Canada's Western Premiers' Conference 2003

FEDERAL/PROVINCIAL/TERRITORIAL FISCAL RELATIONS IN TRANSITION

A Report to Canada's Western Premiers
from the Finance Ministers of
British Columbia, Alberta, Saskatchewan, Manitoba,
Yukon, Northwest Territories and Nunavut

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2003 Canada's Western Finance Ministers' Report to Premiers

Federal/Provincial/Territorial Fiscal Relations in Transition

Executive Summary

The 2003 Federal Budget introduced significant changes to federal funding arrangements for provincial/territorial health and other social programming. This key development in Federal/provincial/territorial fiscal arrangements, which was in response to the February 2003 First Ministers' meeting on health care, is the focus of this year's Western Finance Ministers' Report to Premiers.

The Report answers three questions:

1. What changes are being made to federal/provincial/territorial fiscal arrangements?

2. What do these changes mean for the financing of health care and other social programming in Canada?

3. What challenges to establishing effective and equitable federal/provincial/territorial fiscal arrangements have been addressed by these new arrangements, and which remain?

The Report notes that the recent changes made to federal/provincial/territorial fiscal arrangements as a result of the First Ministers' health arrangement are a welcome first step, but much remains to be done to establish adequate, effective and equitable fiscal arrangements in support of the major social programming provided by provinces and territories:

- The increase in funding falls well short of what Premiers have clearly indicated is required both for base funding for major social programs, <u>and</u> for reform of the health care system.

- Increased support for health care seems to be coming at the expense of federal support for other programs supported by the CHST.

- Most of the new funding is either tied to expanded programming or one-time. While this funding reduces short-term financial pressures, it does little to address the underlying vertical fiscal imbalance that exists between the federal and provincial/territorial governments.

- Furthermore, should federal health reform funding prove insufficient to meet the demands and services anticipated by the February 2003 health arrangement, the vertical fiscal imbalance could be exacerbated.

- Aside from the removal of the Equalization ceiling, little has been done to address horizontal fiscal imbalance, despite repeated calls from Premiers for a strengthened and fairer Equalization program formula.

As a result, Western Finance Ministers call on the federal government to work with provinces and territories to:

a) ensure federal funding in support of major social programs and health care reform is adequate; and,

b) more effectively address vertical and horizontal fiscal imbalance.

The Report also notes that stability and predictability of federal transfers have been deteriorating in recent years, and this presents serious fiscal planning problems for provinces and territories.

Fiscal pressures on provinces and territories are also growing due to direct federal spending in areas of provincial/territorial jurisdiction as well as tied federal funding.

Furthermore, provinces and territories are rarely consulted on this direct and tied federal funding, despite the destabilizing effect it can have on provincial/territorial budgets, and changes are being made to federal/provincial/territorial fiscal arrangements without any consultations with provincial/territorial finance ministers. This is not in keeping with the Social Union Framework Agreement, in which the federal government made commitments to consult with provinces and territories before exercising its spending power, whether through intergovernmental transfers or direct spending.

As a result, Western Finance Ministers call on the federal government to include provinces and territories as active participants in the design and implementation of all program spending and fiscal arrangements that have impacts on provincial/territorial fiscal situations.

2003 Canada's Western Finance Ministers' Report to Premiers

Federal/Provincial/Territorial Fiscal Relations in Transition

Federal/provincial/territorial fiscal arrangements play an essential role in supporting key social programs -- health care, education and social services -- that are among the highest priorities of Canadians. It is therefore imperative that these fiscal arrangements are adequate and effective in meeting the needs of Canadians and maintaining the quality of life that all have come to expect.

The 2003 Federal Budget introduced significant changes to federal funding arrangements for provincial/territorial health and other social programming. This key development in federal/provincial/territorial fiscal arrangements, which was in response to the February 2003 First Ministers' meeting on health care, is the focus of this year's Western Finance Ministers' Report to Premiers.

The Report answers three questions:

1. What changes are being made to federal/provincial/territorial fiscal arrangements?

2. What do these changes mean for the financing of health care and other social programming in Canada?

3. What challenges to establishing effective and equitable federal/provincial/territorial fiscal arrangements have been addressed by these new arrangements, and which remain?

