise sufficient revenue to compensate the Dominion for the losses in the recommended transfers. (It should not be overlooked that the Commission's recommendations make possible balanced budgets in all provinces, and in several after substantial expansion of services. The results to taxpayers can only be compared with what the situation would be if provincial governments now raised their taxes in order to pay for similarly increased services and to balance their budgets. Apart from the impossibility of this in some cases, and the inequities which it would produce, it would cost Canadian taxpayers a substantially larger sum in the aggregate than would equivalent services provided in accordance with Plan I.) The most desirable method of raising the additional revenue would depend on the economic circumstances and poltical policies of the time, but our financial analysis[27] would suggest that a broadening of the income tax basis, and substantial increases in the lower and medium brackets would be the most efficient and economic method. Comparisons with other countries would also suggest that succession duties could contribute a larger proportion of total returns than they do at present.

The substantial increase in the Dominion deficit which the Commission's recommendations would produce is not alarming in view of the greatly improved position in which the Dominion would be put to carry out a comprehensive fiscal and monetary policy in periods of both prosperity and depression, and in view of the relief to business and the economy in general which a coherent, rationally designed taxation system would afford.

Implementation of the Commission's recommendations would throw all the extreme fluctuations of Canadian public finance on the Dominion

---

[26] Note, however, certain restrictions on the Dominion's tax policies which are implicit in Plan I, discussed on p. 85.

[27] See Book I, Chap. VIII.

This is essential if fiscal, monetary, and economic policies are to be co-ordinated with a view to reducing Canadian overhead costs and to minimizing and helping control the swings of the business cycle. While provincial and local governments would be left with relatively stable revenues and expenditures and, through the operation of National Adjustment Grants, would be assured of independent financial security and ability to provide average services, residual deficits and surpluses would concern the Dominion. While other governments would be put in a position to budget closely from year to year, the Dominion would have to budget for the business cycle rather than for any specific fiscal period. This would lead to integration of fiscal policy with monetary and economic policies in a manner which could be made highly beneficial to the general welfare.

A most important element in this integration would be the concentration of deficit financing and special public works programs in periods of depression, and of debt retirement in periods of prosperity, in the hands of one body, the Parliament of Canada. This would permit carrying out a coherent long-range policy, that would be related to national monetary, tariff, industrial, transportation, and developmental policies. For this reason the Commission does not recommend any specific sinking fund provisions on the debt to be assumed by the Dominion, nor on its present debt, since the Commission believes that debt retirement (or debt increase) should be adapted to the business cycle and related national policies.

In order to present the complete picture of the results to be expected from the operation of Plan I, we should show, in addition to the benefits received by provincial and local governments (which will be reflected either in reduced taxation or increased services for provincial residents) the increased burden on Dominion taxpayers. It is misleading to put the latter on a provincial basis, since it is not the provinces, or the provincial governments, as such, that would pay, but Canadian citizens throughout Canada, on a uniform basis and in accordance with their means. As noted in the chapter on taxation, the taxes recommended to be left exclusively to the Dominion apply in large part to income and wealth which is national in character, in substantial measure the product of national policies, and which cannot be identified with purely local effort or local needs. Nevertheless, under the present system, the bulk of this income and wealth is concentrated in a few localities. Consequently, a few provincial governments are in very favourable positions in respect to reserves of taxation, and others in very inferior positions. It is true that to the extent to which the Commission's recommendations will remove these inequities they might be looked on as indirectly taking something from the provincial governments which are now in the more favoured positions. But, as we have pointed out elsewhere, continuation of the present system will cost the citizens of the wealthier provinces more than the tax recommendations of the Commission, and there can be no ground for complaint, or suggestion of unfair discrimination and inequity, in a system which taxes all citizens of Canada, regardless of the province in which they live, on a uniform basis, in order to provide funds required for a national objective. Enabling provincial governments adequately to perform their functions is a national objective. In fact, it is only by the use of national taxation that a province in need, perhaps in part as a result of the operation of national policies, can be helped. National economic policies, adopted in the general interest, inevitably operate to impoverish some areas and enrich others. The only equitable corollary of this is national taxation which treats residents of all provinces equally, and thus provides for some redistribution of surplus income among provincial governments to enable them to perform their functions without imposing excessive taxation on their citizens.

However, the amount which the residents of each province would have to pay in increased Dominion taxation in order to finance the Plan cannot be estimated with any useful degree of accuracy. The figure of $40 million given as the net cost of the Plan to the Dominion Government was arrived at by assuming that all unemployed employables were cared for by direct relief at existing scales. If this estimate is taken as a starting point, it would then be necessary to select the Dominion taxes which would be increased, to forecast the form of the new rate structures, and to estimate the final incidence of the taxes. As the Commission has found it necessary to note in several instances, the province in which a tax is paid is not necessarily the province in which the income taxed is earned. Consequently it must be emphasized that calculations by any formula of the amount of national taxes paid by residents of any one province cannot be accurate, and may be highly misleading. Efforts to make such calculations ignore the truly national character of many of the taxes considered; the uneven distribution, in part as a result of national policies, of taxable income; the possible stimulus to the national income of an improved taxation system;—in fact, the very factors on which the Commission's taxation recommendations are based.

But the cost to the residents of each province under the present division of powers and responsibilities to make up provincial deficits and produce the surpluses available for improved services as provided in Plan I can be shown, and this is of interest as a commentary on the inequities and impracticabilities inherent in the present system.

ADDITIONAL TAXATION PER FAMILY NECESSARY UNDER THE PRESENT SYSTEM TO PUT PROVINCIAL AND MUNICIPAL BUDGETS IN THE SAME POSITION AS PROVIDED BY PLAN I*, YEAR 1937

—	$	Average Family Income $
Prince Edward Island	11·12	774
Nova Scotia	7·08	1,159
New Brunswick	20·25	1,029
Quebec	27·58	1,344
Ontario	3·25	1,504
Manitoba	20·36	1,408
Saskatchewan	63·92	830
Alberta—at current interest rate	4·46	1,222
—assuming full interest paid	20·20	
British Columbia	7·22	1,317

* For the purposes of this calculation provincial sinking funds have been excluded (i.e., taxation would have to be increased more than shown here to make provision for even current sinking funds), and 40 per cent of the cost of relief works charged to capital account is included.

The Commission does not wish to give the impression that it views lightly the heavy additional burdens on the Dominion Government and the substantial increase in the Dominion deficit which its recommendations would involve in even the most favourable circumstances. The Dominion must also be prepared to meet emergency demands of unpredictable magnitude. But whether to provide more efficient and economical government for Canadians under normal conditions, or to prepare for the special stresses and strains of emergency conditions, the Commission is convinced that the Dominion's first interest lies in seeing Dominion-provincial relations established on a sound and equitable basis. The immediate cost to the Dominion Government of this will be repaid many times in the economies and greater efficiency of government, the security to investors and to recipients of provincial services, the provision of means to supply basic national standards of education and welfare services and to maintain desirable developmental programs, and the stimulus to the national income made possible by its recommendations.

Chapter III

TAX TRANSFER RECOMMENDATIONS

1. Personal Income Taxes

The personal income tax is the most highly developed modern instrument of taxation. It can be more delicately adjusted to individual circumstances, and thus made fairer in its incidence, than any other tax. It adjusts itself automatically to economic fluctuations. It can raise a given revenue with less burden on the national economy than any other tax because it is drawn from surplus income rather than made a burden on costs. That is, no income tax need be exacted from an individual unless he has an income above that necessary for subsistence. No obstacle is thus put in the way of employment at wages or salaries not exceeding the subsistence level, and it is probably in these marginal fields of employment that the major solution of our unemployment problem lies. The income tax is collected directly and relatively cheaply, with no hidden costs and waste. And it has become an integral part of modern economic, political and social policy. It is the most effective method yet devised, within the framework of the capitalist economy, for achieving the social and humanitarian objectives of our civilization; for applying wealth which is made possible only by organized society for the benefit of society as a whole; for preserving the freedom of individual initiative and at the same time making possible the financing of those services which can be most economically provided by the community as a whole.

Nevertheless, as our review of the Canadian taxation system[1] shows, the income tax (made up as it is in many provinces of a Dominion tax plus a provincial tax) has failed to fill a role in Canada commensurate with its possibilities. It is crippled and seriously distorted by the present division of jurisdiction. It cannot, under the existing system, be developed in the most equitable and efficient manner. We have shown some of the results of the present division of jurisdiction, and the inevitable friction and injustices which have arisen in the competitive scramble for revenues.[2] Rates vary between provinces, and in some cases between municipalities, to an extent that is startling in the medium and upper brackets of income, and that creates serious inequities, and practical obstacles to freedom of movement.

Dominion, Provincial and Municipal Income Taxes Payable by a Married Man with No Children*

(Prior to 20 per cent increase in Dominion rates in September 12, 1939, budget, and to War Budget increases in the United Kingdom and France.)

Gross Income	$3,000	$10,000	$100,000
Tax payable by resident of:—			
Charlottetown, P.E.I.	61 90	821 20	38,249 15
Halifax, N.S.	30 00	546 00	32,518 50
Saint John, N.B.	30 00	636 00	35,283 50
Quebec, Quebec	30 00	546 00	32,518 50
Montreal, Quebec	33 00	655 20	39,022 20
Toronto, Ontario	44 55	778 70	39,920 54
Winnipeg, Manitoba	77 04	993 28	46,864 62
Regina, Saskatchewan	71 50	1,034 25	58,230 90
Edmonton, Alberta	65 00	1,036 00	58,228 50
Victoria, B.C.†	60 00	1,051 00	55,513 50
New York, U.S.A.	28 00	655 00	38,274 00
London, England	283 13	1,910 63	50,120 00
Paris, France	579 00	3,564 00	54,239 00

* Assuming all earned income in $3,000 and $10,000 brackets, and $14,000 earned income in $100,000 bracket.

† No allowance made for exemption allowed by B.C. on dividend income from B.C. corporations.

We have noted the integrated and complementary nature of our economy, moulded by national policies and operating as a national unit; the consequent unequal regional distribution of income, and particularly of taxable surplus income, in Canada; the sharp and largely uncontrollable fluctuations in regional incomes; the great inequity as between provinces in the revenues available for provincial services; the impossibility at times for some provinces of providing services of average Canadian standards; and finally, the difficulty for some provinces, because of their limited control over mere sectors of the national economy in assuring either citizens or investors of the future of the province.

The unsuitability of provincial (and municipal) jurisdiction in the income tax field is only partly due to the obstacles which it creates to the development of a business-like and efficient tax structure for the country as a whole. The income tax,

[1] See Book I, Chap. VIII.

[2] The situation is very similar to, but on a much larger scale than that prevailing in Ontario before the abolition of the municipal income tax, which was characterized by the Provincial Premier and Treasurer, in his budget speech of March 9, 1937, as a "disgraceful checkerboard system—full of inequalities, anomalies, hardships".

because of the nature of the Canadian economy, is productive only in some units. Those provinces in which a provincial income tax is, or would be, relatively unproductive feel aggrieved because they think that income earned within their jurisdiction is, through the operation of national policies, concentrated in more fortunate provinces where it may be taxed for provincial purposes.

Changes in tax rates, exemptions, and other regulations by a provincial government affect Dominion revenues, and vice versa, in quite arbitrary and uncontrollable ways, and variations between the schedules and regulations of different governments taxing the same individual give rise to a sense of grievance. We should note in addition the extent to which the present divided jurisdiction, coupled with the inability of the Dominion to compel the provinces to comply with treaties on subjects within provincial jurisdiction*, weaken Canada's ability to enter into effective international agreements respecting income taxes, which have recently become of importance. One result of this may be inability of the Dominion to secure fair treatment for Canadians investing abroad, and another may be the discouragement of investment in Canada by foreigners.

The Commission thinks it desirable that the income tax should be used in accordance with modern practice, as the equalizer and chief instrument of adjustment in the whole tax system. This is particularly necessary in view of the existing tax burdens on business costs, marginal industry, and low-income groups. The rate and the appropriate curve of progressivity necessary to reform and control the tax structure can only be achieved if this equalizing instrument of taxation is under one authority. That authority can only be the Dominion.

The Commission attaches far greater importance, of course, to the beneficial effect on the national income which would result from reform of the tax system than to certain economies which would result from unified collection, but additional advantages of unified control would be reduction in the cost of tax collection and greater efficiency in collection.

The growth of demand for contributory social services, usually proposed to be financed in part by wage taxes which can be regarded as a particular form of income tax, makes it increasingly important to have unified collection. If Dominion unemployment insurance and relief, or provincial welfare services, in co-operation with the Dominion, should be put on a contributory basis, it is essential that the premiums be co-ordinated with the general income tax and the whole tax system. If provincial levies of this character are made there should be an arrangement for collection jointly with corresponding Dominion levies.

The Commission accordingly recommends that the provinces and *ipso facto* their municipalities should withdraw entirely from the personal income tax field, (though retaining the right to levy premiums for social insurance within their competence by way of a proportionate tax on wages and salaries if they choose to do so). This step is an essential part of its general financial plan. But it is also justifiable on the grounds of equity as between taxpayers and as between provinces, and on the grounds of sound fiscal and social policy.

* See Lord Atkin's judgment in *Attorney-General of Canada v. Attorney-General of Ontario et al* [1937], A.C. 316.

2. Corporation Taxes

We have given an account in Book I of the rise of corporation taxation, and of the existing situation.[3] The present complexity is beyond belief. The most important item is the corporation income tax, levied by the Dominion and most provincial governments. There are, in addition, taxes levied by one or more governments, on various bases such as capital stock, number of business places, gross revenue, physical volume of output, period of operation, mileage of track or wire, mileage operated, note circulation, insurance premiums, investments, volume of deposits. These taxes apply on different terms to banks, chain stores, electric power companies, finance companies, gas companies, grain companies, insurance companies, investment companies, land companies, loan companies, mining companies, oil companies, pipe line companies, race tracks, railway companies, sleeping car companies, steamship companies, telegraph companies, telephone companies, tramway companies, trust companies, fire insurance companies, accident and guarantee companies, and "miscellaneous" companies. They have grown up in a completely unplanned and unco-ordinated way, and violate every canon of sound taxation.

Complaints by business organizations about the inequities resulting from the present chaos in corporation taxes and the unnecessary cost of tax compliance were made to the Commission from end to end of the Dominion.[4] In general we find these complaints to be well-founded.

The primary criticism of the present system is that business has been made an object of taxation in itself. It is one thing to use the corporate organization as an agent to collect taxes cheaply and simply from final recipients of wages, interest and dividends,[5] but in Canada business itself is taxed. Some $20 million of total Dominion and provincial corporation taxes comes from specific taxes which bear no relation to net profits, and have naturally become fixed charges, embodied in the overhead. As such they increase the costs of production of all Canadian business, impair its competitive power, and crush out marginal enterprises. The remainder of the revenue from corporation taxation (being virtually all the Dominion revenue and about 40 per cent of the provincial) is derived from corporate income taxes which are not real income taxes. They apply to *corporate* net income at a flat rate, but are not adjusted to the net income of the corporation *owners* at either a uniform or graduated rate. And although they are not a fixed charge on business in the same way that the specific corporation taxes are, they penalize investment in industry (particularly during a period of successive rate increases) as compared with other forms of investment, or hoarding.

It is, of course, impossible to calculate the amount by which diversion of investment, increased business costs and elimination of marginal enterprises reduce the national income, increase unemployment and weaken Canada's competitive power in international trade. But these consequences are regrettable since every penny now raised by direct taxation on business could be raised without any of these disadvantages by properly adjusted taxation on business owners.

The second major criticism of the present system is the inevitable inequity, lack of uniformity, and lack of efficiency arising from the divided jurisdiction. Corporate business has naturally adapted itself to the national policies and local concentrations of power and income which we have noted as so characteristic of the Canadian economy. Several provinces have consequently been led to devise elaborate formulae, differing in almost every province and in relation to every business, which can be applied to whatever assets fall within their jurisdictions, or which, in more extreme cases, will extract as much as the corporation can pay before it is clearly advantageous for it to sacrifice its investment and withdraw completely from the province. But in many cases once the initial investment has been made the corporation cannot withdraw. As a result, investments in different forms of business are taxed at different rates in the same province; investments in the same kind of business are taxed at different rates in different provinces; investments in business operating on a national scale are double- and triple-taxed with no relation to earning power; certain forms of business can be, and are, singled out for discriminatory taxation; tax compliance costs are uselessly and unreasonably increased. And again, it should be added, the same amount of revenue could be secured without imposing any of these discriminatory and inequitable burdens.

[3] Book I, Chap. II and Chap. VIII.

[4] Ex. 88, Brief of Canadian Manufacturers' Ass'n; Ex. 267, Brief of Citizens' Research Institute; Ex. 394, Brief of Canadian Chamber of Commerce; Ex. 188, Brief of Associated Boards of Trade of B.C.; Ex. 202, Brief of Victoria Chamber of Commerce; Ex. 268, Brief of Toronto Board of Trade; Ex. 343, Brief of Chambre de Commerce de Montréal; Ex. 107, Brief of Chartered Banks of Canada; Ex. 113, Brief of Canadian Federation of Mayors and Municipalities; Ex. 92, Brief of Canadian Life Insurance Officers' Ass'n. For discussion of cost of tax compliance see this section Chap. VIII.

[5] Prior to 1926, dividends of corporations subject to Dominion taxation were exempted in the hands of shareholders from the normal tax, though not from the supertax or surtax. In consequence of this exemption the corporation tax would be regarded, at least in part, as a normal income tax collected at the source, although unlike Great Britain the Dominion allowed no rebate to shareholders whose income was too small to be subject to any income tax, or to one at less than the corporate rate.

The genesis and explanation of this system lie in the division of jurisdiction in the field, the efforts of provinces to tax objects which are in no economic sense provincial, and in the somewhat indirect and concealed nature of the tax and consequent lack of organized protest. When the taxes were merely nominal no particular hardship was caused, and the ease and cheapness of direct collection from corporations over-rode consideration of minor inequities. But there has been a steady upward tendency in rates which has increased alarmingly in recent years. Current corporation tax revenues (both Dominion and provincial) are double those in 1929.[7]

The Commission accordingly recommends the complete withdrawal of provinces from the corporation tax field as defined below. Only by such a step can we hope to achieve reasonable uniformity in impositions on business. The growing tendency to victimize exposed businesses would be checked. The costs, and annoyances, of multi-tax compliance would be reduced. The Dominion would presumably, in most cases, replace these taxes by increases in the corporation income tax, but ultimately it would be in a position to reform the general tax system, and to shift government burdens from business costs, which would encourage development of our marginal resources and employment of our surplus labour.

It is not necessary to support this recommendation at length. The existing medley is the product of the present division of jurisdiction; of accident and of occasional pressure; of failure to realize the economic results, and of lack of definite responsibility for them; and is so grossly inequitable to, and such a heavy burden on, Canadian industry and development, Canadian investors, and Canadian labour, that a fundamental and sweeping reform is necessary.

A detailed list of the taxes currently affected is given in the Annex below, and these are the taxes included in the transfers recommended in Plan I. It should be made clear that this recommendation does not apply to all taxes paid by corporations, as it does not include bona fide provincial and municipal licence fees, real estate taxes, and consumption taxes collected through corporations.

Coupled with this recommendation is the proposal that a portion of the collections from mining and oil-producing companies should be turned over to the provinces. The Commission recommends that the rebate be an amount equal to 10 per cent of company profits derived from mining and oil production in the province, and that this be paid to the government of the province concerned. Only approximate estimates can now be made of the amounts involved, but appropriately designed tax-return forms would produce the necessary information in the future without difficulty. In the meantime, it is believed that the Commission's estimates may be taken as sufficiently accurate for working purposes.

It is also recommended that profits from smelting and refining operations (provided that the ores used are provincial products) should be treated as mining profits both to facilitate the technical problem of allocating earnings in the case of joint enterprises, and because smelting and refining business based on domestic ores and oils will in the great majority of cases terminate with the exhaustion of the local mine or oil well. In other words, all mining and oil producing company profits will be included *except* investment portfolio earnings, profits from mining, smelting or refining other than native products of the province, and earnings from any fabrication or further processing beyond the refined product. (In the case of an enterprise such as the Hudson Bay Mining and Smelting Company, operating on the Manitoba-Saskatchewan border, it will be necessary for the company to allocate its profits, very much as it does today for provincial tax purposes.)

This proposal recognizes the justice of the provincial claim to direct participation in the profits arising from the exploitation of their wasting assets,[8] and will supply revenues both to amortize provincial expenditures on development and to prepare for the expenditures necessary when the resources are depleted. On the other hand, it should be recognized that, although the resources belong to the provinces, their profitable development depends to a large extent on Dominion tariff, trade and monetary policies, and on Dominion expenditures on transportation and development, and that the Dominion is also entitled to a direct share of these resource revenues in order to amortize its own expenditures on developing them.

The mining tax rebate is recommended because the profits of these companies are made from the depletion of natural resources within the province. No similar proposal is made in the case of other natural resources such as forests, water-powers, agricultural land, and fisheries, because adequate

[7] Since this was written the Dominion corporation income tax has been increased 20 per cent, and a new form of corporation taxation—the excess profits tax—has been added for purposes of war financing.

[8] *E.g.*, Ontario contended that the Dominion income tax should not tax profits from mining operations. (Brief Pt. II, pp. 52-55, see also Ev. pp. 7584*ff.*) British Columbia contended that much of its revenue was derived from the depletion of natural resources and that the Dominion should make allowance in its income tax policy. (Brief pp. 181*ff*; Ev. pp. 5079*ff.*)

conservation measures can, in the great majority of cases, maintain the resources unimpaired.

It is quite true that it would appear that adequate conservation policies are not, in fact, now being generally followed. This, however, is entirely a matter of provincial policy, and under the general arrangement proposed in the Commission's fiscal plan all provincial governments are assured of sufficient revenues to carry out any reasonable and desirable conservation program. Public interest in conservation is evidently increasing in Canada, and if adequate funds are made available considerable expansion in this work may be expected.

It is also true that certain specialized forms of natural resources, other than mineral deposits, are subject to exhaustion in the sense that conservation or replacement would be uneconomic. For example, the white pine of the Ottawa valley and New Brunswick, the black walnut of southwestern Ontario, the black spruce of the lower St. Lawrence, the Douglas fir of British Columbia, many forms of wild life and some agricultural prairie lands have been, or are being, exhausted, and their replacement is not practical. Nevertheless, resources of this nature can be evaluated with a far greater degree of accuracy than hidden mineral resources, and they presumably possess certain scarcity or monopoly values which enable provincial governments to apply appropriate royalties, stumpage dues, and licences under their public domain revenue powers to compensate for the depletion of assets.

Annex

The Commission's proposal is that the provinces should withdraw from all corporation taxes except bona fide licence taxes, taxes on real estate, and consumption taxes applicable to corporations and other consumers. It is not proposed that corporations should be exempted from those taxes which would fall on their business if it were conducted by an individual, but a tax imposed on a type of business in which only corporations engage may well be in substance a tax on corporations. The essence of the Commission's recommendation is that a corporation should be taxed by a province (and its municipalities) in respect of its business only in the same way that an individual or partnership would be taxed. The Commission's recommendation applies in addition to analogous taxes which, by one device or another, in substance tax business entities more than an equitable estimate of provincial or municipal services rendered. The following list of provincial corporation taxes now in existence is illustrative, but not intended to be exhaustive, of the corporation taxes to be given up.

