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**VERBATIM TRANSCRIPT OF
HOUSE COMMITTEE PROCEEDINGS**

COMMITTEE: STANDING COMMITTEE ON PUBLIC ACCOUNTS

DATE: Thursday, October 7, 2004

SUBJECT(S) BEFORE THE COMMITTEE:

Equalization - Discussion of principles, impact on the finances of the province, and current issues.

NOTE:

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COMMITTEE

MEMBERS PRESENT: Ronald MacKinley, Chair
Jim Bagnall, Vice-Chair
Wayne Collins
Wes MacAleer
Wilbur MacDonald
Dr. David McKenna
Hon. Robert Ghiz

MEMBERS PRESENT: Richard Brown

MEMBERS ABSENT: Cletus Dunn

GUESTS: Part I - John Palmer
Part II - Hon. Mitch Murphy
Part III - Dr. Robin F. Neill

STAFF: Marian Johnston

STANDING COMMITTEE ON PUBLIC ACCOUNTS
Thursday, October 7, 2004
10:00 a.m.

**Part I - John Palmer, Director of Economics,
Statistics and Federal Fiscal Relations**

Tape No. 1

Ron MacKinley (L) (Chair): I guess we'll call the meeting to order. It's a little after ten. The first presenter will be Mr. John Palmer, Economics, Federal Relationships with the province. He represents the province. If you can come forward to enlighten us what we—and basically, what this is about is equalization, discussion of principles, impact on the finances of the province, and current issues. It's good to see you, Mr. Palmer, and who is your assistant with you?

John Palmer: Nigel Burns is helping me put together this presentation and he is now one of our representatives when we deal with the federal government on equalization. He's an expert in it.

Ron MacKinley (L) (Chair): Now, how would the committee like to go? Would you like Mr. Palmer to say what basically what the base is and then ask questions afterwards? (Inaudible Comments)

Ron MacKinley (L) (Chair): Alright, go ahead.

John Palmer: Do I have to push a button here?

Ron MacKinley (L) (Chair): No, it's on.

Jim Bagnall (PC): Your light is on.

John Palmer: It's automatic, okay, that's good.

Ron MacKinley (L) (Chair): You might have to pull it probably closer to you, I don't know.

John Palmer: That's good. The purpose of my presentation is to lay sort of a background as to exactly how equalization works so that everyone has a common understanding of the process that we go through.

I'm the Director of Economics, Statistics and Federal Fiscal Relations and I've been dealing with the federal finance department on matters concerning equalization for some 25 years right now, so we will go through this fairly straight forward presentation and if you have any

questions during it, I'm quite happy to take whatever you have.

Okay, the equalization program, as everyone knows, is actually provided for and there's a commitment in the constitution as the federal transfer is regarded as important enough to warrant a constitutional provision. It's 36.2 in the constitution which states, "that the parliament and the Government of Canada are committed to the principle of making equalization payments to ensure the provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation." That essential, that statement is the foundation of how the whole program functions in Canada.

In terms of how this commitment is made to work within the system we have in place now, the equalization entitlements are paid to provinces under the authority of the federal Fiscal Arrangements Act. It's important to realize that it's a federal program; it's under federal legislation, and the bottom line is that the federal government calls the shots on how this program operates.

Entitlements are made on the basis of a formula which I'll describe in a moment, that is actually specified in the federal act and it has regulations pursuant to that as well. But essentially, the way the money is calculated is actually defined in this federal act. One of the points that I should make is that equalization in the Canadian constitution is set up in such a way that it's federal money being paid out to poorer provinces, if you wish. It does not involve the movement of dollars from richer provinces' revenues to poorer provinces. Some countries actually do have a system of negative entitlements whereby very rich provinces, the revenues are drawn down and used to transfer to poorer provinces, richer to poorer. We don't have that in Canada. There's no such thing as negative equalization.

The formula itself, in the Fiscal Arrangements Act is written in such a way that it has a five-year renewal. It actually—the new formula, if you will, began April 1st of 2004 of this year and discussions take place on amendments to the formula, things we don't think are correctly defined, discussions on the level of entitlements and so on, will take place

through the federal/provincial finance ministers' committee structure and federal ministers meet with provincial ministers periodically and essentially discuss what should or should not go in the formula.

