



# **Fiscal Balance and Fiscal Relations between Governments in Canada**

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**Government of Canada**

**March 2002**

**[www.pco-bcp.gc.ca/aia](http://www.pco-bcp.gc.ca/aia)**

## Consensus or myth?

*“In starting from the hypothesis that the needs are in Quebec and the money is in Ottawa, the Commission on Fiscal Imbalance is using a false premise, which inevitably leads to false conclusions.”*

– **Conseil du patronat du Québec, March 7, 2002**

*“In its appearance before the Séguin Commission, the Chambre de commerce du Québec maintained that Quebec suffers more from an imbalance of wealth than from a fiscal imbalance. In light of this statement, transferring the GST or tax points, as the report recommends (...), would aggravate that imbalance and might penalize the less well-off provinces.”*

– **Chambre de commerce du Québec, Press Release, March 7, 2002**

# Two assertions in the report of the *Commission on Fiscal Imbalance* (Séguin Commission)

1

Fiscal imbalance

2

Invasion of provincial  
jurisdiction

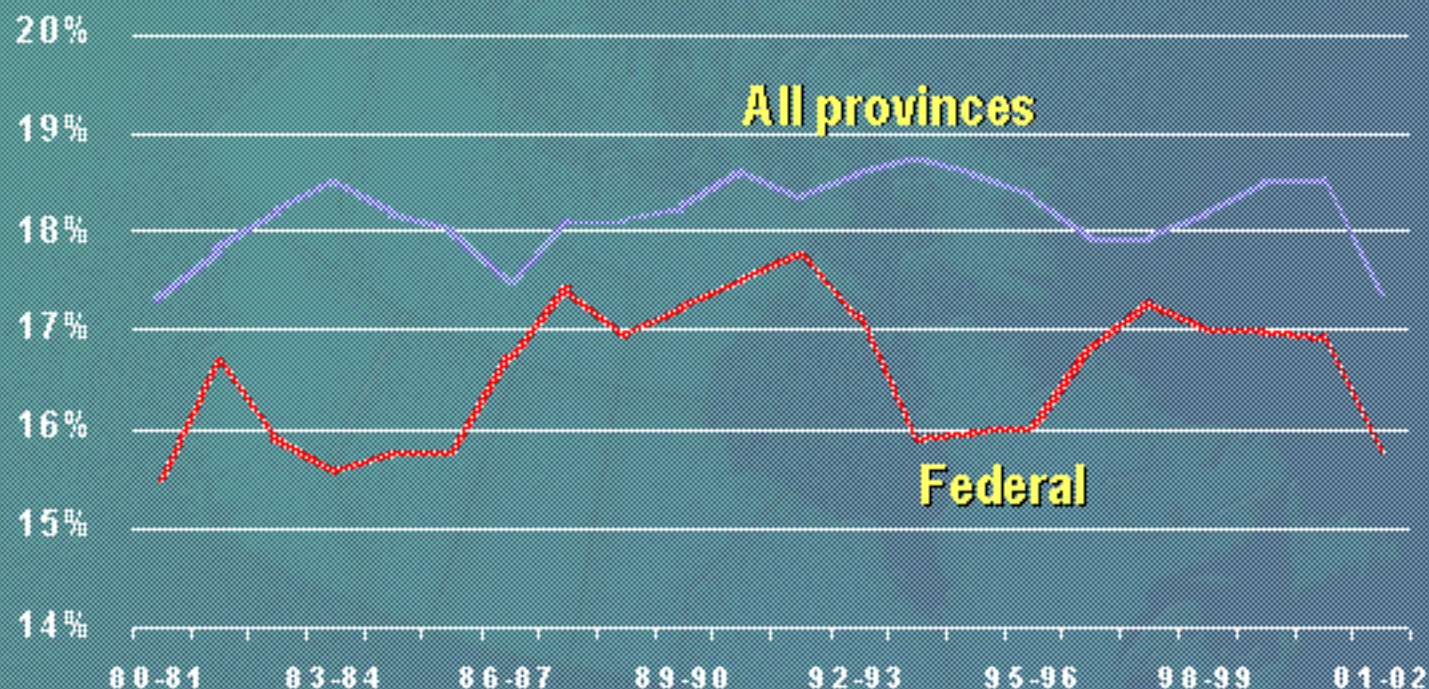
# 1 *The fiscal imbalance myth*

➔ *historical evolution*

➔ *projections*

# Evolution of revenues

## Federal and provincial revenues (% of GDP)

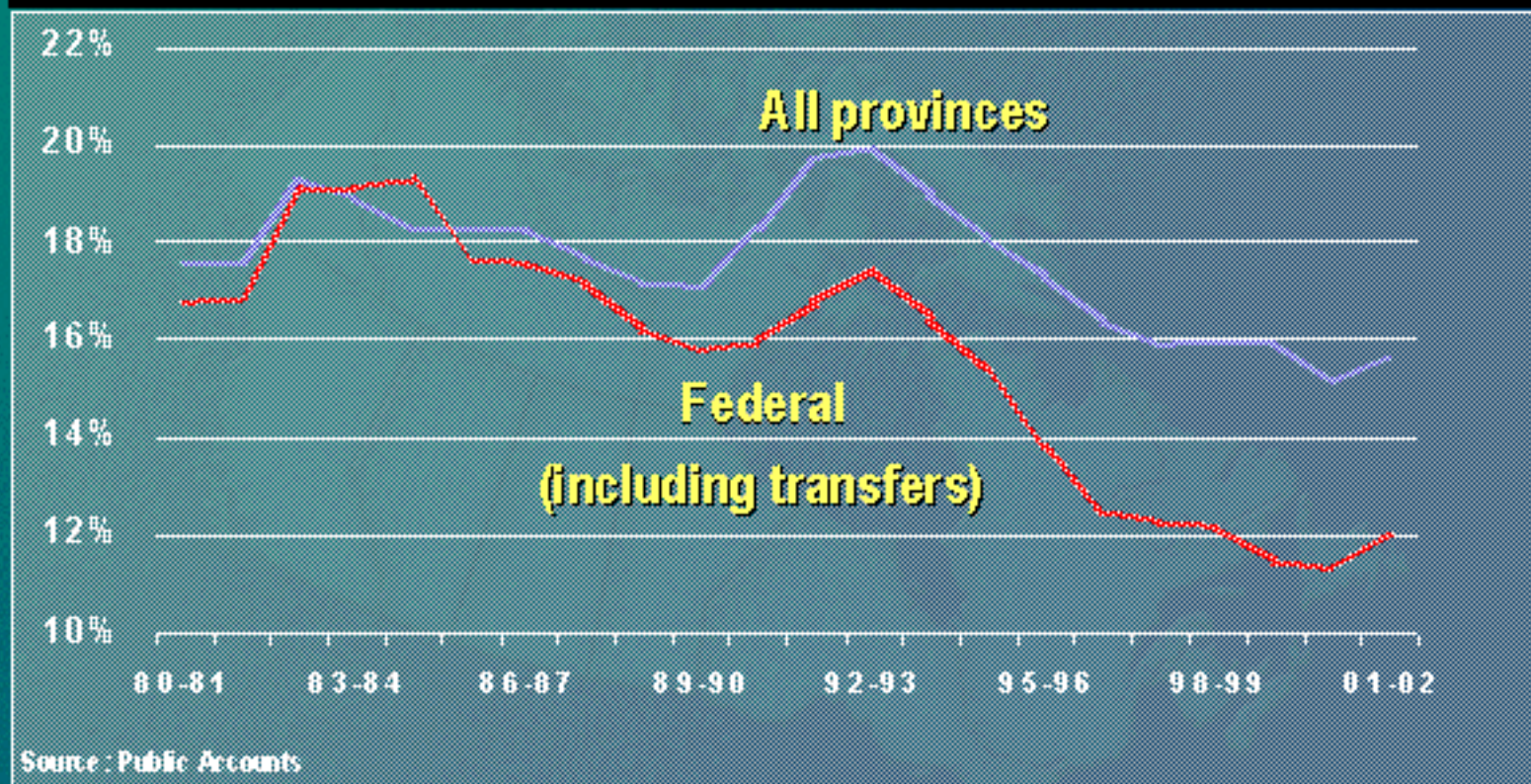


Source : Public Accounts

**Provincial government revenues have long exceeded federal government revenues**

# Evolution of spending

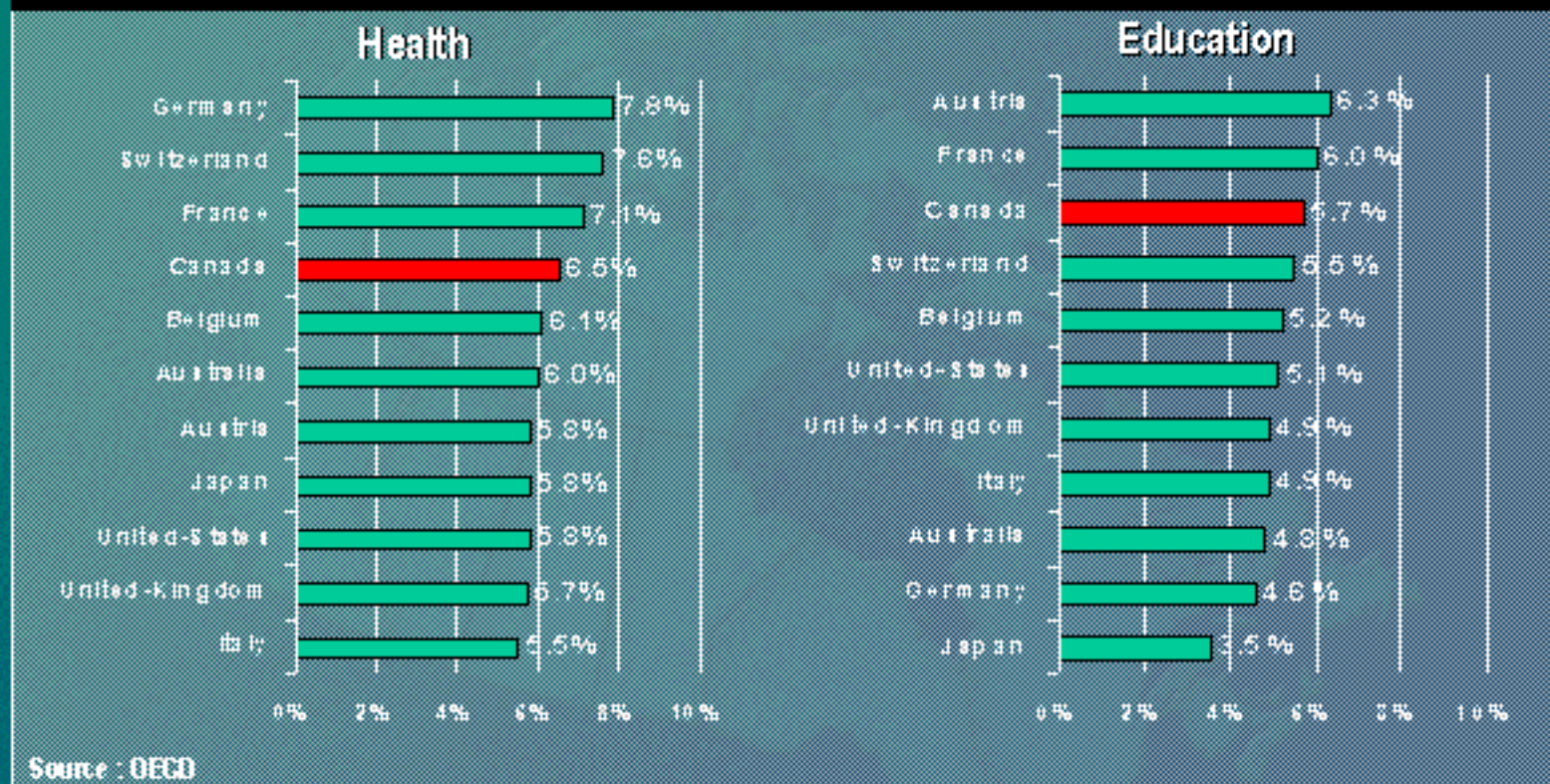
## Federal and provincial program spending (% of GDP)



Program spending has grown less quickly than the economy

# Public spending on health and education

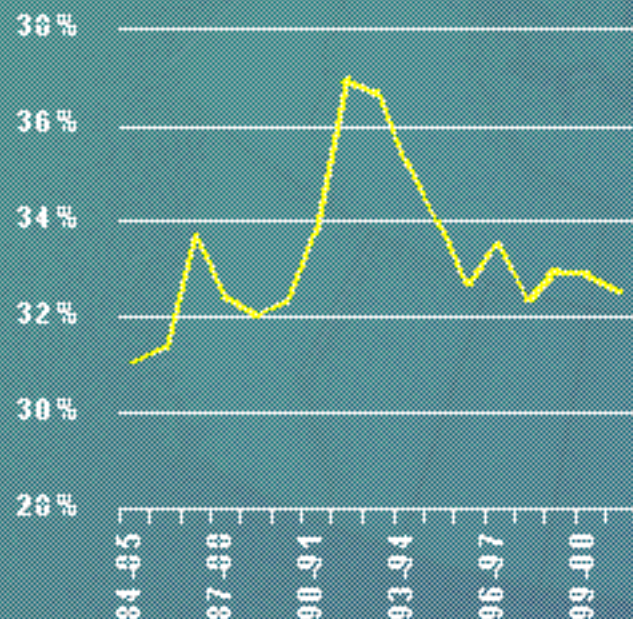
## Public spending on health and education, 1998 (% of GDP)



