Policy
OPTIONS
Politiques

VOLUME 8 NUMBER 7
SEPTEMBER 1987

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SEPTEMBRE 1987

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Cover Art Courtesy Duke of Argyle Gallery, Halifax, N.S.
Brian LaSaga • *Barn in the field, 1987* • Acrylic • 12″ × 16″ • Newfoundland

By Deborah Coyne

Fairer, Functional Taxation

A reformed, simplified tax system should be based on a fair distribution of the burden and an egalitarian redistribution of wealth

The federal government's much-delayed White Paper ensures that tax reform will be one of the main issues of public debate until after the next general election. That is a political tactic. The most unpopular part of the reform—extended taxation on consumption—will remain to be settled either by this government after it has obtained a renewed mandate or by its successor.

This delay means that Mr. Wilson's contribution to Canadian tax policy cannot be evaluated yet. In fairness, it should be said that, after three years of tax increases that have hurt many people with low and middle incomes, while giving more breaks to the wealthy, the government is now taking some steps in the direction of a more equitable tax system. They are, however, small steps. Whatever is done about consumption taxes, it will remain true to say that Mr. Wilson has tinkered rather than reformed. Our tax system remains in many respects regressive in its social effects and inefficient in its economic effects.

At this stage, therefore, the first contribution to the debate of the next year or two should not be to argue about the detail of Mr. Wilson's measures but to try to clarify the objectives we want the tax system to serve and hence the principles on which it should be constructed.

In my view, we should expect the tax system to meet two fundamental goals: the raising of revenue to finance government activities in accordance with the equitable principle of ability to pay; and the bringing about of a more egalitarian distribution of income and wealth. The present system meets neither of these goals.

To reorient the tax system around these objectives, and to emphasize the overriding concern for equity and justice, three major changes are required. First, we should eliminate most corporate and personal tax deductions, exemptions and credits. Second, we should fully integrate the personal and corporate income taxes and fully tax capital gains to ensure that the burden of taxation is distributed more fairly among all taxpayers. Third, a tax on accumulated personal assets—either an inheritance tax or a wealth tax—should be implemented to complement the income tax.

These changes, in contrast to the White Paper proposals, would help correct distortions in the current system in a way consistent with reducing corporation concentration, discouraging sterile financial activities by paper entrepreneurs, encouraging more capital formation in Canada and ending the disturbing bias toward debt financing by Canadian business.

In addition, these changes would be an important precondition to the successful pursuit of a key social policy initiative: the integration of our tax and transfer systems and the implementation of a guaranteed minimum income.

In setting out this program for reform, we should firmly distance ourselves from the U.S. tax reform initiative, which is fundamentally inequitable and inappropriate for Canada. We must retain and enhance our progressive tax rate structure rather than adopt a flat rate structure and we must not pursue the regressive approach of shifting more of the burden of taxation to corporations from individuals.

In addition, we must not allow our efforts to be guided by so-called "revenue-neutrality". Rather, tax reform provides an opportunity to reexamine the budgetary process as a whole and to examine how better to link revenue raising and spending in a more open, accountable and responsive manner.

In this way, we may not only make progress towards a more sustainable fiscal balance but also ensure that all Canadians have a better understanding of, and confidence in, the system of public finance. Moreover, it is essential that any substantive change in the tax system be accompanied by modifications of the process that will effectively increase the political cost of using the tax system to buy off special interests; otherwise it is highly likely that, as in the past, even the most well-intentioned reforms will rapidly unravel.

The current concern over tax reform is related to the widespread disillusionment and cynicism over the role of the government in society and the economy and, more broadly, the relationship between the individual and the state. The government, which appears increasingly dominated by narrow business interests, is considered remote, unaccountable and unable to cope with the challenges we face today: poverty and unemployment, inadequate education and training, and the widening income gap between affluent and poor Canadians. The traditional instruments for the management of social and economic change, notably, fiscal (taxing, spending) and monetary policy, are subject to heavy criticism, and the fixation with "the magic of the marketplace" is increasingly being called into question.

The impetus for tax reform is not related only to the fact that the tax system is increasingly considered to be ineffective, or at best a limited policy tool. It also arises from the fact that the system is increasingly considered to be unjust and unfair. Taxation, like any government action, depends for its legitimacy on a perception of evenhandness by those subject to its burden and benefits.