Provincial Corporation Taxes

(Applying in one or more provinces—see Book III, for details of individual provincial corporation taxes.)

1. Accident and Guarantee Companies.
   (*a*) Flat rate.
2. Banks.
   (*a*) Capital stock
   (*b*) Number of branches
   (*c*) Average monthly volume of business
   (*d*) Excess of average monthly deposits over the sum of average loans and the increase in investments in provincial and municipal securities during the year
   (*e*) Net income
   (*f*) Reserve fund and undivided profits
   (*g*) Private bankers
   (*h*) Average amount loans and deposits.
3. Building Companies.
   (*a*) Flat rate—not over $500.
4. Chain stores.
   (*a*) Capital stock
   (*b*) Places of business
   (*c*) Net income.
5. Electric Power Companies.
   (*a*) Capital stock
   (*b*) Places of business and population
   (*c*) Power lines and plants (Electric Power Taxation Act—Alberta)
   (*d*) Gross revenue
   (*e*) Net income
   (*f*) Electric meters in use.
6. Express Companies.
   (*a*) Capital stock
   (*b*) Places of business
   (*c*) Mileage operated
   (*d*) Gross revenue
   (*e*) Net income
   (*f*) Surcharge.
7. Extra-Provincial Companies.*
   (*a*) Retail sales in province
   (*b*) Capital invested or used in province
   (*c*) Gross income from construction contracts
   (*d*) Authorized capital and capital stock
   (*e*) Net income tax
   (*f*) Surcharge of $50.
8. Finance Companies.
   (*a*) Capital stock
   (*b*) Places of business
   (*c*) Gross revenue
   (*d*) Flat rate
   (*e*) Net income.
9. Fire Insurance Companies.
   (*a*) Gross premiums
   (*b*) Flat rate
   (*c*) Net premiums.
10. Gas Companies.
   (*a*) Capital stock
   (*b*) Places of business and population
   (*c*) Gas consumed

* New Brunswick did not have a general corporation tax until 1938 except on Extra-Provincial Companies.

(d) Gross revenue
(e) Net income
(f) Gas meters in use.

11. Grain Companies.
(a) Capital stock
(b) Elevators
(c) Net income
(d) Surcharge.

12. Insurance Companies.
(a) Gross insurance premiums
(b) Net insurance premiums
(c) Places of business
(d) Investments (extra-provincial companies)
(e) Net income
(f) Flat rate on head office in or outside province (life only)
(g) Capital stock
(h) Surcharge.

13. Investment Companies.
(a) Capital stock
(b) Places of business
(c) Gross revenue
(d) Net income.

14. Land Companies.
(a) Capital stock
(b) Places of business
(c) Gross revenue
(d) Net income
(e) Investments and capital
(f) Investment within the province.

15. Liquor Export Companies.
(a) Flat rate—$15,000 per annum.

16. Loan Companies.
(a) Capital stock
(b) Places of business
(c) Investments and deposits
(d) Gross revenue
(e) Net income
(f) Fixed rate
(g) Investment within the province.

17. Mining Companies.
(a) Capital stock
(b) Places of business
(c) Profits
(d) Net income (metal mining companies)
(e) Alternative 2 per cent mineral tax—assessed value of ore removed from mine (metal mining companies only)
(f) Coal mines and coke ovens, output tax on tonnage.

18. Oil Companies.
(a) Capital stock
(b) Places of business
(c) Net income
(d) Number and size of tanks
(e) Pipe Line Taxation Act—based on the assessed valuation of the pipe line.

19. Pipe Line Companies.
(a) Capital stock
(b) Places of business
(c) Net income.

20. Race Track Companies.
(a) Capital stock
(b) Places of business
(c) Number of days track open
(d) Net income.

21. Railway Companies.
(a) Capital stock
(b) Mileage operated
(c) Net income
(d) Places of business
(e) "The Railway Taxation Act"—gross earnings
(f) Agreement
(g) Surcharge
(h) Flat rate
(i) Payment in lieu of taxes—C.N.R.

22. Sleeping Car Companies.
(a) Capital stock
(b) Places of business
(c) Net income
(d) Investment in cars for use in Canada
(e) Annual fixed charge not exceeding $300.

23. Steamship Companies.
(a) Capital stock
(b) Places of business
(c) Net income
(d) Flat rate.

24. Telegraph Companies.
(a) Capital stock
(b) Places of business
(c) Gross revenue
(d) Net income
(e) Amount invested in lines and property
(f) Number of miles of wire used
(g) Flate rate
(h) Surcharge.

25. Telephone Companies.
(a) Capital stock
(b) Places of business
(c) Gross revenue
(d) Net income
(e) Telephone instruments in use
(f) Long Distance Tolls.

26. Tramways Companies.
(a) Capital stock
(b) Places of business
(c) Mileage operated
(d) Gross revenue
(e) Net income.

27. Trust Companies.
(a) Capital stock
(b) Places of business
(c) Gross revenue
(d) Gross earnings on investments for others
(e) Net income
(f) Fixed rate
(g) Gross profits.

28. Miscellaneous Companies.†
(a) Capital stock, value of shares or capital employed
(b) Places of business
(c) Net income
(d) Annual returns and registration fees based on authorized capital
(e) Other taxes—Gasoline dealers
(f) Surcharge.

29. Surcharge on Corporation Taxes.
(a) Interest.

---

† Includes all companies not specially taxed.

3. Inheritance Taxes

In 1867 there were few large fortunes in Canada, and such concentrations of wealth as did exist were largely local in origin and in the form of local property—land, merchandise, ships, small saw-mills, flour mills, etc. The joint stock company with its attendant characteristics of large scale enterprise, widespread ramifications, and narrow concentration of wealth in security form, was as yet little developed. The coming of the railway greatly altered this situation, both directly and indirectly. To carry out projects, so tremendous in relation to the times, involved pledging the credit of the whole country, but the profits and control were concentrated in a few hands in a few localities. As better transportation facilities made possible specialization and industrialization (and a huge increase in production and wealth), big fortunes, which were in large part based on and made possible by the new national economy, grew and became increasingly concentrated in a few growing metropolitan areas. The evolution of this process and its important implications to succession duty taxation have been noted in various places in Book I.

The provinces first entered the field of succession duty taxes during a period when they were more hard pressed financially than the Dominion, and up to the present the Dominion has left the field entirely to them, though there can be no question of the Dominion's legal power to levy such taxes at whatever rates or by whatever methods it pleases. The rates at first were low, the yields small, and the disparities consequently unimportant. But in recent years the first crop of Canadian millionaires has ripened for harvesting; rates have been substantially increased; and in the scramble for revenues—from wealth which can no longer be considered as local in origin—inequities of double taxation, impediments to free movement of capital, excessive administration, litigation and tax compliance costs, and a strikingly disproportionate division of revenues have come into existence.

Inheritance taxes take two principal forms—a tax levied on the whole corpus of the estate, which is usually called an estate tax, and a tax levied on the shares passing to beneficiaries, which is usually called a succession or legacy duty. The constitutional limitation of the provincial taxing power to "direct taxation within the province" has produced a series of complicated legal decisions as to the validity of provincial succession duty statutes. It is unnecessary to discuss the details of these cases except to note that, in conformity with the decisions, each province in Canada now imposes death taxes on all property situate within the province and also on all transmissions within the province of personal property situate outside it.

This legal situation has led to great unfairness and inequality in the amount of tax exacted from estates of the same size and bequeathed to beneficiaries bearing the same degree of relationship to the decedent. One estate having assets only in the province in which the decedent was domiciled and passing to beneficiaries within that province will be taxed only once; another estate of the same value having assets in several provinces will be taxed by each province on the assets locally situate within it, and will be taxed a second time on the transmission of the property to the beneficiaries in the province in which they reside. It is plainly inequitable that two similar estates within the same province should be taxed substantially different amounts because assets of the same value are held in different forms. Whatever may be said of the taxing of real property and of tangible personal property, on the basis of situs, the application of rules ascribing an artificial situs to intangible personal property appears to produce results which are quite indefensible. Thus, company shares are taxed by the province in which the transfer office of the company is situated on the basis that such shares have a situs at the place where they may be effectively dealt with. Again, moneys payable under insurance policies are taxed in the province in which they are payable, and this place of payment may be determined by the place in which the application for insurance was made many years earlier.[10]

Administrative regulations also frequently give rise to vexatious delays and other abuses. Most provincial succession duty statutes impose duties of disclosure on executors and administrators, and forbid insurance companies to make payments, and other companies to allow transfers of shares until releases have been obtained from the provincial authorities; and heavy penalties are imposed for breach of these provisions. In the result, executors are frequently obliged to engage in litigation to establish that the estate is not subject to taxation or else (as the price of being allowed to realize

[10] *E.g.*, a person who, twenty years ago was temporarily resident in Quebec may have applied for an insurance policy. Under the terms of the Quebec Insurance Act, Sec. 213, the policy was made subject to the Quebec statute and was payable within the Province. Even though the insured person moved to British Columbia, and maintained his domicile there for twenty years until his death, unless he had taken steps to amend his policy, the moneys payable under his policy would be subject to Quebec succession duties on the theory that the debt is payable and, therefore, physically situate within Quebec.

the assets of the estate) make payment of a tax which they believe is not legally due. It was said that such cases arise most commonly in estates of moderate size where, if the property subjected to double taxation comprises a substantial portion of the estate, serious hardship may result.[11]

The Commission heard many complaints from business organizations about the inequities and vexations of the present situation.[12] Several of the provinces also criticized the present situation, though largely on the ground of inequality of the yield as between provinces.[13]

Logically the difficulties of double taxation could be minimized by an adequate system of reciprocal agreements between the provinces, but the history of such agreements does not suggest that this remedy, even if possible, is likely to be permanent. Over a number of years reciprocal agreements to avoid double taxation were made between most, if not all, provinces in Canada; they were repudiated within a very short time.[14] So long as such agreements can be destroyed by the unilateral act of one of the parties, the protection which they afford is temporary and uncertain.

The features of double taxation between provinces which we have discussed appear also as between the provinces of Canada and foreign countries. Double taxation tends to impede the free flow of investment capital between other countries and Canada, and can only be avoided by agreements between taxing authorities. Some provinces have attempted to negotiate such agreements, but the agreements which they may make can never have the binding force of international treaties or conventions; nor is it quite reasonable to expect other nations to negotiate separately with each Canadian province. The Dominion is in a much better position to negotiate international agreements and it would no doubt do so if it had sole control of inheritance taxes and was thus able to implement the undertakings which it would have to give.

We have discussed at length in Book I of this Report the integrated nature of the economy and the tendency of surplus income and taxable wealth to "pool up" in certain metropolitan areas where the head offices of national enterprises are located. This in part explains the differences among the provinces in the per capita yield of succession duty taxes. From 1926 to 1939, for example, 85 per cent of all succession duty collections were made in Ontario and Quebec yet during these years these two provinces produced on the average only about 65 per cent of the national income. While undoubtedly the exploitation of natural resources within the province has frequently been the source of large incomes and large estates, this exploitation has often been facilitated by national transportation, trade, and monetary policies. Other large estates have been the result of accumulation of profits from mercantile, financial, transportation and other enterprises with national ramifications. And it may be reasonably assumed that every large estate in recent times has been at least in part accumulated out of profits from nation-wide enterprises. Hence, whatever the situation when wealth was largely the result of local enterprise, it cannot now be assumed that the provinces have any moral right to the exclusive enjoyment of the tax on the ground that provincial policy has made possible the accumulation of large estates. Indeed, the only equitable way in which the tax could be left to the provinces would be by a system of centralized collection and redistribution among the provinces, perhaps on a per capita basis.

The great variability of the yield from succession duties in general makes them unsuitable as provincial taxes from the point of view of stability of revenues. The death of one rich man may distort a province's revenues out of all proportion. Windfalls of this sort may tempt a government into unduly optimistic expenditures. On the other hand, budgetary estimates of the yield can be little more than guesswork, and the failure of estimated revenues from the tax may throw a provincial account into serious deficit. Were the tax exclusively a Dominion tax, the yield would be much less variable in view of the much wider population base and, in any case, the variability would not unbalance Dominion revenues to anything like the same degree, in view of the much larger Dominion revenues and wider assortment of tax resources. Given other assured revenues equal to the average

---

[11] Ex. 95, Brief of Dominion Mortgage and Investments Ass'n, p. 14; Ex. 394, Brief of Canadian Chamber of Commerce.

[12] Ex. 66, Brief of Regina Board of Trade, p. 2; Ex. 92, Brief of Canadian Life Insurance Officers' Ass'n, p. 23; Ex. 95, Brief of Dominion Mortgage and Investments Ass'n, pp. 10-17; Ex. 236, Brief of Edmonton Chamber of Commerce, p. 52; Ex. 267, Brief of Citizens' Research Institute of Canada, pp. 60-63; Ex. 268, Brief of Toronto Board of Trade, pp. 45-49; Ex. 394, Brief of Canadian Chamber of Commerce, pp. 5-6; Ex. 401, Brief of Communist Party, pp. 61, 68.

[13] For views of various provinces with respect to jurisdiction see: Brief of Man. Pt. VIII, p. 55; Brief of Sask. pp. 116-20 (Ev. pp. 1589-97); Brief of N.S., p. 52 (Ev. pp. 3497-98); Brief of P.E.I., pp. 47-48: Brief of Ont. Pt. II, pp. 67-69 (Ev. pp. 7661-69); Brief of N.B., pp. 30-31 (Ev. pp. 4062-65).

[14] It was stated in evidence at the Commission hearings in Toronto (Ev. pp. 7667-69) that, following the abrogation by the Province of Alberta of the agreement with Ontario, the latter Province denounced not only the Alberta agreement but the agreements with all other provinces, and there followed the destruction by other provinces of the whole system of reciprocal agreements that had been laboriously built up.

yield of succession duty taxes, there can be little doubt that every province would find its revenue position more stable, and less subject to uncontrollable fluctuations.

The variability of the yield in each province, and the inequalities of the yield as between provinces, are clearly indicated by the following table:—

SUCCESSION DUTY COLLECTIONS IN RELATION TO PROVINCIAL REVENUES, 1926-1937

—	Succession Duty Proportion of Total Provincial Revenues, excluding Subsidies 1926-1937			Provincial Shares of Succession Duty Collections (1926-1937)
	Annual Low	Annual High	Average	
	%	%	%	%
Prince Edw. Island	1·9	7·1	4·3	0·2
Nova Scotia	4·5	14·1	6·7	2·1
New Brunswick	4·6	18·7	8·1	2·0
Quebec	10·0	20·4	13·0	27·4
Ontario	10·4	23·9	17·6	56·1
Manitoba	3·0	10·1	5·2	2·9
Saskatchewan	1·6	3·9	2·7	1·6
Alberta	2·2	7·7	4·0	2·8
British Columbia	2·4	5·0	3·8	4·9
				100·0

In the modern state inheritance taxes are an important instrument of social policy, especially as a means of financing social services and thus effecting some transfer of wealth from rich to poor. Were the provinces completely responsible financially for carrying social services there might be a strong argument for leaving the tax with the provinces. But the Dominion is already bearing a larger portion of welfare costs than that carried by provincial budgets,[15] and our proposal that the Dominion should take over the responsibility for unemployed employables, and should make adjustment grants on the basis of need, will, if implemented, place the major share of the cost for public welfare upon the Dominion. But in any case, it is doubtful whether inheritance taxes can be effectively used by nine provincial governments as an instrument of social policy, at least without serious detriment to the national economy.

Although the total revenue raised by succession duties in all provinces has averaged less than $20 million a year during the past ten years, or between 3 and 5 per cent of the combined Dominion-provincial revenue, succession duties as they are now enforced are detrimental to the Canadian economy. The rates and the degree of graduation of taxation are not uniform in the different provinces and wealthy individuals have, therefore, an inducement to choose with care their place of residence and the location of their investments. They cannot with impunity choose the former on grounds of amenity and the latter in accordance with economic opportunity. There is even an inducement for a province to keep its inheritance taxes relatively low in order to attract the owners of wealth. To avoid double taxation, investors will tend to confine their investments to the province in which they are domiciled.[16] The individual, faced with the prospect of double taxation, cannot be criticized for taking such steps to avoid it as are open to him, but it is not in the public interest that freedom of investment and the free movement of capital within Canada should thus be hampered.

High rates of inheritance taxes are, of course, likely to have important effects on the national economy. It is sometimes contended that they tend to deplete the capital resources of a nation while income taxes do not. This contention is, in ordinary circumstances, mistaken. Both these taxes tend to deplete the capital resources of the state but they take the place of other taxes which would be required instead. Thus, while falling on some citizens, they indirectly enable others to save. In some cases, too, individuals may have been stimulated to make greater savings in order to leave what they consider a suitable provision for their heirs. Of course, just as severe rates of income tax may lead taxpayers to refrain from exerting themselves to earn some additional income which would be heavily taxed, so severe rates of inheritance tax might lead people to avoid accumulations of wealth and to buy annuities.[17]

Admitting the possibility of adverse effects on the national income from excessive rates of

---

15

PUBLIC WELFARE EXPENDITURES 1937-9
(Exclusive of military pensions and after-care)
(Thousands of Dollars)

—	1937	1938	1939
Dominion	111,183	84,141	114,995
Provincial	88,724	84,569	82,986

* Appendix I., p. 37.

[16] It was stated in evidence (p. 9541) by the general manager of a large trust company, that it had been found necessary to advise clients to invest in only one province..

[17] In the case of both taxes some provision has had to be made against the abuse of gifts *inter vivos* and both the Federal Government and the provinces have imposed taxes on these gifts.

inheritance taxes, inheritance taxes in Canada still seem to afford some leeway before this point is reached. In Canada the rates of inheritance taxes, like the rates of income taxes, are light in the lower brackets in comparison with the levies imposed by other countries. For the ten-year period 1926-35, the yield of inheritance taxes per capita was annually from 1·8 to 3·8 times as large in Australia as in Canada, and from 2·1 to 5·2 times as large in New Zealand as in Canada. Nevertheless, if this reserve should be tapped by nine different jurisdictions there can be little doubt that the tendency would be to increase the inequities of double taxation, and to encourage tax evasion by various expedients. If this reserve is to be tapped, there can be no doubt that the most economical method of doing so, and the method least harmful to the national economy, is by the Dominion alone.

A further consideration is the probability—if our financial recommendations are not adopted—that the Dominion may be compelled to enter the inheritance tax field either to assist in meeting recurring deficits in current account, due so largely to financing unemployment relief, or to assist in financing emergencies such as war expenditures. Such a step might indeed be serious to the national economy, as well as to potential taxpayers. And, in any case, it would impair inheritance taxes as a source of provincial revenues.

Finally, inheritance taxes, like income taxes, require a fairly elaborate organization for their efficient collection. There is a certain practical convenience and perhaps less opportunity for evasion if both can be collected by the same authority. The returns which a taxpayer makes in his lifetime afford some help in checking the returns[18] which are made on his death and the converse of this proposition is equally true. The Dominion is probably in a better position than any single province to deter citizens of Canada from establishing domiciles outside Canada for the purpose of escaping from liability for Canadian inheritance taxes.

For the reasons set forth at length above, the Commission recommends that the provinces withdraw entirely from the inheritance tax field. Such a step is an essential part of the Financial Plan recommended by the Commission. But, in any case, the Commission is convinced that inheritance taxes are not a satisfactory source of provincial revenue, whether from the point of view of stability of revenues, or of the effects of the tax on the national economy. The Dominion would be a more efficient tax-gatherer than nine provincial jurisdictions in that it could collect the most revenue at any given rate with least injury to the taxpayer and least harm to the national income. If our financial recommendations are not adopted, and if the provinces still elect to retain inheritance taxes, we think that every effort should be made to work out a common inheritance tax program for all provinces, and to entrust collection to the Dominion which would redistribute on an agreed basis. This at least would have the merit of minimizing double taxation and the present tendencies of inheritance taxes towards immobilizing investment.

* * * *

Federal Administration of Inheritance Taxes.—It would be particularly important, if the Commission's recommendations are implemented, to provide for decentralized collection and to give local collectors adequate authority to clear estates promptly. Nothing could be more indefensible and irritating than prolonged negotiations, at a time of emotional strain and probable financial demands, with a distant authority over details which could be settled immediately by a man on the spot. Succession duty collection procedure consequently cannot be modelled after income tax procedure, where delays in final settlement due to special investigation or pressure of departmental work do not usually result in any hardship or inconvenience to the taxpayer. It must, of course, be recognized that special arrangements would have to be made in Quebec to conform to the differences between the Civil Code and the common law in such matters as the functions of executors and administrators, as to the principle of community of property between husband and wife, and as to laws of transmission. The framing of succession duty statutes involves important questions of equity and efficiency in taxation which are discussed in Chapter VIII of this Section.

[18] See Ex. 357, Brief of N.B., pp. 30-31; Ev. (N.S.), p. 3947.

4. Summary of Tax Recommendations

For reasons set forth in detail in the preceding divisions of this chapter the Commission recommends that the provinces should withdraw entirely from the following tax fields:—

(*a*) Income taxes (with an exception for premiums for social insurance within provincial jurisdiction);

(*b*) Corporation taxes as defined in detail above;

(*c*) Inheritance (or Succession Duty) taxes.

The Commission recommends further that a rebate should be made to the provinces of an amount equal to 10 per cent of all profits of mining (including oil development), and smelting and refining of native provincial mineral products.

The Commission's recommendations in these respects are based on two grounds. (1) The withdrawal of the provinces from these fields is an essential feature of its Financial Plan, since under this Plan the Dominion will assume all deadweight provincial debt, responsibility for unemployed employables, and new National Adjustment Grants to certain provinces. All provinces will, under these circumstances, receive an adequate *quid pro quo* for withdrawal from the tax fields specified. (2) The transfer of these tax sources to the Dominion and their use by a single jurisdiction is essential, both for reasons of equity as between provinces, and for assuring that these tax fields will be exploited with least harm to the national income.

In view of the general provisions of Plan I it is not necessary to consider the objection that some provincial governments would, in the case of any of these taxes, or all taken together, forgo more than others. Provincial governments are undoubtedly more interested in having adequate revenues to perform their functions than in taxes for their own sakes. Since such revenues as a whole are assured, and in the majority of cases far more definitely assured than could be done by any conceivable delegation of taxing powers,[19] the Commission's proposals cannot be criticized on the ground that some one of the transfers recommended, taken individually, will affect provinces unequally.