A lot of the technical work is undertaken by officials and in fact, I'm the provincial representative on this Fiscal Arrangements Committee which involves assistant deputy ministers across the whole country. And there's a Technical Committee that reports to the Fiscal Arrangements Committee which looks into specific questions concerning measurement problems and so on and Nigel is actually our representative from Prince Edward Island on that.

An awful lot of this discussion looks into the minutia of statistics and data and the kind of measurement problems that we feel don't necessarily allow us the correct entitlements. But essentially, it all comes to a head every five years in order to build a new formula, make changes to the formula, which, as you can see, it happened on April 1st, 2004 of this year. But I should emphasize that it all is, on last analysis, if the federal government doesn't want to take our advice or feels that we're wrong or whatever, then it's up to them to make the final call because it's their legislation and it's not done through an agreement, per se. There's no signed agreement between the two levels of government. It's strictly a federal decision at the end of the thing.

Now the present formula that determines the equalization entitlements, actually has a long history in Canada and it goes back to the mid 1950's or even before that. There were some equalizing components to the transfers that were made even before that. But essentially, from the mid 50's right through to the 60's and 70's, the formula was enhanced. The number of revenues that were put into the equalization formula were increased. Initially, it just concentrated on income taxes.

Essentially, about 1982, a decision was made that we would incorporate all the revenues available to all provincial governments and most municipal revenues as well, into the formula. The thought being that there are differences in municipal/provincial degrees of authority and revenue making across the country. If you wanted a system that was truly equal, it had to take in the municipal level as well. Basically, in 1982, a major

change was adopted which was to move to a five province standard rather than the national ten province standard. But it did, the federal government did agree at that time that we should cover all revenues. And the formula that we now know actually is pretty much what was put in place in 1982 with some revisions to specific items.

The basic idea about a concept here is that we try to measure the per capita fiscal capacity of every province and make sure that every province has an equivalent of the five provinces' per capita fiscal capacity and that has been in place since 1982.

Now I have the next slide is actually the mathematics of the formula in its sort of simplified form and that is to show that for equalization for province EI is equivalent to the summation across all the revenue sources which are J's, right? The J revenue - there's 33 revenue sources. J, you sum up, the calculation is $\frac{Br_j}{pr}$ which is the per capita standard for the five provinces minus your own province is fiscal capacity for that revenue source per capita. So you compare the five province standard to your own per capita standard and if there is a deficiency, you get that amount of money times the population and they're added up across these 33 revenues. And the revenues include things like personal income tax, corporate income tax, sales tax, as well as the national resource revenues that are not actually available to this province like oil and gas revenues, mining and so on.

So a lot hinges on this calculation of whether or not the Br_j 's and the Bij 's are properly calculated because that determines the deficiency that a province has. And those are done in a standardized way for each province. It's very statistically determined and the t' in the formula is actually the national average tax rate for each one of those revenue sources. The way it is designed is in such a way that no one province can sort of manipulate their own taxes and revenues in order to gain an advantage. Although there are some cases where that might possibly occur. But in Prince Edward Island's case, whatever we do to our own taxes and revenues really doesn't change the amount of money we're?

Part of the Canadian system of equalization is something called the RTS or the Representative Tax System. Some countries don't do this. There are times when it's been questioned whether we

should do this in Canada. But the point of the RTS is to figure out what each province could raise in tax revenues from each of these 33 commonly used provincial and municipal revenue sources at national average tax rates. What we do is we try to assimilate what actual tax practices of each province is, in order to determine their fiscal capacities. And as I pointed out in the formula, these are then compared on a per capita basis with the same calculation for the five provinces and the standard added up. And if you add up across all these revenue sources and you find that you have a positive deficiency or if you're negative in terms of that formula, then you get that amount of money times the population.

If you add up all the numbers and it turns out that your per capita average is higher than the five provinces, then you don't get an equalization. And right now, two provinces don't get equalization and those are Ontario and Alberta. The calculation would indicate that they don't, that their entitlement is actually negative so they don't get it.

Now the five provinces that are in this five province standard are Ontario, Quebec, Saskatchewan, Manitoba and British Columbia. They excluded Alberta because the federal government—and still would claim that their fiscal capacity is so high that they couldn't put it in the formula because it would sort of bankrupt them. They feel it would be too expensive. We would dispute that incidentally.

They also left out the Maritimes, the Atlantic Provinces as a kind of balance. We'll leave out the richest province. We'll leave out the poorest province and we'll go for the middle. It would be our contention that that might have been appropriate in 1982. We're not so sure that would be appropriate in 2004.