Perhaps ironically, despite the major tax reform effort that followed the Carter Commission Report, the conclusion that guided many of the Report's recommendations is as applicable now, twenty years later, as then: *The present system does not afford fair treatment for*

all Canadians. People in essentially similar circumstances do not bear the same taxes. People in essentially different circumstances do not bear appropriately different tax burdens.

It is all too clear that the tax system is no longer guided by the principle of equity in both its horizontal and vertical dimensions. With specific reference to "income", comprehensively defined to include all sources that enhance a person's economic power, horizontal equity requires that individuals with similar income be subject to the same tax liability, and vertical equity requires that higher-income individuals pay not only higher taxes in absolute dollars, but also pay a higher proportion of their income in tax.

Our current system does neither. It is clearly skewed in favour of owners and inheritors, rather than the earners and creators of wealth, and in effect makes it easier for people to stay wealthy than become wealthy. For example, capital gains are taxed more lightly than earned income, if they are taxed at all, after the exemption provisions. Estate and inheritance taxes were abolished by the federal government in the early 1970s, and since then by all provinces. The system also treats those who make money from dealing in money or property much more favourably than those whose income depends on salary, by virtue of the myriad of tax incentives and special credits.

Not only is the taxation system in fact unfair on grounds of horizontal and vertical equity. Taxpayers view the system with distrust and as a means by which government extends favours to a wide variety of special interests who have mastered the intricacies of a fundamentally anti-democratic lobbying process. In addition, it is considered to be unfairly exploited by those who can afford to hire one of the armies of specialists—consultants, accountants, lawyers—to identify and/or create tax loopholes to permit tax avoidance.

As a result, the system is no longer seen as serving the broader public interest by raising revenue to finance government activities as equitably and efficiently as possible, and by redistributing wealth and income in such a way as to ensure concrete progress towards a more egalitarian, just and compassionate society.

The growth of the underground economy, estimated to be anywhere from 5 percent to 8 percent of GNP in 1985 by the Macdonald Commission, is the most concrete manifestation of the decline of public confidence in the tax system.

In light of these glaring deficiencies of the current system, comprehensive tax reform is long overdue. Bearing in mind the overriding importance of equity and the twin objectives of raising revenue according to ability to pay and promoting redistribution, what now are the essential changes that will permit the reorientation of the tax system about these goals?

First there is the elimination of most corporate and personal tax deductions, exemptions and credits. It is clear that numerous tax deductions, exemptions and credits have added needless complexity and inequity to the tax system.

Most personal tax breaks are fundamentally regressive, inasmuch as they benefit higher-income Canadians more and hence unfairly distribute the burden of taxation contrary to the principle of ability to pay. (The refundable Child Tax Credit is an obvious exception to this.)

Similarly, most corporate tax breaks are considered by informed observers to be ineffectual in achieving their putative investment or economic development goals and, in most cases, simply amount to inequitable concessions to special business interests. Accelerated capital cost allowances in particular bias the system in favour of capital-intensive industry, especially in the manufacturing sector, as opposed to more human resource and knowledge-intensive activity in the service and high technology sectors.

Despite this diagnosis, the current government continues to add *ad hoc* distortions to the tax system that can only serve to complicate tax reform. The capital gains exemption, a $100 million tax break to accompany a $220 million subsidy for General Motors in Ste. Thérèse, and special flow-through tax shelters for investors in the oil and gas industry are just a few of the recent measures that have skewed the tax system further in favour of higher-income investors and special business interests.

In addition, the government is now considering the recommendation of a House of Commons Committee for the introduction of extensive tax credits for child care expenses—an approach that will likewise exacerbate the inequities in the tax system, and do little to achieve the real objective, which is the provision of affordable, quality child care to meet the ever-increasing demand.

Even more serious, perhaps, is the evidence that the cumulative effect of the tax increases since 1984/5 has been distinctly regressive and certainly *not* distributed according to ability to pay. For example, the National Council of Welfare has estimated that a two-income, two-child couple earning $15,000 per annum experienced a 90 percent increase in its tax load from $407 in calendar 1985 to $770 in 1986; and a family earning $20,812 per annum—the poverty line for a family of four in a city of more than 500,000—experienced an increase of 35 percent to $1736 over the same period. By contrast, a family earning $80,000 per annum experienced an increase of only 8 percent.

