Fiscal Balance and Fairness

Much publicity has been generated in recent months by the contention that there is a systemic problem in the financial relationship between the federal and provincial governments. Provincial officials, academics, public policy commentators and media outlets argue that there is a "vertical fiscal imbalance", i.e., the distribution of revenue resources between the federal and provincial/territorial orders of government is inconsistent with the cost of meeting their respective constitutional spending responsibilities.

The most recent public debate was sparked by the federal government's agreements with the provinces of Nova Scotia and Newfoundland and Labrador on the treatment of offshore oil revenue and Quebec on health care. However, the issue is more complex and have much longer standing than the oil revenue agreements.

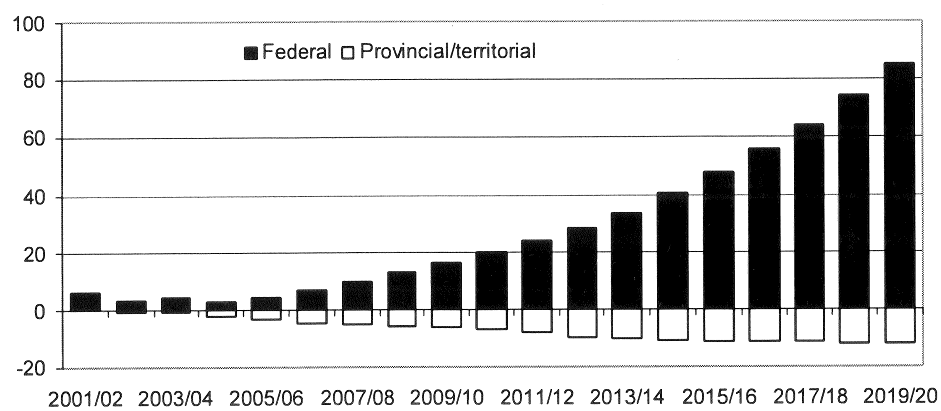
In July 2002, The Conference Board of Canada published a study, *Fiscal Prospects for the Federal and Provincial/Territorial Governments*, which examined the issue of vertical fiscal imbalance. The Conference Board's analysis used its own long-term economic outlook and incorporated all known federal and provincial/territorial taxes and spending commitments. The study projected out to 2019/20 the public accounts of the two orders of government with an emphasis on determining the impact of demographic changes on the cost of public health care and education spending.

The study concluded unambiguously that there was a persistent fiscal imbalance in favour of the federal government. (See attached Chart 9). As the Board's paper put it:

> "With the current fiscal regimes in place, the vertical fiscal imbalance will widen in the future, as only the federal government has the financial capacity to implement new initiatives such as tax cuts and new discretionary program spending. This is because the federal government will be able to achieve a budgetary surplus each year, thereby paying down the debt and entering the so-called virtuous circle of fiscal performance. In contrast, the provinces and territories will have no leeway to implement new policy initiatives over the next two decades. In aggregate, they will neither be able to increase spending nor cut taxes without falling more into deficit."

Chart 9

Federal and provincial/territorial government budgetary balances
($ billions)



Source: The Conference Board of Canada; Federal and provincial/territorial budget documents

Subsequent developments appear to have confirmed the Conference Board's analysis. Since the study's publication, the federal government has delivered three more surplus budgets (to make it eight in a row) while most of the provinces and territories have struggled with deficits as increasing expenditures, particularly for health care, inexorably eat into any revenue growth.

A fiscal imbalance of the size and persistence forecast will harm public services in Canada and weaken the federation. Services will be compromised because the provinces and territories, which have responsibility for key services such as health, welfare and education do not have the resources or flexibility to respond adequately to the growing demands of their citizens. Meanwhile, continuing surpluses at the federal level will encourage the national government to embark on program initiatives outside the priority areas such as healthcare. The federation will be weakened by the constant bickering and maneuvering of the two orders of government as they pursue priorities that are inconsistent with each other, their resources or their jurisdictions.

Recommendation

That the federal government

1. Recognize than many provinces are in a precarious fiscal position that will not be resolved by the current equalization and federal-provincial transfer system;
2. Immediately conduct a public review of all federal transfer programs, and that such a review be completed within 12 months with the mandate to provide recommendations that will restore balance and fairness to the transfer system.

SUBMITTED BY THE TORONTO BOARD OF TRADE & THE HAMILTON CHAMBER OF COMMERCE