

Nova Scotia Government  
Submission to Standing Senate Committee on National Finance  
Tuesday, Nov. 7, 2006  
Presented by Honourable Michael Baker  
Minister of Finance

Good Morning Mr. Chairman,

Let me begin by thanking you and the members of your Committee for your work on this important issue on behalf of Canadians.

While it may not be top of mind for most Canadians, how the federal government addresses the fiscal imbalances that exist within our country, will either positively or negatively, directly or indirectly affect practically every Canadian family.

As you can appreciate, I'm going to focus my remarks on the issues of most concern to Nova Scotia.

At the top of our list, is the need to address the fiscal inequities that exist between and among the provinces and territories....inequities that if left unchecked have the potential to spin out of control, to fundamentally alter the nature of our federation, and in the process, put our nation's future prosperity at risk.

If that sounds like a dire warning, it was meant to be.

If equalization is not adequately funded, or worse still, watered down, regional disparities will simply widen. If Canada is to be a true country, Canadians must receive a relatively equal level of services no matter where they live. That is the minimum all Canadians have a right to expect.

Let me briefly outline the actions Nova Scotia believes would be in keeping with the principles of equalization and the objectives of the constitution.

Equalization needs to be strengthened in order to ensure adequacy of transfers.

We believe the 10-province standard should be restored. The decision to move to a five-province standard was arbitrary and extremely costly to Nova Scotia and contrary to the principles of the Constitution. Since it was adopted in the early 1980's, Nova Scotia has suffered the loss of over \$3.3 billion in foregone federal revenues.

We also believe the representative tax system should be maintained, as it is the truest reflection of a province's capacity to raise revenues. While agreeing that predictability and smoothing volatility by using rolling averages are desirable, annual payments must reflect current conditions. Therefore, we suggest using three year averages beginning with the current year.

We do not support the imposition of artificial ceilings that restrict the extent to which the federal government is prepared to meet its constitutional commitment to Canadians

We do support the comprehensive inclusion of revenue sources including 100 per cent of user fees and natural resource revenues.

With respect to natural resource revenues, excluding them from the equalization formula would unfairly favour resource-rich provinces that also receive equalization transfers. Those provinces would get to keep the full benefit of their resource revenues as well as reap the full benefits of equalization. At the same time, however, the exclusion of resource revenues would lower the average fiscal capacity to which provinces are equalized and thereby negatively impact less-advantaged provinces by forcing them to reduce services below the national norm or to increase taxes above that norm.

I'll return to this subject a little later on, particularly as it relates to Nova Scotia's offshore revenues and how, contrary to popular belief, they support the interests of equalization-receiving provinces.

Mr. Chairman, while these improvements I just outlined support the principles and objectives of equalization as referenced in the Canadian Constitution, Nova Scotia recognizes that in order for equalization to work effectively for all Canadians...and in order for equalization to be acceptable to all Canadians, everyone may need to compromise. We in Nova Scotia are ready to engage in discussion on this issue.

I'd like to now take a few moments to address some of the myths or misunderstandings surrounding equalization that continue to be circulated by some who have come before this Committee and others. Specifically, the notion that equalization rewards wasteful, free-spending provinces, or that Nova Scotia's offshore accord undermines the principles of equalization.

With all due respect, those who argue the former demonstrate a fundamental lack of understanding of the nature and make-up of our country.

Canada is not, as they seem to suggest, made up of ten provinces and three territories all with the same economic opportunities, the same wealth generating capacity, the same economies of scale or the same burden of costs.

Populations differ widely.

The mix, amount and value of natural resources differs widely.

Income levels differ widely

Debt levels differ widely.

These are more than a state of mind, they are real and they are structural.

All of these factors, and more, result in very different fiscal capacities and very different expenditure needs, between and across the provinces and territories

For example, the majority of Nova Scotia tax filers do not have nearly the same income levels as those that exist elsewhere in the country. Roughly 66 per cent of our tax filers earn less than \$30,000 per year; while only nine per cent of our population bears 49 per cent of our personal income tax burden. In wealthier provinces, higher income earners comprise a significantly greater portion of their personal income tax base.

Just a few more statistics worth noting.