Canada's public spending on health and education is relatively high

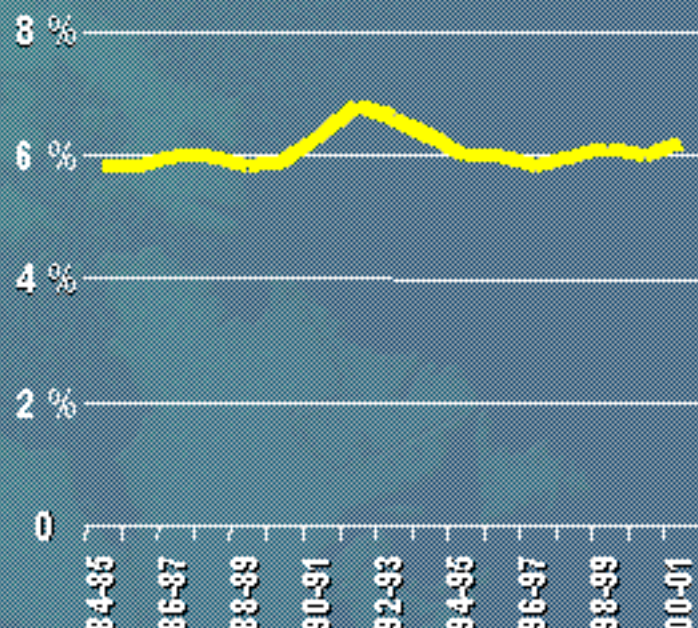
# Evolution of health spending

**Provincial health spending**  
(% of provincial revenues)



Source: Public Accounts

**Provincial health spending**  
(% of GDP)

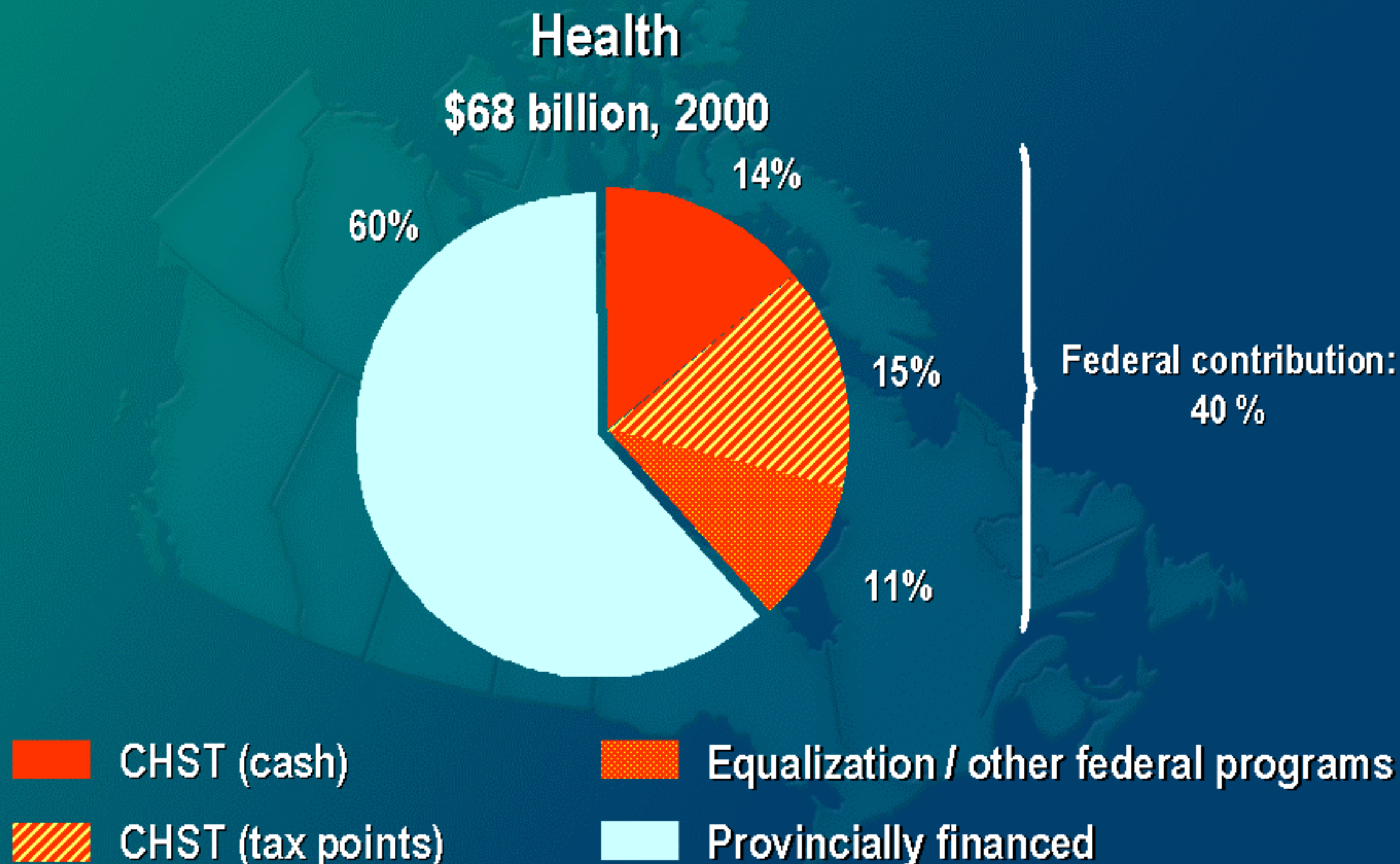


Source: Public Accounts

**Health spending has increased at roughly the same rate as provincial revenues and GDP**

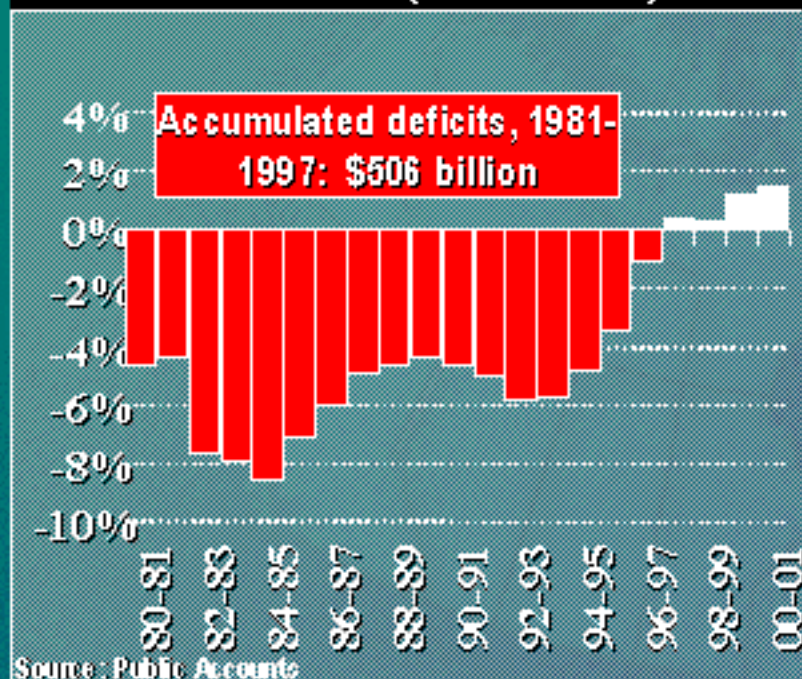


# Federal contribution to health spending

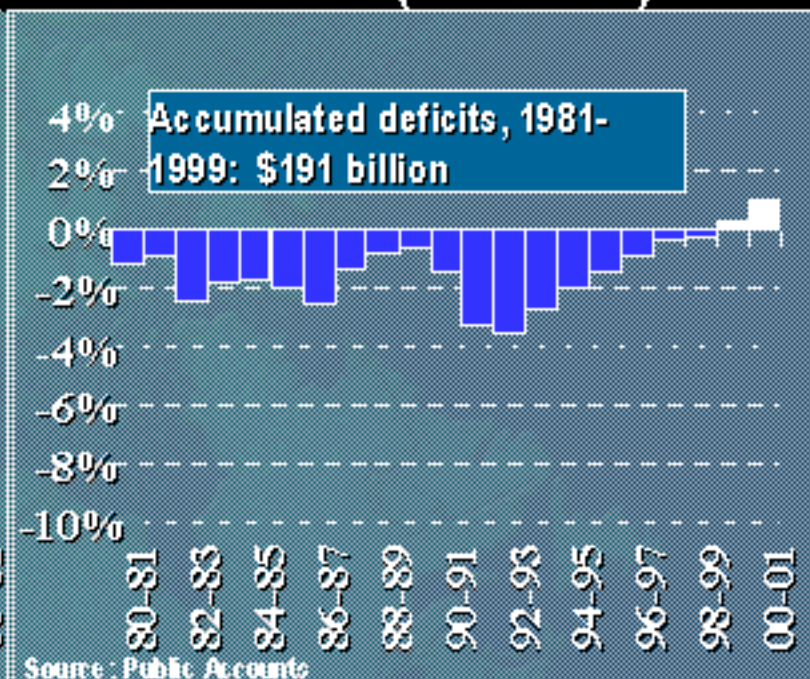


# Evolution of budget balances

**Federal** budget  
balance (% of GDP)



**Provinces'** budget  
balance (% of GDP)

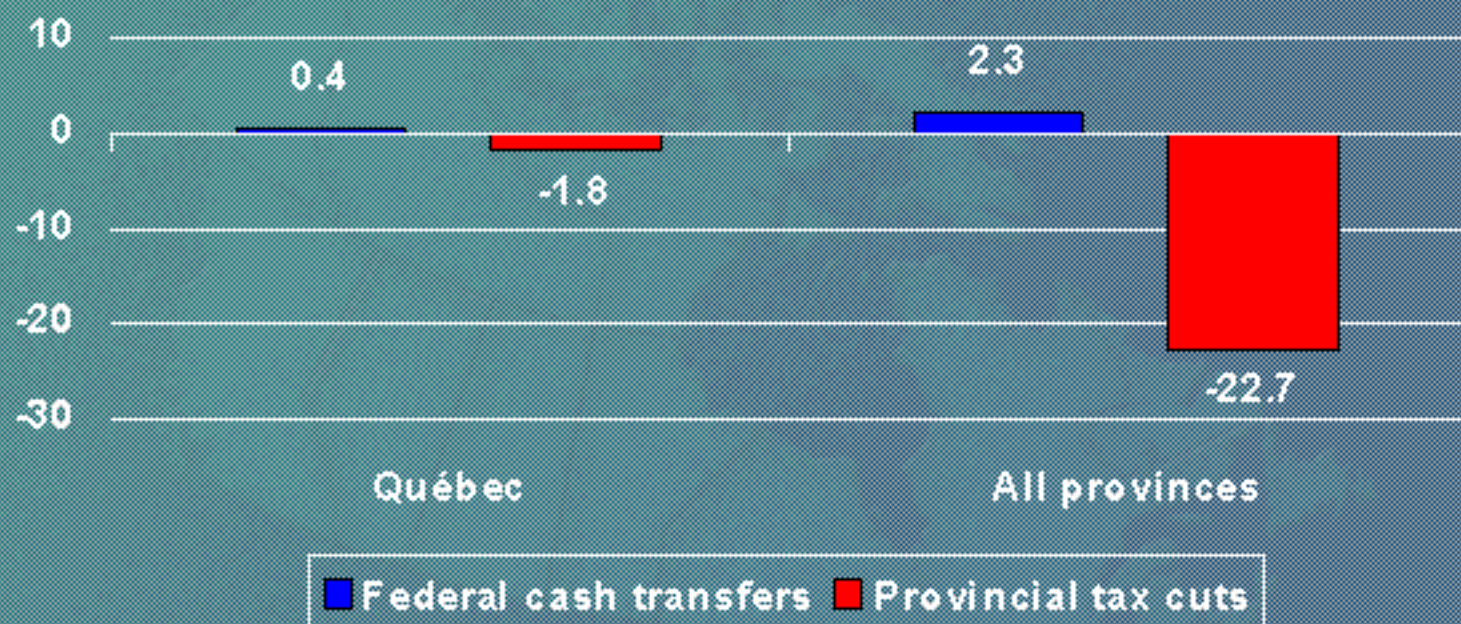


Federal surpluses are recent and small compared with the deficits that preceded them...