It must be recognized that any one of the Commission's proposals, taken alone, might work out in a very inequitable way. This introduces a final consideration, viz., the unfair, and in some cases intolerable, pressure on taxpayers in some provinces and on some provincial governments which would result if the Plan should not be implemented, and circumstances should force the Dominion to increase existing personal income taxes and corporation income taxes in competition with current, or possibly higher, provincial taxes, and probably to enter the inheritance tax field as well. This would not only produce double taxation of crushing proportions, but double taxation which would vary greatly as between provinces, entailing disadvantages to investment and free movement of individuals. It is important to note that under the present system, far from there being any security against this occurring, there is a strong tendency in this direction. It is only under some comprehensive arrangement such as that proposed in Plan I that the provincial governments now in the strongest position will be protected against continued encroachment on their revenue sources without compensating relief from responsibilities.

[19] The Governments of Ontario (Ev. p. 7621) and of British Columbia (Ev. p. 5080) said that if the Dominion abandoned the personal income tax field, they could (with, in the case of B.C., certain other adjustments) arrange their finances satisfactorily. Such a proposal would, of course, not only cripple Dominion finances and be a major blow to possibilities of reforming and modernizing Canadian taxation, but would also completely fail to meet the needs of the majority of the other provinces.

CHAPTER IV

DOMINION AND PROVINCIAL DEBTS

Governments come and go, and human memories are short, but the full history of every administration is preserved for the edification of future generations in the debt—or absence of debt—of each governmental unit.

Government debt was originally incurred either to make communal investment in public works of some form, or to meet emergencies and temporary deficits. In the former case the debt was usually expected to be self-supporting; in the latter to be liquidated quickly when normal conditions returned. So long as it was possible to maintain substantially this position governmental debts presented no particular problem. It was only when large investments in public works turned out to be neither directly nor indirectly self-supporting, and when funded deficits grew to such size that their amortization in a short period of time was not practical, that the problem of deadweight debt arose.[1]

For the purposes of our discussion we may classify government debts in three categories: self-supporting debts which pay their full interest and amortization charges directly; productive, but not directly self-supporting debts represented by tangible and useful assets which increase the productive power and taxable capacity of the economy, and are thus in fact indirectly self-supporting in whole or part; and deadweight debts representing deficits and bad investments for which no tangible or useful assets exist.[2]

The amount of directly self-supporting debt—whether very large or small—of any government is of little importance as far as public finance goes, although it may affect, to some degree, the distribution of income both as between classes and between regions. The importance of productive, but not directly self-supporting, debt will depend on the degree to which the debt is, in fact, indirectly self-supporting. What is of great importance, however, is the amount of deadweight debt, particularly if it is held outside the taxing jurisdiction of the debtor government. This can force a government into bankruptcy, or, less extremely, necessitate an undesirable curtailment of services in an effort to meet the fixed charges without excessive taxation. Few provincial governments are in a position to carry any substantial amount of deadweight debt; the Dominion Government, with its comprehensive tax basis and economic and financial powers is in much the best position to carry this burden advantageously.

It is generally the case that the provinces with the proportionately heavier deadweight debts—arising from unprofitable investments and deficits—are also the provinces in inferior economic positions, and the burden in such cases is doubly onerous. Many of the distortions of the corporation taxation system may be traced to the efforts of governments in this position to secure revenues to which they felt morally entitled but which they normally were not in a position to collect. The deadweight debt burden is also responsible for many of the great disparities in governmental services, with all their undesirable economic and social consequences, in different parts of Canada. And finally, the burden of deadweight debt, which is frequently singled out for political attack, is a constant menace to the credit of the government and the security of investors in its bonds.

It may be argued, however, that where deadweight debt represents extravagance and mismanagement, the electorate should pay for their failure to elect a more business-like government. But, whatever examples of extravagance may exist, only a very small portion of the total deadweight debt of Canadian governments can be charged to mismanagement. The great bulk of it has accumulated partly as a result of investments in transportation and other developmental facilities, which were generally considered sound and necessary at the time, and partly as a result of the unpredictable impacts of the World War, and later of the world depression, with all their attendant social costs. A substantial proportion may be attributed to the lack of effective co-ordination between Dominion and provincial governments in facing such major

[1] For growth of debt structure see Book I: Public Finance section in each chapter.

[2] It may be objected that the concept of deadweight debt is more appropriate to a commercial undertaking than to a government, since deadweight debt (unless due to such losses as embezzlement, for example) may be represented by intangible but nevertheless valuable social assets. For example, although relief debts have no offsetting assets in the balance sheet they were necessarily incurred to keep some of the population from starving, and to preserve the whole social framework; and the offsetting asset of war debts may be the country's independence. But for purposes of practical consideration, a specific classification, reducible to accounting terms, is necessary.

problems as unemployment and transportation. Only in extreme cases of extravagance and incompetence—which usually become notorious and are likely to be condemned in short order—can a largely uninformed and non-technical electorate be held responsible for having failed to check a fiscal policy which later turned out to be disastrous.

At Confederation the expediency was recognized of pooling in the hands of the Dominion the $70 million of largely non-self-supporting provincial debt resulting from railway and canal expenditures. Provincial deadweight debts did not again become a serious problem until the Western Provinces made relatively huge commitments for railway guarantees in the immediate pre-War boom. The Dominion, through the Canadian National Railways, in fact, although not formally, later assumed these guarantees, and saved some at least of the western governments from bankruptcy. During the depression provincial deadweight debts have again begun to mount rapidly as a result of reduced investment earnings, deficits on ordinary account, and relief expenditures. In the most serious case—that of Saskatchewan—the Dominion has already assumed a large part of the provincial debt created by relief, but, as is well known, the debt structure of some provinces demands immediate attention.

Such attention should not be regarded as being primarily an expedition to rescue bondholders, although the Commission does not have to apologize for recommending a solution which does not impose on a few groups of investors losses which arose from general and uncontrollable causes. The principle of national responsibility was recognized by implication when the Dominion made loans to the Western Provinces from 1931 to 1934 to meet maturing debt and interest obligations, and although this practice was subsequently discontinued, some may feel that a moral guarantee remains to purchasers of provincial bonds during this period. The primary purposes of the Commission's recommendation that the Dominion should assume the responsibility for servicing all non-self-supporting provincial debt are to put all provinces in a position to proceed with reasonable borrowing for productive purposes and to put the debt problem in the hands of the government which can most efficiently and advantageously handle it. Destruction of provincial credit not only damages investors (and through investors,—who include banks, trust companies, insurance companies, and other governments,—a major portion of the Canadian people in some form or other), but it directly hurts the residents of the province itself and prevents financing of desirable development on favourable terms, and borrowing to meet some sudden need on anything but ruinous terms. Canada should try to avoid the vicious cycle of high interest rates because of frequent defaults, and frequent defaults because of high interest rates, which has burdened the people of many central European and Latin-American agricultural areas and blocked any improvement in their standards of living.

It has frequently been suggested that the particular difficulties of the Western Provinces be recognized by cancelling their debts to the Dominion. Quite apart from the general considerations of the Commission's Plan I, which applies the same principles to all provinces alike, it would not be just and equitable to single out the Western Provinces, or some of the Western Provinces, for special treatment because deadweight debt has increased more, and more rapidly, there in recent years than in other provinces. In fact, persistent difficulties, reflected in chronic deficits and a long, slow accumulation of deadweight debt may be much more serious, and bear with much greater pressure on provincial residents, both as recipients of services and taxpayers.

A special feature of Canadian governmental debts is the high proportion payable in foreign currencies. These debts were contracted when maintenance of the gold standard was taken for granted, and only fractional foreign exchange rate fluctuations were anticipated. The possibilities of wide variations in the exchange rate due to external and uncontrollable forces, and deliberate variations to facilitate economic adjustment and to redistribute burdens and income internally were not appreciated. Within the last decade, however, exchange rate control has become a recognized and almost respectable weapon in every nation's arsenal of economic policies. It has also become apparent that if this weapon is to be used effectively it must be in the hands of one body, and that all commitments in foreign currencies, by governments or individuals, must be subject to the control of that body.

Only one-half the total provincial debt, and 60 per cent of the total Dominion and Canadian National Railways debt, are payable exclusively in Canadian currency. The potential exchange burden on interest payments in foreign currencies of some $115 million a year, and of maturities averaging about half this amount,[3] for Dominion and

[3] See Book III and Appendix I.

provincial governments alone, is a major item. It is also one which is completely uncontrollable by the provinces (in so far as past commitments are concerned), and one which can now scarcely be held to be primarily a provincial responsibility since the Dominion has accepted full responsibility for exchange policy. Under the Commission's recommendations, the Dominion would meet any additional payments which might arise from exchange rate fluctuations since the Dominion will pay the total debt charges, including any exchange premium, on all provincial debts. (The amounts which the provinces will turn over to the Dominion, representing the interest on their self-supporting debts, is of course a fixed sum in Canadian currency.)

It would be clearly undesirable to relieve provincial governments of their existing debt burdens, and leave conditions which would necessitate or encourage renewed borrowing of a deadweight character and a repetition of the present situation within a short period of time. The Commission's proposals for adjustment and emergency grants in Plan I are designed to avoid the necessity of provincial borrowing to meet chronic deficits or sudden disasters in the future. It is recommended that borrowings for developmental purposes, or productive public works, may either be made directly, on the sole credit of the province, with the one restriction that principal and interest must be payable only in lawful money of Canada, or they may be made through the Finance Commission, after its approval has been secured. In the first case, if a province chooses to borrow directly on its own credit, the service on the loan must be met entirely by the province, and will be excluded in calculations for adjustment grants. If the loan proves self-supporting (directly or indirectly) this will not, of course, concern the province; if the loan should fail to prove self-supporting the province will have to impose somewhat heavier taxation, or make somewhat greater reductions in its other expenditures. In the alternative case, if a province submits its loan proposal to the Finance Commission, and secures the approval of that body, it would be equally unaffected if the loan proved self-supporting. But if the loan shoul fail to be self-supporting, the province would be able to include the charges of the loan should it be entitled to present a claim for an increase in its National Adjustment Grant (or for a grant in case it should not then be receiving one).

A special situation exists in Quebec where the Provincial Government has assisted the financing of certain hospitals and other charitable institutions by granting subsidies, which are deposited with a trustee, for the specific purpose of paying interest and amortization charges on the institution's funded debt. In other provinces where similar assistance has been given, the debt has either been directly assumed or directly guaranteed by the provincial government. The amount which the Province of Quebec has contracted to pay under this arrangement was $15,786,000 as at June 30, 1938. It is not proposed to disturb the present contractual arrangements between the holders of these institutional bonds, the trustees, and the Provincial Government, but in order to put the Province of Quebec in exactly the same position it would be in if these bonds had been directly guaranteed by the Provincial Government, and so on a comparable basis with those of other provinces, the subsidies paid have been included in the calculation of the National Adjustment Grant recommended. The financial results to the Province and to the Dominion are thus exactly the same as they would be if the service charges were transferred to the Dominion—i.e., the National Adjustment Grant would be reduced by whatever amount of debt service was transferred.

It is clear that the Commission's proposals throw a substantial burden on the Dominion. Not only will all existing non-self-supporting debt be assumed by the Federal Government, but it would appear likely that future increases will tend to become Dominion liabilities. This is the Commission's deliberate intention, since there is ample evidence to establish that the Dominion, and only the Dominion, can and should bear the fixed deadweight charges which have arisen from unproductive developmental policies and from depression expenditures largely beyond the control of the individual provinces. There are also positive advantages arising from consolidation and unified management of Dominion and provincial debts. Substantial savings would be achieved, at least relatively, over a period of time by refunding. The most advantageous distribution of maturities and timing of new issues would be possible. Debt management would be in the hands of the government responsible for monetary and exchange policy. As this is also the government which would be responsible for unemployment relief and for dealing with major emergencies such as war, effective co-ordination of all these policies could be achieved.

CHAPTER V

NATIONAL ADJUSTMENT GRANTS

The Commission's recommendations for payment of National Adjustment Grants, and for provision of a body to advise on future adjustment grants and emergency grants, are of major importance for several reasons. They are a complete break from the traditional subsidy system and the principles ostensibly underlying it. They make provision for the Commission's recommendations (other than those for the relief of unemployed employables) on the major subjects of public welfare, education, and provincial developmental and conservation expenditures. They illustrate the Commission's conviction that provincial autonomy in these fields must be respected and strengthened, and that the only true independence is financial security. They meet a number of provincial grievances and claims, raised under other heads. They are designed to make it possible for every province to provide for its people services of average Canadian standards and they will thus alleviate distress and shameful conditions which now weaken national unity and handicap many Canadians. They are the concrete expression of the Commission's conception of a federal system which will both preserve a healthy local autonomy and build a stronger and more united nation.

The proposed method of operation has been outlined in the description of Plan I.[1] Joint provincial-municipal expenditures on public welfare and education have been taken on a per capita base for every province, and, after adjustment in some cases for costs of living and other local circumstances, have been compared with the national average.[2] In addition, the annual average of total current highway, agriculture, and public domain expenditures by each province for the years 1928 to 1931 was taken as the most satisfactory estimate available of "normal" developmental expenditures in that province. (An exception had to be made for the Prairie Provinces, since control of their resources was not transferred to them until 1930, and in their cases, only highway expenditures were taken.) The base period chosen is the most favourable one, from the point of view of the provinces, that could be selected, but the Commission does not consider it excessively generous in view of the expanding nature of highway expenditures, and the evident need for developmental and conservation expenditures in many instances. The proportion of total provincial and municipal taxation to the total income of each province (considering only those taxes which would remain with the provinces under the terms of the Commission's tax recommendations in Plan I) has been compared with the national average. In the subsequent calculations less weight has been given the taxation comparison, which could not be as satisfactorily determined as the education, welfare, and developmental expenditure comparisons, but the taxation comparison was introduced so that no province would be penalized for having provided superior services if it had done so by having taxed its residents with more than average severity, and so that no province would receive a payment to enable it to improve inferior services if it had chosen to have inferior services in order to tax its residents less severely than the average. The only exception to this general method was in the case of Quebec where the notable work of the Church in the fields of education and public welfare could neither be ignored nor measured in monetary terms. Consequently, in the case of Quebec it was necessary to make the arbitrary assumption that the contribution of the Church brought education and welfare service standards up to the national average.

The Commission has for this purpose developed a series of public finance and provincial income statistics in which every effort has been made to secure real comparability, but it is keenly aware of the crudeness of the techniques and the approximate nature of the statistics on which it has had to rely. However, in spite of the margin of error necessarily present, the Commission believes that its estimates furnish a satisfactory working base until more refined statistics are developed. It is the Commission's hope that the Finance Commission (or in the event of the Commission's recommendations not being implemented, some other

[1] See p. 83.

[2] The national average excludes, for reasons to be noted, the Province of Quebec.

appropriate body) will develop and improve this material, which is basic to any serious consideration of public finance in general and Dominion-provincial relations in particular.

The purpose of the National Adjustment Grants to be paid by the Dominion to the provincial governments is then, in brief, to provide for balanced provincial budgets after provision for expansion of education and welfare services to the national average where these services are below it, and expansion of developmental expenditures to the 1928-31 averages of the individual provinces. This is, of course, a radical departure from the existing system of statutory subsidies, supplemented by special subsidies and conditional subsidies. The statutory subsidy system was not, however, so dissimilar in its origin. As we have discussed in Book I,[3] and as noted in the studies made for the Commission[4] the original subsidies were frankly adopted as expedients to make Confederation possible. After functions and taxation powers were allocated to the new Dominion and provincial governments it was clear that the remaining provincial and municipal revenues would be insufficient to support the remaining provincial and municipal expenditures. Reluctantly, for there was strong feeling against one government raising money to be transferred to and spent by another government, it was agreed to meet the difference by Dominion subsidies. Considering the undeveloped state of the taxation system and the nature of the economy of the time, there appeared to be no practical alternative. But although the subsidies were thus initially determined by the calculated fiscal need of the provincial governments, great efforts were made to freeze them in perpetuity at the 1867 amounts, and to this end elaborate formulae were devised to fit the amounts and to give the appearance of equality of treatment. Even at that time statistical equality of treatment did not produce real equality, but the more self-sufficient nature of the economy, and the much smaller scale of public finance as compared with today made the differences of little importance. Neither the growth in governmental responsibilities nor the great regional shifts in taxable incomes which occurred in the next seventy years could have then been foreseen.

As we have recounted at length in Book I it proved impossible, almost from the very beginning, to keep the subsidies at the 1867 level. The fiscal need of some provincial governments made increases necessary, but the increase had always to be justified by some ingenious interpretation of the accepted formula. This led to political bargaining and devious legalistic argument, and failed to meet the necessities of the situation. The provinces were driven to uneconomic taxation methods, and increasing differentials developed in the services which they supplied. With the entrance of new provinces, and the establishment of arbitrary "lump sum" subsidies, and debt allowances and per capita subsidies based on fictitious population figures, the last shreds of logic of the old system vanished. Nevertheless the form was clung to, although the rapid development of the economy and growing disparities in the distribution of taxable income, and the increasing post-War demands on governments made it necessary to supplement the statutory subsidies with a growing number of special subsidies. These in fact departed completely from the theoretical principles of equal treatment, but introduced no new principles and objective scientific criteria in their place.

Experiments were made with the conditional subsidy technique. It first seemed to be a happy compromise, and an escape from the strait jacket of the obsolete statutory subsidy formulae. Assistance could be given where necessary, and administration left in provincial hands, but, as a safeguard against abuses and irresponsible expenditure, the Dominion could enforce compliance with specific conditions and uniform national standards. However, the flaws in the system became clearly apparent when, under the pressure of expanding social service demands and depression conditions in the thirties, the transfers involved grew to huge proportions.[5] A system which might work well, even in a federation, on a limited scale and for certain specific and clearly defined objectives, broke down completely as a means of financing a large proportion of provincial functions. By 1937 the statutory subsidies, special subsidies, and conditional subsidies were nearly half the total of provincial revenues from their own sources. The Dominion in respect to conditional

[3] Book I, Chap. I.

[4] Appendix 2—D. G. Creighton: *British North America at Confederation,* and Eggleston and Kraft, *Provincial Subsidies and Grants* (mimeographed), p. 1*ff.*

[5]

PROVINCIAL SUBSIDIES, 1937

	$ millions
Statutory subsidies	14
Special grants	7
Conditional grants	82
Total	103
Provincial revenues from own sources	226
Grand Total	329

subsidies had to impose either such rigid and detailed conditions (often unsuitable to local conditions), involving such minute inspection and regulation as to be a major infringement on provincial autonomy and practical only in a unitary state, or general conditions which were only nominally observed and no real check on any irresponsible expenditure. The latter proved to be the general, and almost inevitable practice.[6] Even limited efforts at effective regulation of the expenditure of conditional subsidies led to bitter Dominion-provincial fights. But acceptance by the Dominion of the role of a rubber stamp opened the way to waste of public funds, incapacity to deal with national problems on a national scale, and lack of enforcement of national standards where these were appropriate. These weaknesses and abuses were all the more vicious because the pretence was preserved that the subsidies were "conditional", and that violation of the conditions would lead to their suspension of grants. That this was an empty threat, everyone knew. Since such major expenditures as old age pensions and unemployment relief, affecting such a large proportion of the population, have come to be financed by conditional grants, it is neither humane nor politically possible to suspend them. Constant bickering can, and does, go on, and the more flagrant abuses may be corrected as the result of persistent criticism, but the provincial authorities know that in the final analysis the subsidies will be paid.

There are many fields in which the conditional subsidy may be highly useful. Where the amounts involved are not large; where technical criteria for objective and scientific measurement exist; where administration is in the hands of a professional personnel; and where it is in the national interest to stimulate some otherwise lagging local activity, the conditional subsidy may be an appropriate and efficient instrument. In a unitary state, of course, its scope of usefulness would be much greater, since the question of infringing local autonomy (if the conditions are to be enforced) does not arise, or at least does not arise to the same extent. But as a method of financing major functions of government and of providing for necessary inter-governmental transfers in a federal state, it fails to meet the test of efficiency, and dissipates seriously responsibility for public expenditures.

It is for these reasons that the Commission recommends National Adjustment Grants, as outlined above, to balance provincial budgets and to provide for maintenance of average standards. The principle is basically the same as that underlying the Confederation settlement, but the major changes which have occurred since Confederation in the relative taxable capacity and governmental responsibilities of the different provinces make it necessary to discard the assumption that equal per capita payments would provide for real equality of fiscal positions. This assumption has, in fact, long been discarded, and it has been the Commission's effort to replace the obsolete formula, and the *ad hoc* makeshifts which have grown up about it, with a system based as far as possible on ascertainable facts and real equality of treatment.

As explained in the outline of Plan I, no conditions are attached to the National Adjustment Grants. They are given when a province cannot supply average standards of certain specified services without greater than average taxation, but the province is free to determine on what services the grants will be spent, or whether they will be used not to improve services but to reduce provincial (and municipal) taxation. It may be assumed that there will be strong public pressure to improve those services which are below the Canadian average once the necessary funds are available, but it is the Commission's view that the extent to which this is done and the methods by which it is done (i.e., either by direct provincial expenditures or by subsidies to municipalities) can best be determined by the provincial electors and their representatives. The Commission's recommendation for Dominion assumption of relief for unemployed employables will abolish the conditional subsidy in connection with which there have been the most serious abuses and inefficiency. It is recommended, however, that the old age pension system be left undisturbed; the Commission recognizes that the contribution to which the Dominion Government has already committed itself for a primarily provincial responsibility is justified by various national, fiscal, and practical considerations. And the Commission would not consider the future introduction of conditional subsidies for certain limited and clearly specified purposes in other fields objectionable, although it is believed that the provision of National Adjustment Grants will remove much of the pressure for these arising from fiscal need. But in its recommendation for National Adjustment Grants the Commission has deliberately abstained from suggesting that the

[6] Appendix 7—J. A. Corry, ***Difficulties of Divided Jurisdiction***, pp. 28*ff*, *Cf.* Book I, Chap. IX.

grants should be made on conditions which would either violate provincial autonomy in these important services, or simply be a sham.

"YARDSTICKS"

It is necessary to say something of the services which have been selected as a yardstick for determining the adjustment grants. These services represent (1937 basis) three-quarters of the total provincial expenditures which will remain if Plan I is implemented, and slightly more than half the combined provincial-municipal expenditures.

Education and Welfare Services on the Canadian average.—The quality of education and welfare services is no longer a matter of purely provincial and local concern. In Canada today, freedom of movement and equality of opportunity are more important than ever before, and these depend in part on the maintenance of at least minimum national standards for education, public health and care of the indigent. The most economically-distressed areas are the ones least capable of supporting these services, and yet are also the ones in which the needs are likely to be greatest. Whether the remedy lies in emigration from these areas or in the development of alternative means of livelihood, they must not be allowed to become backwaters of illiteracy and disease. Not only national duty and decency, if Canada is to be a nation at all, but equity and national self-interest demand that the residents of these areas be given average services and equal opportunities,—equity because these areas may have been impoverished by the national economic policies which enriched other areas, and which were adopted in the general interest. Those whose interests were sacrificed have some claim that the partnership should work both ways. National self-interest demands it because the existence of areas of inferior educational and public health standards affects the whole population, and creates many grave and dangerous problems. In the modern age these areas be given average services and equal wished, and constant contact and intermingling of the population between favoured and unfavoured regions is bound to occur. The more fortunate areas cannot escape the pressure on their standards and the effect on their people; in this case prevention, in both fiscal and human terms, is much cheaper than the cure.