I. CHANGES TO FISCAL ARRANGEMENTS

The February 2003 First Ministers' health arrangement, along with the 2003 Federal Budget which followed shortly after, introduced a number of changes to federal/provincial/territorial fiscal arrangements. These changes are summarized below.

1. New Funds for Health Care

As part of the February 2003 First Ministers' health arrangement, the federal government announced the following increases in funding for provincial/territorial health care programming:

- A $2.5 billion CHST cash supplement to help alleviate existing pressures in provincial/territorial health care systems. Provinces and territories have the option to draw down these funds any time up to the end of 2005/06.

- A $1.5 billion Diagnostic and Medical Equipment fund. Again, provinces and territories have the option to draw down these funds any time up to the end of 2005/06.

- A $16 billion, five-year Health Reform Fund to be directed towards reforms in three areas: primary health care, home care, and catastrophic drug coverage.

- The federal government will also provide up to $2 billion to provinces and territories for health care at the end of 2003/04 should its fiscal circumstances permit[1].

- A Territorial Health Fund of $60 million to be divided equally among the three territories, with each territory receiving $6.7 million per year for three years, starting in 2003/04.

2. CHST Base Increases

In its 2001 Budget, the federal government announced CHST funding for a five-year period, ending 2005/06, with increases in each of the five years. Increases for 2006/07 and 2007/08 were assumed for fiscal planning purposes in the federal government's October 2002 *Economic and Fiscal Update*.[2] Beyond these previously-known amounts, there were no further increases in the CHST cash base.

In announcing increased funding for health care for provinces/territories in February 2003, the federal government maximized the size of the total increase by including these already-published CHST increases for 2003/04 through 2007/08, along with funds for strictly federal programs/initiatives (i.e. not transferred to provinces/territories).

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[1] This is described in the 2003 Federal Budget as follows: "A federal government commitment to provide up to an additional $2.0 billion for health for the provinces and territories at the end of fiscal year 2003-04, if the Minister of Finance determines during the month of January 2004 that there will be a sufficient surplus above the normal Contingency Reserve to permit such an investment." (*The Budget Plan 2003*, p. 69)

[2] Finance Canada, The Economic and Fiscal Update (October 30, 2002), pp. 77-78.

Furthermore, by not clearly differentiating between transfers to provinces and territories and spending on its own programs and initiatives, the federal government created the impression that transfers were increasing by $35 billion over five years, when the actual increase is $20 billion.

3. Splitting the CHST

The size of the CHST cash transfer is not directly tied to the level of provincial/territorial spending on health, post-secondary education and social services. As a block fund, the CHST is not currently allocated by the federal government among the three program areas; CHST transfers are allocated by the provinces and territories according to their own spending priorities.

While providing flexibility for provinces and territories, this approach has led to considerable confusion as to the degree to which the federal government is supporting individual programs, particularly health care.

In an effort to clarify the amount of support the federal government provides to provinces and territories for health care, the CHST will be split into two separate transfers as of April 1, 2004: a Canada Health Transfer (CHT) in support of health; and, a Canada Social Transfer (CST) in support of post-secondary education, social assistance and social services, including early childhood development.

The federal government plans to allocate the CHST between the two new transfers as follows: 62 percent to the CHT and 38 percent to the CST. These proportions are based on 2001/02 spending shares; that is, since roughly 62percent of total provincial/territorial spending on major social programs was devoted to health in 2001/02, 62 percent of the CHST will be allocated to the CHT from April 1, 2004 onward.

There are indications that the Health Reform Fund will be rolled into the CHT after five years, for 2008/09 onward.

4. Permanent Removal of the Equalization Ceiling

The Equalization ceiling limits the total size, and thereby the total cost to the federal government, of the Equalization program. When Equalization entitlements for all provinces combined exceed the ceiling, all provinces receiving Equalization have their entitlements reduced by the same per capita amount.