The provincial governments' deficits have been much smaller<sup>10</sup>

# Provincial tax cuts and increase in federal transfers

Federal cash transfers and provincial tax cuts  
1994-95 to 2002-03 (\$ billions)

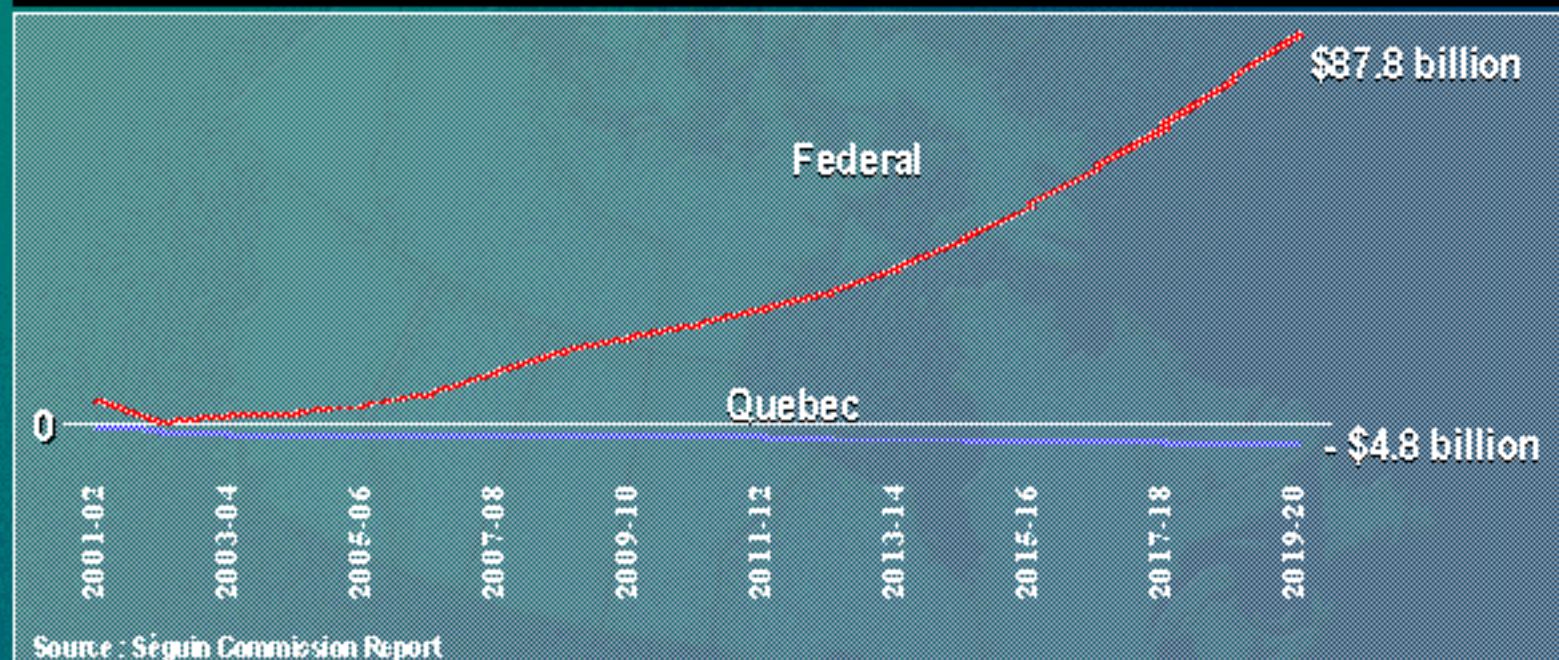


Sources: Finance Canada and provincial budgetary documents

Increase in federal cash transfers ...  
... versus much bigger provincial tax cuts

# Conference Board Projections

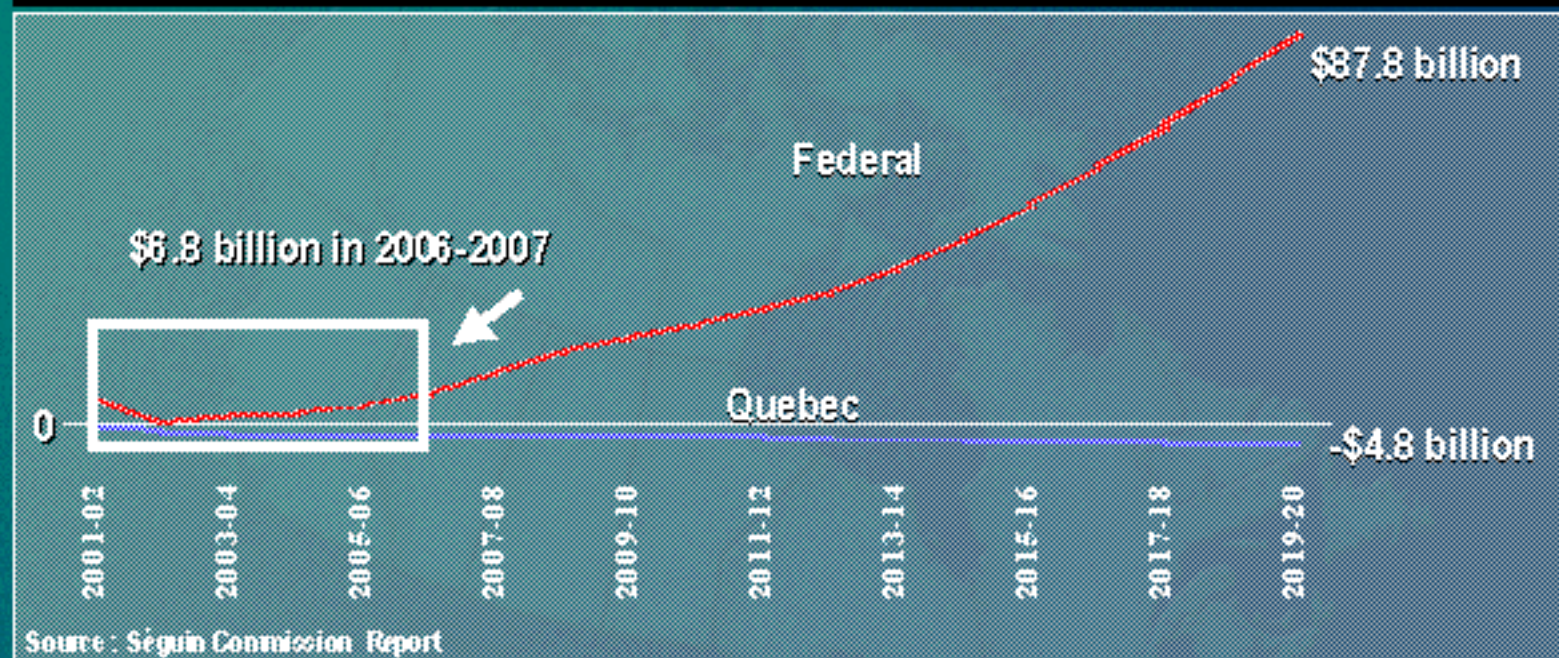
## Budget balance of the Government of Canada and the Government of Quebec (\$ billions)



The Conference Board projections (annexed to the Séguin Commission report) assume that governments will make no decisions during 20 years

# Conference Board Projections

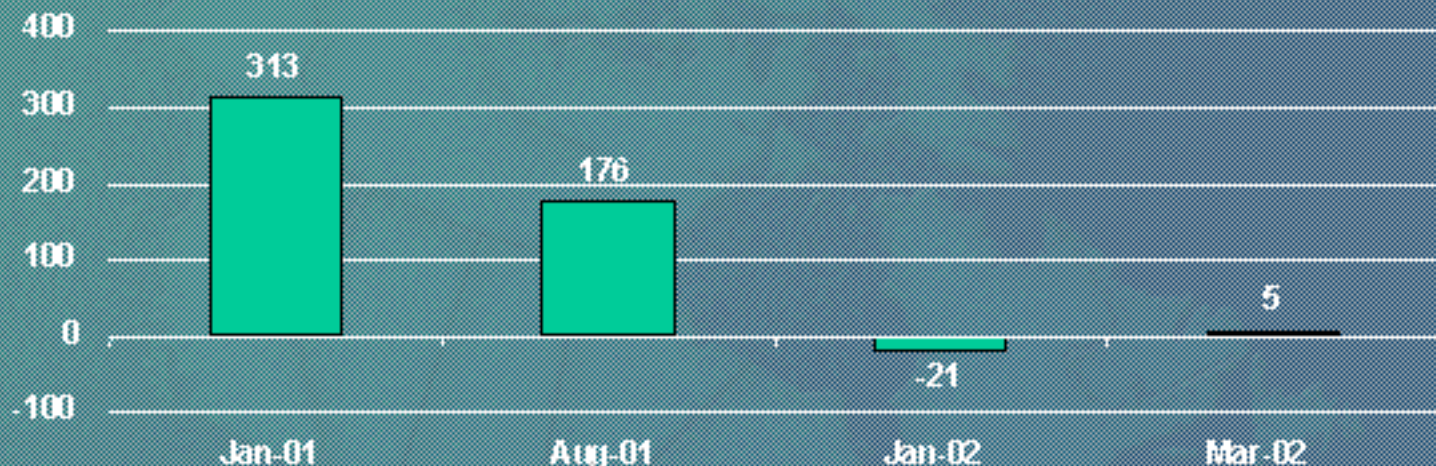
## Budget balance of the Government of Canada and the Government of Quebec (\$ billions)