It will be clear from the discussion in the Social Service Chapter[7] why the Commission has dealt with the problem of relief for unemployed employables in quite a different way. The allocation of jurisdiction to the Dominion in that case, and the affirmation of provincial jurisdiction and the financial strengthening of provincial autonomy through the National Adjustment Grant mechanism in all the remaining fields of social services is a logical division of responsibility based on reasoned principles. At the risk of some repetition of the argument in the foregoing section on Social Services it is desirable to recapitulate the reasons for the Commission's recommendation on the responsibility for unemployment relief. By contrasting the proposed methods the fundamental difference in the nature of the problems concerned can best be illustrated. It will then be clear why the Commission does not believe that the first method—transfer of jurisdiction to the Dominion—would be desirable in the case of most social services, nor that the second method—provision of adequate funds for provincial administration by National Adjustment Grants—would be a desirable way of handling relief for unemployed employables.

The principles guiding the Commission's recommendations are that the recognized needs of those who are incapable of supporting themselves should be a local (i.e., municipal and provincial) responsibility, and that the needs of those who are able to support themselves but lack the opportunity should be a federal responsibility.

The indigent has traditionally been pictured as an unfortunate, of local origin, who is physically or mentally incapable of earning his livelihood. His care has traditionally been a local responsibility, and there are strong arguments to support this allocation of responsibility wherever it is practicable. The community (and the regional area) presumably develop a greater sense of kindred responsibility and neighbourhood spirit than is possible in the national unit; local knowledge and local administration can determine real needs more accurately, establish appropriate standards more fairly, and supervise more economically than can a centralized and distant bureaucracy, and at the same time, be more humane and helpful to the recipient.

But the growth of agricultural and industrial specialization, and of a highly geared and powerful, but highly sensitive and vulnerable economic mechanism introduced new factors. Large numbers of able-bodied workers and farmers were, under the new order of things, periodically threatened with complete destitution. In Canada, the preliminary ripples of 1913 and 1921 gave no warning of the tidal wave of 1930-36. When this struck it hit an economy which, because of a series of fortuitous coincidences, had never suffered a major depression or been faced with the need for a major economic

[7] See Sect. A, Chap. I.

adjustment since it became of age. And it is not surprising that the public finance structure was equally unprepared for the deluge.

The areas in which destitution and the need for relief grew most alarmingly were also the areas in which local revenues and credit fell most abruptly; the traditional local responsibility for relief of destitution broke down almost overnight.[8] Nevertheless, an attempt was made to preserve the façade of the old structure, and huge inter-governmental loans and grants were made for this purpose in a manner which quickly undermined the financial independence of the provinces (which is fundamental to the federal system) and which made a mockery of responsibility in public finance. In one form or another this method of financing relief has been continued on a shifting, *ad hoc*, and always temporary basis.

The traditional technique of poor relief is quite inadequate for coping with the modern problems of mass unemployment and mass agricultural destitution in Canada.

The causes of these problems are in no sense local; they lie in national and international trade cycles, and, to some extent, in climatic cycles. The burdens resulting from these problems never fall with equal incidence on the different provinces; and they are subject to extreme and erratic fluctuations. Both problems call for constructive remedial policies rather than for provision of a mere subsistence for their victims, and remedial policies involve the use and co-ordination of all the weapons in the national armoury—monetary and exchange policy, national taxation and deficit financing, trade and tariff policy. It is for these reasons, in addition to the proven incapacity of municipal and provincial units to bear the financial burden, that the Commission recommends the assumption by the Federal Government of relief for unemployed employables, and relief to a primary industry in general when this burden exceeds the financial capacity of the province concerned.

Developmental and Conservation Services.—The provision for including development and conservation expenditures (provincial highway maintenance, agriculture and public domain) as part of the needs of the provinces has already been described. In a general way the revenue sources remaining to the provinces (together with the National Adjustment Grants in those provinces which receive them) should enable every province to finance a normal developmental program (on the 1928-31 average) including maintenance of the productivity of its natural resources. Separate provision has been made to cover the case of depletion of resources the productivity of which cannot possibly be maintained. As has already been explained it is recommended that the Dominion should pay over to the provincial government concerned mining and oil company taxes equal to 10 per cent of the profits made from exploitation of provincial resources. This would give the provinces a substantially larger revenue than they now receive from corporation taxes of these companies and should enable them (if they so choose) to create new assets, perhaps in the nature of development works, which would offset the depletion and so maintain the general productivity of the provincial economy.

Every province is naturally interested in securing the highest standard of living and the greatest possible measure of economic security for its residents. While the main economic policies of the nation are determined by the Dominion Government, much remains to be done to see that the most advantageous use is made of the province's resources within this framework. There are many cases where community action is more effective than individual action to this end, and it has become a recognized function of provincial governments on occasion to provide facilities such as highways and railways, public utility services, dams and reservoirs to regulate rivers, soil, mineral and forest surveys, which will open up frontier territories and facilitate the development of resources; to protect and conserve resources by forest fire services, cutting restrictions, reforestation protecting game; to develop improved methods applicable to local industries and furnish them with scientific and technical assistance; to battle insect pests and animal and plant diseases; to nurse infant industries and depressed areas; to assist desirable transfers of population and industry—all with a view to strengthening the provincial economy. Some of these services can best be carried out in co-operation with other provinces and by uniform methods, but most of them must be adapted to the special local circumstances and be locally administered. Frequently the objectives are more than economic, and the developmental policies followed will reflect the prevailing political and social philosophy of the particular province. One may favour public ownership, and another development by private capital; one may put

[8] For further discussion see p. 18*ff*.

security and stability first, and another the goal of maximizing the income; one may adopt a laissez-faire attitude in relation to its industries and another a large measure of government planning, assistance and regulation. These are additional reasons why the Commission has adopted a yardstick based on immediate past policy, under generally favourable conditions, rather than any theoretical formula, as an appropriate measure of "normal" developmental expenditures. Resources, needs, and philosophies change, and this measure can only be a temporary one. It is proposed as such, but as one that affords a practical working basis for the present.

The possible benefits from well-administered (and adequately-financed) provincial developmental services are many and large, and affect every resident in the province. It is encouraging to note the recent trend[9] to establish competent professional boards to study provincial economies and consider developmental policies as a whole, rather than to proceed with a number of completely independent projects of widely varying value which may be in direct conflict. An important portion of provincial (and Dominion) deadweight debt is the result of unco-ordinated and ill-considered projects of the latter type.

The Commission has adopted a generous basis for calculation of the adjustment grants, and a generous formula, in its mining tax apportionment proposal partly to make possible more adequate conservation measures. It was brought home clearly in both the evidence submitted in the Commission's hearings,[10] and by the work of the Commission's research staff, that conservation work in general has been seriously neglected, and that far too little attention has been paid to developing the most economic methods of exploiting Canadian resources. Investment in this work is one of the most profitable which Canadian governments can make. There are resources, of course, which cannot be restored or maintained, and there are others which could only be maintained at excessive cost. But the great proportion of our forest resources, our soil resources, our fish and game, can be maintained and improved to the great advantage of the country for generations to come with the use of foresight and a very modest investment.

The problem of exhaustible resources is no less important. Their exploitation should be as efficiently carried out as modern science permits; the rate of exhaustion should be determined by the broadest economic and social considerations, and not solely by the immediate profits of the private producer concerned; in preparation for the day when the last ore-truck trundles out and the last pump stops working, every alternative means of livelihood for the dependent population should be surveyed and developed; and provision must be made in the days of high profits for the amortization of public expenditures on roads, schools, utilities, and other works which will no longer be needed, and for the welfare costs which inevitably accompany such serious adjustments.

---

[9] The following provinces have recently established temporary or permanent economic advisory councils: Nova Scotia; New Brunswick; Quebec, Manitoba; British Columbia.

[10] *E.g.*, Brief of B.C., p. 36*ff*; Ex. 236, Edmonton Chamber of Commerce, p. 21; Ex. 387, Federation of Ontario Naturalists.

CHAPTER VI

PLAN II

The Commission has recommended that the Dominion should assume full responsibility for unemployed employables (and in certain eventualities, of relief to primary industries), and that the necessary jurisdictional changes should be made to enable the Dominion to fulfil this responsibility. It is desirable to examine whether this change would sufficiently relieve the provinces and municipalities of their financial difficulties without the transfer of tax revenues and debt burdens and the provision of adjustment grants as recommended in Plan I. For convenience this simpler arrangement may be styled Plan II. That is to say, Plan II is simply a continuation of the present system of financial arrangements between the Dominion and the provinces with the exception of the Dominion assumption of responsibility for the case of unemployed employables. Many variants to this proposal might be suggested, and some of them will be discussed later.

It is clear that the National Employment Commission, although strongly supporting (with the exception of Commissioner Sutherland) the transfer of responsibility for unemployment to the Dominion, felt that such action must be conditional on some type of compensatory financial adjustments. Mr. Purvis, the Chairman of the National Employment Commission, said in his letter of transmittal of January 26, 1938, to the Minister of Labour:—

> "As requested by you, the Commission has given consideration to the fact that the Royal Commission on Dominion-Provincial Relations is investigating certain questions which have also come within the purview of the National Employment Commission. For this reason the Commission has indicated in its Report where certain action would, in its view, be contingent upon such financial adjustments as may emerge from the Report of the Royal Commission on Dominion-Provincial Relations."[1]

The point is made more specifically in the National Employment Commission's recommendations on the appropriate allocation of jurisdiction and responsibility:—

> "The Commission recognizes that the approval of the Provinces to certain constitutional changes required in connection with the introduction of a nationally administered system of Unemployment Insurance and Employment Service has already been invited by the Dominion Government and that the Royal Commission on Dominion-Provincial Relations will presumably take into account any change in financial obligations involved in this step. This Commission also recognizes that the establishment of a national system of Unemployment Insurance would necessitate a supplementary system of Unemployment Aid to meet those phases of unemployment need which experience abroad has shown cannot be covered by Unemployment Insurance. Such a supplementary system of Unemployment Aid would, in its opinion and for reasons stated later, be best administered by the Dominion. This further step would necessitate determination by the Royal Commission on Dominion-Provincial Relations of the financial basis on which such a system should be established, and in the light of all relevant considerations, of the wisdom of further constitutional and financial changes. The National Employment Commission does not consider it to be within its competence to express an opinion on these changes, other than to record its considered judgment that if financial and constitutional considerations should permit, the co-ordination of a nationally administered system of Unemployment Insurance and Employment Offices, buttressed by a similarly administered system of Unemployment Aid, would have decisive advantages over the present system in coping with problems of employment and unemployment."[2]

In spite of the National Employment Commission's reservations, there has been some expression of opinion that the immediate assumption of unemployment relief responsibility by the Dominion both would be advantageous in itself, and, by lightening the burden on provincial and municipal governments, would satisfactorily solve the outstanding problems of public finance and Dominion-provincial relations. The reasons for the transfer of the responsibility of unemployment have been discussed at length. The problem which concerns this Commission is whether it would be practical to transfer the responsibility for unemployment alone, or whether the transfer of the liability must be combined with the other financial adjustments and reforms recommended by the Commission in Plan I to achieve the major benefits and economies which are expected and possible.

It should be said immediately that this Commission is convinced that the only satisfactory

[1] *Final Report of the National Employment Commission* (1938), p. 2.

[2] P. 28.

approach is along the lines proposed in Plan I, and that palliatives which would merely produce a temporary and superficial equilibrium would, at this stage in Canada's public finances, be short-sighted because in the long run they would invite disaster. Nevertheless, as Plan II (i.e., transfer of relief for unemployed employables) provides a larger immediate gain for some provincial and municipal governments than Plan I, and balances most provincial budgets and provides some with large surpluses, it requires careful examination. This examination will reveal that the advantages to a few governments which appear at first glance

The immediate gain to combined provincial and municipal budgets from Plan II is substantially greater than from Plan I in the case of Ontario, appreciably greater in the case of British Columbia, and slightly greater in the case of Manitoba. It is greater in Alberta if we assume continuation of current interest payments, but less by a somewhat larger amount if we assume full interest payments. This comparison is based, of course, on the assumption that existing provincial and municipal revenue structures are maintained. The gains to the provincial and municipal governments shown in Plan I, however, are calculated

PROVINCIAL AND MUNICIPAL RELIEF EXPENDITURES ON UNEMPLOYED EMPLOYABLES, 1937

—	Provincial		Municipal		Total	
	Current Account	Relief Works Charged to Capital Account	Current Account	Relief Works Charged to Capital Account	Current Account	Relief Works Charged to Capital Account
	$000	$000	$000	$000	$000	$000
Prince Edward Island	21	288	30	34	51	322
Nova Scotia	236	1,173	172	69	408	1,242
New Brunswick	28	614	74	15	102	629
Quebec	11,454	1,386	7,829	—	19,283	1,386
Ontario	8,347	5,252	5,209	100	13,556	5,352
Manitoba	2,584	320	2,050	407	4,634	727
Saskatchewan	9,776	—	500	—	10,276	—
Alberta	1,540	460	995	97	2,535	557
British Columbia	3,408	1,335	749	11	4,157	1,346
	37,394	10,828	17,608	733	55,002	11,561

Total Cost to Dominion after adjustments to common basis as shown in Table 30, Book III, $48,523,000.

to exist do not in fact exist, and that Plan II will not pass the tests of equity in taxation and efficiency in government which Plan I has been designed to meet.

The immediate effect of Plan II on provincial and municipal budgets can be shown very simply, for the only change involved is the reduction of expenditures by the amount of relief to employables. The savings to combined provincial and municipal current account budgets from this, and the savings on capital account resulting from the elimination of relief works are estimated for the year 1937[4] in the above table.

[4] For details of the effect of Plan II in other years (1926, 1930, 1933, 1936-39), see Book III. The effects of Plan I for the same years are also set out in Book III, but direct comparisons are not possible for the reasons given in the text.

after the removal of provincial (and municipal) income, corporation, and inheritance taxes. Where these taxes are above the average, the gain to the provincial and municipal government under Plan II, as shown above, is at the expense of the provincial taxpayer. For example, British Columbia provincial and municipal governments would gain (1937 basis) $4,157,000, and would then have a net combined surplus on current account of $3,237,000—but only on the assumption that provincial and municipal taxpayers in British Columbia continued to pay much more than the national average of provincial taxation in relation to their income—in 1937, $5,914,000 more. In other words, the governmental gains to provinces and municipalities shown in the foregoing table are not comparable with the gains shown under Plan I as a measure of benefit to provincial taxpayers, even before consideration is given to the increased Dominion taxes which Plan II would require.

With regard to Provincial budgets alone, Plan II (using 1936-39 averages as in the case of Plan I, and assuming maintenance of existing taxation) would provide Ontario with a large surplus, and Manitoba, Alberta, and British Columbia with appreciable surpluses.[5] The Maritime Provinces, Quebec and Saskatchewan would be left either in deficit, or with much smaller surpluses than provided in Plan I for expansion of services and reduction of taxation.

On analysis, however, the apparent advantages of Plan II to four provinces prove illusory. In the case of Plan I, the increased burden on the Dominion is offset in some measure by revenue sources transferred to it. Plan II provides for no such revenue transfer, and the increased burden on the Dominion would have to be met in its entirety by increased Dominion taxes, in competition with existing provincial taxes. (This would be modified to the extent to which provincial governments—notably Ontario—which were provided with substantial surpluses by Plan II might reduce taxation.) The net cost of Plan II to the Dominion (1937 basis) would be some $13 million a year greater than the net cost of Plan I, and this additional amount would have to be raised either by increasing already excessive indirect taxation, or by further invasion of direct taxation fields now occupied by the provinces. The effect of this on the economy as a whole, and also on some of the provinces which might appear to get greater benefits from Plan II than from Plan I, could be little short of disastrous. Ontario and British Columbia are, of course, the outstanding examples of the provinces whose governments would appear to gain, but whose residents would have to meet the major share of the increased Dominion taxation in addition to continuing to bear existing provincial and municipal taxation (although possibly at reduced rates). The Governments of Saskatchewan, Quebec, and the Maritimes would all gain less from Plan II than from Plan I, and in addition, their taxpayers, in common with all other Dominion taxpayers, would have to pay more. Of these, the taxpayers of Quebec would be the ones chiefly affected by the necessary increases in Dominion taxation.

To summarize, then, some provinces would appear to gain more under Plan II than under Plan I only if we ignore, in some cases, the heavier than average provincial taxation which their residents would have to continue to pay, and, in all cases, the increased Dominion taxes (with little likelihood of any offsetting removal of provincial taxes) which would have to be paid. The exact credit or debit balance of the residents of each province cannot be calculated, since we do not know to what forms and rates of taxation the Dominion would turn, and what the final incidence of these levies would be. But we do know that the increased taxation would have to come largely from the higher income areas and especially from the residents of the two provinces—Ontario and British Columbia—which at first glance appear to gain greater advantages from Plan II than from Plan I. Thus, although Plan II promises somewhat greater advantages to the *governments* of some provinces than does Plan I, it does not benefit the *residents* of those provinces equally with Plan I.

But of far greater importance than the gains or losses to any given province as between the two Plans (which cannot, in practice, be estimated precisely) are the differences in the probable effects of the two Plans upon the economy as a whole, on the national income, and on the future financial stability and independence of Canadian governments. The gains to provincial and local governments under Plan II can be shown in dollars and cents, but the cost of the Plan to Dominion and provincial taxpayers (who are the same individuals) cannot be measured. Nor can the more important but less tangible benefits to the national income inherent in Plan I be contrasted in statistical terms with the increased pressure on the national income which would be produced by Plan II. But it can scarcely be over-emphasized that these comparisons are basic, and should be decisive, and that the limited comparisons possible in statistical terms are, in themselves, misleading.

Plan I, as we have noted, is designed to stimulate the national income by making possible major taxation reforms which will shift burdens from business costs, marginal enterprises, and sub-par standards of living, to surpluses. Further, Plan I would make it possible to establish uniform and greatly simplified taxation schedules throughout Canada, removing obstacles to the free movement of capital and people. Plan I concentrates debt management and responsibility in one authority—the one with the widest credit base and the one in control of related powers. Plan I provides for

[5] See Book III, Table 55.

average Canadian standards of education and welfare, and generous developmental expenditures in every province, through National Adjustment Grants. And perhaps most important of all, Plan I makes possible the co-ordination of taxation, borrowing (or debt redemption), and expenditure policies throughout the business cycle with monetary and exchange, trade and tariff, industrial and employment policies.

Plan II promises none of these advantages. On the contrary, it would of necessity intensify the evils of the existing competitive scramble for revenues. It would lead to increasing friction between governmental units, increasing double taxation, increasing arbitrary, discriminatory, and confiscatory tax levies, increasing costs of tax compliance, increasing disparities in taxation burdens and government services between regions, and increasing disparities between burdens on and opportunities open to individuals. Plan II makes no provision for either direct or indirect economies in debt service, tax compliance, and tax administration costs, as does Plan I. Nor does Plan II provide facilities for co-ordinating the general public finance policy of the country with major economic policies in order to smooth the business cycle, promote recovery, aid depressed industries and areas, and generally strengthen the national economy. On the contrary Plan II would tend to increase the confusion and conflict between Dominion and provincial policies, and the sterility of policy, which now depress the Canadian national income. All these advantages of Plan I over Plan II apply with even greater force in the event of national emergency (e.g., war) which would force the Dominion to increase taxation in competition with existing provincial taxation,—conditions which without changes as recommended in Plan I will make impossible any major taxation reforms.

Our analysis in Book I shows that in the past financial "transfers"—in the wide sense of this term which covers all methods by which the people in one area are enriched, or freed from their obligations, at the expense of the people in other areas—have occurred at all levels of government. They have resulted from political pressures, confiscatory actions, sectional bankruptcies, favours and protection to selected industries and sporadic direct intervention by the Dominion Government. They have been made in an arbitrary, inequitable and wasteful manner, sometimes through and sometimes outside the public finance system. It is clearly impossible to prevent transfers of some sort from occurring. The point at issue, as between Plan I and Plan II is simply whether they will in future be made, as far as practicable, in accordance with objectively determined national standards as provided under Plan I, or continue as at present but on a larger scale which would be the effect of Plan II. As a method of bolstering the provincial and local finances of distressed areas the present methods are the most wasteful to the economy as a whole which could be conceived, and the cost falls in almost haphazard manner, and with unjustifiable and most inequitable incidence on some groups of the population. Nevertheless, the lack of flexibility and of powers of automatic adjustment and adaptability of our existing public finance system makes it necessary to adopt the methods of arbitrary transfer, whether it is done consciously or unconsciously. We include in the term "transfer" losses suffered by creditors outside the province. For example, when a province or a municipality defaults or reduces contractual interest payments, this is in effect a forced transfer from the investor to the debtor government. When a government provides for some form of private debt reduction or moratorium this is also a forced transfer from creditor to debtor, usually due in some measure to the failure of the public finance system in an emergency to provide adequate transfers through its own channels, and in some measure to efforts to maintain accepted standards of living and some degree of taxable capacity in the area. On other occasions Dominion, provincial, and even local governments have attempted to achieve the same ends by providing special subsidies, artificial prices and special protection for selected industries. National tariff, transportation, public works, monetary, and taxation policies have frequently been directed, both deliberately and unconsciously, to assist living standards and develop or maintain taxable capacity in particular areas. Under the pressure of necessity provincial taxation has frequently been devised to force transfers from "foreigners" in arbitrary and inequitable manner. Sometimes in the public finance system itself an emergency is met temporarily, and usually very unsatisfactorily, by inter-governmental loans—always difficult to collect, and fertile fields of friction. It should not be suggested that special regional consideration in the formulation of national policies, and other transfers of this nature, would not still be necessary and would not still occur under Plan I. But it would appear to be in the general interest to limit them as much as possible, as Plan I does, rather than to create conditions which will tend to increase them, as Plan II would.

All these apparently unrelated cases have one essential characteristic in common; they are devices and expedients to do expensively and unfairly what the public finance system might do in a large measure both economically and equitably. Each device imposes an excessive burden on the national economy. Each, and all together, fail to meet the public finance difficulties effectively. And each creates injustices and bitterness between individuals, classes, and regions which threaten Canadian national unity and spirit. Previous chapters have suggested that this is too high a price to pay simply to avoid the effort of reforming an obsolete fiscal system. It would be even more ruinous to increase this price deliberately by the adoption of Plan II. And it should be noted that while the Government of Ontario is the chief beneficiary under Plan II, the residents of Ontario would have to bear the brunt of the loss arising from continuation and extension of arbitrary transfers.

Possible Additional Provisions for Plan II.— Some additional provisions might be added to Plan II which at first sight present certain attractions. National Adjustment Grants and emergency grants, as proposed in Plan I, might be provided in addition to existing subsidies for those provinces unable to supply the Canadian average standard of services. This would involve setting up a Finance Commission to review such grants and recommend periodic adjustments. The task of such a Commission would be more difficult than that of the Commission proposed in Plan I since calculations of the burden of taxation in each province would be greatly complicated by the retention of income, corporation, and inheritance taxes, at widely varying rates, by the provinces. It would be almost impossible to determine that portion of those taxes which should be considered a burden on the province under review; that portion which was obtained in one way or another from residents of other provinces; and the amount which residents of any given province contributed through these channels to governments of other provinces. We have already noted that Plan II in its simplest form would cost the Dominion more than Plan I, and additional provisions such as the foregoing, unaccompanied by any compensatory transfers of revenue sources, would of course still further increase the cost.

