

BUDGET PAPER B: FEDERAL FISCAL ISSUES

The 2000 Federal Budget did little to address the immediate crisis in Health Care or to halt the equity divide that is growing between Canada's provinces, preferring to concentrate on reducing taxes, largely to the benefit of middle to high income earners.

"The Federal Government has shown a consistent disregard for the concerns of Provinces in their struggle to provide health care to Canadians and a particular disinterest in the concerns of smaller Provinces in their struggle to provide provincial public services at reasonable tax rates."

- Hon. Patricia J. Mella, March 17, 2000

CANADA HEALTH AND SOCIAL TRANSFER

Federal Contributions to Provincial Social Programs

The Canada Health and Social Transfer (CHST) is the federal program that provides financial support for health, post-secondary education and social service spending in Canada's provinces and territories. The CHST was first announced in Finance Minister Martin's second budget in 1995 as a replacement for two long-standing federal programs - the Canada Assistance Plan (CAP) and Established Programs Financing (EPF).

In 1994-95, the combined cash transferred to provinces and territories through CAP and EPF was \$18.7 billion. In 1996-97, the new CHST delivered \$14.7 billion, falling to \$12.5 billion in 1997-98. The annual transfer was raised to \$14.5 billion in the 1999 Federal Budget, still well below the levels prior to 1995-96.

Canadians have consistently identified health care as their top priority for government spending and provinces have been forced to meet growing demand and cost pressures with a drastically reduced federal contribution.

The 2000 Federal Budget allocated \$2.5 billion to a CHST trust fund from the surplus funds of 1999-00. Each province is expected to draw down its portion of the fund over four years "in a manner that best serves their needs". The allocation of funds between provinces is based on a per capita allotment.

Table B.1 identifies federal spending on core CHST, the federal contributions to CHST trust funds and the suggested way for provinces to use the trust funds to smooth CHST revenues from

1994-95 to 2003-04. As compared to 1994-95 transfers of \$18.7 billion, an on-going cash short-fall of at least \$3.2 billion remains even after the announcements in the 2000 Federal Budget.

Table B.1 - Federal CHST Spending: 1994-95 to 2003-04

| | CHST Cash Entitlements | End-of Year Payments to CHST Trusts | Federal CHST Spending | Federally Suggested CHST Cash Stream |
|------------------------------|------------------------------|---|-----------------------------|--|
| <i>(billions of dollars)</i> | | | | |
| 1994-95 | 18.7 | - | 18.7 | 18.7 |
| 1995-96 | 18.5 | - | 18.5 | 18.5 |
| 1996-97 | 14.7 | - | 14.7 | 14.7 |
| 1997-98 | 12.5 | - | 12.5 | 12.5 |
| 1998-99 | 12.5 | 3.5 | 16.0 | 14.5 |
| 1999-00 | 12.5 | 2.5 | 15.0 | 14.5 |
| 2000-01 | 13.5 | - | 13.5 | 15.5 |
| 2001-02 | 14.5 | - | 14.5 | 15.5 |
| 2002-03 | 15.0 | - | 15.0 | 15.5 |
| 2003-04 | 15.0 | - | 15.0 | 15.5 |

Source: Federal Budget 2000, Federal Public Accounts

The table also shows that federal spending on CHST is actually in a state of decline in 1999-00 and 2000-01, despite increasing federal revenues and balanced budgets. Including the new CHST Trust announced in its 2000 budget, actual federal CHST spending falls from \$16 billion in 1998-99 to \$15 billion in 1999-00 to \$13.5 billion in 2000-01.

The CHST Cash Entitlement is the base amount that the Federal Government transfers to Provinces and Territories in any given year. It might be noted that CHST Cash Entitlements differ from Total Entitlements, which include the value of a percentage of provincial income taxes. In 1976-77, the Federal Government transferred income tax room, in the form of percentage points, to the provinces as part of its commitment to provincial social programs. Specifically, the Federal Government agreed to decrease their tax rates on personal and corporate income by agreed amounts so that Provinces could increase their rates but leave the tax payer unaffected.

Provincial CHST Entitlements are determined by a relatively uncomplicated formula which multiplies the national total of CHST Entitlements by each province and territory's share of national population to determine provincial-territorial Entitlements. The CHST formula then subtracts the value of each province's transferred income tax points, whose value grows every year, from the initial calculation of Entitlements. The difference is paid to provincial governments as cash.