The Conference Board projects very small federal surpluses for the next 5 years

## *Uncertainty of the projections*

**Projection of surpluses for 2002 in the United States  
according to the Congressional Budget Office (US\$ billions)**

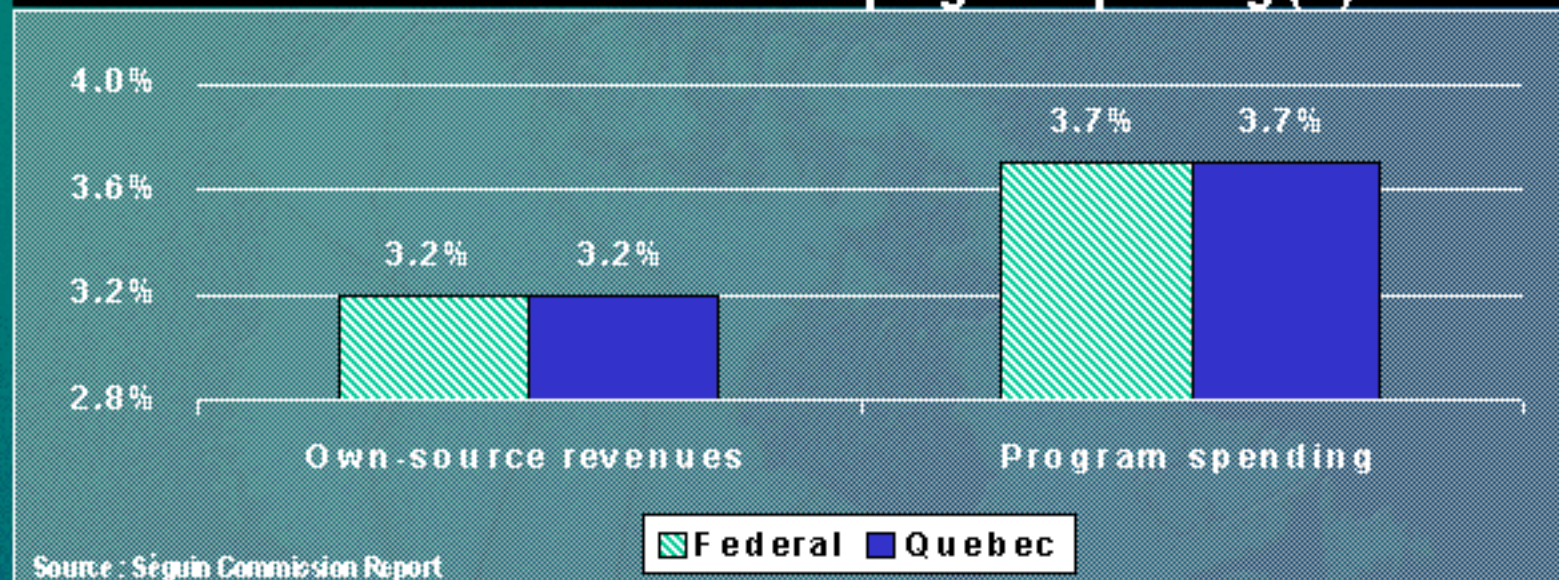


Source : Congressional Budget Office

In just over a year, the projections have changed dramatically because of unforeseen events and the economic situation

# Conference Board Conclusions

Conference Board projections of average annual growth of own-source revenues and program spending (%)

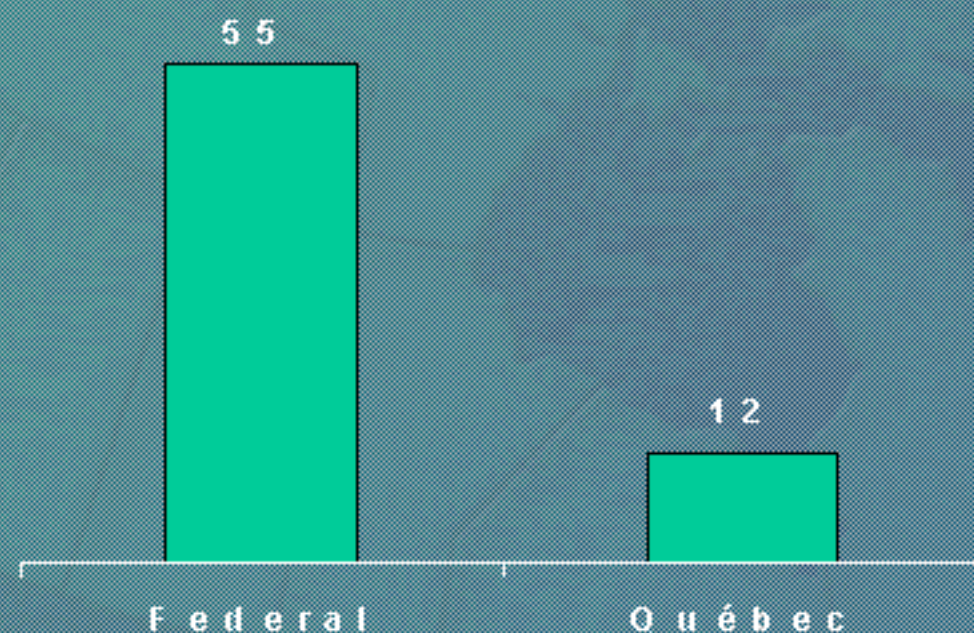


According to the Conference Board, own-source revenues and spending growth will be the same for both governments over the next 20 years

# Conference Board, 5 years ago

## Budget balances in 2001-2002 according to the Conference Board's methodology (in \$ billions)

Budgetary balances that would have been recorded if no decision had been taken since 1997 (in \$ billions)



Source s: Finance Canada and Québec budgetary documents

If the simulation is redone with 1997 as the starting point, the results have nothing to do with the reality



# ***Conference Board projections***

## Québec Gouvernement's Budget Balance

	<b>Conference Board Projections</b>	<b>Forecasted Balance (March 19 Supplement)</b>
<b>2001-2002</b>	<b>- \$0.6 billion</b>	<b>0</b>
<b>2002-2003</b>	<b>- \$1.8 billion</b>	<b>0</b>
<b>2003-2004</b>	<b>- \$2.2 billions</b>	<b>0</b>

Sources : Séguin Commission Report and March 19 2002 Supplement

**The March 19 Supplement is not in agreement with  
the Séguin Commission report**

***The Séguin Commission report  
recommendations would result in a return to  
federal deficits, according to the report's own  
hypotheses***

- Abolition of CHST and transfer of GST revenues**
  - initial net cost of around \$8 billion
  - federal deficits until approximately 2010

- Abolition of CHST, transfer of GST revenues and adoption of 10-province standard for equalization**
  - initial net cost of around \$11 billion
  - federal deficits until approximately 2013

# ***Sound federal financial health - an asset, not a problem***

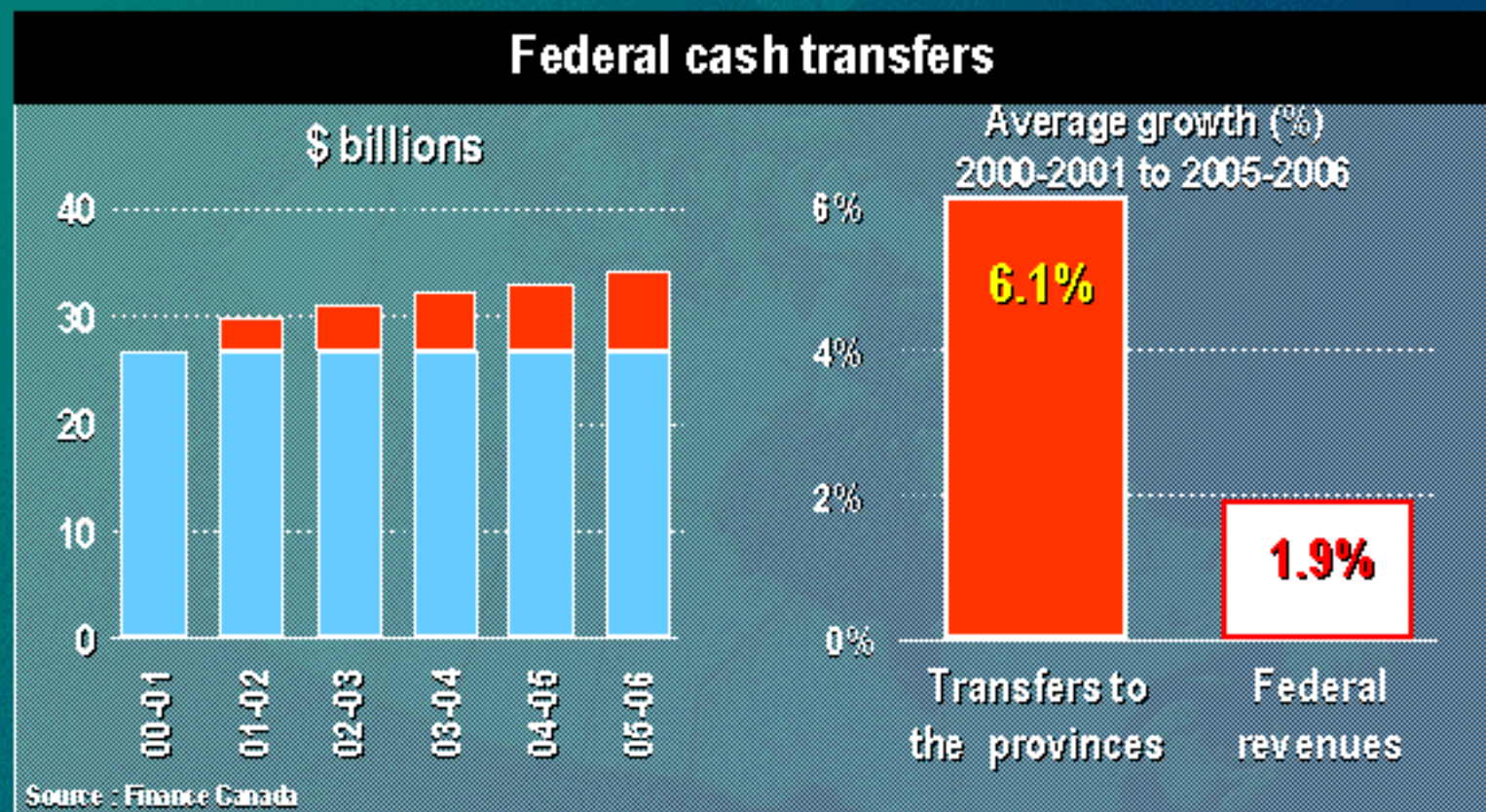
**Helps maintain lower interest rates**

- **provinces: savings on debt servicing (each 1% reduction ultimately saves \$2.4 billion)**
- **citizens: monthly savings of \$147 on a \$100,000 mortgage**

