

by François Vaillancourt

ALTER THE FEDERAL- PROVINCIAL POWERS MIX TO IMPROVE SOCIAL POLICY

Les arguments d'efficacité utilisés pour confier à Ottawa ou aux provinces des responsabilités accrues en matière de programmes sociaux varient selon les programmes envisagés. L'auteur fait valoir la nécessité d'un retrait du gouvernement fédéral du domaine des soins de santé et de la cession des points d'impôt afférents aux provinces. Ottawa pourrait prendre à sa charge tout le domaine du soutien au revenu, en vertu d'une modification constitutionnelle qui lui accorderait la responsabilité dans le domaine du bien-être social. Concernant l'enseignement post-secondaire, la solution la plus judicieuse consisterait pour les provinces autres que le Québec à s'entendre sur une formule de péréquation inter-provinciale selon laquelle les provinces qui tirent profit d'un apport de diplômés universitaires paieraient une partie du coût de l'acquisition de ce capital humain.

The purpose of this paper is to put forward possible changes to the current power sharing and financing arrangements in the field of social policy, *i.e.*, income support, health and post-secondary education (PSE). This is of interest because of the ongoing debate in Canada on both the social union and federal-provincial financial arrangements. The paper is divided into three parts. The first outlines the problem and indicates its roots. The two others propose solutions that would require changes in the federal-provincial distribution of power and that presume an unchanged role for the state.

The original sin: Eve or the snake?

The current debate on the nature and financing of the social union is *a priori* surprising since the constitutional responsibilities for health, PSE and income support programs are quite clear. The difficulty arises from the fact that the federal government, like the snake in the Garden of Eden, was able to use its spending power, a delicious fruit (perhaps an apple?), to tempt the provinces, our 10 Eves, some more coy than others, to undertake actions that they had not initially intended. In the Bible, the snake only did this once by enticing Eve to take a bite of the apple, clearly making her the guilty party, as she (and poor Adam!) were thrown out of the Garden of Eden, thus giving snakes a bad name. In Canada, the federal government tempted the provinces several times after 1945 (Golden, Macintosh, Spartan, *etc.*) and succeeded each time (PSE in 1951, hospital insurance in 1958, and Medicare in 1967). The 10 Eves were not cast out of Canada but felt cheated by the snake when the apples became smaller over time. The federal snake saw its reputation enhanced following the successful seduction of the Eves and, to this day, is tempted and encouraged by some to do it again, although the Eves have become much more reluctant as they have grown wiser with experience.

Why was the federal government successful in tempting the provinces? The following factors appear to be relevant.

- At the end of World War II, the federal government, as a result of the Tax Rental Agreement with the provinces to finance the war effort, occupied the personal and corporate income tax fields entirely. At the time, this was seen as appropriate since the Keynesian view that governments have a role to play in stabilizing the economy was the guiding principle of post-World War II macroeconomic policy. To do this, monetary and fiscal policy had to be coordinated, and, given the control of the Bank of Canada by the federal government, this could be best achieved by giving that level of government the appropriate fiscal tools, *i.e.*, spending and taxing power.

- The increased level of taxation associated with World War II made it easier for governments to justify a claim through taxation to a greater share of GDP. Once this additional tax room was used to pay down part of the World War II debt, resources became avail-

able to finance new programs. Such programs came about as a result of real income growth, along with heightened demand for public services due to the baby boom and possibly changes in tastes such as a desire for a stronger Canadian presence in fields such as the arts.

- The federal administration was in a better position than the provinces to conceive and deliver social programs. This strength derived in particular from the concentration in Ottawa during World War II of Canada's finest minds. This relative advantage was particularly pronounced when smaller provinces were pitted against Ottawa.

- Finally, there was also the acceptance by the rest of Canada (ROC) of the leadership of the federal government as natural or normal, while Quebec was more reluctant to do this.

Solution 1: Money speaks

Let us assume in the first stab at a solution that constitutional amendments are not feasible and that solutions must be reached within the existing constitutional division of powers. There are two possible funding solutions in our opinion: provincial fiscal autonomy or federal fiscal supremacy.

Provincial fiscal autonomy

This solution is simple. All provinces could agree that as of April 1, 2000, they will fully fund programs now partly funded through federal transfers under the Canada Health and Social Transfer (CHST) and will thus raise their personal income tax (PIT) rates by the appropriate percentages on that date. They would also, as of that date, not claim the CHST cash transfers. The federal government would then be left with the choice of either reducing or not reducing its personal income tax rates. If it did not reduce them, it would be raking in important surpluses that could be used to lower the national debt. This would be appropriate, given the anticipated fiscal impact of Canada's aging population, but it would probably trigger taxpayer discontent.

Is such a provincial coup feasible? This would depend on political leadership, but if Ontario, Quebec and either Alberta or BC were on board, this strategy would affect more than 70 percent of the PIT base. As an enticement, the participating rich provinces could offer a revenue subsidy for five years to the poorer provinces. This interprovincial equalization (*à la* German Lander) could be financed by payroll taxes on employers that would be deductible from both the federal and provincial corporate income taxes and also payable by the federal government in its capacity as employer.

