

Presentation to the House of Commons Subcommittee on Fiscal Imbalance

Honourable Mitch Murphy
Treasurer of the Province of
Prince Edward Island

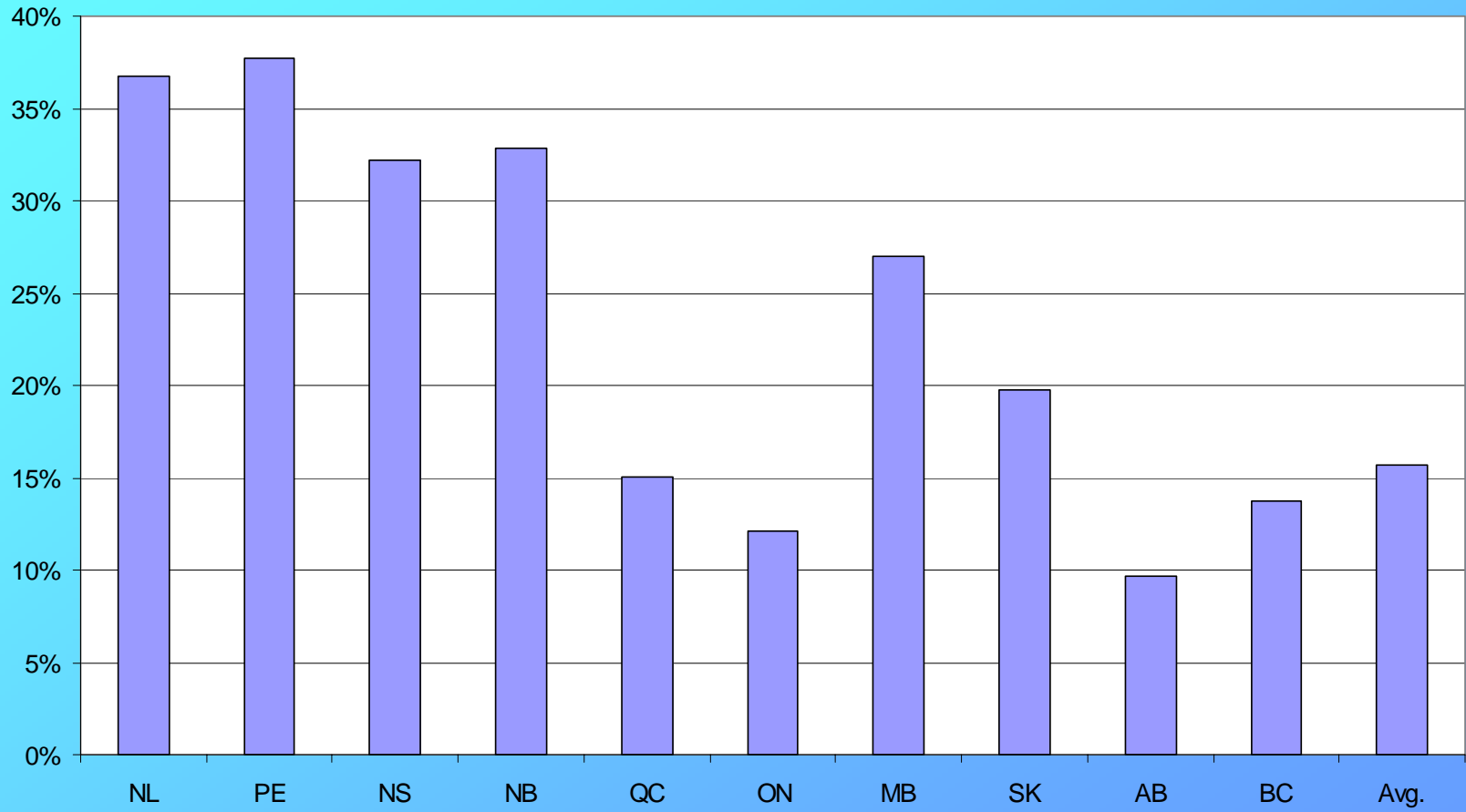
Halifax , N.S.