**Thus encourages economic activity**

- **\$20 billion in construction starts in 2001, compared with \$11 billion in 1995**
- **contributes to tax revenues of all governments**

# The federal government is helping the provinces as much as it can...

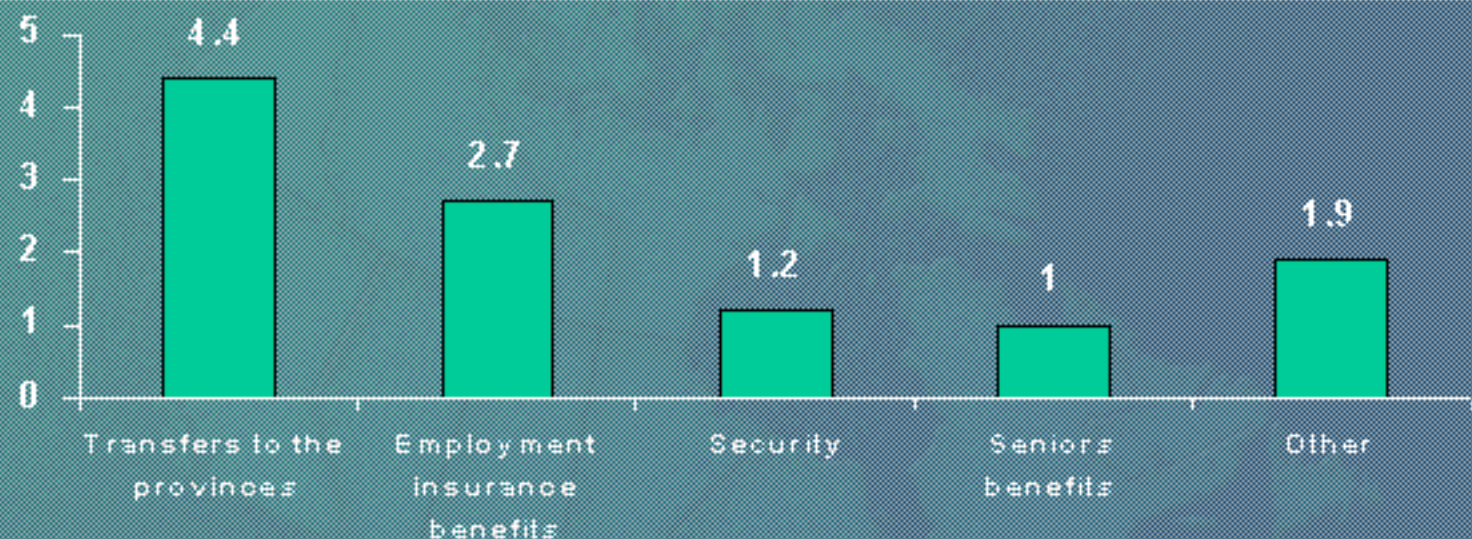


Average annual  
growth of 6.1% ...

... which is appreciably  
higher than predicted federal  
revenues

*... investing in the priorities of Canadians...*

Increase in **federal** program spending in 2001-2002  
(\$ billions)

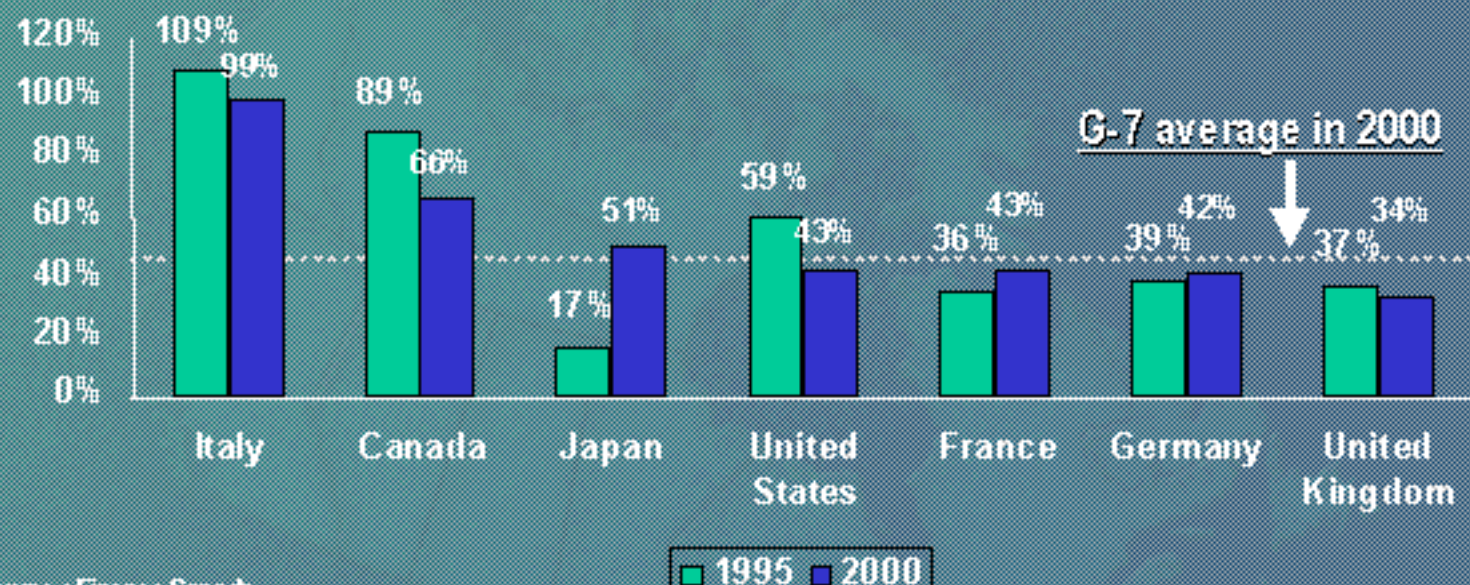


Source : Finance Canada

Of the \$11.2 billion in increased program spending in 2001-2002, 40% went to transfers.

***... and must continue to pay down the debt***

### Total government net debt (% of GDP)



***"While the gains in the war on debt should be celebrated, this is not the time to put down our weapons. (...) there is definitely still a vulnerability."***

**TD Economics, February 19, 2002**

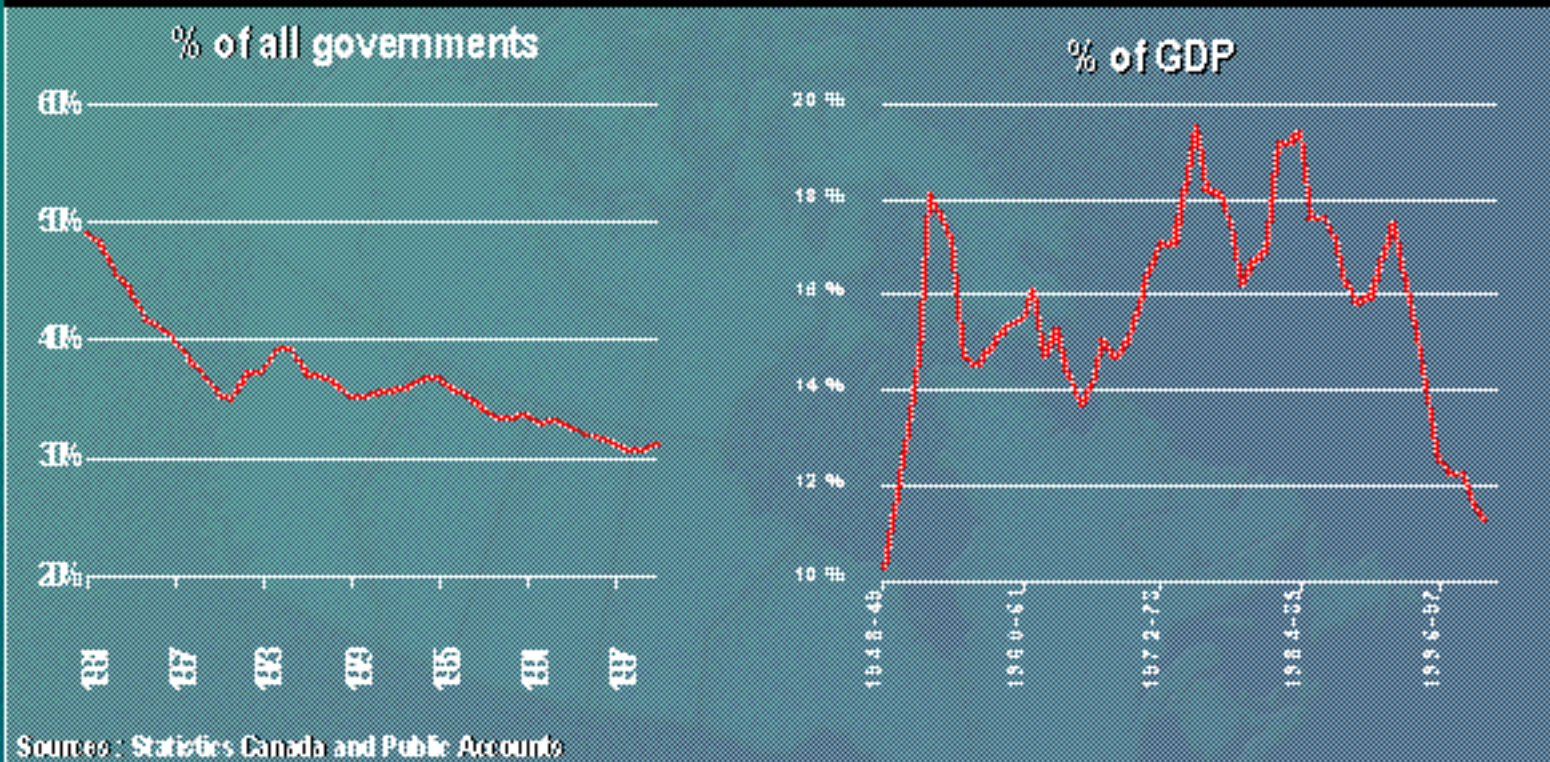
## **2** *The myth of centralizing federalism*

