

# **New Brunswick's Perspective on Fiscal Balance**

## **Submission to Standing Senate Committee on National Finance**

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Thank you for the invitation to provide input – on behalf of the Government of New Brunswick - into the Committee's examination of the horizontal and vertical fiscal imbalance among the various orders of government in Canada. This is a very important issue within the federation and to New Brunswick.

Our government's *Charter for Change* focuses on education, economic development and energy as the means to make New Brunswick more competitive, prosperous and productive. Our goal is to become self-sufficient by 2025. To achieve this, we require a strong partnership with the federal government. We need to make the necessary investments now to grow our economy and build the foundation for a self-sufficient New Brunswick in the future. A stronger New Brunswick contributes to a stronger Canada.

In Canada, both horizontal and vertical fiscal imbalances exist among the senior orders of government. Horizontal fiscal balance refers to the balance among provincial and territorial governments. Vertical fiscal balance refers to the balance between the federal government and provincial and territorial governments.

There are significant differences among provinces in the ability to raise revenues from provincial tax bases. Even after the current Equalization Program – which is designed to reduce these differences - considerable fiscal disparities persist. Some provinces are better positioned than others to provide quality public services at competitive levels of taxation. This is reflective of the horizontal fiscal imbalance in the federation.

At the same time, the vertical fiscal balance currently favors the federal government. The federal government collects more revenues than required to meet its spending commitments, resulting in annual surpluses. That is anticipated to continue in the future. Meanwhile, provincial governments – collectively - will be challenged to balance budgets, in particular due to the rising costs of delivering health care and education, which are provincial responsibilities.

There are different means by which the federal government can address the fiscal balance. From New Brunswick's perspective, the federal transfer system is the preferred vehicle to address both the horizontal and vertical fiscal imbalance. The federal government has a constitutional responsibility to ensure that the playing field across provinces is leveled. It can also play a key role in ensuring that national social programs are preserved and that priorities are addressed through the transfer system.

The federal government could also lower taxes, with provinces and territories subsequently inheriting the “tax room” to increase their taxes. A tax room transfer would, in essence, shift the tax burden – and revenue-raising ability - from the federal government to provincial and territorial governments, with no net impact on taxpayers. However it could also result in widening fiscal disparities as provincial tax bases – and the ability to generate revenue from the tax base – differ considerably across provinces. In effect, a “narrowing” of the vertical fiscal balance through a tax room transfer could result in even greater horizontal fiscal imbalances in the federation. Another consideration is that in an increasingly global marketplace, a competitive tax structure is essential – governments are looking at means to lower the overall tax burden to enhance competitiveness and productivity. A tax room transfer would simply shift the tax burden.

Federal-provincial fiscal arrangements are fundamental to addressing horizontal and vertical fiscal balance within the federation. In a highly decentralized federation like Canada, effective fiscal arrangements are necessary to reduce the fiscal imbalances between governments and contribute to a more competitive, compassionate and vibrant Canada. Canadians - regardless of their place of residence – should be entitled to similar levels of public services and taxation.

Current fiscal arrangements are not effective. The federal government has acknowledged that greater fiscal balance needs to be brought to the federation. New Brunswick is calling upon the federal government to address both the horizontal and vertical fiscal balance as part of this exercise.

### **Addressing Horizontal Fiscal Balance**

From New Brunswick’s perspective, the horizontal fiscal imbalance must be addressed first and foremost. Of particular importance is ensuring that the Equalization Program is strengthened such that it meets the spirit and intent of the Constitutional commitment. An effective Equalization Program will better level the playing field among provinces and provide a solid foundation for other federal-provincial programs to build upon.

The federal Equalization Program is unique in the federation. Its importance cannot be overstated. The principle of making equalization payments is set out in section 36(2) of *The Constitution Act, 1982*:

*Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.*

New Brunswick’s 2006-2007 equalization payment totals \$1.45 billion. To put the importance of Equalization into context, this compares to \$1.3 billion in education spending for 2006-2007. It exceeds what the province collects annually in personal and corporate income tax. Without Equalization, New Brunswickers would face considerably higher taxes and fewer public services, adversely affecting our competitiveness.

Equalization has contributed to a narrowing of fiscal and economic disparities within the federation. In New Brunswick, taxes have been maintained or lowered, public services have been enhanced and key infrastructure investments made, all while maintaining fiscal responsibility. This has contributed to a more competitive and prosperous New Brunswick, which contributes to a more competitive and prosperous Canada.

However, the current Equalization Program is not sufficient - provinces like New Brunswick are not able to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Significant fiscal disparities continue to persist across provinces. Furthermore, the program is not sustainable in its current form, which departs from basic foundations and principles of the past.

New Brunswick's position in regards to the Equalization Program has remained clear and consistent:

- Formula-determined entitlements with no cap or ceiling on total entitlements
- National average standard
- 100% revenue coverage, including resource revenues and sales of goods and services (e.g., user fees)

The province also supports the continuation of the Representative Tax System, or RTS, approach to determining equalization payments. The RTS provides a comprehensive and comparable measure of the capacity of provinces to raise revenues to support public services. It is founded on the actual taxation practices of provinces and is the most appropriate measure of fiscal capacity.

This is a long-standing position of the province, and has been set out in a number of documents and submissions made by the province. It has received unanimous support within the New Brunswick legislature and is shared by a number of other provinces.

These changes would enable the Equalization Program to meet the spirit and intent of the Constitutional commitment, and enable the province to undertake strategic investments that would help grow our economy and enhance our competitiveness, which is vital to meeting our goal of a self-sufficient New Brunswick by 2025.