Another provision might be the capitalization of existing statutory subsidies at the market rate for perpetual bonds, thus relieving provincial governments of an equivalent amount of debt. This proposal would secure a net saving equivalent to the spread between Dominion and provincial interest rates, and part of the technical advantages of the debt transfer proposal in Plan I, but none of the general advantages. To capitalize the subsidies at less than the market rate, as has been sometimes suggested, is simply a proposal for an all round proportionate increase in subsidies, regardless of special circumstances or proven need. It would increase some provincial surpluses, and would fail to meet the fiscal need of other provinces. As the existing subsidies no longer have any relation to provincial fiscal needs, a proportionate increase in them all lacks any justification and would not contribute to a solution of the difficulties. There would, in addition, be serious technical difficulties in assuming a part of provincial debt. Selection of the issues to be transferred, or creation of hybrid Dominion-provincial issues, or transfer over a period of time of individual maturities, would all be extremely complicated operations which would be difficult to carry out without giving rise to discrimination and inequity.

Detailed discussion of either of these proposals is unnecessary since both would intensify the major weakness of Plan II in comparison with Plan I. As Plan II makes no provision for transfer of the essentially national revenue sources, whatever benefits were provided provincial governments would have to be met entirely by increased Dominion taxation (or, in the case of the interest saving from capitalization of subsidies, by the Dominion's contingent liability for future exchange and interest rate fluctuations). Under the present division of taxation powers this would lead to more intensive competition from the Dominion with provincial governments in direct taxation, and probable extension of both Dominion and provincial consumption taxation. The evils of unequal taxation, double taxation, excessive administrative and tax compliance costs, and the restrictions on the use of the chief modern taxation instruments for social and economic purposes arising from divided jurisdiction in income, corporation and inheritance taxation have already been discussed.[6] The burden of consumption taxation and of taxation on business costs has also been noted as one of Canada's serious economic handicaps;[7] it has grown to such proportions that it is now one of the prime factors restricting the employment of marginal resources and labour in Canada. Anything which will necessitate an increase in either of these uneconomic forms of taxation would be even more harmful.

Critical comparison of the two plans illustrates the basic importance of the tax recommendations of Plan I. Re-allocations of expenditures or increased subsidies may be proposed which would balance provincial budgets, but at the expense of an increased burden on the Canadian taxpayer, and increased pressure on the Canadian national income. Palliatives of this sort, however attractive superficially, are damaging and dangerous. The solution of Canadian public finance problems requires constructive action, based on the economic realities of the country, rather than further temporizing; it requires the development of a public finance system, which can follow appropriate and coherent policies integrated with other powerful national economic policies, rather than intensification of the present conflict at the expense of the prostrate taxpayer. And the primary and essential requisites are sweeping tax reforms combined with an orderly and business-like system of revenue transfers to the provinces as recommended in Plan I.

[6] This section, Chapter III.
[7] Book I, Chap. VIII.

CHAPTER VII

MUNICIPAL FINANCES

Although municipalities fall within the exclusive jurisdiction of the provinces, revenue powers and expenditure responsibilities have been delegated to them by the provincial governments which make their financial position an integral part of the whole provincial picture, and consequently, to that extent, of Dominion-provincial relations. The major functions of education, public welfare, and highway construction are shared, in varying proportions, by provinces and municipalities; the whole field of revenue powers left to the provinces is divided, on the average about equally between provinces and municipalities, although the proportions as between provinces vary greatly. The part played by municipalities in taxation (in 1937 municipalities raised 31 per cent of combined Canadian governmental revenues from all sources), and in expenditure makes it essential to consider them in any review of the Canadian public finance system. For this reason the Commission has considered jointly provincial-municipal revenues and expenditures wherever appropriate. The exclusive jurisdiction of the provincial governments over municipal affairs has, however, been recognized throughout, and the distribution of benefits arising from the Commission's recommendations in Plan I, although these benefits were calculated on the basis of the combined provincial-municipal position, is left entirely in the hands of the provincial governments.

Nevertheless, certain aspects of municipal organization and of municipal taxation and expenditure affect the financial position of the provinces and Dominion-provincial relations, and in this chapter they are discussed from these points of view.

1. THE BACKGROUND

At Confederation only rudimentary municipal organization existed outside of Ontario, and in spite of the hope of the Fathers of Confederation that local government would develop quickly in the other provinces and assume some of the burdens of the financially over-loaded provincial governments, growth, particularly in the Maritimes, was very slow. Consequently, from the very beginning there existed a great disparity between the different provinces in the proportionate distribution of provincial and municipal functions. As provincial revenues, on a per capita basis, were roughly equalized by the subsidy system initially adopted, variations in the weight of taxation, and in the government services provided, depended largely on the degree of municipal development. Because of the additional taxation involved, municipal development was opposed in Quebec and the Maritimes, while in Ontario well-developed municipal agencies imposed heavier taxation and took a commanding lead in educational and railway and road expenditures.

The Prairie Provinces established a checkerboard municipal system covering virtually the whole occupied area as rapidly as their settlement permitted; in British Columbia only one-half of 1 per cent of the area (containing 75 per cent of the population) has been municipally organized—a striking illustration of the localization of resources and the physical peculiarities of that province. Prince Edward Island, small in area and population, has required virtually no municipal machinery.

From these diverse circumstances, and accidents of time and place, the present heterogeneous collection of municipal systems arose.[1] The variations from the complex and overlapping multiplicity of units in Ontario and Quebec to the geometric, if not economic, regimentation of Prairie units, and the limited local developments in the Maritime Provinces and British Columbia, have important implications for provincial finances.

Even more important than the variations between provincial systems is the great and increasing spread between kinds of municipalities. Metropolitan centres, tiny hamlets, and sparsely populated rural areas are all known as municipalities. It is obvious that their problems must differ greatly in degree and in kind. We cannot, in fact, speak of *the* municipal problem; there are municipal problems characteristic of certain regions and of certain provincial systems, problems characteristic of certain types and classes of

[1] H. C. Goldenberg, *Municipal Finance in Canada* (mimeographed), pp. 11-25.

municipalities, and problems associated with individual municipalities in special circumstances. The particular revenue, expenditure, or debt factors which may be of dominating importance in one case may have little relevance in another, and sweeping generalizations are thus of very limited utility. In no field is local knowledge and responsibility more important for successful administration. This is an additional reason why the Commission in recommending National Adjustment Grants has not suggested any Dominion conditions or supervision governing the expenditure of these grants, or their division between provincial and municipal governments.

Nevertheless there are some developments which have affected all municipal governments, although in diverse ways and frequently in such a manner as to widen the existing differences. This is important, because to the extent to which a generalization can be made as to what is *the* municipal problem in Canada, it is that wide differences exist between municipalities in ability to support their responsibilities. Since Confederation local political units have been saddled with more and more economic functions, and have become less and less economic units.

Up to the end of the last century Canadian municipalities were, much more than now, the local units in the economy; their people were more on a subsistence, and, therefore, a self-sufficient basis; and the functions of municipal governments were local in the most direct sense of the term, largely arising in every case out of the particular circumstances and desires of the community. Municipal boundaries were more justifiable—each town was a clearly recognizable entity, and rural areas were more than now separate and distinct regions, each with a more highly developed local character. Trade was chiefly between the town and its rural hinterland. Industrial activity was not great and mass-production manufacturing was unknown. Industry was dispersed, and within each community small factories, mills and home handicraft provided most non-agricultural goods. There was a frontier to be pushed out by the discontented or those unable to prosper, as prosperity was then known, in their original area. Occupations required little training or education, and training for one was adequate for many others.

Both the local consciousness and the absence of marked economic differentiation or interdependence between local areas, as well as the relative simplicity of the whole economy, were conducive to the concept of a separate local government for each area; each looked after its own affairs and was not greatly interested in or affected by the affairs of others. Education, roads, maintenance of local law and order, care of the poor, elementary sanitary measures in towns, and the provision of a few communal facilities were, in such conditions, the natural functions of local government.* They were capable of being completely decentralized, and were roughly within the capacity of every local unit to provide. In any case, if inequalities existed, they were simply the result of differences in the ability and ambition and good fortune of the local inhabitants and the stage of development from pioneer days. Such inequalities were of little concern to the province as a whole because they involved services which did not affect the general interests of the province, but were, to a very large extent, of purely local importance.

With the growth of the economy, boundaries between local units became less justifiable, but for purposes of local organization they were not inappropriate prior to the advent of the motor car. The optimum rural area was presumably that traversable by horse in a day, and it did not matter if boundaries were arbitrary lines drawn in accordance with the system of land-surveying, as in the case of most Ontario townships, and of many rural municipalities of the Prairie Provinces. The primary economic functions of government were land settlement and development, and the encouragement of industry, all of which were undertaken by the senior governments of province and Dominion. Social services and economic activities played a small part in municipal government, and could in those days have been considerably extended without putting strain on the municipal structure. Education, largely a local responsibility, was still conceived of in very simple terms. The neighbourhood was both the political and economic unit, and was capable of taking care of its own affairs.

The neighbourhood,—the local area in which each inhabitant knows a large number of the others and is conscious of a considerable community of interest with them,—must always remain a unit of local government, outside of large cities, but economic and social conditions have so changed that the number of matters of peculiarly local concern is restricted, whereas the field of governmental activities is widening. New functions of

* Education was somewhat of an exception since in all English-speaking provinces school districts, at least in rural areas, were not coterminous with local government units.

government cannot be efficiently or fairly divided among a large number of small areas, and some of the old functions have become inappropriate to the municipal sphere.

The great expansion in foreign, interprovincial and inter-municipal trade, and the accompanying increase in economic specialization even among municipalities, have made the economic welfare of one unit dependent on that of others, to say nothing of the outside world. An entire city may be dependent on the production of motor cars, a whole rural municipality on one type of agriculture, whether it be tobacco, fruit, wheat or live stock. Over much of the country each unit is producing primarily for "export" to other units, if not abroad, and imports from others most of its requirements.

The development and widespread use of the motor vehicle have created a need for expensive highways, have enlarged the physical horizon, and have encouraged population movements both transient and permanent. All these factors have influenced trade, relative municipal development, economic differentiation, and the size of the area which can be described as suitable for local government. The trend of land values has in many cases been abruptly altered by the advent of the motor car; the development of cities at the expense of nearby towns, and of suburbs at the expense of cities, vitally affect municipal finance.

Industrialization, the greater complexity of all forms of economic activity, and advancing standards of every description, require an educational system which will give to the largest possible proportion of the people the best possible education. New knowledge with respect to the value of public health services, and the social cost of disease and crime and poverty, have increased the interest and activity of the state in matters of health and public welfare, working and living conditions and wage levels.

Such social and economic changes necessarily affect the nature and scope of municipal government and central government alike. The general tendency to leave the responsibility for conditions within its own area to each municipality, both administratively and financially, and to require new functions of government relating to economic conditions to be undertaken primarily by local government areas whose boundaries are less and less those of balanced economic communities, has created many difficulties and anomalies in the municipal structure. These may be classified under three heads.

In the first place, many local government units are no longer the appropriate areas for governmental purposes of any description. This is particularly true of large cities, and of many rural municipalities in the Prairie Provinces. The case of the metropolitan area is conspicuous. Many people in such areas work in one municipality and live and pay taxes in another. The idea of the municipality as a community of neighbours has been necessarily lost in large cities at least, and the required standard is that of an efficiency which cannot be achieved when five or ten separate governments operate in a single integrated urban area among people who are economically interdependent; nor can the maximum economic welfare of the whole be expected if there are a number of widely varying tax-rates, standards of education and health measures and the like. Likewise in rural areas, the motor car is in process of rendering obsolete old municipal boundaries based primarily on the cruising radius of the horse. The motor car has extended the possible physical area of rural municipalities beyond the maximum desirable from the point of view of maintaining the identity of the neighbourhood. The boundary of a "neighbourhood" is now limited, not primarily by distance but by the other factor, always important, the number of inhabitants. Particularly in Western Canada, where settlement is sparse, municipal areas require extension for purposes of efficiency and economy, and this can now be done without sacrificing the local character of municipal government. It is in the extension of boundaries and in the pooling of costs as between complementary areas that is to be found one of the remedies for the social service costs imposed by transiency on certain unfortunate municipalities.

Secondly, even with adjustment of areas, modern conditions render desirable a large measure of co-ordination between municipalities, in their own interests, with respect to a number of their functions. The police department of one town must take cognizance of a crime committed in another fifty miles away within an hour of its occurrence. With the large and continual movement of people from one area to another maintenance of health services in one municipality is vitally affected by conditions in another. Particularly in rural areas the bringing of hospitals and other necessary institutions up to modern standards is a matter of co-operation between the municipal units concerned, or between the municipalities and the provincial government.

Thirdly, in the case of a number of governmental functions requiring large expenditures (some of which were originally purely matters of local concern and, therefore, the subject of municipal responsibility, and others of fairly modern origin or at least development) the long-run interest of the province conflicts with the existing system of requiring the separate municipalities to find the necessary moneys. This system results in unfair inequalities between municipalities, in failure to maintain uniformly the desirable provincial standards, and in severe strain on the finances of many municipal governments. Modern economic conditions have tended to increase differences which have always existed between municipalities in wealth and tax-paying capacity, and likewise in the expenditures necessary to fulfil certain functions. Very often the poorest municipalities require the greatest expenditures on the services in question. So far as such expenditures are forced on the municipality by provincial legislation, as in the case of some hospital aid and child welfare statutes, the situation is obviously inequitable. An extreme instance is unemployment where the degree of expenditure is affected by provincial or nation-wide conditions and by provincial or federal policy; the municipality in this case is unable to control the amount of the expenditures which it is forced to bear, and its capacity to pay is restricted by the same conditions which render the expenditures necessary.

With respect to matters of admittedly local concern it is obvious that wealthier municipalities always will be able to supply their inhabitants with better services than poorer ones. But it is equally obvious that great inequality among municipalities is inimical to the maintenance of any uniform or minimum provincial standards. Some matters which were once of merely local interest cease to be so because the increase in disparity of wealth prevents the maintenance of approximately uniform standards. Matters of more than local interest should not and cannot be left to a major degree in the field of municipal government. In so far as they remain a municipal obligation the interests of the province as a whole are injured by the sheer inability of some municipalities to raise the same revenue as others either in proportion to population or to the amount of expenditure required, as well as by obstacles to provincial uniformity arising from the deliberate adoption by a municipality of a lower standard than that desired as a matter of provincial policy.

From what has been said it is clear that aggregate municipal figures are of very limited use in analysis of the problems, since the totals conceal the very disparities which create the chief difficulties and inequities. Valid comparisons could only be made and valid generalizations reached after each municipality had been considered separately, in the light of its own particular circumstances. Yardsticks and tests which are applicable to one may be completely irrelevant or misleading when applied to another. A municipality dependent on a single industry differs fundamentally from another of the same size engaged in more diversified economic activities. A Prairie city dependent upon agricultural conditions cannot be compared with an average industrial city in Ontario or Quebec, nor a pioneer community with a mature one. The greatest obstacle, however, is the dearth of statistics, and the lack of uniformity in those available. In some provinces current and capital items in municipal accounts are not distinguished in so far as their statistical presentation is concerned; in others, statements of aggregate municipal finances combine statements compiled on the accrual basis with others on the cash basis. An analytical breakdown is generally lacking, and relatively large amounts are commonly lumped together as "miscellaneous". It is even frequently impossible to distinguish between debt interest and debt retirement payments. The local government of any given area may be in the hands of several bodies[2]—say a village council, a township council, a county council, a school board, a health board, a public utility board, etc., with different boundaries, different fiscal periods, and different systems of accounting, and to disentangle the affairs of these overlapping bodies and secure any consolidated statement of their financial operations and position is well-nigh impossible. Furthermore, what statistics are available in most of the provinces relate only to very recent years. A historical study of municipal finance in general is, therefore, almost impossible. While some of the more recent reports of the provincial departments of Municipal Affairs are more satisfactory, the need for a greater degree of co-ordination and co-operation between provincial and municipal governments with respect to municipal finance statistics remains urgent.

In spite of these serious deficiencies in the material available, and the limitations of the use which can be made of the product, the Commission has attempted to compile statistics on a comparable basis for every province, classified in a manner

[2] There are in Canada some 27,259 local councils and boards with a combined membership of about 125,000 persons, paid and unpaid. Ex. 267, Brief of the Citizens' Research Institute of Canada, p. 8.

complementary to the Dominion and provincial accounts.[3] Instead of the customary classification by cities, towns, villages, and rural municipalities, which is of little value for purposes of analysis owing in part to the great variations in provincial definitions of the units, a new and more significant grouping has been employed—Metropolitan areas, other urban, and rural. "Metropolitan areas" (Montreal, Toronto, Winnipeg, Vancouver, and Windsor)[5] consist of the major cities and their immediately surrounding and dependent towns, villages, and suburban townships. "Other urban" includes all other cities, towns, and villages, in general of more than 500 inhabitants, and "rural" all remaining municipal organizations, although the division between "other urban" and "rural" is in some cases only approximate. The selected metropolitan areas account for something more than two-fifths of all municipal revenues and expenditures, the other urban units for something less than two-fifths, and the rural units for one-fifth.

For details of the methods used by the Commission and the qualifications which should be noted before use is made of the statistics the reader is referred to the Introduction to the Municipal Section in Book III.

[3] This task would have been impossible without the able and willing assistance of Mr. Joseph Howes of the Citizens' Research Institute.

[5] There are several cities—Quebec, Ottawa, Hamilton—larger than Windsor, but they have not the distinctive metropolitan characteristics and problems of Windsor. Greater Ottawa, including Hull, might be considered a metropolitan area, but this was not practical for our present purposes owing to the provincial division of the area.

2. Municipal Functions

Municipal expenditures for 1937 are summarized in the following table, and details are given for selected years in the Municipal Section of Book III.

MUNICIPAL EXPENDITURES, 1937

—	Metropolitan	Other Urban	Rural	Total
	(Millions of Dollars)			
Net debt service (excluding retirements)	32	19	4	55
Education (net, after provincial grants)	28	30	18	76
Public Welfare, including relief	28	18	7	53
Streets and roads (net, after provincial grants)	7	11	13	31
General Government, and all other expenditure)	31	24	12	67
	126	*102*	*54*	*282*
Debt retirement	15	12	2	29
	141	**114**	**56**	**311**

Education and Public Welfare.—These two major municipal functions have certain important characteristics in common, and for our present purposes can be conveniently discussed together. Education accounts for 33 per cent of municipal current expenditures excluding debt charges, and welfare services for 23 per cent.* It is evident that these services will bear the full impact of wide differences in taxable capacity which may exist between different municipal units, and that great differences in ability to support these services on the scale needed today will have very serious consequences.

The great variations which exist in the ability of municipalities to support these services arise in part from the failure to make the municipal unit conform to the changing economy and coincide with an economic unit; in part from the very uneven distribution of taxable income and wealth which has accompanied the development of a nationally integrated economy with a high degree of specialization; and in part from the great expansion and changed nature of the demands made on these services.

The most striking examples of the failure of the political municipal unit to conform to the local economic unit are the component municipalities of the metropolitan areas, and the rural units designed in horse and buggy days. A metropolitan area will normally contain some very wealthy residential suburbs organized as separate municipalities, and some very poor dormitory suburbs; some units that are mainly industrial; some that are commercial; and some "twilight" zones of obsolete residential property. These units may be all parts of one economic organization but there will obviously be the greatest extremes of difference in their financial ability to supply their residents with services. Property assessment per pupil, for example, sometimes differs as much as ten to one. Equally wide differences may exist between adjoining rural municipalities arbitrarily laid out and of exactly the same area, but very different in resources and other economic advantages.

Many of the differences, however, are not due merely to the failure to make political boundaries conform to the appropriate economic unit. One of the prices paid for the higher national income and standards of living achieved since Confederation has been the virtual disappearance, or great reduction in importance, of the small local economic unit. It has been absorbed in the nation-wide, and world-wide, organization of business. There is no longer any necessary or even likely relation between the wealth a municipality produces and local property values and service requirements. Yet responsibilities have been delegated to municipal governments which are justifiable only on the assumption that the local political unit will also be an economic unit with a per capita income not far removed from the provincial average.

But while the differences between taxable capacity of local political units have been increasing, as a natural corollary of the type of economic development which Canada has experienced, the relative cost of education and welfare services, and the need for approximate uniformity in the standards of services provided, have also been increasing. The complex and mechanical modern society is a machine which can produce much more wealth than the self-sufficient units of former days, but it requires a highly trained and well-informed public to run it successfully. If full advantage is to be taken of modern productive facilities, more intensive and longer periods of general education are required; more subjects must be taught; more equipment and more trained specialists are needed; and special and often extensive instruction must also be provided for the various grades of subnormal intelligence which in earlier societies it was safe to leave uneducated. There are similar increases in the need for welfare services arising from the loss of the former degree of family self-sufficiency, the abrupt fluctuations which are characteristic of our present economy, and advances in medical and related sciences. In the cases of both education and welfare, the concentration of population in the cities has made possible the provision of higher standards but has also multiplied costs.

* These percentages are perhaps an understatement for the English-speaking provinces in view of the services rendered by the Church in Quebec.

These developments have been discussed in detail in our historical review in Book I as aspects of the evolution of the economy which are of basic significance to Canadian public finance and the federal system. We are here concerned only with noting the impact of these changes on municipal institutions, and in particular the extent to which approximate uniformity in ability to provide the basic social services has ceased to be a valid assumption.

Streets and Roads.—A significant contrast exists between the trend of development of municipal welfare and education services, and that of the other chief municipal function—the provision of streets and roads. The development of the automobile made necessary entirely new types of both urban and rural roads, on a hitherto unprecedented scale, and was an important factor in shifting population to outlying suburban areas. The municipalities were thus faced with almost immediate necessity of making a tremendous capital investment, that was bound to cause in many cases a reduction in property values through shifts in population which it would facilitate. Extensive programs for reconstruction of urban streets which were launched in the immediate pre-War years were of necessity stranded during the War, but were afterwards carried to completion in a surprisingly short period of time. By the middle twenties virtually all the urban municipalities had rebuilt their streets, and made the necessary attendant changes in sewers, sidewalks and street lighting facilities to meet the new demands. It is true that some of this investment is already obsolete owing to the continued growth in automobile traffic, and that expensive express and overhead arterial roads will have to be cut through congested areas, but the accomplishment of the urban municipalities in equipping themselves with relatively modern and complete facilities in such a short period of time remains a notable one.

