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."

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."

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
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 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 in the above table.

Provincial and Municipal Relief Expenditures on Unemployed Employables, 1937

<table>
<thead>
<tr>
<th>Province</th>
<th>Proportional Relief Works</th>
<th>Municipal Relief Works</th>
<th>Total Relief Works</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current Account</td>
<td>Charged to Capital Account</td>
<td>Current Account</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>$21,000</td>
<td>$208</td>
<td>$000</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>$236</td>
<td>$1,173</td>
<td>$000</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>$28</td>
<td>$614</td>
<td>$000</td>
</tr>
<tr>
<td>Quebec</td>
<td>$11,454</td>
<td>$1,386</td>
<td>$7,829</td>
</tr>
<tr>
<td>Ontario</td>
<td>$8,347</td>
<td>$5,282</td>
<td>$5,209</td>
</tr>
<tr>
<td>Manitoba</td>
<td>$2,584</td>
<td>$320</td>
<td>$2,050</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>$9,776</td>
<td>$500</td>
<td>$995</td>
</tr>
<tr>
<td>Alberta</td>
<td>$1,640</td>
<td>$460</td>
<td>$905</td>
</tr>
<tr>
<td>British Columbia</td>
<td>$3,408</td>
<td>$1,335</td>
<td>$749</td>
</tr>
</tbody>
</table>

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

For details of the effect of Plan II in other years (1928, 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.
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. 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
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 expediency 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. The burden of consumption taxation and of taxation on business costs has also been noted as one of Canada's serious economic handicaps; 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.

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