Meanwhile, along with this inequitable distribution of the burden of increased personal income taxes, the government has exacerbated the distortions in the corporate income tax system so as to further diminish the corporate income tax as a stable source of revenue. More specifically, thanks to the billions of dollars of corporate tax expenditures, the effective average corporate income tax is well below the statutory combined rate of about 50 percent. Since 1984, the share of federal tax revenues generated by corporate income taxes has risen by less than half a percent. In contrast, revenue from personal income tax has grown by 30 percent, and the regressive federal sales tax has yielded 47 percent more.

This instability of revenue is compounded by the so-called "tax loss overhang"—the corporate tax losses that will ultimately be offset against taxes payable. It is estimated to be at least $18 billion (and perhaps as high as $30 billion) and now exceeds Ottawa's total annual tax take from business, estimated to be approximately $9.5 billion. Clearly, the impact of this inevitable exploitation of corporate losses in the future adds extreme uncertainty to the revenue generating capacity of the tax system and any real attempt to control our deficit and national debt.

Thus, recent changes in the tax system have exacerbated the unfair burden of taxation, have increased distortions in the economy as a whole and have rendered the system itself a less reliable source of revenue for the government. The eventual elimination of most personal and corporate tax deductions, exemptions and credits

must be an essential step towards a more egalitarian distribution of income and wealth. Such tax breaks simply add too many inequities and distortions to the tax system and contribute to the current crisis of confidence.

To the extent that some of these measures were intended to serve valid social or economic purposes, there are more direct, accountable and effective means of achieving the same results outside the tax system.

Take, for example, the provisions for limiting tax deductions for television advertising on American border stations that were introduced to encourage Canadian advertisers to advertise on Canadian stations. The recent Broadcasting Task Force has clearly pointed out that such a tax incentive has done little, if anything, to promote the laudable goal of increased Canadian programming.

Another example of the misguided use of tax incentives in relation to certain otherwise desirable social or economic goals is the provision for deducting interest payable on borrowed money used for the purpose of earning income. Certainly, it is desirable to ensure in some way that people be encouraged in their legitimate efforts to actively improve their businesses, create new businesses and so forth. But the evidence now is overwhelming that the current provisions for interest deductibility have, by substantially reducing acquisition costs, encouraged many unproductive takeovers of businesses, whether by way of asset or share purchases, and have contributed to the increasing levels of concentration of corporate ownership.

They have also exacerbated the dangerous over-reliance on debt financing by many businesses, particularly by the targets of takeover bids that must pledge corporate assets and borrow money in order to buy up their shares on the market to prevent the raider from acquiring them.

Sterile paper entrepreneurial activity in pursuit of paper profits is also encouraged by other provisions in the tax system that permit corporations to transfer money from one company to another by way of tax exempt dividends, on the theory that once tax has been paid by one corporation the income should not be subject to further taxation. However, as the Chairman of the House of Commons Finance Committee recently observed: *When you mix up the ability to deduct interest on borrowed money with the ability to transfer money from one company to another tax free by dividend, then you have the soup cooked up to perfection for the corporate raider—money available tax free.* Clearly, limitations on the deductibility of intercorporate dividends are required.

Opponents of reforms designed to limit the tax deductibility of interest on borrowed money, and the transfer of money tax free between corporations by way of dividend, can be expected to argue that these measures would disadvantage Canadian businesses relative to foreign investors who are able to take advantage of such preferential tax treatment. Indeed, this was precisely the argument made in the early 1970s that was accepted by the then Minister of Finance when he extended the interest deductibility provisions to purchasers of shares as well as purchasers of assets. This argument should, however, no longer be persuasive (if it ever was) given our broader objective of removing the distortions in the tax system in respect of investment activity.

Sterile paper entrepreneurial activity . . . is also encouraged

Instead, there are other more direct ways of offsetting any alleged disadvantage vis à vis foreign investors. For example, Gordon Bale has proposed a direct tax on a foreign corporation that has acquired control of a Canadian corporation as a result of a "subsidized" cash takeover. It could be a deterrent tax set at a flat rate of 15 percent of the value of the shares, or a compensatory tax whereby the rate reflects the tax saving flowing from the interest deductibility in the foreign country. To make the tax effective, there should be a provision for a lien against the assets of the Canadian company acquired. Where not all shares are being acquired, the 15 percent deterrent tax should be levied on the Canadian shareholders who sell their shares to the foreign company (since presumably, this will be passed on to the foreign purchaser in the form of a higher price demanded by the Canadian shareholder).