It was clear from the first that a satisfactory network of rural roads could not be planned, financed, and built by the rural municipalities. As a result, provincial governments stepped in and progressively assumed an increasing proportion of the capital and upkeep expenditure, although the degree and method of participation varied widely. Possibly because the variations in road standards provided by poor and rich municipalities were more directly evident than equally important variations in welfare and education services, and because the need arose more suddenly and strikingly, and because there were pressure groups more directly interested and better organized, the logic of pooling resources in the common interest was brought home more rapidly. Urban municipalities did not benefit equally from provincial assistance, although provincial governments have in many cases assumed the expense of the costly main highway approaches to the larger centres, and there are important indirect benefits from the lower transportation charges and enlarged market afforded by the provincial highways. Nevertheless, it would appear that since the advent of the automobile, urban municipal taxpayers have borne a particularly heavy burden for the provision of modern streets and roads. The bulk of the capital borrowing for this purpose was on a ten to fifteen year basis, with relatively high and progressively increasing amortization charges, and as a result those municipalities which have been able to maintain their debt retirement schedules are now extinguishing their remaining road debts very rapidly. This factor largely explains the buoyant position of Ontario municipal finances in particular,[6] although it may well be charged that the rapid equipment of the urban areas, and their present strong financial position, have been achieved by something in the nature of a discriminatory capital levy on real estate owners, for the taxes may not cease when the roads are paid for but may be continued for other purposes.

It has not been attempted to do more in this review than to note the effect of the changes in basic conditions on the ability of municipalities to carry out their traditional functions. These functions have grown more costly and more complex as a natural correlative of the development of the economy; the economic basis of the municipality which determines its ability to perform these functions has meanwhile grown more narrow and vulnerable; as a result the traditional administrative unit is today too small and limited to perform these functions efficiently or distribute their costs equitably. We have noted the extent to which provincial governments have recognized this fact in the provision of streets and roads, and the extent to which it has been neglected in the provision of welfare and education services.

Appropriate adjustment of municipal administrative units to modern conditions, and greater equalization of the chief municipal burdens, are, of course, entirely a matter of provincial jurisdiction and discretion. Plan I, however, by putting all provincial governments in improved and more stable financial positions, makes possible reorganization and reforms along lines which would remove important sources of some differences and inequities which threaten national unity and welfare today.

[6] Estimated municipal debt for streets, roads, and bridges in Ontario fell from $183 million in 1930 to $149 million in 1936, and has since declined at an even more rapid rate.

3. MUNICIPAL REVENUES

Municipal revenues for 1937 are summarized in the following table, and details are given for selected years in Part 3 of Book III:—

MUNICIPAL REVENUES, 1937

—	Metro-politan	Other Urban	Rural	Total
	(Millions of Dollars)			
Real Property Taxes	102	91	52	245
Sales and Income Taxes	6	*	*	6
Other Taxes (1)	8	11	1	20
Licences, Permits, Fees	5	4	1	10
Public Utility Contributions	2	4	*	6
Other Current Revenue (2)	10	6	5	21
	133	**116**	**59**	**308**
Provincial Government Grants (3)	*4*	*6*	*9*	*19*

(1) Chiefly business taxes, and also (in the Maritimes) personal property taxes.

(2) Rentals from municipal property, interest and penalties on tax arrears, and miscellaneous income of all kinds, some of which should probably be credited to capital account.

(3) Not included in revenue totals but deducted from appropriate expenditures in the table on p. 142.

Of the total, which was 31 per cent of the revenues of all governments in Canada in 1937, 80 per cent is derived from real property taxation. The real property tax is at once the largest single tax in Canada and, for the reasons briefly discussed in the foregoing sections, one that is called on to meet functions the cost of which varies tremendously between local units of government. As a result we find many instances in which this tax (which for the bulk of the population is the heaviest paid in the course of the year) is twice as much in relation to property income for residents of some areas as for those other areas in the same province. There are extreme instances in which it is several times as much and striking contrasts can be found between immediately adjoining areas. Examples are numerous and well-known, and many were given in evidence before the Commission,[7] where the tax amounted to practical confiscation, or to a forced and inequitable capital levy, and where it forced the abandonment or destruction of property. More difficult to establish and illustrate, but perhaps of even greater general importance, is the effect of the pressure of the tax on individuals and business enterprises in marginal positions throughout Canada, and particularly in depressed areas.

[7] *E.g.*, Ex. 9, Winnipeg Real Estate Board; Ex. 98, Ont. Assoc. Real Estate Boards.

Taxation of Real Estate

It is very generally maintained that property taxation as a whole is too high.[8] This general proposition is based sometimes on one, sometimes on another set of circumstances. People have, for instance, been ejected from their homes because they were unable to pay the taxes. Here the proposition would mean either that incomes are too low or alternatively that, where low incomes prevail, it is wrong to impose a tax on a necessity of life such as shelter. Others have found that property which has ceased to yield an appreciable income is still subjected to heavy taxation. This situation has led to the surrender of property to the taxing authority and in other cases to the demolition of buildings which cannot command rents in keeping with their assessments. In this case it may be rather the method of assessment than the property tax itself which is at fault. Others complain that the income from real property is more heavily taxed than income from other investments. In one sense this is true, but it must be remembered that a property tax, once imposed, tends to be capitalized so that the value of the property is reduced once for all by the capitalized value of the tax, just as it would have been reduced had it been subjected to a mortgage of equal amount. Any subsequent purchaser pays the reduced price and presumably gets the same net return on his investment as if he made alternative investments. The initial act of confiscation may be deplored. It cannot be redressed years later without the unjustifiable enrichment of subsequent purchasers of the property.

(8) The following briefs complain of unduly burdensome or inequitable taxation of real estate:

Ex. 7, Brief of Manitoba, Pt. VII; Ex. 8, Brief of Manitoba, Pt. VIII; Ex. 9, Winnipeg Real Estate Board; Ex. 17, Winnipeg Board of Trade; Ex. 18, The Union of Manitoba Municipalities; Ex. 19, The City of Winnipeg; Ex. 21, Rural Municipality of St. James, Manitoba; Ex. 24, School District of Winnipeg, No. 1; Ex. 25, Manitoba School Trustees' Association; Ex. 28, The Greater Winnipeg Youth Council; Ex. 31,The Home and Property Owners Association of Winnipeg; Ex. 34, Brief of Saskatchewan; Ex. 49, Saskatchewan Urban Municipalities Association; Ex. 66, Regina Board of Trade; Ex. 67, Saskatoon Board of Trade; Ex. 98, Ontario Association of Real Estate Boards; Ex. 113, Canadian Federation of Mayors and Municipalities; Ex. 172, Brief of British Columbia; Ex. 181, Municipalities of British Columbia; Ex. 182, City of Vancouver; Ex. 183, British Columbia School Trustees' Association; Ex. 199, Vancouver Real Estate Exchange; Ex. 206, Provincial Council of Women, British Columbia; Ex. 236, Edmonton Chamber of Commerce; Ex. 238, Cities of Alberta; Ex. 248, Taxpayers' Protective Association of Edmonton; Ex. 249, Calgary Board of Trade; Ex. 255, The United Farmers of Alberta; Ex. 267, Citizens' Research Institute of Canada; Ex. 268, Board of Trade of the City of Toronto; Ex. 281, Ontario Municipal Association; Ex. 282, National Construction Council; Ex. 284, The City of Toronto and Ontario Mayors' Association; Ex. 285, Property Owners' Association of Toronto; Ex. 286, East York Business Men's Association; Ex. 288, Home Builders' Association of Toronto; Ex. 297, Brief of Ontario, Pt. II; Ex. 367, City of Saint John; Ex. 394, The Canadian Chamber of Commerce; Ex. 400, The Roman Catholic Separate School Trustees' Association of Ontario. See *per contra* Ex. 105, Brief of The Single Tax Association of Canada.

In still another sense taxation on real property may be said to be too high. A municipality to function adequately requires a certain revenue. It may be impracticable to obtain this revenue by taxing land and improvements if a point is reached at which an increase in the rate of the tax would not produce an increase in its yield. Or it might be highly unjust to continue to tax land because in so doing revenue would be raised by imposing an undue burden on one group in the community while imposing no proportionate burden on other groups. The fact, already noticed, that the real property tax tends to be capitalized is a matter of aggravation in respect of this inequity whenever what is under consideration is not the continuance of high rates of long-standing but a further increase in the rates. Many large municipalities which press for financial relief fully realize that if this relief were extended to all municipalities any tax by which it was financed (whether Dominion or provincial) would take more from their citizens than the municipality itself would receive. Here the essence of the complaint is that the municipality has been required to finance costly services without being given adequate powers of taxation. The remedy would lie either in decreasing the demands made on the municipality or in supplementing its revenue by some form of provincial grants-in-aid. For these various reasons the cry arises on all sides that the taxation of real property is too high, but this is an opinion which cannot in most cases be proved or disproved by any objectively determined scientific criteria.

It is argued that the failure of the construction industry to make any substantial recovery is evidence that real property taxation as a whole is excessive, and that a reduction in rates would divert the marginal consumer's dollar into better housing instead of into alternative, and possibly less socially useful, channels. And it is charged that a tax of such a rigid nature as the Canadian real property tax is particularly unsuited for a country such as Canada, already burdened by a high fixed overhead which has to be supported by a sharply fluctuating income, and that the heavier the tax, the more vicious and undesirable its effects. Unquestionably in many areas the tax was established at a high rate during a period of rapidly rising land values, and was deliberately intended to contain some element of the "single" tax, or of a capital gains tax; the justification for this naturally disappears once the trend of land values flattens out or drops sharply.

The Commission believes that there is great weight in these general contentions even when they cannot be statistically established, or related to other than hypothetical alternatives. In this connection the benefit to municipalities of the Commission's recommendations in Plan I should be noted. On the 1937 base they would provide a net saving to municipalities of some $20 million, or 8 per cent of the real property tax. This saving, of course, would not be evenly spread, but largely concentrated in the chief distressed areas.

But although no positive finding can be made on the abstract contention that real property taxes are too high, particularly in the absence of proposals for compensatory alternatives, certain gross inequities which now exist can be specifically noted. They are, chiefly, different levels of taxation (to support the same functions) in different municipalities; and great variations in taxation, as a percentage of income, even in the same municipality.

The different levels of taxation in different municipalities arise from the performance of similar functions with very different means. The remedy, as has been suggested in the previous section, is the reorganization of municipal units more in conformity with modern economic conditions. In addition certain services might be pooled (whether through the provincial government or among a group of municipalities) so as to redistribute the cost of services in relation to capacity to pay.

The variations in taxation, as a percentage of income, between individuals in the same municipality result from the assessment of taxation on an assumed capital value of real property rather than on income. Although the assessed capitalization is supposed to be closely related to, or specifically based on, earning power, it is in many cases not so in fact owing to faulty assessments, unrecognized changes in earning power, or inability to rent a property at all. The first of these defects may be due to lack of competent assessors; the second, to lack of sufficiently frequent re-assessments and facilities for appeal; the third is inherent in the present system of taxation. To correct the inequity of taxing an individual on the capitalized value of an income which he cannot make would not require as drastic a change as putting all property taxation on an income basis. (Even in the countries frequently cited as examples of a more equitable system of property taxation on an income basis there is a large element of arbitrary valuation.)

It would appear that a rough adjustment of this particular inequity could be achieved if allowance were made for a rebate of a portion of the tax applying to improvements (although not to the land) when it was established that it had not been possible to rent the property on reasonable terms during, say, six or nine months of the year.* The property should in any case be taxed sufficiently to cover the cost of services rendered to it. To the contention that such a provision would reduce the stability of municipal revenues it could be replied that under conditions in which the operation of such a provision would be of any importance, the revenues under the present system are only superficially stable, bolstered up by uncollectable tax arrears,[11] and that it is grossly unfair virtually to confiscate the property of those who have already been the chief sufferers from adverse rental conditions.

Tax Exempt Crown Property

It was also complained to the Commission[12] that it was unjust to exempt Crown property from taxation when that property was being used for some normal commercial purpose, such as electric power distribution, and would, if in private hands, be taxable; or when it was being used in a profit-making commercial enterprise, such as a provincial liquor store. The Commission suggests that such property should be subject to taxation on the same terms as that of private enterprises.

A somewhat different problem is presented by Crown property which is not being used for any commercial purpose, but which involves the municipality in considerable expense.* This is especially the case with respect to military property. On the other hand, the municipality frequently benefits substantially from the presence of the Crown property such as post offices and legislative buildings. The Commission can make recommendations only in very general terms. The Commission recommends that the senior governments should make payments *ex gratia* in place of taxation in respect of all property (other than commercial enterprises which should be assessed and taxed on the same basis as private property) held by them in municipalities, but that the amount of these payments should depend on the nature of the property and the extent to which it benefits from municipal services. It may even be expedient for both senior governments to lay down some general principles to govern these payments and to employ arbitrators to apply them to individual properties in the event of being unable to reach an agreement with the municipality. The principle is clear that the burden of providing services for government properties should be spread widely by federal or provincial taxation, as the case may be, and not charged against neighbouring properties. But the amount of the payment appropriate in each case will depend on a number of circumstances, of which the assessable value of the property may not be one.

* The Ontario Assessment Act, c. 272, s. 125, makes a certain vacancy allowance on property which is not rented.

11 Municipal tax arrears rose $78 million between 1930 and 1935.

12 Ex. 52, Sask. Assoc. Rural Municipalities; Ex. 109, Can. Electrical Assoc.; Ex. 154, Union of N.S. Municipalities; Ex. 158, City of Halifax; Ex. 159, Halifax Board of Trade; Ex. 181, Municipalities of B.C.; Ex. 267, Citizens' Research Institute; Ex. 281, Ont. Municipal Assoc.; Ex. 285, Toronto Property Owners Assoc.; Ex. 343, Chambre de Commerce de Montreal; Ex. 394, Can. Chamber of Commerce.

* *E.g.*, Halifax and Esquimalt. It was declared in evidence to the Commission (p. 5289) that in the latter city out of $9,790,000 for improvements, $8,212,000 was tax-exempt.

4. Municipal Debts

Municipal debts are on the whole more closely related to municipal capacity to bear them than are the chief municipal functions. A poor municipality may incur just as great costs per capita as (or even larger costs than) a rich one in providing education, for example, but it is extremely unlikely to have as heavy debt charges, simply because it could not in the past have borrowed as much money. On the other hand, it is true that a poor municipality may have to forgo desirable capital works and improvements because of its poor credit standing.

In general, municipal indebtedness is closely related to the corresponding asset, and, ideally, is amortized within the life of the asset. But wide latitude is frequently given to estimates of the life of the assets. In recent years particularly, the funding of general deficits (largely caused by relief expenditures) has obscured this relation somewhat, but the contrast with the general debt of the senior governments remains notable. (It is interesting to note that most provinces originally also earmarked their borrowings for specific purposes, and undertook to amortize them accordingly, but as time went on, and as through refundings and funding of general deficits the debts became increasingly confused and indistinguishable, even nominal adherence to this practice was discarded.) Outstanding municipal debt in 1937 may be classed roughly as follows:—

MUNICIPAL DEBTS, 1937

—	Metropolitan	Other Urban	Rural	Total
		(Millions of Dollars)		
Schools	115	87	15	217
Roads, streets and bridges	189	130	27	346
Other general	317	144	12	473
Gross general	*621*	*361*	*54*	*1,036*
Less sinking funds	106	71	5	182
Net general	515	290	49	854
Utility—net	143	99	15	257
Guaranteed—net	45	1	—	46
Bank loans	52	36	24	112
Total, net	**755**	**426**	**88**	**1,269**

With a few notable exceptions municipal debts, in contrast with Dominion and provincial debts, have not increased since 1930. Severe retrenchment has been necessary in a number of cases, and although relief costs have been a heavy burden for some centres, five-sixths of the total cost has been met by senior governments. The cities with a considerable increase in debt since 1930 are those in which unemployment has been concentrated, and where the cost of even 20 to 30 per cent of total relief expenditures threw municipal budgets badly out of balance. Even in these cases, however, there have been some reductions in net debt since 1934, particularly in Ontario.

On the other hand, debt charges have increased somewhat for nearly all urban areas and notably those with large relief borrowings. This is largely due to increased amortization charges on relief and deficit financing. Interest charges, as distinct from total debt charges, have tended to decline, since municipalities in a strong financial position have been able to refund on favourable terms, and municipalities in a weak position have had to reduce their borrowings rigorously. Admittedly, such a reduction may be a very undesirable one, if it enforces curtailment of socially necessary or desirable expenditures, simply because an obsolete division of municipal units throws crushing responsibilities on some area unsuited to bear them. On the other hand, it may be a healthy check to extravagance or to optimism which the events of the depression have shown to be excessive. But there is marked inequity in a system which imposes the highest borrowing costs, and rigid restriction of borrowing, or even total prohibition, on the haphazardly delimited local areas which are normally the poorest, or have been the hardest hit, as a result of cyclical developments and national policies beyond their control.

The hardest hit municipalities were forced into default, and it is illuminating to analyse the factors responsible for these extreme examples of breakdown. These examples may properly be called extreme since the effort made by most Canadian municipalities to honour their obligations, at the expense of drastic reduction in desirable services, is striking. Generally speaking, defaults occurred only under intolerable strain and pressure. Roughly classified, defaults occurred in*:—

(*a*) working-class dormitory suburbs—i.e., the poorer residential districts—of metropolitan areas;

(*b*) one-industry towns, in which the one industry was closed down by the depression;

(*c*) rural, and dependent urban, units where the whole area had been overwhelmed by natural disaster, such as the Western drought.

* Defaults by derelict towns resulting from miscalculation as to the economic future have, of course, occurred in many regions throughout Canadian history.

Examples in the first class are but further evidence of the chaotic condition of municipal organization in Canadian metropolitan areas. Large blocks of poorer class residential areas which were arbitrarily segregated into separate municipalities, whose inhabitants were particularly hard hit by the depression, and whose local relief and welfare services increased correspondingly, were inevitably saddled with an inequitable and frequently overwhelming share of depression burdens. At the same time neighbouring municipalities, which were part of the same economic unit but which harboured a more fortunate or sheltered group, had no increased responsibilities to face, and were able to take advantage of depression conditions to reduce costs and cultivate a smugly superior attitude to their less fortunate neighbours. The other classifications, which taken together account for only a small portion of the defaults, are simply among the minor routine casualties of modern hit-and-run society, but even in their cases organization of the local administrative units more in conformity with modern economic conditions, and more even spreading of the risks, would have reduced the casualties.

Consideration of municipal defaults must include the constitutional questions of whether provinces, by virtue of their exclusive power to legislate concerning municipalities, may legislate with respect to insolvent municipalities and of whether they may deal with the bonded indebtedness of a municipality which is not insolvent. Whatever the answers, it is obvious that a province could, by valid legislation, make it difficult or impossible for the creditors of a municipality, whether solvent or insolvent, to collect their debts. Nor would it have any difficulty in turning a solvent municipality into an insolvent municipality if this were a necessary condition for securing jurisdiction over its affairs. The Commission thinks that in such matters the jurisdiction should be clear and the responsibilities precise, and it recommends that if the British North America Act is amended, provinces should be given specific power to legislate in respect to municipal debt whether or not the municipality concerned is solvent.

In this respect the Province of Quebec stands in a special position. If Plan I is implemented, the Dominion will have to assume a portion of the municipal debt of that Province. The distribution of the benefits to the municipalities would, of course, be within the discretion of the Province, but presumably it would wish to deal with the debt situation in the metropolitan area of Montreal. This might require legislation dealing with the debt of municipal units of very different credit standing, and it would be essential that the Province should have adequate legislative power to deal with the situation effectively.

Provincial Supervision of Municipal Borrowing

The degree of provincial responsibility for the conduct of a municipality's affairs is variously interpreted. But it would seem clear that when the provincial government creates a subsidiary body, and delegates to it certain revenue powers and responsibilities, it should see to it not only that these powers are adequate, with efficient management, to match the responsibilities, but also that there is efficient management. This obligation would appear to be particularly important for individuals who loan money to the municipality on the obvious assumption that the provincial government will not establish conditions, or permit conditions to develop, which may make its repayment impossible. Indeed, there is an even stronger case for a province to stand behind the credit of the local government bodies which it has created than for the Dominion to stand behind the credit of the provinces as has been recommended in Plan I. In addition to providing for an approximate matching of revenues and responsibilities (and, as suggested in the previous sections, a substantial measure of pooling of resources and averaging of expenditures to remove the wide existing differentials) the province should supervise adequately municipal borrowing. Supervision of borrowing would ideally include not only an examination of the purpose and immediate need for the borrowing, but also determination of the best form and terms of the borrowing, and continuing regulation of sinking funds, or repayment, provisions. Some or all of these forms of control are now exercised, although with widely varying degrees of strictness, by each province. If a municipality's borrowings are excessive it may be because the province has saddled it with greater responsibilities than revenue powers, or because the municipality's affairs are being incompetently handled, or because the municipality's growth has been checked by unfavourable, and possibly unforeseeable, circumstances. In any case the province has a responsibility, both to creditors and prospective creditors of the municipality, and to taxpayers and recipients of services in the municipality. This responsibility can be exercised to some extent by close supervision of municipal borrowing, and of municipal budgeting, accounting, and administrative practices; perhaps even more importantly, by providing conditions under which a municipal civil service—adequately paid, professionally trained, and politically independent—can develop.

If provincial governments supervise municipal borrowing closely and enforce efficient administrative practices, municipal credit should quickly reflect the increased measure of security. Indeed, under these conditions (and assuming an equitable division of revenue powers and expenditure responsibilities) the credit of a municipality should be as good as that of a province. In addition, municipalities, as a result of their practice of earmarking their borrowings and relating their debts to specific assets, normally pursue conservative debt retirement programs—always an attraction for the investor. However, there may be circumstances under which a province will wish to assume municipal indebtedness, either by refunding debts or by guaranteeing them. It may, for instance, feel that its municipalities are not receiving the credit rating to which they are entitled; or that some of them have been unduly burdened in the past by obligations which the province itself would have met if it had had the means to do so; or that certain municipal amalgamations are desirable and that an advantageous debt settlement is a necessary preliminary. In such cases a province would, if Plan I were implemented, have two courses open to it. It might employ the sole credit of the province, in which case it could not count the obligations which it assumed in making an estimate of its fiscal need when seeking an enlargement of its National Adjustment Grant; or it might endeavour to carry out the refunding through the machinery recommended under Plan I. In the latter case the debt would have to be approved by the appropriate body which (as has been explained in an earlier chapter) would consider all the circumstances, including the credit of the Federal Government and its ability to guarantee the debt. If approved the debt would become an obligation of the central debt agency, but the municipality or municipalities concerned would have undertaken to reimburse the agency for the debt charges and would, presumably, have been required to assign revenues for this purpose. In addition the province would have underwritten the debt. If refunding of this character were resorted to, it would lie with the province to decide whether the heroic debt retirement provisions which appeal to private investors should be adopted or whether they should be modified so that the municipality, with its debt charges substantially reduced, might be in a position to finance future capital expenditures on a pay-as-you-go basis with economy to its taxpayers.

In Conclusion

Local and municipal institutions fall under the exclusive jurisdiction of the province, and the Commission has, therefore, refrained from making specific recommendations with respect to municipal reform, except where the problem falls within Dominion-provincial relations. The Commission has sought rather to outline the problems which must be faced, assuming that municipal reform will sooner or later be undertaken by the provinces. It should be noted that, if the Dominion assumes responsibility for unemployed employables and if the Commission's financial recommendations are implemented, not only will the municipalities derive direct benefits, but the provinces will be in a much better financial position to attack the problem of municipal reform than heretofore.

