

# THE FEDERAL DISCUSSION PAPER: ROAD MAP TO A FIRST MINISTERS' CONFERENCE

Paul Boothe

While the federal budget papers may not be compelling reading, Ottawa's discussion paper *Restoring Fiscal Balance in Canada* is required reading for the Canadian political class. It provides a clear road map to a First Ministers' Conference on fiscal federalism and makes it clear that Stephen Harper wants a quid quo pro from the provinces in return for redressing the vertical fiscal imbalance between Ottawa and the provinces. Among other things, the prime minister is signalling he wants a strengthened Canadian economic union by eliminating barriers to interprovincial trade. Paul Boothe goes through this important federal paper and concludes that "it reflects the new government's ideology — a move away from the current environment of increasingly complex overlapping responsibilities toward classical federalism with more clearly delineated roles and responsibilities."

La lecture du budget fédéral n'est sans doute pas des plus passionnantes, mais toute la classe politique canadienne devrait au moins lire le document d'accompagnement. Feuille de route en vue d'une conférence des premiers ministres sur le fédéralisme fiscal, ce document révèle clairement l'intention de Stephen Harper d'obtenir des provinces une compensation pour le redressement du déséquilibre fiscal vertical. Le premier ministre y indique notamment qu'il souhaite renforcer l'union économique en supprimant les barrières au commerce interprovincial. À l'examen de cet important document fédéral, Paul Boothe conclut qu'« il reflète l'idéologie du nouveau gouvernement, qui consiste à s'éloigner de l'environnement actuel caractérisé par un chevauchement complexe des responsabilités pour se rapprocher d'un fédéralisme classique fondé sur une délimitation plus claire des rôles et responsabilités ».



It is now generally accepted that fiscal arrangements between Ottawa and the provinces were becoming increasingly unworkable in the final years of the former Liberal government. Commentators cite the increase of federal spending in areas of provincial responsibility after the elimination of the federal deficit, the increase of bilateral deals between selected provinces and Ottawa and the changes to Equalization that followed the 2004 Health Accord as evidence that the consensus over fiscal arrangements was breaking down. While increased federal spending in provincial areas began in earnest with Jean Chrétien's government, the breakdown of the consensus seemed to accelerate under Paul Martin, probably because of his government's minority status and the perception by provincial premiers that he was especially vulnerable to political pressure.

The new Conservative government was elected in January 2006, in part on a platform of "open federalism." It

promised to reform fiscal arrangements and address provincial concerns regarding a persistent "fiscal imbalance" between Ottawa and the provinces — a concept that had been dismissed by the federal Liberals. After the election, the new government laid out its analysis of the issue and its broad strategy toward reforming fiscal arrangements in a budget paper entitled *Restoring Fiscal Balance in Canada: Turning a New Leaf*, included in Budget 2006.

In what follows I evaluate the federal arguments and proposed process to reform fiscal arrangements outlined in this budget paper and offer some brief policy conclusions.

To understand the federal strategy, it is useful to consider its motivation. First, it reflects the new government's ideology — a move away from the current environment of increasingly complex overlapping spending responsibilities toward classical federalism with more clearly delineated

roles and responsibilities — and attending enhanced accountability.

A second motivation is to preempt the political hostage taking that characterized the Martin minority regime and to arrest the deterioration of fiscal arrangements, which had progressed from principles-based federalism to chequebook federalism (in the later Chrétien years) to the smash-and-grab federalism practised by some provinces during the Martin minority regime. It is clear that the federal government has no desire to repeat the experience of the Martin government, when provincial premiers would travel to Ottawa to demand a meeting with the prime minister and refuse to leave without some agreement to transfer federal funds to their province.

A third motivation is to prepare the provinces and all Canadian voters for a future of limited federal resources — the empty piggy bank. The spectacular increase in federal spending under Prime Minister Martin — largely transfers to provinces — together with the Conservative government's promise to reduce the GST by two percentage points and to further increase defence spending has substantially reduced the likelihood of large federal surpluses in the future.

The overall goal of the federal paper is to build the framework to con-

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tain the discussion within boundaries that are acceptable to Ottawa. The strategy has three elements.

The first element is to symbolically change direction. The government began this during the election campaign by acknowledging what most voters (and journalists) believed and the former Liberal government denied: that a fiscal imbalance between the

federal government and the provinces exists. The Liberal government had waged a long war with the provinces over the hearts and minds of Canadians over the existence of the fiscal imbalance and lost. Recognizing the war was lost, the Conservatives have turned necessity into a virtue, not only admitting the existence of the fiscal imbalance but pledging to address it. A key tactic of the strategy is to point to a number of policy "concerns" (i.e., mistakes of the previous government), both to explain the current problem with fiscal arrangements and to point toward a solution.