The foregoing discussion of the effects, at best ineffective and at worst perverse, of several key tax incentives serves to illustrate why the elimination of most personal and corporate tax breaks is a critical element of tax reform designed to reorient the tax system about the key goals of revenue raising according to ability to pay and the redistribution of income and wealth.

To undertake such change successfully, however, we will have to recognize and rise above the pressures of those who will inevitably and forcefully resist. If we fail to do so, we will face the same outcome as in 1981, when vociferous business reaction to Finance Minister MacEachen's ill-fated budget scuppered the proposals that, among other things, would have limited interest deductibility and eliminated many tax loopholes.

Another reform measure should be the integration of personal and corporate income taxes, and the full taxation of capital gains together with all other sources of income at progressive tax rates.

Many proponents of tax reform today advocate a shift of the tax burden to corporations in order to permit a reduction in personal income tax rates. Indeed, the recent tax reform package in the United States was explicitly designed to accomplish this end. More specifically, the United States has replaced fourteen personal income tax brackets ranging from 11 percent to 50 percent by two brackets set at 15 percent and 28 percent. The corporate income tax rate is now set at 34 percent and the corporate tax burden increased by some 25 percent. Both the personal and corporate tax bases have been substantially broadened through the elimination of many tax breaks and, for example, the full taxation of capital gains.

Fundamental problems are already emerging, however, in the American reform package. To begin with, now that the corporate tax rate exceeds the relevant personal income tax rates, new efforts at tax avoidance have been generated, involving schemes to "disincorporate" in order to take advantage of the lower personal rates. Indeed, the U.S. Treasury Department is preparing yet another major study, due in December 1987, that will have to recommend changes to correct these new distortions.

More importantly, the decision to shift more of the tax burden onto corporations is fundamentally inequitable and regressive and, in the Canadian context, will do nothing to advance our goals of raising revenue according to the equitable principle of ability to pay and bringing about a more egalitarian distribution of income and wealth.

We must recognize that corporations are legal fictions and have no independent taxable capacity. All corporate taxes eventually and inevitably are paid by individuals without regard to their ability to pay—whether by consumers (through higher prices), or by employees (through lower wages), or by shareholders (through reduced earnings).

Although tax incidence analysis is not generally well developed, Canadian studies indicate that, due to the less competitive structure of our markets, Canadian businesses are much more likely to treat taxes as a cost of doing business. Thus, the incidence of increased corporate taxes is generally shifted to consumers and employees and therefore has a disproportionate impact on lower-income Canadians.

In addition to the regressive incidence of corporate taxes, another problem with our current segregated approach to the taxation of corporations arises from the fact that corporate source income is taxed twice—once in the hands of the company, and again in the hands of the individual shareholders. The effect of this double taxation has been mitigated somewhat through provisions for a dividend tax credit for shareholders which now effectively offsets about one-third of the tax that the company is presumed to have paid.

Yet this approach is fundamentally flawed.

First, it benefits only higher-income taxpayers who have the resources to invest and often provides relief in excess of the taxes that the corporation has actually paid (if any) after taking advantage of any available tax breaks.

Second, there is no evidence that the dividend tax credit has had its intended effect of stimulating equity (as opposed to debt) financing. Indeed, according to Douglas Hartle, the credit is likely simply a windfall tax saving to resident investors, delivered at high cost to both federal and provincial governments. (The cost has been estimated to be close to $1.6 billion in 1986.)

While it may be desirable to encourage capital formation within Canada, there are surely much better and more direct, accountable ways to provide such incentives outside the tax system, such as by way of a matching grant system. Matching grants would, for example, be particularly useful as a way of encouraging more research and development, and much more effective than the ill-fated Scientific Research Tax Credit.

The current approach to the taxation of corporations also exacerbates the different tax treatment of the three different forms of investment income—capital gains, interest and dividends—and distorts productive investment activity. For example, as long as the combined federal and provincial corporate tax rate continues to be less than the relevant combined personal marginal income tax rate of the investor, and as long as capital gains are either half-taxed, or even fully exempt, as the 1985 amendment is phased in, the tax system is biased towards the retention of income within the corporation and the distribution of any benefit in the form of a capital gain or dividend income.