The Federal Government considers the tax transfers to be an on-going and increasing federal contribution to provincial revenues and social programs, despite the fact that these taxes have been part of provincial own-source revenues for over twenty years. The tax transfers do not appear in the federal Public Accounts as either a revenue or an expenditure item.

Provinces have called on the Federal Government to restore CHST cash funding to at least its 1994-95 level of \$18.7 billion, disregarding federal claims that the growth in tax points has restored CHST funding to previous levels. Provinces also wish to see the federal cash contribution to health care grow into the future to reflect population growth and cost pressures.

Prince Edward Island CHST Revenues

The Canada Health and Social Transfer is Prince Edward Island's second largest federal revenue after Equalization. Revenue from this transfer in 2000-01 is \$74.4 million. This amount is \$16.5 million *less* than the 1994-95 transfer amount of \$90.9 million. By contrast, Prince Edward Island's spending on Health and Social Services is budgeted at \$312.9 million in 2000-01, and \$44.1 million is allocated to Post-secondary Education - which are respectively \$30.4 million and \$10.6 million *more* than the Province spent in these areas in 1994-95. Thus CHST today contributes only 21 per cent to provincial social spending as compared to 29 per cent in 1994-95.

The following table shows Prince Edward Island's CHST cash entitlements and CHST recorded revenues since 1994-95. CHST Entitlements for any given year are initially based on forecasts by the Federal Department of Finance, but are subject to adjustments when actual data becomes available as to provincial-territorial populations and personal and corporate income tax collections across the country. Prince Edward Island records any adjustments to cash payments in the fiscal year in which the correction is made.

The figures from 1994-95 relate to the sum of payments under Established Programs Financing (EPF) and the Canada Assistance Plan (CAP) which were replaced by the CHST beginning in 1996-97.

Table B.2 - CHST Entitlements and Revenues, Prince Edward Island

| | CHST Cash Entitlement | CHST Revenues | Revenue Change from 1994-95 |
|------------------------------|--------------------------|------------------|--------------------------------|
| <i>(Millions of dollars)</i> | | | |
| 1994-95 | 89.0 | 90.9 | - |
| 1995-96 | 88.3 | 88.8 | (2.1) |
| 1996-97 | 71.4 | 77.7 | (13.2) |
| 1997-98 | 61.3 | 63.5 | (27.4) |
| 1998-99 | 61.3 | 63.1 | (27.8) |
| 1999-00 | 70.2 | 71.4 | (19.5) |
| 2000-01 | 74.1 | 74.4 | (16.5) |
| 2001-02 | 74.0 | 74.0 | (16.9) |
| 2002-03 | 74.0 | 74.0 | (16.9) |
| 2003-04 | 74.0 | 74.0 | (16.9) |

Source: Federal Budget 2000, Prince Edward Island Public Accounts, Provincial Treasury Estimates

After 2000-01, the Province's CHST revenues are forecast to be \$16.9 million less than the cash provided in 1994-95.

EQUALIZATION

Federal Contributions to Provincial Equity

Equalization is the largest single revenue source for the Government of Prince Edward Island. It is the federal program which is intended to put provinces on a reasonably equal footing in terms of their ability to provide services to their residents without imposing onerous rates of taxation. It is enshrined in Canada's Constitution under section 36.2 with the following commitment:

“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.”

- Canada Act, 1982 (U.K.)

The Federal Government makes Equalization payments to provinces based on a detailed formula that assesses each province's ability to raise revenues so that Equalization-receiving provinces will be able to have adequate revenues relative to a per capita standard.

The standard adopted by the Federal Government currently embodies the fiscal resources of the five "Standard" provinces of British Columbia, Saskatchewan, Manitoba, Ontario and Quebec. It might be noted that this does not provide for full equality because even after Equalization, the government of Prince Edward Island's revenues are only 92.6 per cent of the national average on a per capita basis. Ontario has revenue capacity of 100.3 per cent, while Alberta has 135.9 per cent of the revenue capacity of other provinces. Moving to a true National Average Standard from the current Five-Province Standard would raise national Equalization Entitlements by approximately \$1 billion annually.

In recent years, provinces have dramatically increased the level of public services they provide, both in historical terms and as compared to the Federal Government. This increase in program spending, in view of federal restrictions to CHST payments, has necessitated increased reliance on own-source provincial revenues. National Equalization payments have risen in consequence, but the restricted revenue standard of the current program has meant that the relative disadvantage of less affluent provinces has become intensified.