As part of the February 2003 First Ministers' health arrangement, the federal government announced plans to permanently remove the Equalization ceiling, effective 2002/03.

Despite the fact that the Territorial Formula Financing (TFF) ceiling was imposed to provide equivalent treatment for the territories, the TFF ceiling was not removed as part of the health arrangement package. The territories are continuing discussions with the federal government, urging equal treatment for the territories through removal of the TFF ceiling.

5. New Funds for Early Learning/Child Care

The 2003 Federal Budget announced increased funding for provinces and territories in support of early learning and child care services. This funding, which totals $900 million over five years, is to be provided to provinces and territories through the CHST in 2003/04 and the CST in 2004/05 onward.

Table 1 shows transfer increases over the next five years.

Table 1
Increases to Federal Transfers to Provinces and Territories
for Health, Education and Social Services
Millions of Dollars

	2003/04	**2004/05**	**2005/06**	**2006/07**	**2007/08**
CHST Supplement	1,000	1,000	500		
Diagnostic/Medical Equipment Fund	500	500	500		
Territorial Health Fund	20	20	20		
Health Reform Fund	1,000	1,500	3,500	4,500	5,500
Health Subtotal	2,520	3,020	4,520	4,500	5,500
Early Learning/Child Care	25	75	150	300	350
Education/Social Services Subtotal	25	75	150	300	350
Total	2,545	3,095	4,670	4,800	5,850

Source: Finance Canada

II. WHAT DO THE NEW ARRANGEMENTS MEAN?

1. Impact on Federal Funding Shares

Prior to the February First Ministers' Meeting, Premiers called on the federal government to provide sufficient funds to increase the federal share of provincial/territorial health and social program spending to 25 percent by 2009/10. This was to be accomplished by increasing the share to 18 percent in 2002/03, and then by one percentage point per year until the share reaches 25 percent (in 2009/10).

The funding committed to by the federal government in February 2003 is not sufficient to achieve the goal of a 25 percent share by 2009/10.

Territorial Health Fund

The Territorial Health Fund was provided as an interim measure in recognition of the fact that the additional per capita funding provided in the February 2003 health arrangement does not address the challenges of providing health care in the North. Even with the new health arrangement funding, the cuts imposed on the territories as part of the CHST restraint measures in the mid-nineties have not been restored.

Splitting the CHST

There is broad support for the principle of splitting the current CHST into separate health (CHT) and social (CST) transfers in order to increase transparency and accountability to the public. However, the manner in which the split will be made creates serious concerns in respect of CST funding in particular.

Prior to the creation of the CHST, federal support for health and post-secondary education was provided through Established Programs Financing (EPF) transfers, while support for social services was provided through the Canada Assistance Plan (CAP).

Table 2 compares federal cash funding levels for health under EPF and the proposed CHT. The table also shows federal cash funding in respect of post-secondary education and social services, as it existed under EPF and CAP, compared with the proposed CST. Since there was no separate accounting of individual program support under the CHST, no figures are available for the 1996/97 through 2003/04 period.

Table 2
Federal Funding of Major Social Programs, 1994/95 to 2007/08
Billions of Dollars

	EPF/CAP 1994/95	**EPF/CAP 1995/96**	**CHST Years**	**CHT/CST 2004/05**	**CHT/CST 2005/06**	**CHT/CST 2006/07**	**CHT/CST 2007/08**
Health	8.1	8.0	….	12.7	13.0	13.4	13.8
Post-secondary education and Social Services	10.6	10.5	….	7.8	8.2	8.5	8.8
Total	18.7	18.5		20.5	21.2	21.9	22.6

Source: Finance Canada

As the table shows, federal cash transfers for major social programming (CHT plus CST) will be $20.5 billion in 2004/05, or $1.8 billion higher than in 1994/95. This "net" increase is actually comprised of an increase in funding for health of $4.6 billion and a reduction in funding for post-secondary education and social services of $2.8 billion. In other words, about 60 percent of the increase in federal support for health care comes at the expense of its commitment to social services and post-secondary education.

