


ing popularity. It stands to reason that a governing party that is seen as likely to win the next election will attract more leadership hopefuls than one that faces probable defeat. Thus, those parties with hotly contested leadership races tend to do well simply because those are the very parties whose electoral prospects were the brightest to begin with.

What does all this suggest for Kim Campbell? On the one hand, there is clear evidence to suggest

that first ministers who take office without a tough fight are likely to be relegated to the opposition benches come the next consultation with the voters. On this view, a first ballot cakewalk for Campbell may be a sign of electoral disaster lurking over the horizon. On the other hand, the current Tory race seems to have already contradicted the historical trend toward more competitive national leadership contests. A Campbell first ballot victory in June,

followed by a successful fall election campaign, would certainly defy the historical record. But it would also confirm the almost unprecedented character of the Campbell phenomenon that has emerged in the spring of 1993.

Patrick J. Monahan is Director of the York University Centre for Public Law and Public Policy and is Associate Professor at Osgoode Hall Law School, York University. 

AN EQUITABLE AND EFFICIENT DEFICIT REDUCTION STRATEGY

Questionable Tax Breaks Cost Ottawa Over \$5 Billion Annually

by Neil Brooks

Canada has a deficit crisis. The need to cut government spending is urgent. Everyone must be prepared to sacrifice for the good of the country. Although this is the central message that business interests and others have been pressing on the federal government for the last decade, this year (for no apparent economic reason) deficit hysteria appears to have reached new heights.

When business interests talk about the need to cut back on government spending, they invariably have in mind the social programs that benefit, by and large, low-income families and the middle class. Occasionally, they will also renounce public subsidies for business; however, here they usually have in mind the direct subsidies that benefit farmers, regional development, and the development of some natural resources. These subsidies tend to benefit groups that are not well represented in the powerful national business organizations. Moreover, arguably some of them further national goals.

Somewhat surprisingly, in their zeal to end wasteful government spending to reduce the deficit, business interests always seem to over-

look a large number of subsidies that benefit them almost exclusively, serve no national goals, are incredibly cost-inefficient, and cost the government billions of dollars a year.

It is now well recognized by most public policy analysts that the *Income Tax Act* contains numerous spending programs that benefit big business and their owners. The repeal of even a small number of these programs would save the government billions of dollars and at the same time increase fiscal equity and further economic prosperity.

CAPITAL GAINS

The most inequitable and inefficient subsidies in the *Income Tax Act* are those that provide preferential tax treatment to taxpayers who realize capital gains: taxpayers can realize \$100,000 of capital gains tax free over their lifetimes, and only 75 percent of gains over this amount have to be included in their income for tax purposes.

From 1985 to 1990, the average annual amount of capital gains reported by individuals was \$11.7 billion and by corporations \$10.8 billion. The average annual cost to

the federal and provincial governments for the subsidy inherent in the \$100,000 lifetime exemption alone was between \$2.5 and \$3.0 billion. Well over 50 percent of this subsidy went to the richest 1 percent of Canadians.

The principal argument the Conservative government advanced in 1985 for providing an additional subsidy for investors who realized capital gains was that it would encourage investment. This claim is ridiculous. Almost all capital gains are earned on the sale of real estate and financial assets. The investment behaviour that matters for the economic growth of the nation is investment in assets that will enhance productivity — plant and equipment, research and development, and the training and education of workers. The subsidy does almost nothing to encourage this type of investment.

Even more ludicrous was the government's claim that a subsidy for capital gains would spur venture capital activity. Venture capital represents a minute fraction of the assets that would typically qualify for capital gains treatment — less than 1 percent, according to a U.S. study. Thus, this

subsidy to encourage risk taking is not only viciously regressive but also absurdly inefficient.

THE DIVIDEND TAX CREDIT

Shareholders who receive dividends from Canadian corporations can claim a dividend tax credit. This reduces their income tax payable on dividend income by about one-third. In 1989, this subsidy for shareholders cost the federal government alone about \$655 million. One-fifth of 1 percent of tax filers, those earning over \$250,000, received over 20 percent of this subsidy.

The government introduced this subsidy for Canadians investors mainly to reduce the cost of equity

"... the government could both increase the prosperity of the Canadian economy and further the goal of social justice while at the same time reducing the deficit, if that were its real agenda."

capital for Canadian firms. But, in a small economy such as Canada's, in which foreigners can freely invest, and in which many large investors such as pension funds are tax-exempt, attempting to increase share prices by giving a tax break to individual Canadian investors is futile. If share prices do increase because of the dividend tax credit, foreign shareholders and tax-exempt institutions are likely to withdraw funds from this market. The overall effect on the price of Canadian equity securities might well be negative.

FAST WRITEOFFS

In its 1987 tax reforms, the Conservative government reduced some subsidies for corporate capital investment. But several rates at which corporations are allowed to depreciate capital investments remain too generous. And in its 1992 budget,

when the government was cutting back on direct spending programs, it increased the capital cost allowance for some equipment from 25 to 30 percent. Over a five-year period, the cost of the increase alone in this subsidy was estimated to be \$730 million.

By allowing corporations to write off their assets for tax purposes faster than they are in fact depreciating, the government provides firms with, in effect, an interest-free, non-collateral, non-recourse loan in the amount of the taxes they can thus defer. By 1988-89 Canadian corporations had been able to defer over \$37 billion in taxes largely because of fast writeoffs. In that fiscal year they deferred an additional \$2 billion. Although in theory these taxes are only postponed, studies show they are unlikely ever to be repaid.