The recent surge in preferred share financing as an alternative to debt financing is an example of this disturbing bias. (Preferred share issues have provided 34 percent of outside financing in the 1980s compared to 18 percent in the 1970s.) The impact of this on the soundness of a business's financial structure is equally deleterious since it results in a built-in drain on earnings otherwise available for new investment.

Given the serious shortcomings of the corporate income tax system, it is time to consider a completely new approach that will assist in reorienting the tax system about the goals of raising revenue and redistributing income and wealth, while minimizing its impact on the nature of investment activity. This new approach involves an integration of the personal and corporate income tax systems that would effectively treat corporate tax as merely a withholding tax, and would attribute corporate profits to shareholders to be fully taxed at their individual tax rates.

The most desirable means of accomplishing integration can be found in the system recently adopted in Australia. It involves connecting the shareholders' tax credit to the actual tax paid by the corporation to ensure that there is no over-compensation as under our present dividend tax credit system. A distinction is drawn between two categories of corporate income—income that is taxed at the full rate, and income that is not taxed. Dividends paid out of untaxed income are not eligible for the credit.

This system could be adapted to accommodate the lower rate of corporate tax for small businesses in such a way as to flow the benefits through to the shareholders. But at the very least we must return to a system in which the preferential rate is lost when revenues exceed a specified maximum level.

This system of integration of personal and corporate taxes would also take into account the high level of foreign investment in Canada. By imposing an effective withholding tax at the corporate level, and providing a tax credit for resident shareholders only, it would ensure that full integration would not result in a substantial drain of potential tax revenue to foreign treasuries. More specifically, if non-resident shareholders were eligible for the tax credit in respect of their pro-rata share of corporate profits, this income would simply be taxed and generate tax revenue in the foreign country. Instead, under the proposed integration system, non-resident shareholders would not be able to claim a Canadian tax credit for the corporate tax paid on their behalf, but would not be disadvantaged, since in most cases they would still be able to claim a foreign tax credit in their country of origin in respect of their foreign tax liability.

The integration of personal and corporate income taxes is clearly a key reform in eliminating distortions in the tax system favouring certain types of investment activity and methods of financing. But integration must be complemented by other measures to achieve this goal. One of these is the full taxation of capital gains like any other source of income, rather than half-taxed as at present. In this regard, the conclusions of the Carter Commission are as valid today as twenty years ago: *A dollar gained through the sale of a share, bond or piece of real property bestows exactly the same economic power as a dollar gained through employment or operating a business. Equity principles therefore dictate that both should be taxed in exactly the same way.*

Again, though, we must not underestimate the force of those who will resist such changes. For example, the Carter Commission made very similar proposals for the integration of personal and corporate taxes and the full taxation of capital gains. Yet business lobby groups,

reflecting such interests as those of corporate executives who realized that their corporate control would be weakened if the tax system encouraged high payouts of corporate profits, were able to head off the change.

The implementation of some form of wealth tax is the third key element in a meaningful process of tax reform, and would reflect a determined effort to promote a more egalitarian distribution of income and wealth. Canada is almost the only developed industrialized country to have abandoned estate or inheritance taxes. The federal estate tax was abolished in 1971 with the introduction of the capital gains tax. (Since then, all the provinces have likewise abandoned this tax field.) Under the present system, an individual's death simply triggers a deemed disposition of assets. However, only half of the capital gain is notionally subject to tax and even this is now effectively meaningless since the introduction of the $500,000 lifetime capital gains exemption.

Yet it is clear that inheritance is a major source of inequality in the distribution of wealth and as a 1986 Statistics Canada survey established, wealth (defined as the value of total selected assets less total debts) is even more unequally distributed than income. Certainly, estate taxes ought to play a crucial role in creating a more equal society and breaking down the accumulations of hereditary wealth.