*"A fiscal gap in favour of the federal government can only aid and abet intervention in the provinces' fields of jurisdiction..."*

**Séguin Commission report, page X of the Summary**

# Program spending

## Federal program spending

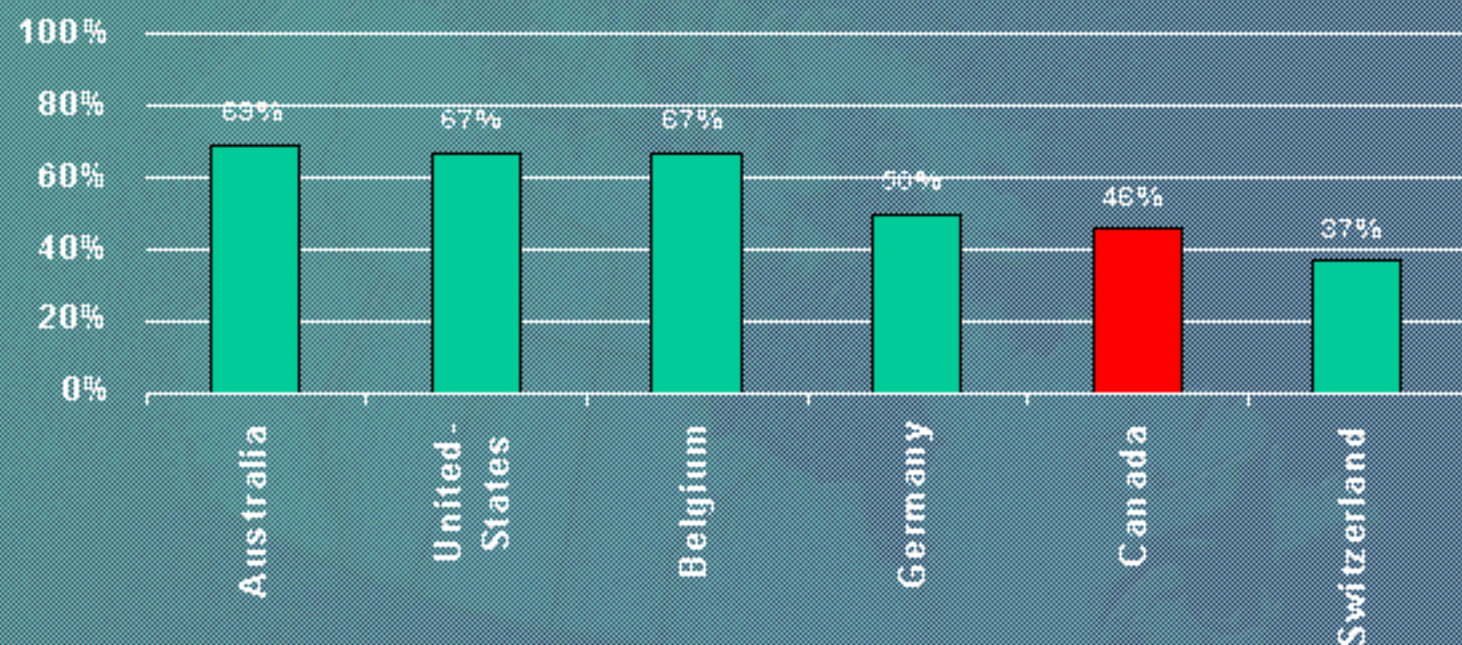


Federal program spending is at its lowest  
level since 1948...



# Distribution of government revenue

Federal share of revenue (% of total government revenue)



Sources : Séguin Commission and Statistics Canada

In Canada, the federal share of total government revenue is relatively modest

# Provincial governments' autonomy guaranteed by their access to major revenue sources

Traditional tax bases are shared by Ottawa and the provinces

## Common revenue sources

	<u>Federal</u>	<u>Provincial</u>
Personal income tax	✓	✓
Corporate income tax	✓	✓
Sales taxes	✓	✓
Payroll taxes	✓	✓

Provincial-only tax bases are growing

## Provincial-only revenue sources

	<u>Federal</u>	<u>Provincial</u>
Gambling, sale of alcohol		✓
Property taxes		✓
Natural resource revenues		✓

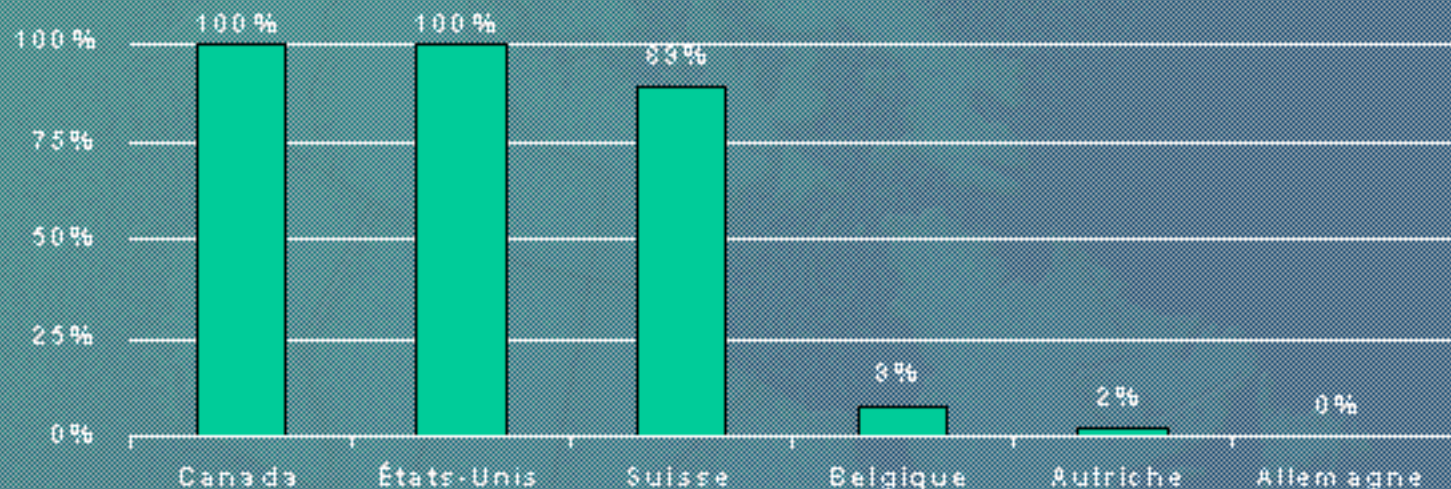
Federal-only tax bases are small and volatile

## Federal-only revenue sources

	<u>Federal</u>	<u>Provincial</u>
Customs tariffs and import duties	✓	
Taxes on non-residents	✓	