In addition to this systematic restriction on federal payments of using a reduced standard, the Equalization program is subject to a further explicit cap on payments that imposes a ceiling of \$10 billion in 1999-00, increasing with annual GDP after that year.

It should be noted that all Canadians in similar circumstances pay the same level of federal tax, no matter where they live. It is a misnomer to believe that Equalization necessarily penalizes citizens in non-Equalization receiving provinces, such as Ontario and Alberta. For example, a single individual in Alberta earning \$35,000 pays the same amount of federal income tax, Goods and Services Tax and fuel excise tax as a similar individual earning \$35,000 in Prince Edward Island.

The Government of Prince Edward Island is concerned that the Federal Government is too narrowly focused on restricting payments under the Equalization program and not sufficiently committed to its Constitutional obligation to ensuring that all Canadians receive reasonably comparable levels of public services at reasonably comparable levels of taxation.

The 2000 Federal Budget noted the following record of national Equalization Entitlements over a ten year period.

Table B.3 - Federal Equalization Entitlements

| | Equalization (\$billions) |
|----------------|------------------------------|
| 1994-95 | 8.6 |
| 1995-96 | 8.8 |
| 1996-97 | 9.0 |
| 1997-98 | 9.7 |
| 1998-99 | 9.6 |
| 1999-00 | 9.8 |
| 2000-01 | 9.5 |
| 2001-02 | 10.0 |
| 2002-03 | 10.3 |
| 2003-04 | 10.7 |

Source: Federal Budget 2000

This presentation is in sharp contrast to the 1999 federal budget in which Minister Martin made a point of stating in his speech that,

“the latest data indicate that payments this year (1998-99) will now total \$10.7 billion, \$2.2 billion more than projected in the 1998 budget.

And next year, Equalization payments will be \$600 million higher than projected”

- Hon. Paul Martin, February 16, 1999

Prince Edward Island Equalization Revenues

In 1999-00 Equalization revenues are forecast to be \$244.4 million, up slightly from the 1999 Provincial Budget estimate of \$241.9 million. Moving forward, Equalization revenues in 2000-01 are expected to remain relatively stable at \$244.9 million.

As shown in Table B.4, Equalization revenues in 1999-00 are forecast to be \$24.1 million lower than

in 1998-99, which stems from the fact that Prince Edward Island received an unprecedented prior year adjustment in that year of \$46.9 million when federal estimates for 1996-97 and 1997-98 were revised upwards.

This table highlights the variance that can take place in provincial Entitlements as more accurate information replaces preliminary estimates in the Equalization formula for a given Entitlement year. For example, the first federal estimate of payments to Prince Edward Island pertaining to the 1997-98 Entitlement year was \$185.1 million, made in February 1997. Accurate information on provincial income tax collections became available in December 1998, which helped to raise the official estimate to \$233.1 million in February, 1999. Further information on the 1997-98 fiscal year has become available from Statistics Canada and other provinces since then and the most recent estimate, of February 2000, stands at \$236.3 million. Thus the initial federal estimate for 1997-98 was \$51.2 million below the most recent federal figure for that year.

Table B.4 - Equalization Entitlements and Revenues: Prince Edward Island

| | 1994-95 | 1995-96 | 1996-97 | 1997-98 | 1998-99 | 1999-00 | 2000-01 |
|------------------------------|------------------------------|---------|---------|---------|---------|---------|---------|
| | <i>(millions of dollars)</i> | | | | | | |
| Equalization Entitlements | | | | | | | |
| First Federal Estimate | 185.9 | 202.0 | 196.4 | 185.1 | 198.6 | 222.0 | 236.1 |
| Most Recent Federal Estimate | 192.0 | 192.2 | 208.3 | 236.3 | 231.6 | 240.6 | 236.1 |
| Equalization Revenues | 200.7 | 187.9 | 187.2 | 208.3 | 268.5 | 244.4 | 244.9 |

Source: Prince Edward Island Public Accounts, Federal Department of Finance Official Estimates and 2000 Prince Edward Island Budget

Actual Entitlements, rather than revenues, have actually been relatively stable since 1997-98 in the order of \$236 million to \$240 million. The Provincial Treasury revenue estimate of \$244.9 million for 2000-01 is based on continued stability with some upward adjustments to reflect anticipated provincial revenue growth into the new year.