Indeed, many observers would go further and impose a full-fledged wealth tax or net worth tax as is now levied in at least eleven OECD countries. Admittedly, a wealth tax may be difficult to design (e.g. with respect to the valuation of components of wealth such as future pension rights, life insurance policies, etc.) and would not raise much revenue. But it is estimated that if only 2 percent of the net wealth of the wealthiest quintile (20 percent) of the population was taxed at a rate of perhaps 1 to 2 percent of net worth, enough revenue would be generated to lift all low-income families in Canada out of poverty. In any event, the primary purpose of a wealth tax is not to raise revenue but to complement the income tax, by taxing "income" that is not normally taxed or not taxed fairly.

In considering how best to tax wealth, we should reject the option of fully taxing bequests and gifts under the income tax as a substitute for a tax on inherited wealth. Nor should the so-called consumption or expenditure taxes be considered a more attractive and practical way of bringing spending from wealth into the tax net without raising the "spectre" of confiscation. Rather, an explicit tax is required.

The reintroduction of an estate/inheritance tax, or perhaps even a broader version of an annual wealth tax, must be considered an essential component of any tax reform strategy. Moreover, if the government proceeds with its plans to shift more of the burden of revenue raising away from the income tax system to a regressive tax such as a new national sales or business transfer tax, the need for some form of wealth taxation will be even more important, particularly on grounds of equity and fairness.

Many proponents of tax reform argue that Canada must track the United States' reform initiative, particularly with respect to the shift to a flat two-tiered personal income tax structure. They argue that Canada's personal (or indeed corporate) income tax rates cannot deviate significantly from those in the United States; otherwise, we risk an exodus of people and investment south of the border. These proponents also assert that, as with the U.S. initiative, our tax reform must seek to be "revenue neutral" so that any windfall in tax revenues generated from the broadening of the tax base through the elimination of tax breaks would be offset by a reduction in personal income tax rates.

Both these proposals—for a flat tax rate structure parallel to that in the U.S. and for revenue neutrality—should be rejected by Canadian policy makers. To begin with, the impact of these changes in the United States has been fundamentally regressive and inequitable. The replacement of 14 tax brackets ranging from 11 percent to 50 percent by two brackets set at 15 percent and 28 percent, while accompanied by steps to broaden the tax base, nevertheless effectively amounts to a windfall of savings for many high-income taxpayers and simply freezes pre-existing distributional inequities. Even the much applauded step of dropping 6 million low-income taxpayers from the tax rolls is just a smoke screen, since, in the absence of any indexation of personal income tax, these persons are simply those who have been added to the tax rolls since the early 1980s and there is nothing to prevent their being added back on, especially as the pace of inflation picks up.

The U.S. tax reform package also retained the full deductibility of mortgage interest on first and second homes, as well as of property taxes, with the result that those who own capital and property will consolidate their wealth and the polarization within American society will increase.

Finally, the commitment to revenue neutrality has meant that nothing has been done to correct the horrendous U.S. budget deficit. Americans are deluding themselves if they do not admit that eventually taxes will have to be raised.

The Canadian tax reform strategy must not mindlessly copy that pursued in very different circumstances south of the border. It is widely acknowledged that, given our greater commitment to collective welfare and the provision of public services, Canadians are prepared to pay more taxes than our American counterparts. Indeed, as Arthur Donner has noted, we should take into account government transfers to individuals in gauging the consumer tax burden in Canada, since a large share of the taxes we pay actually flows back to us through such programs as medicare, family allowances, old age security, post secondary education subsidies and so forth. In this light, the net direct tax burden today is in fact somewhat lighter today than it was when it peaked at 6.8 percent of personal income in 1970.

Also our tax reform strategy should not be guided by "revenue neutrality". Rather, we should seize the opportunity to spur constructive public debate on how to link more closely our revenue-raising and expenditure programmes and how to develop a more open, accountable and responsive budget process that will ensure that all Canadians have a better understanding of and confidence in our system of public finance.

In seeking new ways to balance revenues and expenditures, we should first distinguish between two separate issues: budget size and budget balance. As Nate Laurie persuasively argues, the budget size should be determined according to social priorities, resource allocation, and the desirable distribution of income, wealth and power. Only after we have established the necessary level of spending in this way, should we then examine the issue of budget balance and the raising of sufficient revenue. And this may very well involve an increase in taxes to finance higher levels of spending.