# ***Provincial control over their own-source revenue***

**Constituent units' control over their tax bases and tax rates  
(% of their own-source revenue)**



Sources: OECD (1999), *Taxing Powers of State and Local Government*

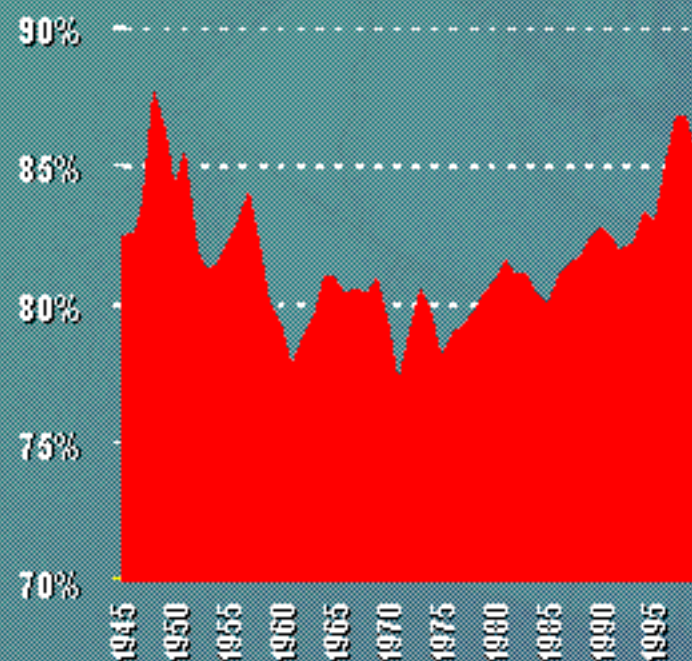
**Full control of own source revenues**

**- another advantage of fiscal arrangements in Canada**

# Fiscal autonomy of provinces

## Own-source revenues as % of total provincial-local revenues

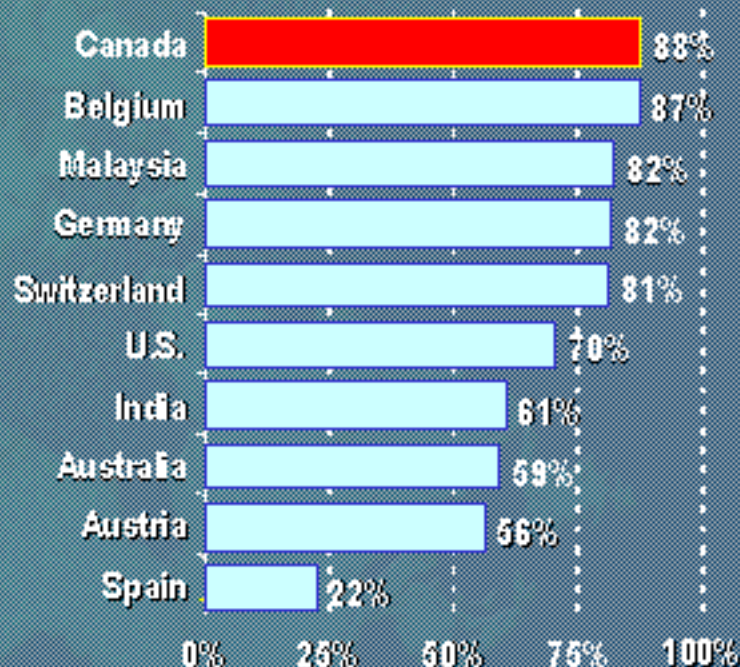
Canada, 1945-2000



Sources: Statistics Canada (2001) and Watt (1999)

Highest degree of  
autonomy in a half century

International, latest available data

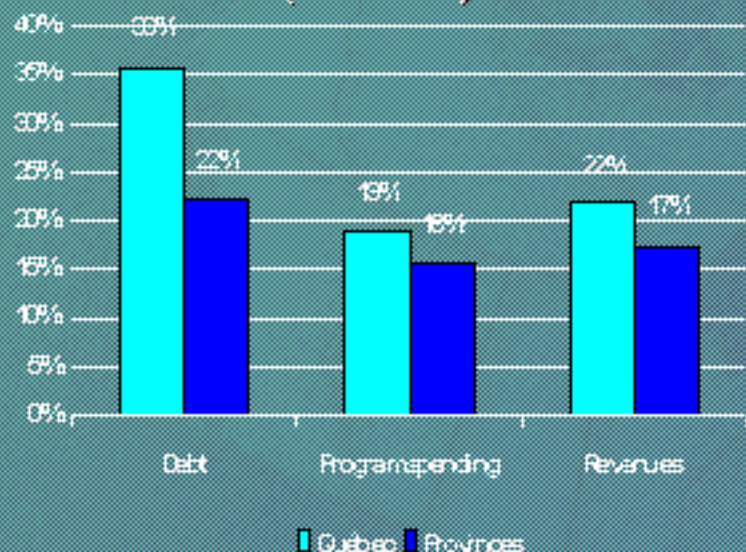


Greater autonomy than in  
any other federation

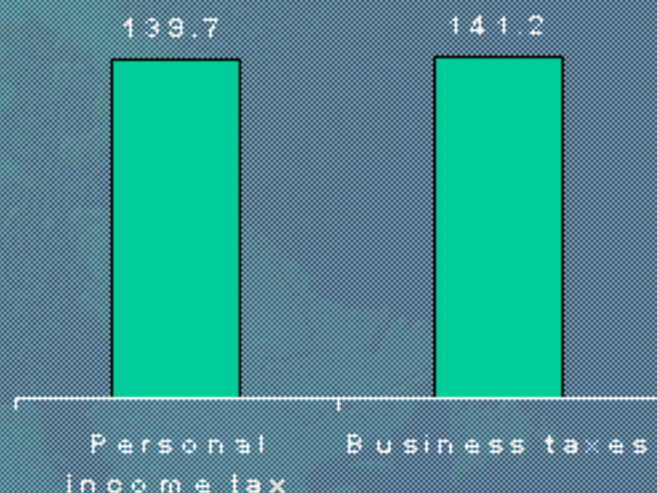
# Governments made their own budgetary choices

## Program spending, revenues and fiscal effort, 2001-2002

Debt, program spending and revenues  
(% of GDP)



Fiscal effort in Québec  
(provincial average = 100)



Sources: Public Accounts and Finance Canada

Québec government tax and spend more than the average

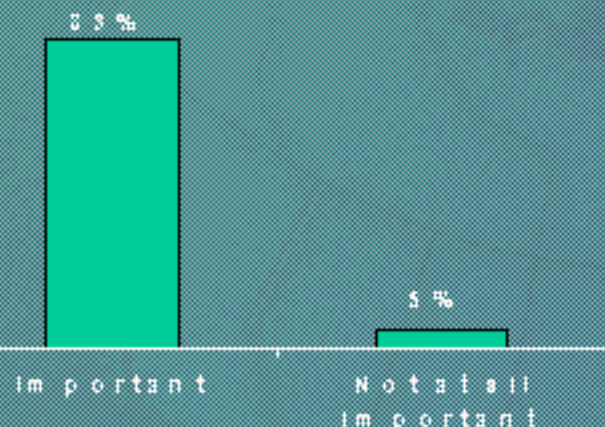
## ***Spending Power and Canada Health Act: completely legal and constitutional***

*"The federal Parliament [has played] a leading role in the provision of free, universal medical care throughout the nation. It has done so by employing its inherent spending power to set national standards for provincial medicare programs [...] The constitutionality of this kind of conditional grant, I note parenthetically, was approved by this Court in Reference Re Canada Assistance Plan."*

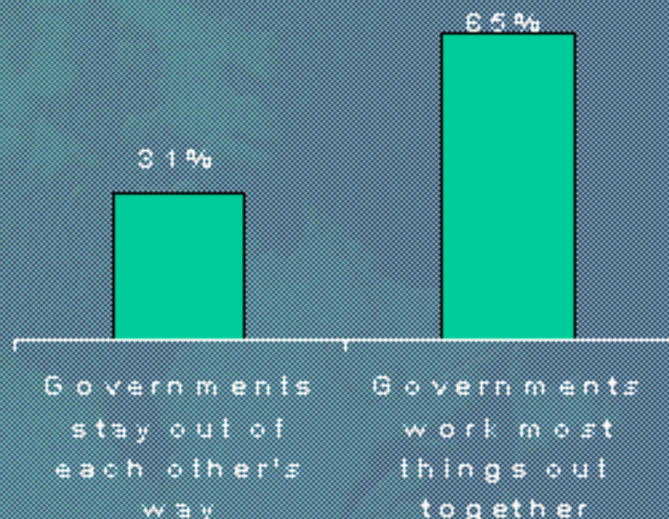
**Eldridge v. B.C. (Attorney General) [1997] 3 S.C.R. 624, at par. 25**

# Quebecers' opinion on cooperation between governments

National standards for medicare are...



Thinking about how governments make decisions, which would be best for Canada...



Sources: Elos and CROP-CRC

**Quebecers believe their governments should work together**

## Conclusions (1)

The “fiscal imbalance” is a myth.  
The facts show that:

- federal surpluses are small compared to past deficits
- all governments face pressures
- all governments have access to the revenues they need to finance their spending
- the recommendations of the Séguin Commission would put federal finances back into the cycle of deficits



## Conclusions (2)

The invasion of provincial jurisdiction is also a myth.  
The facts show that:

Federal program spending is at its lowest level since 1948

The provinces have access to the same revenue sources as the federal government, and transfers have very few conditions

Federal investments respect the Constitution

Canadians, including Quebecers, want their governments to work together