The recent reports by the Council of the Federation Advisory Panel on Fiscal Imbalance and the Expert Panel on Equalization reaffirm certain key elements of New Brunswick's position. In particular, they call for a principle-based, formula-determined program, a national average standard, and for resource revenues to remain within the program.

Much of the current debate on Equalization relates to whether resource revenues should be included in the program. Currently, resource revenues are included and from New Brunswick's perspective, they should continue to be so. To put the debate into perspective: a formula-determined program with a national average standard and 100% resource revenue coverage would result in an additional \$200 million for New Brunswick

annually. In contrast, a formula-determined program with a national average standard and 0% resource revenue coverage would mean approximately \$170 million less for New Brunswick annually. Fiscal disparities among provinces would be widened even further if resources were removed, with provinces such as New Brunswick – with limited access to resource revenues – losing entitlements to the benefit of resource-rich provinces like Saskatchewan and British Columbia.

The fundamental arguments supporting New Brunswick’s position on Equalization can be summarized as follows:

#### Formula-determined entitlements with no cap or ceiling

- Entitlements should be formula-determined and not fixed in legislation
- The revenue-raising ability of provinces should be equalized to the same per capita level after equalization payments
- A cap or ceiling serves to constrain entitlements, violating the spirit and intent of the Constitutional commitment by limiting the capacity of the program to achieve its fundamental objective
- When a cap or ceiling is applied, provinces are no longer equalized to the level of the designated program standard, resulting in a widening of fiscal disparities that the program is designed to reduce
- One way to mitigate program costs without subjecting entitlements to a cap or ceiling is to employ a moving average of a number of years within the program

#### National Average Standard

- A national average standard more accurately reflects the level of fiscal disparities throughout the country
- A national average standard is more indicative of “reasonably comparable” than the current program standard

#### Full Revenue Coverage

- Comprehensive revenue coverage is an important principle of a fair and equitable Equalization Program
- Comprehensive revenue coverage is necessary to ensure that differences in provincial revenue-raising ability – and resulting disparities - is adequately captured
- Natural resource revenues are among the most significant sources of fiscal disparities across provinces; the removal of resource revenues from the program would exacerbate fiscal disparities among provinces even further, moving the Equalization Program further away from achieving its constitutional objective
- Revenues from the sales of goods and services are used to support the provision of government services; removal of these revenues from the program would underestimate provincial fiscal capacity and serve to widen fiscal disparities among provinces even further
- By excluding certain revenues from the Equalization Program, revenue-raising ability of provinces will not be equalized to the same per capita level after equalization

## **Addressing Vertical Fiscal Balance**

In addition to addressing the horizontal fiscal balance via the Equalization Program, New Brunswick believes that vertical fiscal balance must be further addressed. The Province supports the continued use of the federal transfer system to provide this balance between the federal government and provincial and territorial governments.

With the introduction of the Canada Health and Social Transfer in 1996-1997, provinces and territories incurred major reductions to social program transfers from the federal government. Health transfers have since been restored. However, there is still a considerable shortfall in terms of federal funding for post-secondary education and social services via the Canada Social Transfer.

The federal government's funding share of provincial-territorial spending on health care, post-secondary education and social services has eroded considerably, despite recent health care infusions. While cash transfers are now growing, they have not kept pace with growing costs. For example, in New Brunswick, the federal contribution via the Canada Health Transfer, Canada Social Transfer and related arrangements now stands at 23%, down from 29% less than two decades ago. This share stands to erode further without more adequate social program transfers. To put this in context, in the infancy of Medicare, hospital insurance, post-secondary education and social assistance and services, the federal government was an equal partner in these programs of national importance, sharing in the cost of eligible expenditures.

The federal government and provincial governments have noted the importance of post-secondary education and skills training to a more competitive, vibrant economy. Education is a major plank in New Brunswick's strategy to move towards greater self-sufficiency.

New Brunswick has called upon the federal government to restore the value of the Canada Social Transfer cash transfer to its 1994-1995 level – at a cost of approximately \$2.2 billion - with an appropriate growth escalator thereafter. This would provide additional funding for provinces and territories to invest in post-secondary education and social services. Additional funding to enhance skills training is also required to meet workforce needs now and into the future.

Investing in strategic infrastructure is fundamental to enhancing competitiveness and productivity. All governments are facing the challenge of maintaining existing infrastructure while investing in strategic infrastructure. Health care, education, transportation, communications and “green” infrastructure are vital to building a competitive advantage for Canada. In concert with provincial and municipal governments, the federal government has a key role to play in ensuring that Canada's infrastructure needs are addressed.

The federal government must recognize that differences in fiscal capacity among provinces and territories affect their ability to undertake strategic infrastructure initiatives. A meaningful strengthening of the Equalization Program would mitigate this challenge.

### **Fostering a Stronger Partnership**

Canada's federation has been built on partnership since its infancy. All regions of the country have benefited. Our social program network has evolved from this partnership. Our infrastructure has developed from this partnership. Our standard of living has developed from this partnership.

The federal government – and provinces and territories – acknowledges that today's system of fiscal arrangements needs to be fixed and fiscal balance needs to be restored in the federation. We have an opportunity to make things right.

We have an opportunity to meaningfully strengthen the Equalization Program to meet its constitutional objective. In New Brunswick's view, this can best be accomplished by a formula-determined program with a national average standard and full revenue coverage. This will help enhance the competitiveness of Canada's least-affluent provinces and the country as a whole.

We also have an opportunity to make meaningful, new investments in post-secondary education and infrastructure that will help make New Brunswick and Canada more competitive in the global marketplace.

Now is the time for meaningful federal-provincial-territorial dialogue on a solution that is in the national interest, one that will enable all provinces and territories to be partners in Canada's continued growth, prosperity and competitiveness.