Friday, February 18, 2005

Background

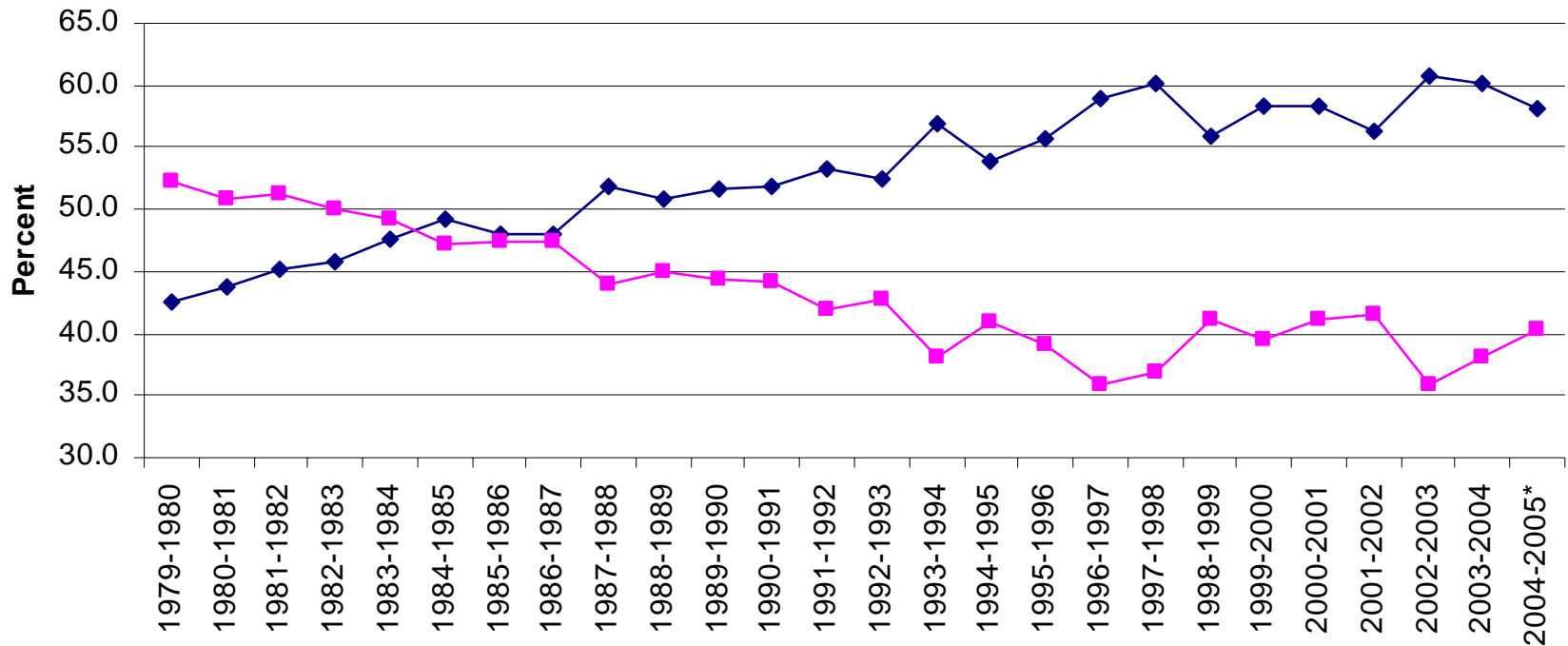
- PEI welcomes the opportunity to discuss this subject and advance the public debate on such a critical fiscal issue.
- All provinces have an interest in this subject but Prince Edward Island has a special interest in view of its small size and dependence on federal transfers.
- The following chart shows how we compare with other provinces.

Federal Transfers as a Percentage of Provincial Revenue, 2002



Transfer Dependence

PROVINCIAL AND FEDERAL REVENUE AS A PERCENTAGE OF TOTAL REVENUE, P.E.I., 1979-80 to 2004-05



2004-05*: Based on Q2 Fiscal

◆ Provincial ■ Federal

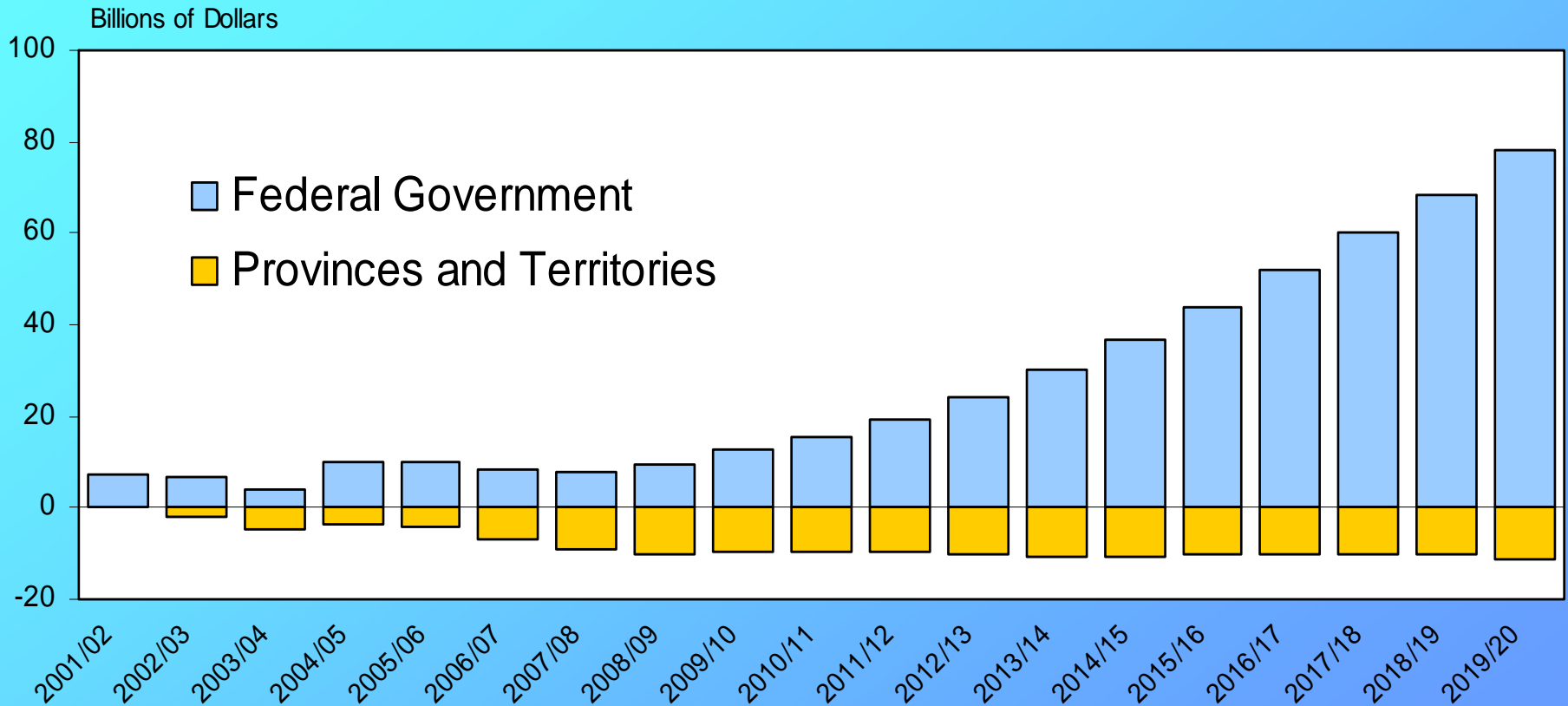
Need for a Correct Balance

- We see the balance in two dimensions.
- In the Vertical dimension there is the need to ensure that the mix of revenues between the two levels of government are appropriate for their respective spending responsibilities
- In the Horizontal dimension there is the need to ensure that revenues across provinces are also adequate to sustain public services for all Canadians.
- If either balance is out of kilter it will result in unnecessary social hardship in some quarters, economic inefficiency and inappropriate policies