The Chapter discusses some of the more fundamental problems which must be faced if municipal financing is to be efficient and municipal taxpayers are to be equitably served. It has pointed out that the size of the municipal unit in metropolitan and rural areas is, in very many cases, no longer economic or in keeping with administrative efficiency; that local needs no longer determine municipal functions and that many functions, essentially provincial, are still left with, or have been imposed on, the municipalities; that municipal revenues are in many cases far from adequate to support municipal functions; that there is almost universal complaint across Canada of undue, or inequitable, taxation of real estate, though the complaints are not always well founded; that although the total of municipal debt has not risen substantially during the depression, the credit of many "one-industry" municipalities, working-class "dormitory suburbs" of metropolitan areas, and metropolitan communities generally, has been severely strained, and even destroyed in some cases, because of relief costs. The need for the provinces assuming greater responsibility for the credit position of their municipalities has also been pointed out.

The Commission has deemed it appropriate to discuss the municipal situation at some length because municipal governments were at great pains to bring their case before the Commission, which was greatly impressed with the earnest and public-spirited endeavour devoted to this basically important sphere of Canadian public life. Democracy begins with local government, and local government cannot be politically healthy and stimulating unless the problems set to those who conduct it are possible of solution. The essence of financial responsibility lies in the possibility of balanced budgets which permit of far-sighted planning, and this condition has been in grave peril in Canadian municipalities during the last decade.

Chapter VIII

EQUITY AND EFFICIENCY IN TAXATION

The Commission is directed by its terms of reference to examine whether taxation, as at present allocated and imposed in Canada, is as equitable and efficient as can be devised. The examination has been made in Book I[1] and reasons have been given for returning a negative answer to the question thus propounded. The financial plan recommended by the Commission as Plan I has been devised with a view to effecting some important improvements in the Canadian system of taxation and to making possible a thorough reform of that system in respect both of its equity and its efficiency. The purpose of the present chapter is to advance a number of recommendations and suggestions for reform and to show how the adoption of Plan I would make it possible to give effect to them. Equity and efficiency in taxation are closely related and in practice neither can be pursued without regard for the other. It will, however, be convenient to direct discussion in the first place to efficiency in taxation.

Efficiency in Taxation

Efficiency in taxation has been defined in Book I[2] as skill in collecting a given amount of revenue with the least possible burden on the national income. Taxation, taken together with the expenditure which it defrays, does not necessarily impair the national income. Indeed, the national income should be enlarged by the influence of the services which governments supply, and, if wise policies are followed, the form which the national income takes as a result of taxation and expenditure will be preferable to that which it would have taken had the functions of government been more restricted. While the present chapter is devoted to equity and efficiency in taxation it must be remembered that it is equally important that governmental expenditures should also be governed by considerations of efficiency and equity. However, as the proportion of the total national income which is taken by governments rises, it becomes only too probable that taxes will be employed which seriously impede the expansion of the national income. In calculating the proportion of the income which is taken by governments their non-tax revenue in the form of licences, liquor store profits and so forth must be included and, if social services are financed by compulsory contributions, these too must be counted.

Inefficiency of Taxation on Costs.—Generally speaking, the national income will be restricted if revenue is raised in ways which lead to an increase in production and business costs. To this general proposition there is an obvious exception in the case of taxes which appear to increase the costs of an industry but which, in so doing, merely operate to drag into the open and impose upon it concealed costs which had previously been borne by the public, e.g., taxes on vehicles which damage the roads, levies to provide compensation for those injured in industrial accidents, or to provide maintenance for those thrown out of employment. In these cases it is true that a marginal firm, or even a marginal industry, may be eliminated, but in the long run its disappearance should be socially beneficial, as it is likely to be replaced by a firm, or an industry, which can pay its way. Taxation which forces an industry to bear its legitimate costs will sometimes operate, just as minimum wage laws may operate, to destroy a substandard industry.

But, except in a special case of this character, it is very undesirable that taxation should eliminate either a firm or an industry by destroying the margin of profit which enables it to remain in operation. This is precisely what taxes which increase costs of production tend to do. Many firms and many industries are, no doubt, able to bear these taxes. But firms which are struggling to survive may find that taxes affecting their costs of production compel them to raise their prices, and that although their competitors also have to raise their prices, their sales fall off because of diminished consumption. In the long run these struggling, or marginal firms, may find that their business has become unprofitable or, worse still, that they can continue in business only at a loss. The result will be that marginal firms will tend to disappear and that other firms which had formerly had a comfortable margin of profit will in their turn become marginal. At the same time

[1] Ch. VIII.
[2] *Ibid.*

new enterprises will be deterred from entering a business in which costs have been raised by taxation, and consumption restricted by high prices. The result of the tendency of marginal firms to disappear and of the tendency of potential investors to refrain from engaging in new enterprises, is that both labour and capital resources will be thrown out of employment and that the national income will be correspondingly diminished. Out of this diminished national income a larger revenue than before will have to be raised, as the unemployed will have to be maintained at the public cost. If, in order to raise the larger revenue, new taxes are imposed which bear on costs, the vicious circle will be completed.

The alternative to taxes which increase business costs lies in taxes falling on profits or other surpluses. In the long run this means that these taxes should be replaced by an expansion of the personal income tax. As an immediate measure they would presumably be replaced, in the main, by increasing the rate of tax on corporate income. This (which would result almost automatically from the implementation of Plan I) would in itself be a great step forward, for although the corporate income tax partakes of the character of a tax on costs it is paid only by businesses which show a net profit and imposes no burden whatever on enterprises which are unable to bear it. It would, therefore, occasion no diminution of the national income in the way which has been described. Nor should it exercise the same deterrent effect on new investment.

It has been shown in Book I[3] that in Canada a larger part of the total revenue of governments than in other comparable countries has been raised by taxes which increase costs, and it has been shown that this harmful taxation is not merely the result of a mistaken policy which can be changed at will, but that it is a practically inevitable consequence of the present allocation of the burdens of government and of the sources of revenue as between the Dominion and the provinces. The financial arrangements which the Commission has proposed in Plan I are designed to go to the root of the evil and to remove the basic obstacle to a sound fiscal policy. By relieving provincial governments of many of the charges which they now have to meet, and transferring these charges to the Dominion, Plan I makes it possible, and necessary, for the provinces to renounce the use of taxes on corporations, personal income taxes and succession duties. The Dominion, as the sole government employing these important forms of taxation, will then be in a position to give effect to substantial reforms, some of which will follow automatically from the unification of taxing authority.

In another chapter[4] a list is given of the various taxes which provinces impose on corporations in addition to those which an individual or partnership carrying on the same business would have to bear. Many of these are taxes which increase the costs of production because they have to be paid even if no net income is earned by the corporation. In practice, it is service corporations—banks, finance companies, chain stores, investment companies, trust companies and loan companies—which have suffered most from taxes based on their capital stock, or on some other index which bears no necessary relation to their earnings. In their turn the chief victims have been the white-collared workers whom these companies would have employed if they had not been forced to close this or that office, or if they had been disposed to expand their operations. And unemployment cannot develop in any section of the highly integrated Canadian economy without tending to spread, by reason of the reduced consumption of the unemployed, to other sections of the economy.

The Dominion is in a far better position than the provinces, and than the Dominion and the provinces together, to sweep away all these objectionable taxes and replace them by increasing the rate of taxation on the net incomes of corporations. As has already been suggested this reform, while it would be important, should only be preparatory to a more radical change which would shift the burden of these taxes to the personal incomes derived from business (and, of course, from other sources too). Other taxes which increase costs, of which the sales tax is the leading example, could be gradually replaced by revenue derived from the two main instruments of progressive taxation—the personal income tax and the succession duties—if, as Plan I provides, these were employed by the Dominion alone. The same use cannot, in practice, be made of these taxes if both the Dominion and the provinces use them, for the imposition of a high rate of tax in one province makes it difficult for the Dominion to increase its own rates without causing great hardship to taxpayers in that province, even though there may be much to be said for higher rates of federal taxation so far as the other provinces are con-

[3] *Ibid.*

[4] Pp. 115*ff*

cerned. The importance of reforms which would replace taxes on costs by taxes on surpluses can hardly be over-emphasized, for it is largely through the avoidance of burdens on what have been described as marginal enterprises that more sustained employment of the nation's manpower and of the nation's capital can be achieved.

Inefficiency incidental to other repressive taxes.—Avoidance of burdensome taxes on costs with their repressive effects on employment is not the only objective at which an efficient tax policy should aim. It should seek to avoid other deterrents to desirable economic behaviour and, when possible, should provide incentives to desirable behaviour. The Commission has had occasion to point out how succession duties, as at present imposed by the provinces, operate to distort investment throughout Canada in a way which is economically undesirable.[5] Uniform succession duties which would completely eliminate the evil of double taxation of the same property, and which would minimize the possibility of evading the tax, would make it possible to derive the maximum revenue from this source with the least harm to the national income. It is theoretically conceivable that this result might be obtained by a complicated interprovincial agreement coupled with appropriate Dominion legislation, but experience shows that close voluntary co-operation of this character is extremely improbable. Even if an agreement were made it might, in addition to its beneficial consequences, have the undesirable effect of making it difficult to adjust the details of the tax from time to time to suit changing conditions. Plan I, as has been shown, would both ensure complete uniformity and afford full opportunity to modify the structure of the succession duties as experience might show to be necessary for equity as between taxpayers and for efficiency in administration.

What has been said of succession duties has its counterpart in respect of the personal income tax. In this case, however, the imposition of the same tax by both Dominion and provinces (and even by some municipalities) is not a mere possibility but an accomplished fact. The freedom of action of the Dominion is seriously cramped when it has to find taxes which will operate without causing undue hardship either in provinces which have or in those which have not their own income tax.

[5] P. 117.

When the same citizen has to pay income taxes to two authorities which have different definitions of taxable income, or which allow different exemptions, or which adopt different systems of progression, or between which there is dispute as to priority in assessment, he is likely to be a more than usually unwilling taxpayer. He feels that two different taxes cannot both be right, that they cannot both be the most equitable that can be devised. Almost certainly he will think of the one less unfavourable to himself as the more equitable. Uniformity in income tax structure is conceivable as a matter of agreement, but it is improbable. Under Plan I uniformity is automatic, since there will be only one personal income tax in all Canada, and the field will be clear for perfecting the tax.

From the point of view of efficiency in taxation (as well as from that of equity which will be considered later) it is important that the tax should be perfected. It has already been suggested that the aim should be to make the personal income tax take the place of the corporate income tax which partakes of the character of a tax on business costs. These two income taxes, as they are employed today, have as one of their results that investment income in the form of dividends is taxed twice while all other income (including investment income in the form of bond interest) is taxed once only.[7] The two taxes as now imposed make the income from corporate enterprise less vulnerable to taxation if the capital structure of the enterprise is largely composed of bonded debt. Yet this type of capital structure is hardly deserving of the encouragement which the Canadian taxation system extends to it, for the heavy fixed charges which it involves import a rigidity into the national economy which may be dangerous in times of depression. Nor is it expedient to penalize (as at present) corporate organizations as contrasted with partnerships, individual enterprises, and publicly-owned enterprises. It might be found practicable to obtain, by taxing income generally at a higher rate than at present, enough revenue to replace the revenue which would be forgone if dividends as an item in personal incomes were exempted to the extent of the tax paid upon them at the source as net corporate income.

This device, namely the retention of the corporate income tax coupled with an exemption in respect of the personal income from dividends, would put

[7] As a matter of equity there is no clear reason why bond interest should have been accorded this favoured position; and as between two recipients of dividends the combined effect of the two income taxes is somewhat regressive in comparison to the alternative type of taxation.

the individual taxpayer in the same position as if he had received the dividends free from taxation as corporate income but had been required to pay personal income tax in respect of them just as on all other items in his personal income. It appears preferable for several reasons to the complete abolition of the corporate income tax. In the first place the retention of the corporate income tax is convenient if Plan I is adopted and the Dominion undertakes to hand over to the province concerned an amount equal to 10 per cent of the profits arising from the exploitation of its mineral wealth. In the second place the corporate income tax is useful in ensuring that non-residents of Canada do not escape a rate of tax appropriate to direct investment. These non-residents may be Canadians living abroad, or may be foreigners who have invested in Canada. In either case it will be for the income tax authority of their place of residence to consider whether or not their personal income taxes should be arranged so as to avoid double taxation of the portion received from Canadian dividends. In the third place the corporation tax has the advantage from the standpoint of the Government of being payable when the income is earned by the corporation without the delay incidental to its distribution to the shareholders. It would, therefore, act as a tax on undistributed profits without, however, penalizing the shareholder in the long run.

It is only fair to note two considerations which affect the equity of this change in the character of the corporate income tax which appears so important from the point of view of efficiency. The first is that the corporate income tax tends (just like the real property tax which is discussed elsewhere)[8] to be capitalized and to diminish the market value of the security by the capitalized value of the existing tax. Inequitable as the tax itself may have been in its inception, its removal would produce a further inequity—namely the enrichment of holders of securities who have purchased them since the tax has been in operation. This second inequity need not, however, be a compelling reason for retaining in perpetuity a tax which is undesirable from the point of view of efficiency. It would be possible to take the bold course of exacting a tax on the windfall gain which would accrue to the holder of a security if the corporate income tax were removed (or, as has been suggested, counterbalanced by an exemption in respect of the personal income tax). Or the removal (or counterbalancing) might take place gradually. The essential thing is that new corporate enterprises should not be discouraged by the prospect of the tax. The second consideration is that the device of exemption from personal income tax does not readily meet the case of small incomes in respect of which the rate of personal income tax payable on the highest bracket of the taxable income is less than the rate at which the corporate income tax is imposed. To take an extreme example, an income too small to be taxable may consist entirely of dividends. In this case equity would demand that the holder of the income should be entitled to claim a refund of the corporate income tax, while efficiency might make it seem inexpedient to invite such claims.

There are, of course, many other ways in which the personal income tax might be improved and some of these will be discussed when equity in taxation is considered. It would, however, be beyond the scope of the Commission's instructions, and of its competence, to draw up an elaborate scheme of reform. It will suffice, at this point, to discuss the type of graduation which should be used in designing a progressive income tax. If, as at present, the successive brackets within which the income falls are taxed at progressively higher rates, the rate applicable to the highest bracket may become very high while the total income tax expressed as a percentage of the total taxable income is much lower. The effect of applying a very high rate of taxation to any increment of a large income is, of course, not entirely predictable.[9] There are various possibilities. An indomitably acquisitive taxpayer might behave exactly as if no tax were imposed unless the rate on the highest bracket of his income rose to 100 per cent. A taxpayer who was mathematically inclined might work out the odds which he might reasonably accept in investing for capital appreciation rather than for an income of which governments would receive the lion's share. An altruistic taxpayer might, at little sacrifice to himself, make donations to charity within the limits allowed as exemptions for purposes of the income tax. An astute taxpayer might think of ways in which he could share his income with those who would otherwise be his dependents. It is a matter of conjecture which of these consequences would be most likely—but it is a matter which should be studied. It is only by systematic research that a taxing authority can make sure

[8] P. 144.

[9] In some provinces the rate on the highest bracket of a very large income would exceed 100 per cent if Dominion and provincial taxes are combined. If any very rich men lived in these provinces their behaviour might be observed.

that the indirect effects of the taxation which it imposes are not highly injurious to the national income. The ultimate consequences of taxation may be so obscure that it is quite futile to rely on the taxpayers themselves making known through their parliamentary representatives the full effects of the tax. But consequences which are obscure are not, for that reason, unimportant, and taxation offers a most fruitful field for research. It is a matter of policy whether or not the probable consequences would be desirable or undesirable. If they were considered undesirable they might be avoided by applying lower rates, than those now applied to the highest brackets of taxable incomes, to the totality of the taxable income. A typical large income might pay the same amount as at present and yet its possessor might not be subjected to the same economic incentives as at present.

Inefficiency arising from high cost of tax compliance.—In another chapter the Commission has discussed the economies which can be made in the cost of tax collection through cordial and intelligent co-operation between governments.[10] Under Plan I most of these economies would be secured automatically since, in respect of three important taxes, one taxing authority would be substituted for many. There remains to be considered the important question of the cost to the taxpayer of complying with the laws which impose taxation upon him.

Representations from business organizations placed such emphasis on the cost of tax-compliance that the Commission attempted to secure some measure of this burden. Through the facilities of the Canadian Manufacturers' Association, a questionnaire was circulated among about 100 Canadian firms constituting a representative cross-section of Canadian industry. In the hope of obtaining fuller and franker information than might otherwise have been supplied, the firms were not asked to make their identities known to the Commission. The replies were received by the Canadian Manufacturers' Association and a code number affixed. Copies of the information were then forwarded to the Commission's office at Ottawa. About seventy replies were received. The information came from firms ranging in size from those whose office staff consists of one person only to some of the giant corporations of the Dominion. The information thus secured included not only the costs of tax-compliance but also costs on industry arising from compliance with government inspection, audits, statistical returns, etc. The answers to the questionnaire disclosed a wide variation from one firm to another depending upon the volume of business done, the nature of the business, the geographical scope of its operations, and the care taken in filling in the returns. It is not possible to reach conclusions applicable to all companies nor is it possible to arrive at a monetary estimate of the gross burden on all corporations but certain general conclusions may be stated. For a small company with a restricted geographical scope of activity, the burden is very small and perhaps not unreasonable; the principal complaints of such companies were that extra work was required and time was taken which might have been better devoted to more productive work. For large companies whose operations expose them to the full impact of Dominion, provincial and municipal regulations, taxing statutes and collections of statistics, there is a material extra burden imposed. One very large corporation estimated that its annual cost of preparing government returns was $90,000; it was required to file annually twenty-nine returns to the Dominion Government, sixty-four returns to seven provincial governments, and seven municipal returns, and it was subject to fifty audits and inspections; an additional staff of thirty-three persons was needed to prepare these returns. In addition to the actual out-of-pocket costs the larger companies emphasized the loss in productive capacity caused by diverting time and energy of responsible officers from the development and improvement of the business to the supervision of tax-compliance, or collection of data. Certain of the answers also stressed the difficulties created by divergences between Dominion and provincial requirements as to information required for their respective returns. For example, the lack of uniformity in depreciation allowances may require considerable extra work in preparing quite separate depreciation schedules. The answers also mention the loss of time and disruption of business caused by duplication in audits by different units of government.

These complaints deal with a number of distinct matters and raise some ancillary questions. In the first place there is the cost of preparing the returns required by governments for the purpose of calculating the taxes payable by the business. This expense is in itself a sort of taxation although the amount may be difficult to estimate. Efficiency in taxation requires that it should be reduced to the very minimum and the Commission believes that a substantial reduction would result from the adoption of the recommendations of Plan I looking

[10] Sect. C, Ch. II.

to the replacement of the numerous taxes on corporations by a single tax on net corporate incomes.

In the second place, there is the cost to business of the audits designed to test the accuracy of the returns. Governments, to keep their own costs of collection low, are apt to require audits at times inconvenient to business and sometimes long in arrear. The proposals of Plan I would, if adopted, lead to a reduction in the number of audits, since there would be no further occasion for audits by provincial governments which would withdraw from the taxation of corporate income. A single taxing authority would be in a better position than ten potential taxing authorities for arranging audits in a convenient and inexpensive form and for endeavouring to avoid the evil, of which the Commission received complaint, of reopening assessments years after the event and demanding financial readjustments in cases in which there was no accusation of fraud. Some of the hardships complained of may have been incidental to the elaboration of a new form of taxation. A single taxing authority is in the best position to apply quickly and intelligently the lessons of experience.

In the third place, there is what might be termed the cost of tax avoidance. No one wishes to pay more than the law requires. Taxation statutes are often drawn in great detail but their effect is not always crystal clear. Sometimes the amount which a business is required to pay can be substantially reduced by the exercise of care in its accounting practices and by the arrangement of details of the business. From the point of view of the business the cost of obtaining skilled advice and making the adjustments indicated is part of its tax burden since it is an expense which would not be necessary but for the imposition of the tax. From the point of view of the government imposing the tax these expenses may at times appear as incidental to an effort to escape from a legitimate burden. But from any point of view it is regrettable that there should be occasion for them. The proposals in Plan I, by reducing the number and complexity of taxing statutes, should do something to reduce these expenses, although it is impossible to eliminate them altogether.[11]

In the fourth place, governments demand a great deal of information from businesses which is not concerned directly, or even at all, with taxation. In the survey conducted by the Commission little distinction was made by businesses between returns required for purposes of taxation and returns incidental to other matters. It seems probable that business men treat both types of return as but different species of the same genus, namely governmental interference. This attitude is the easier to take because there seems to be widespread scepticism as to the value of much of the statistical information which governments collect. Yet much of the information is necessary for governmental purposes and useful for industry as a whole.[12] The Commission suggests that a special effort should be made by statistical branches to place before the industries concerned, at the time when information is requested, the value of the compilations which will be made possible by their co-operation—a co-operation which does involve a certain expense to business. It is always possible that in the course of preparing a justification for a return it may be found that it is no longer of practical importance, in which case the contemplated demand on business need not be made.

It will be seen that the major reductions in the cost of tax compliance are dependent on the adoption of Plan I and are not possible either under present conditions or under Plan II. It is, therefore, necessary for the Commission to add that, if Plan I is not adopted, there should be close voluntary co-operation between Dominion and provinces with a view to using common returns and common audits wherever this is practicable and to combining returns so as to minimize the cost to industry.

Equity in Taxation

It must be the wish of every thoughtful citizen that as far as is humanly possible the burden of government should be justly distributed and that every citizen should realize that he is making a just contribution—no more and no less—to the common expenditures. Taxation moreover cannot be efficient if it is grossly unfair and if two citizens, similarly situated, are called on for grossly unequal contributions to the cost of government. From the standpoint of the efficient tax-gatherer the less heavily taxed of the two might be required to pay more. From the standpoint of the taxpayer the more heavily taxed of the two is being victimized. Taxpayers are most willing to pay when they can see that they are getting value for their taxes. In so far as they are contributing to the deadweight costs of governments, taxpayers are most willing to pay if they believe that they are being asked for

[11] For complaints as to number of taxing statutes see Ex. 88, Brief of Canadian Manufacturers' Association, Ev. p. 2315.

[12] *E.g.*, trade statistics, accident statistics.

no more than their fair share of a common expenditure. It is, therefore, essential to efficiency in taxation that taxpayers should be convinced that the taxes exacted from them are taxes which it is fair that they should pay and which it would be unreasonable for them to grudge. But it is hard to find a canon of taxation which would be generally acceptable and it would be hard to apply any canon to the intricate mass of taxation which exists in Canada today. Any individual tax can be criticized on the ground of equity only if it operates unequally as between two citizens in substantially similar positions. When the system of taxation is considered as a whole it would, no doubt, be significant if it could be related to the income of each citizen so as to show what percentage of his income each man pays. But our taxes are very complicated and the incidence of many of them is likely to shift, so that the person who pays a tax in the first instance may not be the one who eventually bears its weight. It is, therefore, impossible to say with confidence what weight of taxation any one taxpayer bears. Nor is it possible to compute what his net income would have been had the tax system been different from what it is.