The decision of the federal government to reallocate funds away from post-secondary education and social services to raise its share of funding for health care is contrary to the recommendations of the Premiers and the advice of the Romanow Commission. As indicated in the Commission's final report, "In addressing the apparent deficit in health funding, that deficit should not be passed on to post-secondary education and social assistance." [3]

The Health Reform Fund

A major component of the health funding provided in the 2003 Federal Budget is linked specifically to health reform. Canadians generally affirm their desire for a sustainable health care system, recognize that reform is necessary, and support new public investments targeted to health reform.

However, although a welcome infusion of funds, the latest federal contribution raises concerns in regard to both adequacy (to meet both ongoing pressures and desired reforms) and flexibility (to address the unique needs and priorities of different provinces and territories).

First, in terms of adequacy, health care cost pressures reflect both ongoing growth in the demand and expectations of the population for existing services as well as any new reform measures. By focusing largely on the latter, the new federal health funding does not support provinces and territories in their efforts to maintain and support the existing health care system.

Furthermore, there is concern that the level of new federal funding for reform will not be sufficient to meet the demands and requirements of new programs and services anticipated by the First Ministers' health arrangement. Provinces and territories are concerned that the implementation of targeted health reform initiatives will create programs, service demands, and expectations that are not adequately funded by the Health Reform Fund and cannot be sustained without additional federal funding.

Second, in regard to flexibility, because provinces and territories are responsible for managing and delivering health care, they are in the best position to assess the needs of their citizens and to identify the priorities for renewal and innovation.

As acknowledged by the federal government, provincial and territorial governments have all taken significant steps to invest in important reforms to improve their health care systems. However, given existing differences in health resources, priorities and community preferences, the level of investment and the focus of reform vary from jurisdiction to jurisdiction. The Health Reform Fund must be implemented in a way that respects these differences, by allowing provinces and territories to target reform funds to best meet their needs.

[3] *Building on Values: Final Report of the Commission on the Future of Health Care in Canada*, page 69.

III. OUTSTANDING ISSUES

While the changes to federal/provincial/territorial fiscal arrangements announced in the 2003 Budget are beneficial in some ways, more effort is required if all of the challenges in establishing effective and equitable arrangements are to be addressed.

As is clear from the previous section, one of the key challenges will be to address the fact that the new federal funding falls short of the recommendations of the Premiers in respect of both base funding for major social programs and funds for the reform of the health care system. Other key outstanding challenges are discussed below.

1. Horizontal Fiscal Imbalance

Provincial and territorial governments have differing abilities to raise revenue. This situation is generally referred to as the horizontal fiscal imbalance in Canada.

The Constitution commits the federal government to providing equalization payments to ensure that all provinces have "sufficient revenues to provide reasonably comparable public services at reasonably comparable levels of taxation" (Section 36(2) of the *Constitution Act*, *1982*).

The current Equalization program has shortcomings in terms of adequacy, in part due to arbitrary program restrictions to reduce the federal government's financial exposure. These restrictions inhibit the program's ability to adequately redress the horizontal fiscal imbalance that exists in Canada.

The elimination of the ceiling on entitlements beginning in 2002/03 removed one of these restrictions. However, the federal government has not responded to the Premiers' call for more adequate and sustainable fiscal arrangements, "… including work on the development of a strengthened and fairer Equalization program formula, including as one possible alternative, a ten-province standard that recognizes the volatility around resource revenues, and comprehensive revenue coverage."[4]

A second program to address horizontal fiscal imbalance in Canada is Territorial Formula Financing (TFF), the main source of revenue for the three territories. The TFF arrangements are designed to fill the gap between expenditure needs to provide comparable levels of services as the provinces and the ability of the territories to raise their own revenues given small populations dispersed over large geographical areas and the higher costs of providing services in the North. However, alterations and arbitrary reductions to the TFF over time mean that financing levels no longer measure the "expenditure needs gap" as defined in the original formula, and do not adequately address territorial spending needs.

Horizontal fiscal disparities must be adequately addressed. The consequences of failing to do so are that key public services may be at risk and/or that tax rates may differ significantly across Canada.