Present Situation

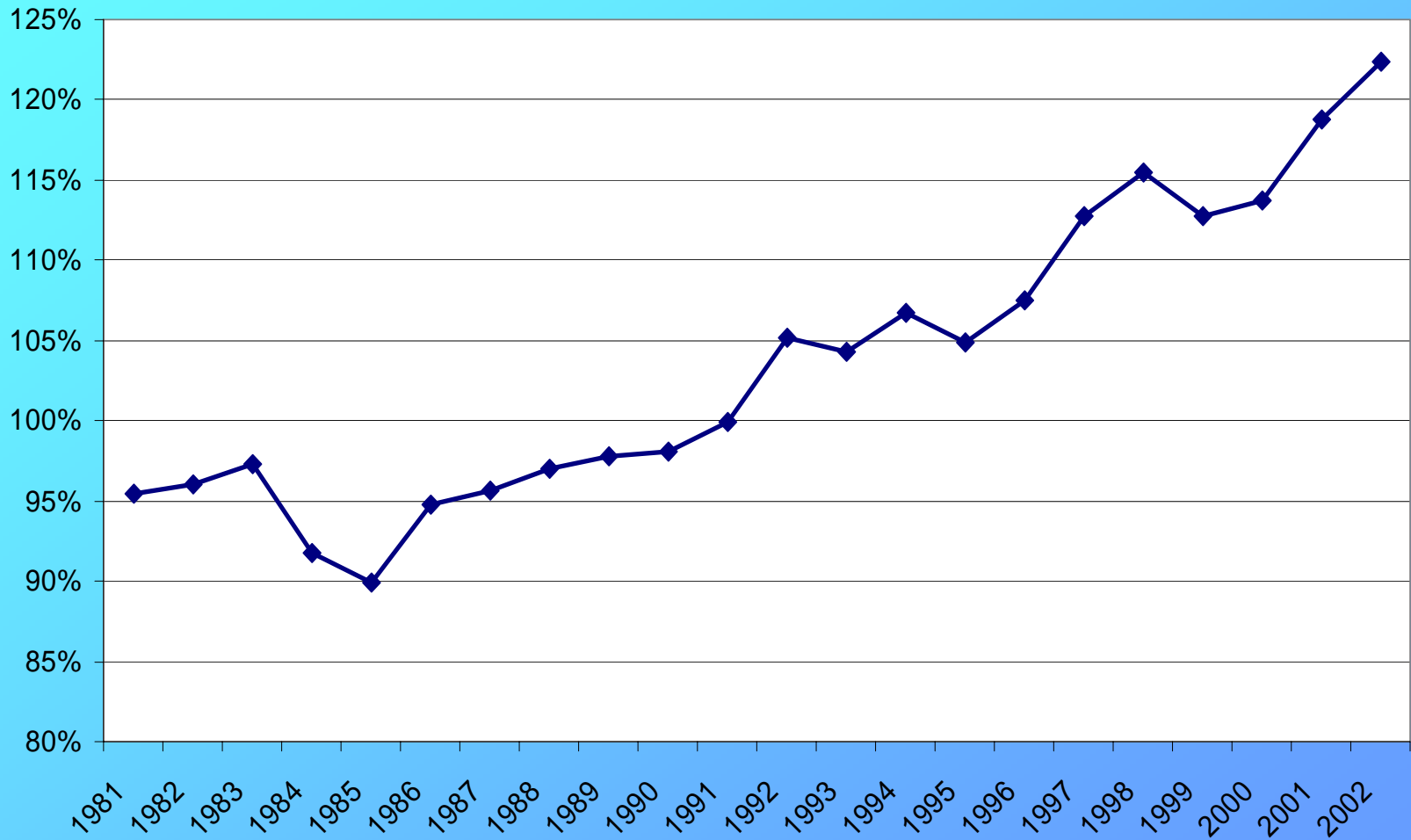
- It is evident to us that both the vertical and horizontal balances need correction.
- The Conference Board of Canada's projections clearly show that over time one can expect growing surpluses federally while provinces struggle to support vital services.
- Instead of providing long term thoughtful solutions the federal government has chosen to use its fiscal power to undertake ad hoc decisions and conclude bilateral deals.