In other words, we should not permit our concern with the deficit and budget balance to dictate the budget size and hence what our priorities should be as the current finance minister is doing. Controlling the deficit and our national debt is of course critical, but it can be attacked much more effectively through adjusting taxes openly and accountably, rather than through ill-considered, arbitrary expenditure cuts and hidden indirect tax increases.

Despite a number of discussion papers recommending the opening up of the budget process and moving away from the strict budget secrecy convention, little change has occurred. And despite the strengthening of the powers of the House of Commons Standing Committee on Finance, which has increased the opportunities to promote public policy changes in an open, parliamentary forum, the Committee still plays no formal role in the budget process.

It is time to create a Standing Committee of the House of Commons on economic development matters that would absorb the Finance Committee and be responsible, among other things, for holding wide-ranging pre-budget hearings and for serving as a forum for a continuing national dialogue on general directions for economic policy.

Consideration should also be given to the idea of an annual white paper on government expenditures as in Britain, as well as the creation of an umbrella Estimates Committee that, in tandem with the Standing Committee on Economic Development, would examine the full range of expenditures and undertake a constructive review of specific programs and departments in an open, accountable forum.

With respect to federal-provincial transfers, as in Australia we should conduct an annual, rather than quinquennial review of federal-provincial fiscal arrangements involving the equalization formula, grants for health care and post secondary education and the Canada Assistance Plan. This should take place in conjunction with the regular budget process in a forum that will permit a much greater degree of public participation, rather than be confined to "experts" within the respective government bureaucracies.

Consideration should also be given to the establishment of a special permanent federal-provincial Tax Structure Committee that would, among other things, monitor the division of the tax field between the two orders of government and seek to harmonize federal and provincial approaches to taxation. It would also bring about needed adjustments to the equalization formula, such as a possible shift to a representative expenditure base from the current representative fiscal capacity base to bring it into conformity with section 36 of the Constitution Act of 1982. The Committee would regularly report to the proposed Standing Committee of Parliament on economic development matters.

As I have emphasized throughout this article, meaningful tax reform in Canada must aim to reorient a vastly simplified tax system about two fundamental objectives: raising revenue according to the equitable principle of ability to pay, and promoting a more egalitarian distribution of income and wealth. In sum, these two objectives dictate a number of specific directions for reform including the elimination of most personal and corporate tax breaks, the full integration of the personal and corporate income tax systems, the full taxation of capital gains, and the reintroduction of a federal inheritance tax.

In addition, we should retain and enhance our progressive rate structure, and firmly eschew the concept of "revenue neutrality" and a fixation with U.S. tax reform.

Finally, we should seize the opportunity presented by the tax reform debate to undertake a transformation of the budget process to link more closely the revenue raising and expenditure processes so as to permit effective public input and to raise the political cost of allowing the tax system to be "bought out" by special interests.

Such reforms, going far beyond the White Paper proposals, are needed to restore public confidence, not only in the equity and fairness of the tax system, but also in the ability of the government to manage our national finances responsibly and accountably and to direct social and economic change for the benefit of all Canadians.

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OPINION

How To Be Sovereign

By Ben Sivertz

Just about every day someone speaks or writes to urge that Canada assert Northern Sovereignty, on pain of its loss. That is nonsense.

If it were merely nonsense, I would not mention it. I do mention it because I think it harmful to keep talking about demonstrating sovereignty over the Queen Elizabeth Islands and the territorial waters around them. If we go on in that vein, our hearers cannot help thinking that we ourselves doubt that we own them.

Many Canadians seem to think that Canada's ownership of the Arctic archipelago and the associated territorial waters is being challenged. In fact there is no such problem, and never has been since Great Britain and Norway vacated their claims in the last century.

During the planning of the Distant Early Warning Line I was Director of Northern Administration and sat with officers of External Affairs and National Defence opposite representatives of the United States to draw up the agreement governing construction and operation of the stations across Arctic Canada.

The Americans accepted everything we proposed for the construction phase: maximum use of Canadian contractors, suppliers, transportation, labour. They listened to us about measures to avoid damage to the environment or damage to the livelihood and social structures of the indigenous people. Being military men and business administrators, they did not always understand, and often said so. But in not even one respect did they demur. They undertook to do everything we asked, and in my experience they carried out their undertakings faithfully.

When construction was complete we slipped easily into the operational pattern without change in the attitudes of the United States representatives. Not once did any of those scores of Ameri-