Signalling a new direction is always easier when one is not forced to justify past actions. The new government took full advantage of its lack of track record to focus on a number of policy "concerns" that arose under its predecessor. Leading the list was the concern over the large, unplanned federal surpluses and the end-of-year expenditures used to avoid them. In opposition, the Conservatives argued that such surpluses or end-of-year spending damaged democratic decision-making and weakened accountability to Parliament. In addition, large surpluses provided prima facie evidence of the fiscal imbalance as defined by provincial premiers: Ottawa has the resources while provinces have the program needs.

The federal paper goes into some detail to explain the reasons for large, unplanned surpluses, pointing out that provinces also had significant unplanned surpluses over the same period. Ironically, the existence of persistent, unplanned provincial surpluses raises questions about the existence of the fiscal imbalance — exactly the point made by the previous govern-

ment. Rather, as Andrew Coyne has noted, it points to a fiscal imbalance between federal and provincial governments and taxpayers. The paper attributes such surpluses both to the surprising strength of the Canadian economy and to the very prudent fiscal rules in place.

A second concern is described as the "blurred accountability due to reduced clarity in roles and responsibilities." Here the federal paper points both to increased federal involvement in areas of provincial responsibility such as early childhood development and housing and to the neglect of some exclusive federal responsibilities such as defence, border security and immigration.

In addition to addressing two of its own concerns (albeit shared with the provinces) regarding past federal policy, the federal paper devotes significant space to dealing with provincial concerns over the size and predictability of federal transfers to provinces. The Equalization Program is largely ignored, as the federal paper was released before the O'Brien report on equalization and territorial financing, and the federal strategy has been to wait and see if a provincial consensus emerges before showing its hand. However, the federal paper goes to some lengths to defend past federal

policy on health, post-secondary education and infrastructure transfers and so-called regional spending. This is an essential part of building the framework to contain the fiscal imbalance discussion. The paper argues that in the case of health spending, predictable, sustainable funding was put in place with the 2004 Health Accord, noting that the funding, slated to grow at 6 percent annually (faster than the Canadian economy or federal revenues), exceeds the amounts recommended in the Romanow report.

Turning to post-secondary education, the paper acknowledges that



Dave Rector,  
General Manager, BC Operations

## EPCOR is cleaning up the heavy metals flowing into Howe Sound.

In 2005, the British Columbia government turned to EPCOR to clean-up contaminated water from the abandoned Britannia Mine, one of the largest sources of heavy-metal water pollution in North America. "The copper from two pennies dissolved in an Olympic-sized pool would make it uninhabitable for fish," says David Rector from EPCOR. "At Britannia, more than 450 kilograms of toxic copper metal were pouring into Howe Sound every day. That's enough copper to make 70 million pennies a year." In less than a year, EPCOR developed a new water treatment facility that captures and removes heavy metals. The facility is a vital part of the rejuvenation of the Britannia area, located on BC's famed Sea-to-Sky Highway. This is just one more way EPCOR is providing Canadians with power and water in the most responsible and reliable way. See [epcor.ca](http://epcor.ca) for more.



Jason Ransom, PMO

Prime Minister Harper has signalled in the 2006 budget discussion paper that he wants a **quid pro quo** from the provinces, particularly on strengthening the Canadian economic union, in return for addressing the vertical fiscal imbalance between Ottawa and the provinces.

federal transfers have declined as a share of total spending on post-secondary education since the mid-1990s. However, direct federal spending in post-secondary sector, mainly in the areas of student assistance and research funding, has grown substantially. The result is that the total federal contribution (including both transfers to provinces and direct spending) has kept pace with provincial spending and even grown slightly over the past decade.

With respect to infrastructure, the federal paper acknowledges the decline in public infrastructure investment (as a share of GDP) over the last four decades. It points, however, to recent significant increases in federal transfers for transportation, municipalities and border infrastructure. In addition, it notes the GST relief and the share of the federal gasoline excise tax granted to municipalities to provide resources to fund infrastructure investment.

Finally, the federal paper addresses the concern expressed by some provinces (notably Ontario) regarding federal spending targeted to specific regional needs. Here the paper argues that “comparability does not mean uniformity” and that the federal government is bound by the Constitution to “promote equal opportunities for the well-being of Canadians.” Such a responsibility requires tailoring some federal programs to meet particular regional needs. Further, the paper argues that the federal government needs the capacity to insure regions against natural and man-made disasters such as floods, ice storms, BSE and SARS.