In 2004, Nova Scotia had the third highest personal income tax rate for the middle and high income brackets and the second highest corporate income tax rate.

In other words, Nova Scotia is at the limit of its ability to raise revenues through taxation.

On one hand, we have less capacity to raise revenues through taxes than other provinces. And on the other, we have higher per capita costs for providing health and other vital services.

For example, Nova Scotia has the second oldest population in the country, the country's highest rate of disability and among the country's highest chronic disease rates.

In 2005-06, health spending alone accounted for almost 48 per cent of total program spending. With one of the oldest and sickest populations in the country, these health care pressures will only get worse as our population continues to age and as more young and healthy income earners are lured west by salaries we can't compete with. Over time, this will place even greater pressure on Nova Scotia's ability to address its other expenditure needs....the need to invest in education, research and technology, safe highways, safe communities....all of the things that will help Nova Scotia's economy grow to the national norm and help our country prosper.

Mr. Chairman, as an equalization-receiving province, we are not... as some would suggest... wasting our equalization dollars, we're using them to provide Nova Scotians, to the greatest degree possible, with a standard of service to which the constitution states all Canadians are entitled. Broad sweeping assumptions that focus on spending and not overall fiscal capacity do little to help advance what is already a very complex and difficult issue to resolve.

Again, for the record, I would point out that Nova Scotia has posted five consecutive balanced budgets, we improved our credit ratings, and we made significant down payments on our debt - including every penny of the \$830 million we received through our Offshore Accord...and we're relying more and more on our own success and own source revenues. In 1996-97 provincial revenues accounted for 61.3% of our total revenues. In 2006-07 they now account for 64.2%. Accomplishments that didn't come easy in light of the rising cost of health care and other public services. They required some tough choices.

And it doesn't look like our choices are going to get any easier any time soon. We have a huge infrastructure deficit (over \$3 billion for road and highways alone), there is pent up demand for improved services in a host of other areas, and, as I noted a moment ago - our high taxes rate put us at a competitive disadvantage in attracting people and businesses to locate in our province and retaining the skilled people who we already have.

That's why we still rely on equalization, which represents approximately 22 per cent of our total revenues.

So let me sum up this part of my presentation with this. Those who philosophically oppose equalization, oppose by extension the notion that Canadians no matter where they live should receive relatively equitable levels of service at relatively equitable levels of taxation.

With all due respect the authors of the Constitution got it right. And they're wrong.

Equalization was enshrined in the constitution to help, if not to level the playing field, at least make it more even. It was put in the constitution as a tangible way for the Parliament of Canada to connect Canadians with one another. It is as much about our values as Canadians as it is about dollars and cents.

I'd now like to address the suggestion that Nova Scotia's Offshore Accord undermines the principles of equalization.....that it amounts to equalization, outside of equalization.

This suggestion may be the result of a lack of understanding around the constitutional and historic background of the Accord and the legal and policy objectives it fulfills.

The Nova Scotia Offshore Accord is a bi-lateral agreement that resolved a long-standing jurisdictional dispute between Nova Scotia and Canada dating back to the early 1980s. In 1982 Nova Scotia agreed to set aside its claim to jurisdiction in consideration of a joint management regime and sharing of offshore revenues.

Canada's agreement, particularly with respect to the sharing of offshore revenues, was rooted in its constitutional obligation under section 36.1 to further economic development in all regions. By setting aside this legal dispute, offshore development was expected to proceed.

The 1982 agreement, and its successor, the 1986 accord, provided that Nova Scotia would be the principal beneficiary of offshore revenues until Nova Scotia achieved an agreed upon per capita fiscal capacity. A capacity the authors noted should be well above the national average. In fact, they identified a fiscal capacity of 140 percent. The authors of the Accords did this, recognizing that equalization could and likely would threaten to undermine the intent of the accord. That is why they knowingly and willingly included equalization off-set payments to protect the offshore revenues from being clawed-back.

The Nova Scotia Accord is a bilateral agreement, and bilateral agreements are essential if the Parliament of Canada is to help provinces achieve their economic potential. It does not follow that, because such agreements may, directly or indirectly, improve the present or future fiscal capacity of a province, they undermine the Equalization Program. Otherwise, the economic development principle and other legitimate areas of bilateral agreement between Canada and the provinces would be impeded. And that would not be in the best interest of any area of our country.