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[4] See for example the 2002 Annual Premiers' Conference New Release entitled "Premiers Call for New Funding Partnership for Health Care for Canadians" (August 1, 2002)

2. Vertical Fiscal Imbalance

The February 2003 First Ministers' health arrangement provides for a significant increase in federal funding for health. Provinces and territories will receive funding targeted for reform of the health care system and for equipment purchases, as well as at least one one-time supplement to the CHST to deal with existing problems.

The targeted funding is expected to result in increased provincial/territorial health spending; that is, it creates additional spending requirements which will mean a higher provincial/territorial spending track for health care. Furthermore, provinces and territories are concerned that new federal funding for reform will not be sufficient to meet the demands and requirements of the new programs and services anticipated by the February 2003 health arrangement.

Unlike the targeted funds, the CHST Supplement(s) are intended to be used by provinces and territories to address existing needs. However, since these funds are "one-time" payments, they are not built into the base CHST funding. As such, while welcome, these funds do not translate into an ongoing commitment from the federal government.

In short, then, much of the new money flowing to provinces and territories is either "one-time" or tied to expanded services related to health care reform. While this funding may help to alleviate short-term financial pressures, it does little to address the underlying vertical fiscal imbalance that exists between the federal and provincial/territorial governments. Provinces and territories will continue to struggle to finance the highest priority programs with the greatest cost pressures, while the federal government collects considerably more revenue than it requires for its own programs.

Furthermore, should federal health reform funding prove insufficient to meet the demands and services anticipated by the February 2003 health arrangement, the vertical fiscal imbalance could be exacerbated.

3. Stability and Predictability of Federal Transfers

Given the current fiscal environment in which provincial and territorial governments now operate, defined by thinly balanced budgets and increasing demands, particularly in health care, the stability and predictability of transfers have become increasingly important issues.

Equalization

The current Equalization program is inherently volatile because revenue and economic data are updated for up to 30 months following the end of a fiscal year. This has resulted in dramatic adjustments to Equalization payments, particularly when the updates affect multiple open fiscal years. [5]

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[5] An equalization year remains open for adjustment up to 30 months after the end of that particular fiscal year. Therefore, at any given time, four years are open for adjustment - the current year plus three prior years.

The following are examples of the types of updates that result in dramatic changes in Equalization, creating considerable fiscal challenges for recipient provinces.

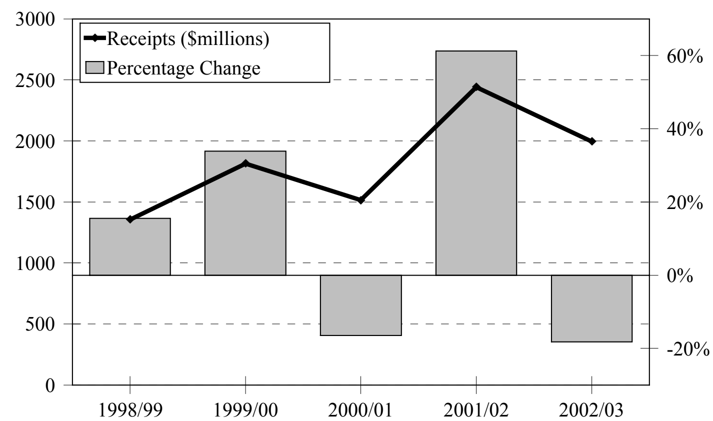
- Updated economic information for the mining tax base that was received in October 2002 and February 2003 resulted in substantial and unexpected changes in provincial entitlements for all years open to adjustment.

- In October of 2003, provinces and territories will be subject to a significant revision of population information that will affect Equalization entitlements for four fiscal years; these population adjustments will affect the CHST as well. The financial implications of having a multiple-year change in population information could be very significant for individual provinces.

Fiscal shocks create financial instability for recipient provinces, thereby reducing public confidence in the effectiveness of Equalization to assist less affluent provinces in providing reasonably comparable public services at reasonably comparable levels of taxation.