Federal fiscal supremacy

This scenario is the reverse of the provincial autonomy one. Here, the federal government announces that as of April 1, 2000, it will take back the income tax points previously transferred to the provinces (including the extra 16.5 percent abatement to Quebec) and fully fund CHST programs through cash transfers tied to population and GDP. It achieves this using equal per capita grants with possibly a more generous equalization scheme, mainly to compensate Quebec. This is easier to implement than the provincial autonomy scheme because there is no coordination issue but also because the federal government is the PIT tax collector for the ROC provinces.

Which solution is preferable? The answer to this question varies across the three policy areas covered by the CHST as follows :

- *Post-secondary education*: There are currently no Canadian standards that apply to the level of funding, the source of funding (fees/public subsidies), and the quality and portability of the output, though accreditation by North American bodies does matter in some professional fields (engineering, medicine, etc.). While interprovincial migration is less important now than 20 years ago, it still occurs, affecting, in particular, young better-educated anglophones. Atlantic Canadians and Quebec anglophones migrate mainly to Ontario, while Ontarians and Prairie residents migrate to Alberta and BC. Given this, it would be appropriate to have varying ratios of fees to public subsidies, with provinces losing graduates charging higher fees since they cannot recoup their investment through tax revenues, and it is unlikely that equalization payments fully compensate for this. It also makes sense to have greater coordination between ROC and English-Quebec universities on portability and quality issues. These considerations suggest that provincial fiscal autonomy in PSE is appropriate.

- *Health*: This is the area where the most stringent CHST standards apply and the only one with a financial penalty mechanism applicable to the use of provincial user fees. This is also an area where additional funds are likely to be tied to specific spending purposes in the near future. Yet, it could be argued that there is much less need to have national standards

It could be argued that there is much less need to have national standards in health care than in post-secondary education.

in this area than in PSE, given the lifetime distribution of health spending (concentrated on older individuals and around the time of death) which does not lead to a loss of initial investments by the provinces. What is unfortunate is the prohibition on user fees that could be used to send signals as to the real costs of various choices in health care. Increased provincial fiscal autonomy would facilitate the introduction of user fees.

Perhaps provinces should trade off tying additional CSHST funds to health with the introduction of a nonzero ceiling on user fee financing equivalent to say five percent of health spending;

- *Income security.* There are no standards as to the level of benefits to be paid out to welfare recipients, leading to important variations across provinces. Furthermore, since the replacement of the Canada Assistance Plan (CAP) by the CHST, there is no longer a 50/50 sharing of the additional cost of new welfare cases. As a result, there is an incentive for provinces to offload welfare recipients onto federal income support programs such as Employment Insurance (EI) and (except for Quebec) the disability component of the Canada Pension Plan (CPP). Thus, it would make sense to have a better integration of federal and provincial income maintenance programs in both ROC and Quebec. In ROC, where two of the three programs are already federal, it would appear appropriate to shift welfare from the provincial to the federal level. In Quebec, where two of the three programs are provincial, the administration of a block-funded EI by the province would seem appropriate.

We thus come to the conclusion that the CHST is really three programs and that economic logic lends to a different treatment of each.

Solution II: Who does what?

Given the above discussion, and if we now assume that amending the constitution is feasible, it is not surprising that the most appropriate solution would involve:

- the federal government finally taking over the field of income support by a constitutional amendment giving it responsibility for welfare. This would allow full coordination between EI and welfare payments and programs, and make offloading activities unnecessary. Provinces could still administer welfare. Such an amendment would raise the hackles of all Quebec politicians. Ottawa could ignore this or choose to devolve EI and welfare to Quebec. What matters is coordination;

- the federal government formally withdrawing from the field of health care. It could do so by a constitutional amendment restricting its spending power in the field and by ceding the necessary tax room to the provinces who could then choose to implement user charges. Such payments need not be at the point of service but could be billed later. They could then be used to improve resource allocation and reduce demand where appropriate;

- the federal government also formally withdrawing from the PSE field, conditional on the provincial governments of ROC formally agreeing to an interprovin-

cial equalization scheme in higher education, with provinces benefiting from an inflow of university graduates paying part of the cost of the human capital thus acquired. Quebec uses higher fees for English-speaking universities to attain the same result.

Conclusion

The ongoing social policy debate reflects the fact that Canada is both a natural and an historical federation. Natural federations are made up of distinct ethnic/linguistic/religious groups and survive as one country only

by being federations: India, Switzerland and Belgium are examples of this. Historical federations were created as federations because of historical settlement patterns and coordination difficulties due to distance, but they are

quite homogenous in terms of their demographic make-up: Australia, Germany and the US are examples of this. Natural federations tend to have stronger subnational states than historical ones; historical federations tend to see a strengthening of the central government as time goes by. In Canada, Quebec (French/Catholic) and ROC (English/Protestant) form a natural federation, while the nine provinces of ROC are an historical federation. As a result, the Canadian federation is particularly difficult to manage. The Calgary Declaration, if amended to nine instead of ten equal provinces, would reduce some of these difficulties. In the meantime, the provincial fiscal autonomy option should be seriously examined.

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The CHST is really three programs and economic logic suggests we should treat each one differently.

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