Fiscal Position of the Provinces and Territories Relative to the Federal Government



Source: Conference Board of Canada, Fiscal Prospects for the Federal and Provincial/Territorial Governments, Update February 2004

Ratio of Provincial Expenditures to Federal Spending, Canada



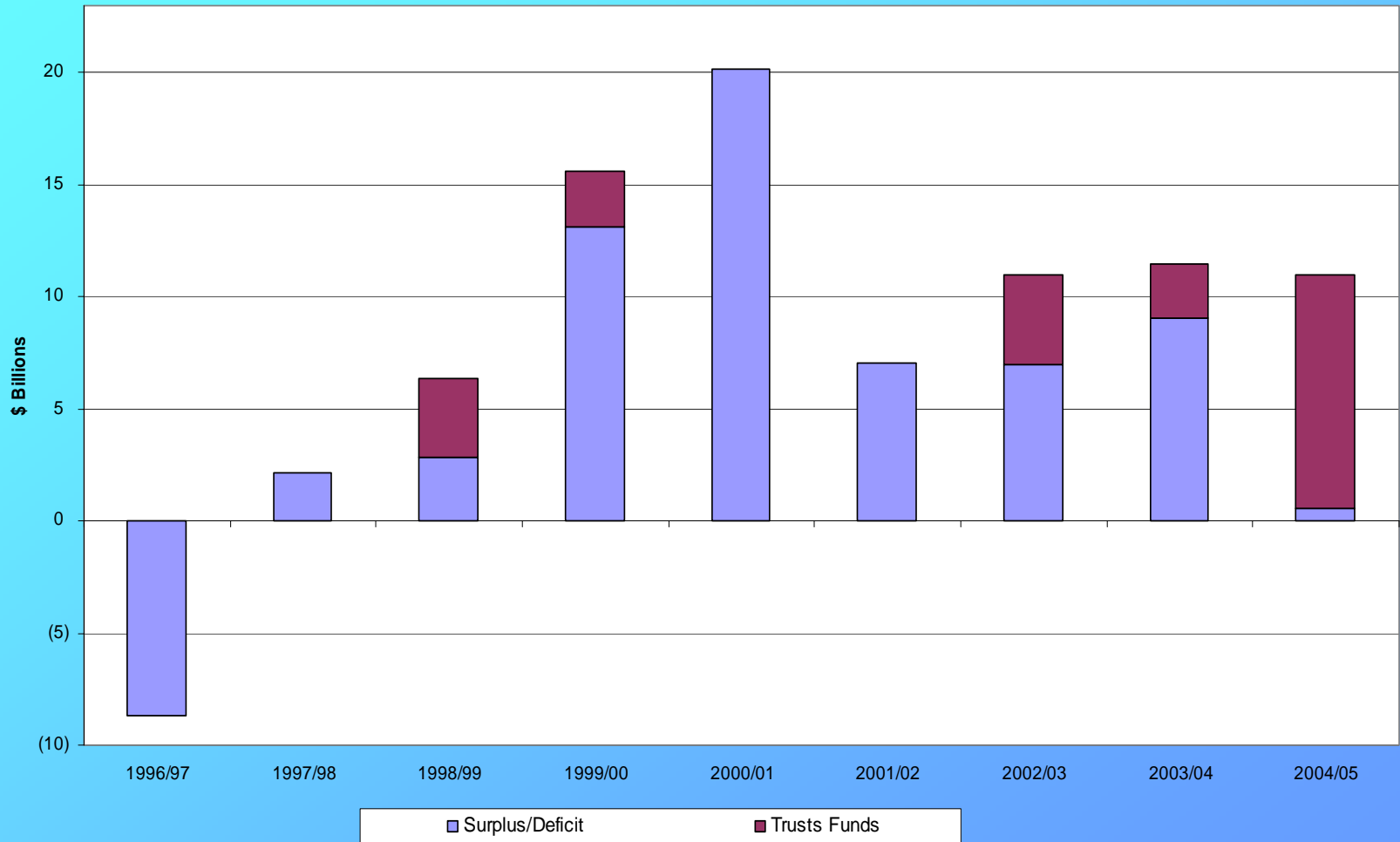
Federal Reaction

- The federal government still refuses to acknowledge that there is a fiscal imbalance.
- They have used their fiscal power to focus on one off deals such as the Gas Tax for Cities, Early Childhood Development and Offshore financial arrangements.
- Federal funding commitments for Health come with federal conditions and the negotiated financial arrangements smack of expediency.