**T**he second element of the strategy underlying the federal paper is to lay out the *quid pro quo*, i.e., what the federal government wants in return for reform of fiscal arrangements.

Under the previous federal government, when Ottawa was seeking to spend money in areas of provincial responsibility, discussions largely centred on two issues: the amount of the transfer and what, if any, conditions would be attached. This positioning put Ottawa at a disadvantage at the outset of every negotiation, and the disadvantage was especially pronounced when the minority Martin government had, as one of its central campaign promises, a pledge to “fix health care for a generation.” Promising only “open federalism,” the Harper government had much more scope to set the terms of reform and to demand some economic reforms in return for addressing provincial concerns.

The budget paper makes clear that provinces are expected to deliver on measures to enhance the Canadian economic union. Key to enhancing the economic union is reduction of barriers to labour mobility, especially the recognition across provinces of credentials for professionals and skilled workers and recognition of immigrants’ credentials.

In addition, the paper argues for the need to further harmonize securi-

ties regulation across the country, an initiative pursued vigorously (if not very successfully) by the previous government. Finally, the paper argues for

For the improved accountability benchmark, the paper points to the focus in Budget 2006 on federal responsibilities, including border secu-

issue of fiscal arrangements reform. It has changed the debate from one over whether the fiscal imbalance exists — a debate that the former government had already lost — to how we address the issue. Through the paper, the government has developed the framework or boundaries within which the debate will take place. It has also set the benchmarks by which success will be measured. Success includes leaving room for the federal government to fund its own responsibilities adequately and to continue to run modest surpluses.

**The federal paper provides solid evidence that the Harper government has a clear, well-defined strategy to bring a political solution to the issue of fiscal arrangements reform. It has changed the debate from one over whether the fiscal imbalance exists — a debate that the former government had already lost — to how we address the issue. Through the paper, the government has developed the framework or boundaries within which the debate will take place.**

more tax harmonization, especially in the area of sales taxes.

The final element of the strategy is to set the benchmarks and timetable by which success is to be judged. Consistent with Conservative ideology, these benchmarks include improved accountability, fiscal responsibility, predictability of transfers, an efficient economic union and enhanced collaborative management of the federation.

The first two are to be achieved by clarifying roles and responsibilities and by ensuring that transfer reform does not impede Ottawa's ability to continue to run surpluses (albeit modest ones). Predictability of transfers is a key provincial concern that can be addressed in a straightforward way with a new equalization formula and an explicit escalator for the federal support for post-secondary education. Efficient economic union is a key federal concern that can be addressed by provincial action on harmonizing professional and skilled work credentials, the credentials of professional and skilled immigrants and movement toward a single regime for securities regulation. Finally, enhanced collaborative management of the federation is to be achieved by meeting the other benchmarks. This is undoubtedly a very different set of benchmarks than provinces might propose to measure the success of reform of fiscal arrangements.

ity, defence and justice. For the fiscal responsibility benchmark, the paper points to the new *Federal Accountability Act*, the creation of a parliamentary budget officer to provide independent fiscal forecasts to parliamentarians and annual and medium-term debt reduction targets. Also included is a proposal to allocate unbudgeted surpluses to the Canada Pension Plan. For the predictability-of-transfers benchmark, the government points to the growing health funding guaranteed by the 2004 Health Accord.

To further meet these and the other benchmarks presented, the government commits to make public, by fall 2006, its approach in four areas: allocating unplanned surpluses, reforming Equalization and territorial financing, providing federal support for post-secondary education and training, and providing federal support for infrastructure.

Before presenting its approach to these issues, the government commits to consult with policy experts and the public. Finance ministers will meet to discuss the issues, and other ministers will consult with their stakeholders as well. The process will culminate with a meeting of first ministers in the fall of 2006 and be implemented in Budget 2007.

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Will the strategy work? Of course it is impossible to be certain about future political outcomes, but Ottawa's plan is clear, it is practical, and it fits the government's political timetable: i.e., it prepares the Conservatives for the possibility of a 2007 election. In addition to having a skilful plan, the government has also, to date, been lucky. Its first stroke of luck is that the O'Brien report, tabled subsequent to the budget by the Expert Panel on Equalization and Territorial Formula Financing, has provided the government with a principles-driven, affordable formula for reforming Equalization. The second stroke of luck is that, in the aftermath of practising smash-and-grab federalism, premiers are badly divided. In their two meetings since the federal budget, premiers have been unable to reach a common position on Equalization or broader fiscal arrangement reform or, in some cases, even to demonstrate that they understand the issue. Thus, both by design and by good fortune the federal government is well placed as it moves toward a First Ministers' Meeting in the fall of 2006.

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