BUSINESS MEALS AND ENTERTAINMENT

Business people, including self-employed professionals, can deduct 80 percent of the costs of their "business" meals and entertainment. Yet the personal benefits from meals and entertainment are likely the same whether they are incurred in a business context or not. When almost 400,000 Canadians, including 150,000 children, are dependent on food banks for survival, this \$1 billion subsidy for business meals and entertainment represents an outrageous perversion of collective morality.

In addition, like all these tax subsidies, this subsidy is not only inequitable, it creates economic inefficiencies. If the subsidy were repealed, Canada might have fewer workers waiting on and entertaining business people. But, since businesses would presumably continue to spend their gross revenues on activities designed to increase their profits, more workers would likely be engaged in productive activities

— maybe even doing research and development.

BUSINESS LOBBYING AND POLITICAL ACTIVITIES

Businesses spend hundreds of millions of dollars every year lobbying governments for favourable treatment. A special rule inserted in the tax act in the early 1960s allows these expenses to be deducted. The result of this tax rule is that the public is forced to subsidize the efforts of businesses — and business groups like the Business Council on National Issues — to influence the political process, but not groups representing other points of view. This subsidy results in an obvious distortion in the public policy process.

ADVERTISING

When businesses invest in advertising as opposed to physical property, they receive the most generous

"... when the government assists its largest corporations with billions of dollars of tax breaks, the commitment to protect the rest of us from 'waste, fraud and abuse' — so piously expressed when directed at the poor — suddenly vanishes. It is impossible to determine which corporations benefited from particular tax expenditures ..."

tax treatment — an immediate write-off. The correct tax policy would require large companies to deduct some of their advertising expenses over several years since some of it clearly contributes to brand recognition and product acceptance that may last for many years.

The brief descriptions of these tax subsidies are meant simply to illustrate how the government could both increase the prosperity of the Canadian economy and further the goal of social justice while at the

same time reducing the deficit, if that were its real agenda. But two further points about tax subsidies might be noted.

To protect taxpayers from "waste, fraud and abuse," when the government provides aid to its poorest citizens it creates extensive sets of rules and regulations requiring the poor to disclose even the most intimate details of their personal lives in exchange for government assistance. Yet when the government assists its largest corporations with billions of dollars of tax breaks, the commitment to protect the rest of us from "waste, fraud and abuse" — so piously ex-

pressed when directed at the poor — suddenly vanishes. It is impossible to determine which corporations benefited from particular tax expenditures, let alone how much additional employment or other economic benefit we might have received as a result of providing them with these hand-outs. In fact the government does not even publish the cost of these business tax spending programs.

Business interests sometimes argue that repealing these subsidies would amount to tax increases on business, not spending cuts. But of course that is nonsense. Cutting these programs is no more a tax increase

than cutting direct farm subsidies is a tax increase for farmers, or cutting unemployment insurance is a tax increase for unemployed people. These subsidies just happen to be delivered indirectly by allowing the recipients to offset them against their tax liability, but otherwise they are absolutely equivalent to direct spending programs. Collectively, these subsidies are costing the federal treasury well over \$5 billion annually.

Neil Brooks is Professor of Law and the Associate Dean at Osgoode Hall Law School.



DEFICITS AND DEBTS: REDEFINING THE COUNTRY AND THE POLICY AGENDA

Managing the Transition to a New Fiscal Federalism Poses Big Challenge for Ottawa

by Donald J. Savoie

The ties that bind Canada may be varied but there is one that has been prominent for the past 35 years — that is, federal transfer payments. To be sure, some politicians of the day saw those payments as the underpinnings of a caring society and as an investment in Canada's mutual insurance policy. However, there is no denying that it was also the price the centre had to pay to develop and protect Canada's industrial heartland.

Government deficits and debts, together with the requirements of the global economy, are now playing havoc with our mutual insurance policy. As each region becomes inserted differently into the global economy, their links with the outside world will become more important relative to their economic linkages within Canada. The result is that the economic well-being of each Canadian region will depend less and less on that of the others. These developments alone are push-

ing the industrial heartland to hang question marks alongside a number of federal transfer programs both to regions and to individuals. Why should it continue to support transfer programs to regions that are no

"People in British Columbia will be asking why they should continue to finance equalization payments to keep universities, hospitals and schools in Newfoundland or Nova Scotia open while they have to close some of their own."

longer captive markets for its manufactured goods?

The global economy is also imposing a new discipline on how governments manage their finances. It is no longer possible to have an expenditure budget or a government debt completely out of sync with those of other nations. The size of the public debt, the efficiency of tax systems,

and the level of taxation and interest rates determine in part a country's ability to play on a world stage and its economy to be competitive.

The point here is that the global economy would threaten Canada's mutual insurance policy even if the federal treasury and those of the wealthier provinces were relatively healthy. Such is not the case. Ottawa's fiscal problems are well documented: the ratio of the federal debt to GDP has risen from a post-war low of 20 percent to well over 50 percent. Despite significant tax increases, the introduction of new taxes and the promise of a "balanced budget," Ottawa's annual deficit remains at over \$30 billion a year, as it has for the past eight years or so. The cost of servicing the federal debt now accounts for about 40 percent of all the revenues Ottawa takes in every year.

Until a few years ago, this was essentially an Ottawa problem. It no longer is. All provincial governments, including those from the tra-