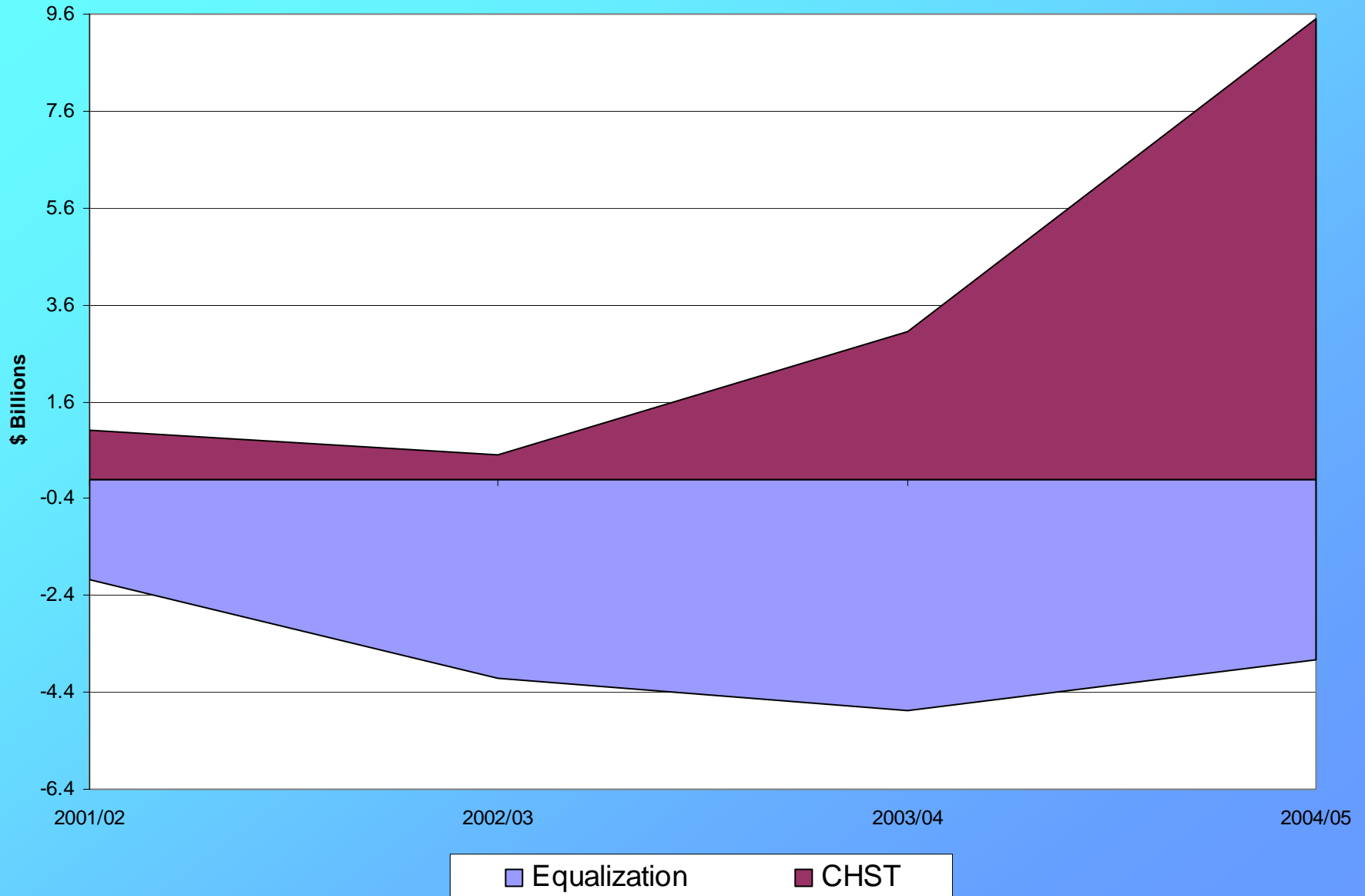
Financing Health

- Federal financial arrangements for Health have largely come from unbudgeted surpluses through Trusts and one time payments.
- And in large measure from savings from reduced Equalization.
- For PEI the net effect is that federal transfers have barely expanded and in constant dollars are still below 2001-02 levels.

Federal Surpluses



Federal Spending Priorities



Equalization and CHST Funding to PEI - 2001-02 to 2004-05.

				Forecast
\$ Millions	2001-02	2002-03	2003-2004	2004-2005
Equalization	282.3	222.4	243.8	278.7
CHST + Funds	88.9	89.5	110.2	122.8
Total	371.2	311.9	354.0	401.5
Constant Dollars	371.2	303.7	332.8	369.6