The only substantive difference between Nova Scotia's bi-lateral agreement with Ottawa to support the development of our offshore, and Ottawa's support of Quebec's Aerospace Industry or Ontario's Automotive Industry for example, is we had to give something up to support our economic development objectives. They didn't.

Regardless, in all cases, the Government of Canada was fulfilling its constitutional right under section 36.1 to support the prosperity of every province of our country for the benefit of every citizen of our country. One of the most important constitutional objectives of the Parliament of Canada.

And for the record, let me reiterate a point I made earlier: Nova Scotia's offshore resource revenues are fully accounted for in the equalization formula. They increase the benefits available to equalization-receiving provinces. Their exclusion, like the exclusion of natural resource revenues in any other province, would seriously undermine the spirit and intent of what equalization is intended to achieve by significantly underestimating their contribution to fiscal capacity.

Mr. Chairman, I spent the better part of my time here today, speaking to the fiscal imbalances that exist between and across provinces.

I hope the reason why I am spending more time on the horizontal imbalance than the vertical imbalance is clear.

Simply put, I believe it is the fiscal inequities between provinces that pose the greatest threat to our nation's prosperity and unity.

Furthermore, I believe the issue of vertical imbalance is well understood.

Most observers, including the current federal government, have accepted the fact that cutbacks in federal transfers to the provinces for health and social programs are a large part of the reason Ottawa has consistently posted huge federal surpluses, while most provinces have consistently struggled to maintain quality public services and stay within budget.

Federal surpluses, I might add that make strengthening equalization more affordable.

In support of this, and in the interests of time, I would refer you to the testimony of my colleague from Prince Edward Island, Minister Murphy, who clearly laid out how the cost of equalization as a percentage of Federal GDP has dropped in recent years. From 1.3% of GDP or 8 % of federal revenues in 1982 to 0.8 % of GDP or 5.1 % of federal revenues today.

I would also reiterate Minister Murphy's concerns respecting the transfer of tax points as a means of closing the vertical gap. Tax Point transfers would benefit larger, wealthier provinces to a far greater extent than they would smaller, less wealthy provinces where the value of a tax point is much smaller. In other words, tax point transfers would widen the horizontal gaps that currently exist between provinces.

Let me also raise another concern, one that I am sure most of my colleagues would agree with. And that is, any increase in equalization must not be financed from federal savings as a result of withdrawing from existing cost-shared programs. To do so, would be to negate or perhaps erode a province's ability, particularly the ability of smaller, less wealthy provinces, to maintain, let alone improve, the level of public services they provide their citizens.

There are presently 22 federal/provincial cost-shared agreements in Nova Scotia set to expire in 2006-07 at a value of \$31.8 million.

It would be disingenuous for the federal government to claim it has addressed the fiscal imbalance on the one hand, while at the same time backing out of cost-shared arrangements they have historically funded. At best, it would amount to a zero sum game for Canada and do nothing to address the horizontal or vertical imbalances that currently exist.

Likewise, any cap on equalization, must not claw back the hard fought gains Nova Scotia and Newfoundland stand to gain through our offshore accords. As I stated earlier, Nova Scotia set aside its legal claim over the offshore with the signing of a legally-binding bilateral agreement with Ottawa. An agreement designed to help Nova Scotia's economy grow and our country prosper.

If the Parliament of Canada took any action to breach the equalization off-set provisions of the accord, it would place Canada in the untenable position of undermining or neutralizing the revenue-sharing arrangements set out in the 2005 Accord. Such an act would call into question the bona fides and, indeed, Honour of the Federal Crown.

Mr. Chair, I hope you and your Committee members now have a better understanding of Nova Scotians position with respect to both the horizontal and vertical fiscal imbalances we are confronting. And I hope I've cleared up a few myths and misunderstandings. I know I have already gone well past my time. I'll conclude my remarks, by, once again, thanking you and the Members of your Committee for your time and interest in Nova Scotia's position.

I'll be pleased to answer any questions you may have.