Figure 1 illustrates the volatility of the current Equalization program for Western recipient provinces over the last five years. It should be noted that the degree of volatility has historically been most pronounced in Saskatchewan; for example, Saskatchewan's Equalization receipts decreased by over $500 million from 2001/02 to 2002/03, to below zero.

Fig 1: Equalization Receipts of BC, Saskatchewan & Manitoba



Source: Finance Canada

CHST

There is volatility in CHST cash payments to provinces as well. In Alberta, for example, CHST cash payments for 2002/03 were revised downward by over $400 million, including prior years' adjustments.

For the federal government, the aggregate cash outlays for the CHST are known years in advance, subject to the agreements made by First Ministers. However, the allocation among the provinces and territories is determined by the value of the tax points, which has proven to be quite volatile and unpredictable in recent years.

The impact of revisions to the value of a province's tax points on CHST cash receipts depends on the interaction between the five-province standard and the value of the equalized tax points.

Table 3 shows the impact of a $1 billion increase in basic federal personal income tax (BFT) in various combinations of provinces.

Table 3
Impact on CHST Cash When PIT Revenues Change
Millions of Dollars

	If AB PIT Revenues $1 billion Higher	If ON PIT Revenues $1 billion Higher	If BC or QC PIT Revenues $1 billion Higher	If MB & SK PIT Revenues Higher by $500 million each	IF NS, NB & NL PIT Revenues Higher by $333 million each
BC	19.6	8.0	-11.6	-11.6	0.0
AB	-133.8	24.0	9.2	9.2	0.0
SK	4.8	2.0	-2.8	-2.8	0.0
MB	5.5	2.2	-3.2	-3.2	0.0
ON	57.1	-55.8	35.7	35.7	0.0
QC	35.3	14.5	-20.8	-20.8	0.0
NB	3.6	1.5	-2.1	-2.1	0.0
NS	4.5	1.8	-2.6	-2.6	0.0
PE	0.7	0.3	-0.4	-0.4	0.0
NL	2.5	1.0	-1.5	-1.5	0.0
NU	0.1	0.2	0.1	0.1	0.0
NT	0.0	0.0	0.0	0.0	0.0
YK	0.1	0.2	0.1	0.1	0.0

Source: Finance Canada; Alberta Finance

Alberta is not part of the five-province standard and so does not affect the value of the equalized tax points in other provinces. As a result, a $1 billion increase in BFT in Alberta reduces Alberta's CHST cash transfer by $134 million, which is distributed among all other provinces and territories, with Ontario and Quebec gaining the most.

Ontario is part of the five-province standard so when its tax points rise, it increases the value of the equalized tax points of other provinces, which is then re-distributed in part back to Ontario. Consequently, Ontario's reduction in CHST cash is only 42 percent ($78 million less) of that experienced by Alberta, and the gains in other provinces/territories are comparably reduced.

For the other provinces, the unadjusted value of their tax points is far enough below the equalized value of their tax points that the $1 billion increase in BFT does not directly affect their cash transfer. Since British Columbia, Quebec, Manitoba and Saskatchewan are part of the five-province standard, the equalized value of their tax points does rise with the increase in BFT, but the changes are small and are the same irrespective of where the increase occurred. Finally, Nova Scotia, New Brunswick, Newfoundland and PEI are not part of the standard, so there is no change in the equalized value of the tax points in response to the BFT increase and no change whatsoever in CHST cash transfers.

Territorial Formula Financing

The availability and quality of data for the calculation of Territorial Formula Financing (TFF) grants is inadequate and creates unpredictable volatility in TFF, making fiscal planning difficult for the territorial governments.

4. Direct Federal Spending and Tied Federal Funding

When the federal government chooses to invest in areas of provincial/territorial jurisdiction, it can do so through transfers to provinces and territories or through direct spending. The choice of funding approach has important implications for provinces and territories.

Direct spending allows the federal government to allocate funding based on its own perception of need in program areas that it favours. In some cases, such as the Canada Child Tax Benefit, the expenditure is in keeping with provincial/territorial priorities, and may even result from joint agreement and action.