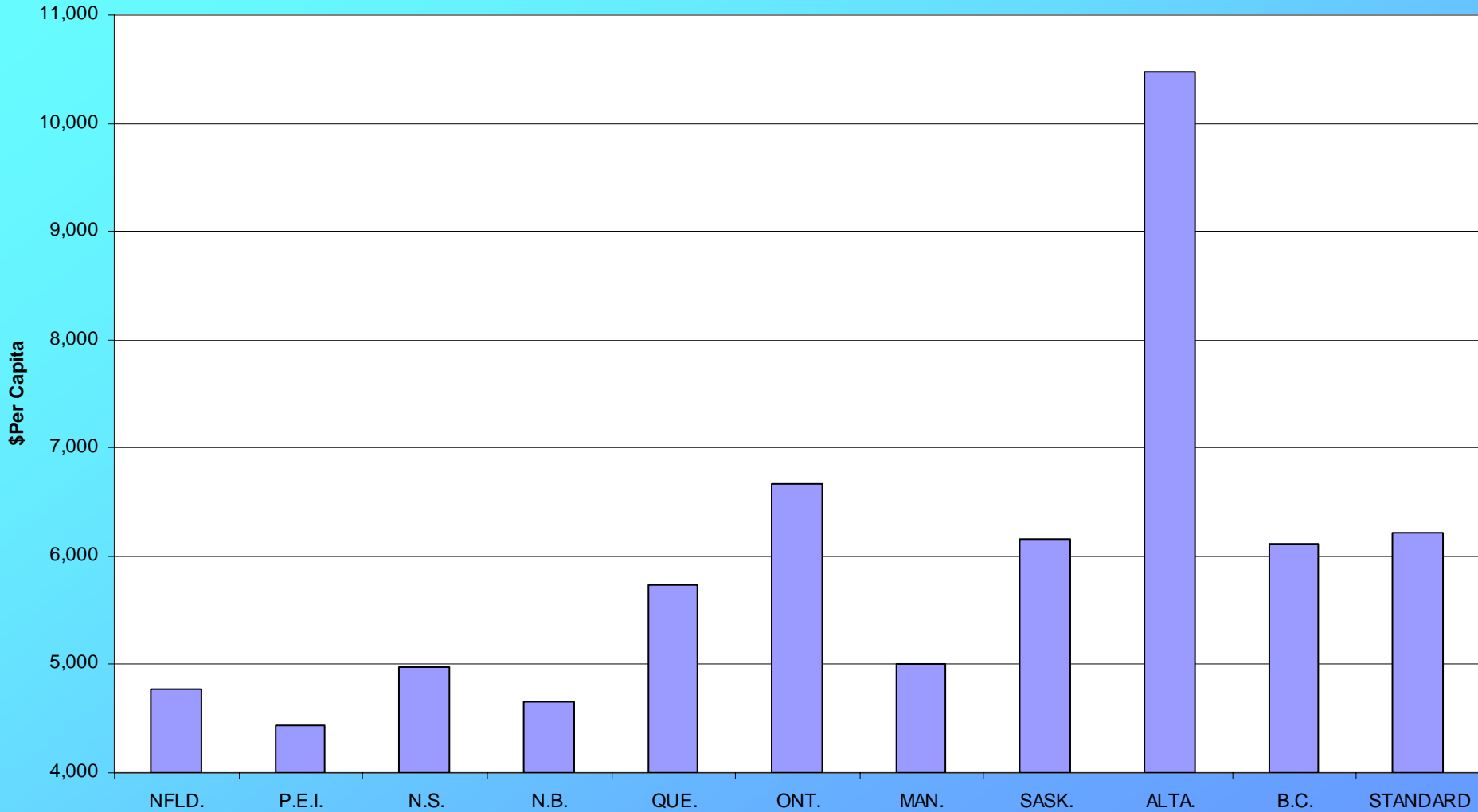
Federal Responsibility

- The federal government must recognise that it has a growing structural surplus and should not use this power to coerce provinces into expanding programs that are within their domain, against their will.
- Revenues must match spending responsibilities as defined by the Constitution.
- After all there is only one taxpayer.

Horizontal Concerns

- The fiscal resources of provinces are highly varied.
- PEI presently has the most limited financial resources, Alberta the most.
- The Equalization program has provided the counterbalance but its principles have been violated in recent years.
- The new Equalization arrangement is very troublesome after 2004-05.

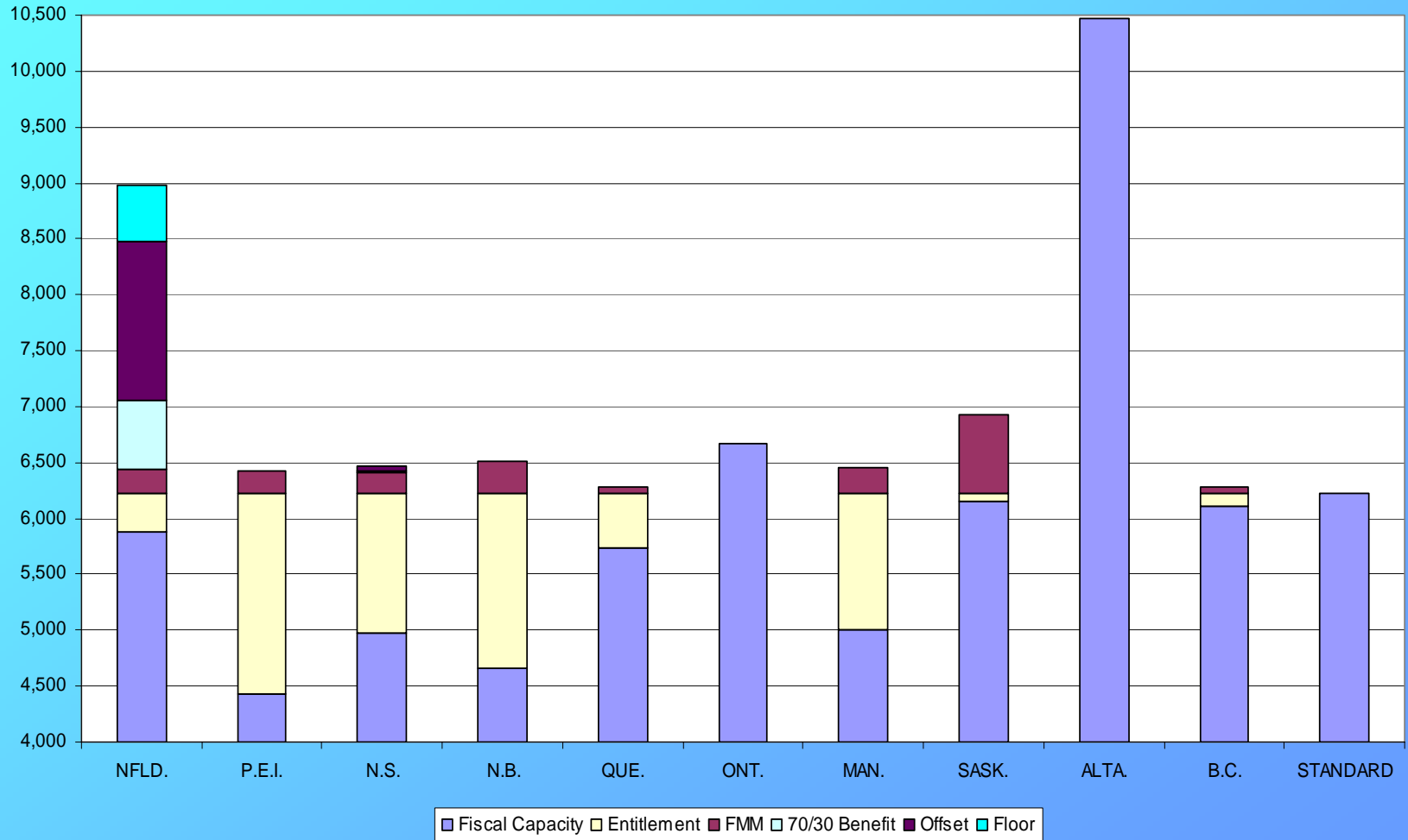
Provincial Fiscal Capacity: 2004/05



Equalization

- Resource rich provinces are receiving special treatment.
- The offshore accords and special arrangements for provinces such as Saskatchewan and BC indicate present federal thinking.
- The new Fiscal arrangements mean that the responsiveness of Equalization to changing fiscal circumstances will be difficult to accomplish. To do this the Act must be changed.