It may simplify our treatment if we exclude from our discussion of equity those taxes which are in substance a price which the taxpayer pays for specific benefits which he receives and which he is free to forgo. No problem of equity arises here (so long as the price is not exorbitant) for the taxpayer gets value for his money and his income is not diminished.[13] Other taxes may be disregarded because they are linked to some specific benefit which the taxpayer will receive although he is given no choice in the matter.[14] Other taxes, too, can be divorced from any consideration of equity as between taxpayers because they are designed to penalize certain forms of behaviour in the interests of society. Just as the difference between a price and a tax is a matter of degree so is that between a fine and a tax. The taxation of liquor, for instance, may in the interests of temperance be made something of a deterrent and in this case the consumer, though he may complain of intolerance, cannot well complain that he is inequitably taxed in comparison with citizens of simpler tastes. A large, though indeterminate, part of the revenue from the tariff may be treated in this way, as being a deterrent imposed to discourage the purchase of foreign goods.

[13] *E.g.*, postage, water rates.

[14] *E.g.*, local improvement taxes, premiums payable under social insurance plans so long as these do not exceed the value of the coverage.

Equities as between Individuals.—Subject to such reservation as may have to be made on these grounds of public policy, it is arguable that the tax burden should be so apportioned that every citizen will contribute according to his ability. This doctrine may be understood in various ways. It may mean that each citizen should contribute a uniform percentage of his income; or that he should contribute a uniform percentage of his income after deducting the minimum cost of his maintenance and of that of his dependents; or that he should contribute a higher proportion of this surplus if it is large than if it is small. The third version of the doctrine embodies the principle of progression. It is in accordance with the idea that equality of sacrifice is what should be sought, and not far removed from the idea that the necessary revenue should be raised with the least aggregate sacrifice to the citizens. Even among those who agree that progression is desirable there is no agreement as to the optimum rate of progression.

In practice no system of taxation can claim to conform to these exalted principles, the strict application of which would condemn any form of taxation (unless partaking of the character of a price or of a fine) which fell upon incomes so low that they provide a bare subsistence for those dependent on them for support. But principles which cannot be rigidly applied may, nevertheless, serve as a guide.

As far as possible no taxation should be imposed on the necessary minimum expenditures of low income groups. If, as was contended in some of the submissions, all citizens should be made tax conscious in order that a sense of civic responsibility might be fostered, this result can best be achieved by taxes on minor luxuries such as tobacco. In Canada there are some consumption taxes which do fall on low income groups and if these groups are in the future required to pay social insurance premiums it will be important that the taxes which they now bear should be reduced or removed. In the meantime these taxes may be regarded to some extent as a means of payment for essential services rendered to these groups by the state and, therefore, as being, in a broad sense, a price paid for necessaries.[15] This argument is the only possible justification for municipal taxes which increase the cost of the minimum of shelter, though it must be conceded that it is not clear that if taxes on cheap

[15] A similar argument could be used if universal non-contributory old age pensions were financed by a sales tax, the incidence of which appeared to be highly regressive.

housing were removed the benefit would be immediately passed on in the form of lower rents any more than it is clear that increases in existing taxation would be passed on in the form of higher rents. In theory, however, this would be the case and it is reasonable to expect that, in the long run, there will be a dominant tendency in this direction. Some municipalities do make an attempt to exempt minimum housing requirements from the full burden of the taxation of real estate and further moves in this direction would appear desirable.

Very few taxes lend themselves readily to systematic progression and, if it is desired that the total weight of taxation should progress at a given rate, these taxes will have to progress at a much greater rate. In Canadian practice the two main progressive taxes—the personal income tax and succession duties—are imposed at very high rates on very large incomes and very large estates and exact far less from medium incomes and medium estates than do similar taxes in Great Britain, Australia, and New Zealand. The result is that while Canadian taxation is probably progressive as between medium and large incomes it is possibly regressive as between small and medium incomes.[16] From the standpoint of equity this distribution of taxation seems objectionable and the two taxes which are under consideration could easily be adapted so as to readjust it. But a discussion based on equity and efficiency in the narrow sense would be incomplete if it did not indicate that other considerations may enter into the determination of a tax policy. For instance, large incomes and large estates may be considered as undesirable in themselves and may be taxed accordingly. Heavy taxation may, in this case, be treated as something which will have a stabilizing and democratizing effect on the community, while similar taxation of the preponderantly important class which enjoys medium incomes might be thought of as socially dangerous. Or it may be considered that the taxation of large incomes and large estates may (without being unjust) be so high as to harm the national income by discouraging both exertion and investment. In either of these cases considerations of equity would normally be modified in the interests of over-riding considerations of public policy.

Inequities as between different regions of Canada.—With these general considerations in mind the more serious inequities of Canadian taxation, as at present allocated and imposed, can be considered. The most glaring inequity is territorial. If the taxes which the citizens of each province pay (including taxes paid to the Dominion, taxes paid to the province, and taxes paid to municipalities and other taxing authorities created by the province) are expressed as a percentage of the total income of the area concerned, it has been shown in Book I[17] that this percentage differs greatly as between provinces and that it is highest in the least wealthy provinces. The differences are even greater if the total taxes paid in each province are expressed as a percentage, not of the total, but of the surplus income of the province, i.e., of the total income less the cost of subsistence of the inhabitants. The whole structure of Plan I is designed to reduce (though Plan I will not eliminate) this inequality. Under the Plan each provincial government would be in a position to provide, either directly or through its municipalities and other agencies, normal educational, social, and developmental services for its people without having recourse to exceptionally heavy taxation. Differences in taxation might well continue but they would correspond to differences in the services provided. To realize this result as between provinces it is essential that the two taxes which lend themselves most readily to progression should be entrusted to the Dominion Government alone and should be made uniform throughout Canada. It is in this way only that money can be found for the National Adjustment Grants, payable to the provinces whose need is great, without resort to types of taxation which would nullify the very purpose of the grants. Just as in the discussion of efficiency in taxation questions of equity arose, so this arrangement, which conforms to standards of equity, has marked advantages from the point of view of efficiency. The maintenance of the national income of Canada requires that every government in Canada should provide adequate developmental, educational, and social services for its people. This is not reasonably possible today. Plan I would make it possible. But Plan I cannot produce these consequences unless the provinces proceed to effect, as between various areas within the province, the same sort of equalization that Plan I would produce as between the provinces. At present neighbouring municipalities performing similar services for their citizens frequently have very different rates of taxation and it is very inequitable that these

[16] Book I, Ch. VIII.

[17] *Ibid.*

differences should persist. If Plan I is implemented, provincial governments will be financially able to deal with this situation.

Questions of Equity and Efficiency relating to Particular Taxes.—In the course of the public hearings many representations were made to the Commission concerning the inequity or inefficiency of particular taxes as at present imposed, and some further suggestions have occurred in the course of the Commission's work. In this connection specific recommendations do not appear appropriate as many conflicting considerations are involved, some of which the Commission is not in a position to appraise. Discussion of a general character may serve two purposes: it may call attention to a number of grievances; and it may indicate the need for constant vigilance in adapting taxes to changing conditions.

In connection with the personal income tax it is frequently contended that it is unfair, or even unjust, to tax an individual on that part of his income which he has already paid by way of income tax to another taxing authority. This is what happens in the Western Provinces and on large incomes is a very important factor. The following table shows the percentage of the gross income taken by the provincial income tax in British Columbia and Alberta, where the income tax paid to the Dominion is not allowed as an exemption, and, in contrast, the proportion taken in Ontario, where the provincial rate is half the Dominion rate, but where the income tax paid to the Dominion is allowed as an exemption:—

PROVINCIAL INCOME TAX—PROPORTION OF GROSS INCOME

(Married man with no dependents—prior to September, 1939 Dominion Income Tax increase)

Income	British Columbia	Alberta	Ontario
$			
100,000	23%	26%	7·4%
500,000	27%	29%	7·8%
1,000,000	27%	30%	7·7%

This grievance results from the existence of Dominion and provincial income taxes neither of which concedes priority to the other. It would disappear automatically if Plan I were adopted. At present some provinces complain that they must perforce concede priority to the Dominion income tax[19] and, if they do so, the taxpayer's grievance does not arise. In practice neither the grievance of the individual nor that of the province is much alleviated by pointing out that a careful readjustment of the rates of tax could raise the same revenue from the same people without taxing anyone on income which he had already paid in income tax. If Plan I is not adopted there is, however, much to be said for making some such readjustment. As between a Canadian and a foreign jurisdiction the question of priorities is an appropriate subject for international agreement—and the scope of such an agreement can be wider if the Dominion is the sole authority levying an income tax, or if all provinces accept the Dominion's definition of taxable income.

Various suggestions were made as to the exemptions which should be accorded under the Dominion income tax law. The Ontario Brief, for instance, suggested an exemption for children attending universities. The same relief to parents of university students could probably be more equitably given by a reduction in university fees which would benefit rich and poor alike, whereas an income tax exemption would mean far more to high than to low income groups. The same sort of objection applies to the proposal for exempting life insurance premiums from personal income tax.[20] In both cases the objection would be greatly modified if the income tax exemption were replaced by a tax rebate of a fixed sum equal to the tax at a low rate on the income to be exempted.[21] There is much to be said for such an exemption in the case of life insurance as an incentive to prudent behaviour. Yet, it could easily be made to appear harsh and heartless to tax the equally praiseworthy investments of those who by reason of some disability are uninsurable or of those who prefer to provide for their future in other ways. A further suggestion was that the Dominion, which charges interest on underpayments of income tax, should pay interest on overpayments made in error. The point may appear to be a small one, but the fact that such a grievance should have been deemed worthy of inclusion in a provincial brief[22] suggests that it is worth while to make a small financial sacrifice in order to make an equitable adjustment and to remove the danger of creating a "victimization" psychology in taxpayers.

[19] Ex. 296, Brief of Ont., Pt. I.

[20] *Ibid.*, Pt. II.

[21] This idea is developed later. An exemption for moderate insurance premiums is allowed under the British Columbia income tax.

[22] *Ibid.*, Pt. II.

The Dominion income tax at present treats all royalties as investment income and taxes them at the rate applicable to that income, although the royalties received by authors are the reward of exertion, differing from wages only in that they are deferred and hazardous, and differing in all but name from the royalties received in respect of coal or oil. This is a minor matter but it seems worth mentioning as an illustration of the possibility of constant perfectionment of an instrument of taxation in the light of experience.

It has been suggested that the taxation of investment income paid to non-residents provides a suitable way of raising a revenue with no burden to the Canadian taxpayer. This is, of course, true only if no further foreign borrowing is contemplated either by public or private bodies, and if immunity from this type of taxation (as contrasted with normal taxation of an enterprise in which a foreigner may have invested) is not considered to have been a tacit condition in past borrowing. The Commission is not in a position to appraise either of these two conditions, but it may be pointed out that the taxation of income payments to non-residents is a suitable matter for international agreement. Some such agreements have already been made, and it will be easier to make them if the Dominion is the sole authority levying a personal income tax. While Canada as a debtor nation might gain on balance today by taxing foreign investors, forbearance may be a *quid pro quo* in other arrangements. And Canada may not be forever a debtor country.

In connection with the corporate income tax it has been suggested that provision should be made, by way of incentive as well as on grounds of equity, to exempt for obsolescence of plant and equipment as well as for normal depreciation. The Commission notes that some action in this direction has already been taken and looks on this as yet another instance of perfecting a novel instrument of taxation in the light of experience.

A contention by the electrical industry[23] presents very great theoretical difficulties. It is said that it is unfair to those consumers of electricity who are supplied by privately-owned utilities, if the rates they pay must include provision for taxation, while other consumers of electricity, who are supplied by publicly-owned utilities, may have their rates lowered to the extent of eliminating profits. Whether the rates charged to consumers are, in fact, raised by taxation of the profits of privately-owned utilities, at a rate applied to profit from all other forms of corporate investment, is open to doubt. But it is clear that a province or municipality which chooses to supply electricity at cost can charge lower rates than an enterprise which operates for profit, assuming that both enterprises are more or less equally efficient. If the publicly-owned utilities had been taxed on the profits which would have been earned had such a policy not been pursued, it is said that in 1936 a revenue of upwards of $7,700,000 might have been raised.[24] The simplest practical method of removing this inequity would seem to lie in the replacement of the corporate income tax (and of all other taxes peculiar to corporations) by an expansion of the personal income tax, or by the more expedient way of obtaining this result, namely, the exemption of dividends from personal income tax to the extent to which they have already been taxed as corporate income.[25] If taxes on costs, e.g., on the electricity supplied, had been substituted for taxes on profits, this additional revenue might have been obtained at the expense of those who have, it is said, virtually received an untaxed distribution of the profits of publicly-owned utilities. A similar result would have been achieved by taxing publicly-owned utilities on the assumption that they should have charged higher prices. The Commission is not prepared to recommend either of these two courses and considers that, in the circumstances, the consumers of electricity purchased from publicly-owned utilities must be allowed to retain such advantages as they now enjoy. Nor would it be easy to say what should be done if a publicly-owned utility paid dividends to a province or municipality. Should its earnings be subjected to the corporate income tax or not? The exemption which, in one way or another, is accorded to publicly-owned enterprises may, of course, be considered as the use of an incentive to drive provincial governments to socialism, for if all enterprises were publicly-owned the income of a province might be freed from the burden of the corporate income tax, much as it was contended in one of the submissions[26] that a province escapes this burden if its businesses are conducted by individuals or partnerships. If this larger issue is raised the answer seems to lie in the exemption for the purposes of the personal income tax of dividends, to the extent to which they have already been taxed as corporate income.

---

[23] Ex. 109, Brief of Canadian Electrical Ass'n, Inc.

[24] *Ibid.*, p. 8.

[25] The general case for this course of action has been stated *ante*, p. 152.

[26] Ev. Senator Farris, p. 5029.

It is necessary to consider complaints made with respect to the corporate income tax because, although it has been suggested that this tax is objectionable as being a tax on profits, its retention has been recommended (subject to a counter-balancing exemption). It has been contended that it is inequitable that a corporate income, in which profitable and unprofitable years occur, should be taxed on the profits of the profitable years and receive no consideration for losses in the unprofitable years. A corporation which has a net profit every year will pay the same tax over a prolonged period whether it is assessed year by year, or permitted to average several years' income in computing the tax to be paid. But if net income alternates with losses, a corporation will pay less if it is allowed to average its net income over several years than if it is taxed on the full net income in every year in which there is a net income. Put differently, two corporations with the same net income in the course of a long period may be very unequally taxed in respect of this income if they both pay on the full net income in the years in which there is a net income. The corporation which has occasional losses is relatively overtaxed to the extent of the tax payable on income equal to the losses. The Commission considers that, if the system can be conveniently introduced, it is fairer to tax corporations on the basis of their average income over, say, a three-year period. There would be some loss to the national revenue (unless rates were raised slightly to compensate for it) but there would be a certain advantage in stabilizing the yield of the corporate income tax, since the taxable income would be less variable from year to year.*

Averaging might also have a place in connection with the personal income tax, although its purpose would be different. It is less likely than in the case of corporations that losses would alternate with net incomes, but the rate of tax varies greatly with the size of the income so that a taxpayer with an exceptionally high income in some one year would gain substantially if he might average his income over a three-year period. This consideration would be of very great importance if capital gains were treated as income and capital losses were deductible. However, the administrative difficulties would probably be greater in averaging personal incomes than in averaging corporate incomes.

The question whether or not capital gains should be assessed and taxed as income, and capital losses allowed as a deduction, arises both in respect of personal and corporate incomes. It is a difficult question. It is hardly practicable to assess the whole of a taxpayer's property annually to determine how much he has been enriched or impoverished within the year, and the usual suggestion is that only realized cash profits should be treated as income. The problem is a very complicated one in which questions of equity and efficiency are both involved. It is not inequitable that capital gains should be taxed, provided that an allowance is made for losses and that there is averaging of net income over a period of years. But it is not everyone who counts capital gains as if they were components in his annual income. The return to the taxing authority becomes more variable from year to year as gains and losses are included in computing taxable income. The technical administration of the tax becomes complicated, and a complication which is worth while when substantial sums are involved becomes wasteful when the gains and losses on capital account are small. The effect of various plans for taxing capital gains on the investment policy of taxpayers—on their reluctance to sell securities whose value has risen within the year, or their eagerness to sell those whose value has fallen—is difficult to appraise. With the means at the command of the Commission it is impossible to appraise. Devices designed to reduce this effect on investment policy involve complications in administration and give rise to various possible inequities. The whole question deserves careful study. The Commission's offhand opinion is that capital gains are best taxed through the succession duties and that (except perhaps in the case of taxpayers whose income is mainly derived from buying and selling) they cannot advantageously be classed as income.

If it is desired to make the income tax somewhat more productive this result might be achieved by replacing the exemption of that part of the income necessary for the taxpayer's maintenance and that of his dependents, and such exemptions as might be accorded in respect of other reasonable expenditures, by a reduction of the tax payable by a fixed and equal amount which would be equal to the tax payable on the sum of these exemptions if each constituted the sole taxable income of the taxpayer. No great inequity would be involved, for the purpose of these exemptions is to make sure that the requirements of a decent subsistence are exempted from taxation. At present any one exemption operates with far greater benefit to the

* An alternative method of stabilization would lie in changing the rate of the tax from year to year, making it vary inversely with the estimate of the income subject to tax.

rich than to the poor and frequently relief is given where none is needed. The same considerations do not apply to exemptions for charitable donations whose purpose is to promote munificence or at least to protect charities against the indirect consequence of high rates of income tax on those who sustain them.

The effect of such a change on the tax payable by a married man with two dependents, and a gross income of $10,000 annually, is illustrated in the following table:—

DOMINION INCOME TAX PAYABLE

(pre September 1939 war budget increase of 20%)

—	I under present system	II if exemption for dependents fixed at the rate ruling in the lowest bracket.
Taxable income	10,000	
less exemptions	− 2,800	
	7,200	10,000
Tax (and 5% sur-tax)	462.00	787.50
Less fixed exemptions—		
man......$30		
wife...... 30		
2 children 24	—	84.00
	462.00	703.50

In the case of succession duties it is often argued that the tax should progress rather in proportion to the total wealth of the beneficiary than according to that of the decedent. It is obvious that there would be great administrative difficulty in assessing the estate of every recipient of a legacy as at the moment of its receipt. His taxable income of the preceding year would be readily ascertainable but would not be a thoroughly satisfactory basis for assessment. However, something might be done to lower the rate of duty in the case of a decedent who makes provision for a large number of dependents or whose estate is divided on intestacy among a number of children. Usually a transmission to children is taxed at a lower rate than a transmission to more remote relatives or to strangers. It would be in keeping with this universal practice to extend some concession to large families. This point would be of particular importance if Plan I is adopted and a uniform succession duty made applicable to the whole of Canada.

Various aspects of the sales tax were brought under discussion in the public hearings. There is a strong case for the progressive elimination of this tax partly because it is a tax on costs, partly because (except in the case of very low incomes)[28] it is regressive, partly because, if social insurance premiums are collected from very low income groups, those who pay the premiums can hardly be expected to pay the sales tax as well. The sales tax is open to the further objection that the tax is pyramided because, if it is collected from the manufacturer, each subsequent dealer in the commodity taxed calculates his profit on the price which he pays—a price which includes the tax. The effect is that the tax, which collects for the government a given percentage (today 8 per cent) of the manufacturer's price, takes from the ultimate taxpayer approximately the same percentage of the retail price. A number of points of detail were mentioned in the public hearings, objecting to the tax being levied on prices of materials which included freight charges, claiming relief in the case of payment of the tax on sale of goods to a purchaser who became bankrupt and never paid for them, and asking for frequent and final audits. These are not questions with which the Commission feels competent to deal, but they are points on which experience should be continually used as a guide in making further improvements.

In spite of its many defects the sales tax is one which many governments may be driven to use. The Province of Saskatchewan and the City of Montreal already use it. The Provinces of Nova Scotia and British Columbia asked for an extension of provincial taxing powers which would validate a retail sales tax.[29] The School Trustees of British Columbia advocated a provincial sales tax earmarked for education.[30] So did the Vancouver Real Estate Exchange.[31] The Calgary Board of Trade made similar representations[32] as did the Home Builders' Association of Toronto.[33] But many briefs either expressed dislike of the existing sales tax[34] on grounds which have already been indicated, or opposed its extension to the provinces.[35] The Quebec Hospital tax on meals was

[28] Book I, Ch. VIII.
[29] Brief of N.S., p. 33; Brief of B.C., p. 352; Ev. p. 4840.
[30] Ev. p. 5348.
[31] Ex. 199.
[32] Ex. 249.
[33] Ex. 288.
[34] Ex. 401, Brief of Communist Party; see also Ex. 91, Brief of Canadian Manufacturers' Ass'n and Ev. p. 2449; Ex. 280, Brief of Canadian Importers and Traders Ass'n, Inc.
[35] Ex. 206, Brief of Provincial Council of Women, B.C.; Ex. 236, Brief of Edmonton Chamber of Commerce; Ev. p. 3126 (Trades and Labor Congress).

denounced for similar reasons.[36] The upshot of this discussion is that a sales tax does raise revenue and if levied at the source excites no great opposition from those who pay it. Its incidence, however, when it is traced out, does not make it a desirable component in a tax system. Its indirect costs are high. Its rating on considerations of equity and efficiency must, therefore, be low. In particular circumstances it may well appear to be the least of several evils. The Commission appreciates the full strength of the argument against the tax and hopes that its general recommendations are of such a character as to remove any demand for its imposition except by the Dominion.

In connection with excise taxes a question of jurisdiction was raised. Provinces are obliged to frame their taxes on such things as fuel oil or gasoline so as to conform to the courts' definition of direct taxes. It is claimed that in some cases the result is inefficiency and expense in collection.[37] It would be in keeping with the general tenor of Plan I that, if the provinces withdraw from certain fields of taxation, they should have full power conferred on them to levy taxes on certain named commodities which would include fuel oil and gasoline. The general power of delegation recommended in an earlier chapter would make it possible to extend the list. It would also be in keeping with Plan I that the Dominion should limit its excise duties on liquor so as to respect the profits of provincial liquor stores which form no inconsiderable part of the revenues on which the provinces would have to rely.

Some of the many and varied problems which arise out of the taxation of real estate have been discussed in another chapter.[38] No taxes have been more bitterly denounced and it is the hope of the Commission that an indirect effect of the adoption of Plan I would be to reduce the burdens which these taxes have to carry, to facilitate some readjustments as between municipalities, and consequently to make it possible to carry out some of the reforms which are suggested in the chapter on municipalities.

[36] Ex. 342, Brief of Montreal Board of Trade, Ev. p. 8149.

[37] Ex. 34, Brief of Sask., p. 123; see also Ev. pp. 4163-4 *re* Nova Scotia.

[38] Pp. 144*ff*.