In others, however, it can be problematic for provinces and territories by increasing, rather than decreasing, cost pressures and by distorting provincial/territorial spending priorities. For example, federal initiatives that increase the demand for post-secondary education (scholarship funds, loan improvements, tax incentives) without addressing the associated (increased) supply issues leave the costs of the latter to be borne by provinces and territories.

Provincial/territorial fiscal pressures from direct federal spending are intensified when "tied funding" is involved -- when provinces and territories are required to match federal dollars or otherwise cost-share particular programs or services in order to access federal funds.

Tied funding is particularly challenging for poorer provinces/territories that are not able to participate as readily in these programs. In addition, tied funding often involves provincial/territorial responsibility for ongoing program funding after federal funding has expired. Finally, since recent tied programs have tended to be entirely "pre-funded" out of year-end federal surpluses, they do not represent an ongoing cost to the federal government, whereas they do represent ongoing costs for provinces and territories.

5. Insufficient Provincial/Territorial Involvement

As noted in the previous section, provinces and territories are concerned that federal spending, exercised inappropriately, can distort provincial/territorial priorities, and have a destabilizing effect on provincial/territorial budgets. One of the key reasons this is the case is the lack of provincial/territorial involvement in the design and implementation of federal funding initiatives in areas of provincial/territorial jurisdiction.

The absence of consultation is not restricted to federal direct or tied funding; it extends to transfer arrangements as well. For example, the decision on how to split the CHST into separate funds for health and for other social programming was made unilaterally by the federal government, without any consultation with provincial/territorial finance ministers.

Provinces and territories want to be more active participants in the development of federal government programs and funding arrangements that enter areas of provincial/territorial jurisdiction, rather that just being advised of the final arrangement prior to public announcement. This desire is in keeping with the Social Union Framework Agreement (SUFA), in which the federal government committed to consultation with provincial/territorial governments at least one year prior to significant funding changes in existing social transfers, and to give at least three months' notice, along with an offer to consult, before introducing new Canada-wide initiatives funded through direct transfers.

IV. CONCLUSION AND RECOMMENDATIONS

The recent changes made to federal/provincial/territorial fiscal arrangements as a result of the First Ministers' health arrangement are a welcome first step, but much remains to be done to establish adequate, effective and equitable fiscal arrangements in support of the major social programming provided by provinces and territories:

- The increase in funding falls well short of what Premiers have clearly indicated is required both for base funding for major social programs, <u>and</u> for reform of the health care system.

- Increased support for health care seems to be coming at the expense of federal support for other programs supported by the CHST.

- Most of the new funding is either tied to expanded programming or one-time. While this funding reduces short-term financial pressures, it does little to address the underlying vertical fiscal imbalance that exists between the federal and provincial/territorial governments.

- Furthermore, should federal health reform funding prove insufficient to meet the demands and services anticipated by the February 2003 health arrangement, the vertical fiscal imbalance could be exacerbated.

- Aside from the removal of the Equalization ceiling, little has been done to address horizontal fiscal imbalance, despite repeated calls from Premiers for a strengthened and fairer Equalization program formula.

Western Finance Ministers call on the federal government to work with provinces and territories to:

a) ensure federal funding in support of major social programs and health care reform is adequate; and,

b) more effectively address vertical and horizontal fiscal imbalance.

The stability and predictability of federal transfers have been deteriorating in recent years, and this presents serious fiscal planning problems for provinces and territories.

Fiscal pressures on provinces and territories are also growing due to direct federal spending in areas of provincial/territorial jurisdiction as well as tied federal funding.

Furthermore, provinces and territories are rarely consulted on this direct and tied federal funding, despite the destabilizing effect it can have on provincial/territorial budgets, and changes are being made to federal/provincial/territorial fiscal arrangements without any consultations with provincial/territorial finance ministers. This is not in keeping with the Social Union Framework Agreement, in which the federal government made commitments to consult with provinces/territories before exercising its spending power, whether through intergovernmental transfers or direct spending.

Western Finance Ministers call on the federal government to include provinces and territories as active participants in the design and implementation of all program spending and fiscal arrangements that have impacts on provincial/territorial fiscal situations.