Fiscal Capacity per Capita after Equalization and Bilateral Deals: 2006/07



Offshore Accords

- “Under these agreements the Government of Canada transferred all royalties from the offshore resources to the two provinces”
- “It would be unfair to taxpayers in other provinces to provide an even more generous treatment to offshore revenues in calculating Equalization”
- “Its effect would be to disadvantage those provinces with few natural resource in those that have many”
- From July 2001 PCO Website, Government of Canada.

Getting the Balance Wrong

- Under present arrangements we will see an accelerating exodus of business, young population and extreme difficulties in providing basic Health and Social Services to an increasingly elderly population.
- Why?
- Because public services will slip and taxes will be increasingly uncompetitive.
- The imbalance must be corrected.

Correcting the Imbalance

- There must be a steady shift in fiscal resources from the federal level to the provincial level, combined with steps to ensure that the horizontal balance is also corrected.
- Provinces which are deficient in natural resource bases require additional assistance, not less.
- Some provinces with excess revenue resources may not require this shift.
- Growing Equalization at 3.5% is not the answer.

Comparison of Alberta to other Provinces

- Impact of natural resources on relative fiscal situations is clear. Alberta has very low levels of taxation for its own people.
- Cannot ignore the immense fiscal resources that can come from natural resources.
- Concern that new Equalization will do this.
- A move to Macro formulas would result in disaster for provinces without natural resources

Comparison of Alberta's Tax Effort On Provincial Revenues and Program Spending Per Capita

Province	Per Cent	\$ Millions	Spending Per Cap
NFLD.	66.2	(947)	9,315
P.E.I.	68.0	(211)	8,658
N.S.	71.3	(1,373)	7,420
N.B.	68.8	(1,134)	8,034
QUE.	65.4	(16,721)	9,796
ONT.	74.3	(20,904)	8,437
MAN.	64.9	(2,275)	8,583
SASK.	60.8	(2,890)	9,651
B.C.	68.0	(8,614)	8,661
Total	69.8*	(55,071)	8,893
ALTA.	100.0	0	9,277

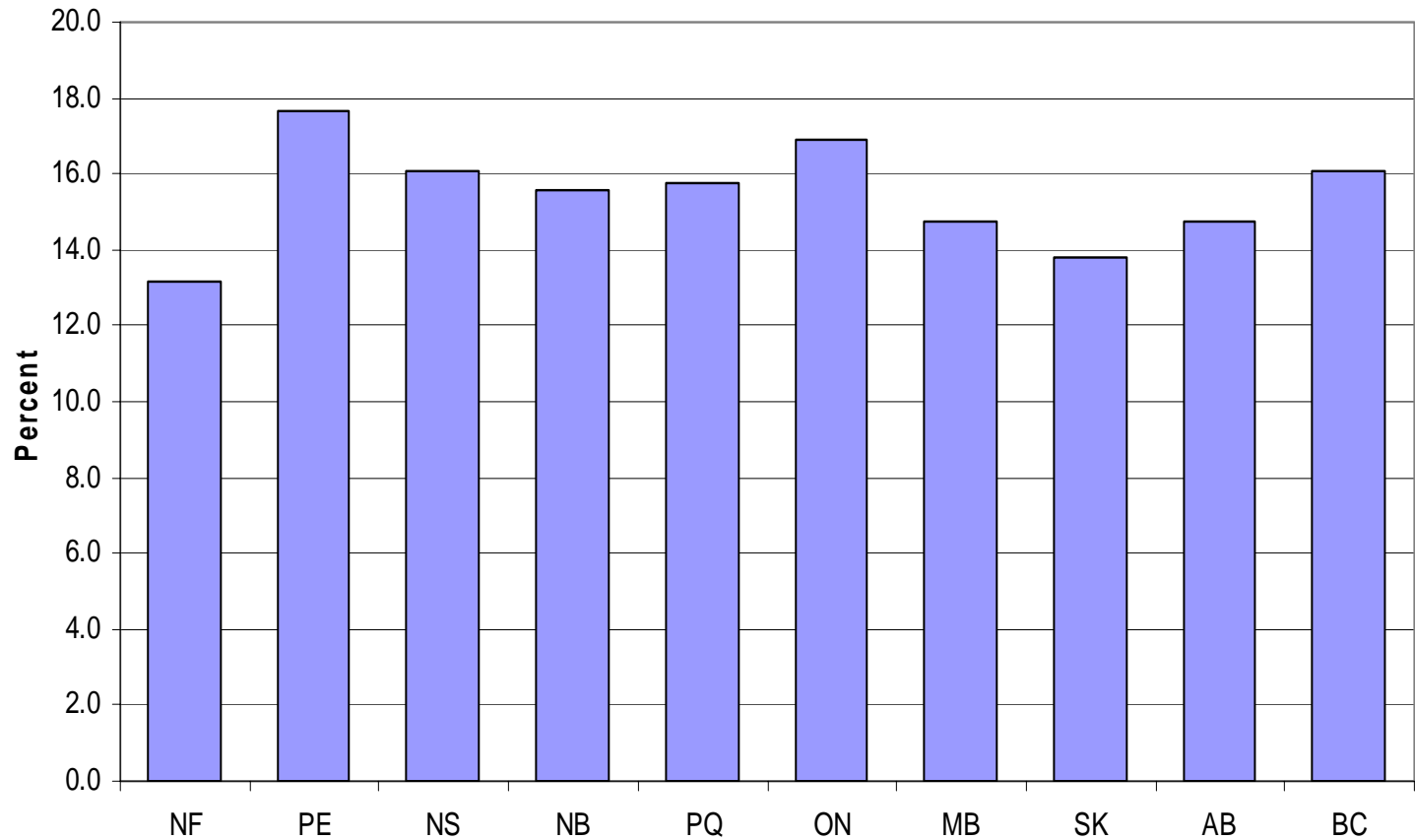
* Excluding Alberta , 2004-05 data, spending data 2003-04.

Correcting the Imbalance

- Shifting tax points from the federal level to provincial is an option, so long as the horizontal impacts are taken into account.
- Must bear in mind that a move to transfer fiscal resources from the federal level to the provincial level has very uneven effects and demands appropriate measures to support poorer provinces.
- Perhaps need to do selectively? Should look at the revenue side of the federal equation as well as the transfer side?
- Is the Federal tax treatment of oil and gas overly generous?

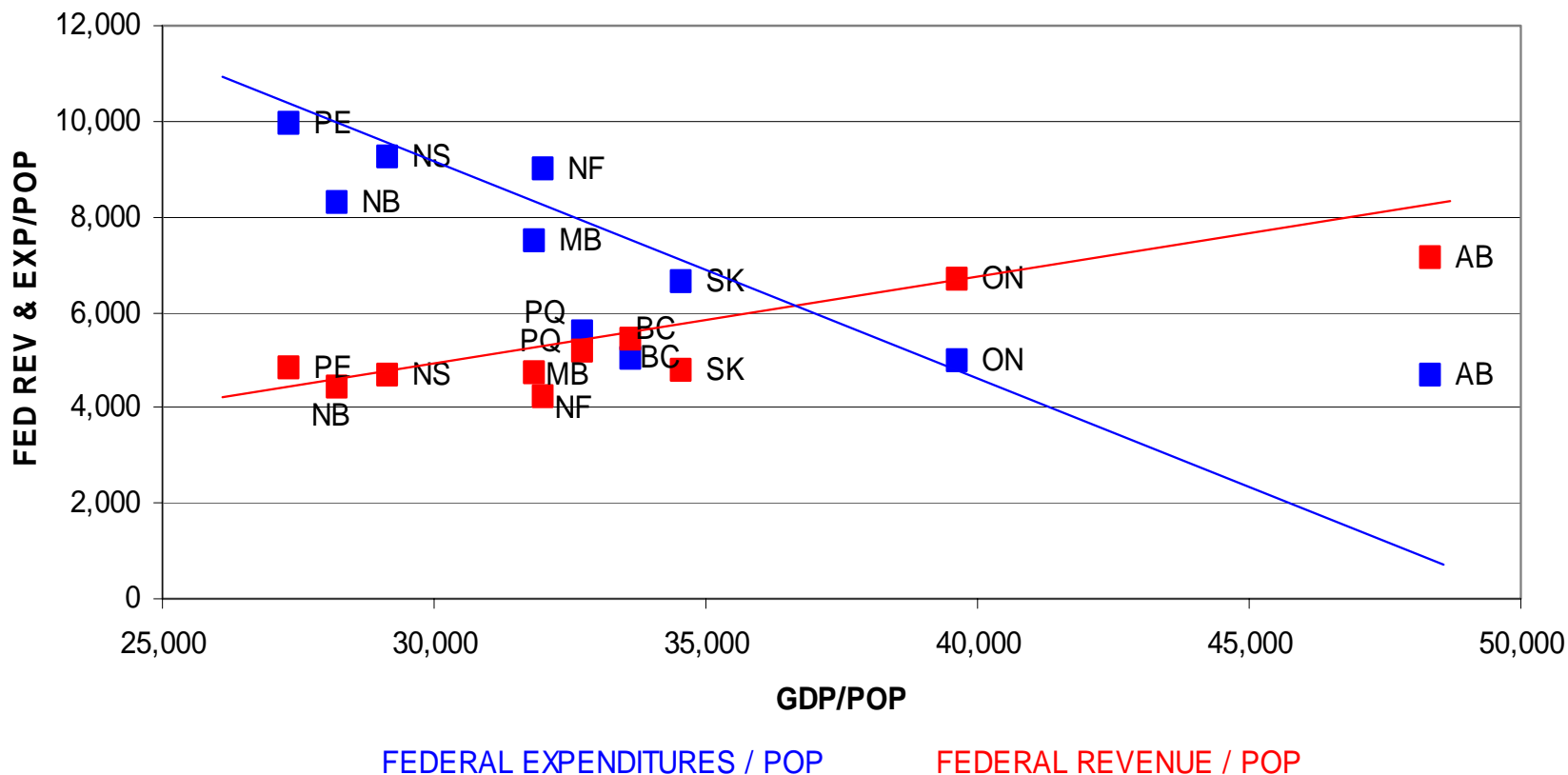
Federal Revenues

Federal Government Revenues as a Percent of Provincial G.D.P. 2002



The Balance of Federal Spending and Revenues

FEDERAL GOVERNMENT REVENUE AND EXPENDITURE (PER CAPITA)
RELATIVE TO PROVINCIAL G.D.P. (PER CAPITA), 2002



Constitution of Canada

“36. (2) 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.”

Summary

- Prince Edward Island feels it is essential to restore the appropriate fiscal balance across Canada.
- This must take into account both Vertical and Horizontal Fiscal Balance
- The growing federal surplus cannot be ignored and should not be used for ad hoc special deals.
- There is no evidence that the federal government has taken its role seriously on this issue and is presently in a state of denial.
- This attitude must change for the good of Canada.
- The balance of federal spending and its revenues must be both taken into consideration.