Now the basic formula has got some special provisions in it. Basically, to reduce the tax back impact of in the case of some provinces, for example, offshore oil and gas, in the case of Newfoundland and Nova Scotia. The way the formula would work there is that any additional money, any monies that they would receive in revenues would be automatically withdrawn from their equalization payments and so there are some provisions to ensure that that doesn't happen completely, the 70/30 provisions. And there's also provisions for floors in case of major drops in year-to-year entitlements. So you don't just—if there

was a huge drop from one year to year in your entitlement, then there is a provision in there to prevent that from happening. You get some compensation for that.

I should point out that the entitlements themselves are paid to us on the basis of an initial estimate which we have provided for at the beginning of the financial year, for the year in question. And that number is then adjusted over a sequence of events over the coming four years, roughly four years. So how many actual calculations are there made of each entitlement?

Nigel Burns: Eight.

John Palmer: There's eight. Until these entitlements are finalized, there are eight calculations made. We do know from our own experience, there's a very large variation in the first entitlement to the second, third, fourth. It's only until you get to about the fifth entitlement that the numbers start to settle down, and there could be very large variations. And that extends for us from one fiscal year to another. We would get the first two, in the first fiscal year? The first three come in the fiscal year in question and then we get another two the following fiscal year, another two the following fiscal year. And those changes in these entitlements, we would record as prior adjustments in our books. And that's one of the reasons why we have a great deal of volatility in the payments that we get from the federal government.

And that's the way the money is delivered to us. They give us this kind of a first estimate. We get paid on that. We're getting paid on that as we sit here for the first estimate for 04/05. And then that will be adjusted actually later this month. It's changed and the numbers for 03/04 or 02/03 or 02/01, they get adjusted too. We get a change in the payment cycle. In February, the same thing happens and this sequence is through until eventually the final estimate is delivered which is about four years after the first estimate is delivered.

This is sort of a very cryptic view of actually the numbers that we have in play right now for 04/05 showing the per capita calculation for each province. Let me just—Prince Edward Island is the second column from the left and you can see, the blue bars show what the calculation of the five, of

each province's fiscal capacity is in national average tax rates. This is a calculation that is made by federal finance. This is the calculation that goes into this formula. And in our case, you can see that the fiscal capacity of Prince Edward Island for the current year under this first calculation they've made for us for this year, subject to change, is \$4,359 a person, is actually the lowest in the country. You can see it, just looking across, the five province standard.

So if they do the same calculation for Quebec, Ontario, Manitoba, Saskatchewan and British Columbia, that calculation shows it to be \$6,126 per person, the five province standard that is noted on the calculation there. So the gap between the 6,126 and the 4,359 which is 1,767 is the deficiency and equalization takes that number, multiplies it by population and says, okay, this is what we're going to pay you. That's how equalization works.

What you're looking at there is the summation of all the calculations for each one of those 33 revenues in the base. So if there's a calculation like that being done 33 times, but when you add it all up, each province has the same five province; every province that receives equalization ends up at the same point. You can see that if you run your eye across the top, every province, Newfoundland, PEI, Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, Saskatchewan and BC end up with \$6,126 per capita off the equalization. That's the whole idea of the program.

You can also see from this diagram how large the fiscal capacity of Alberta is and this, of course, is a concern. You can see that Ontario is actually above the line as well. So those two provinces don't get equalization. But if the recalculation of this 04/05 or 05/06 or any other year pushes the blue above the 6,126, in this case, and you can see that British Columbia is pretty close to it, they would not get equalization either. So we take that number, 1,767, multiply it by our population and that's the equalization entitlement.

Honourable Robert Ghiz (L): (Indistinct)

John Palmer: We have always relied on equalization very considerably and the main reason for that is, of course, our natural resources. We don't have natural resource revenues at all

here. It's one of our distinguishing features.

In terms of the absolute amounts of money, who gets most and so on and so forth, this pie chart takes those 04/05 numbers which add up to \$9.5 billion and shows where the money actually goes. Of course, this is determined, not as much by the populations of each of these provinces, this is taking those numbers and multiplying by population. And you can see that Quebec gets by far the largest amount of equalization part. That number had been around \$5 billion and it's dropped quite considerably in the last few years but they get around 40 per cent of all equalization. And you can see that Prince Edward Island gets around 2.6 per cent and that has been about where we've been for several years. We get about 2.6 per cent of the amount of money being provided in equalization.

These numbers will change by year, by entitlement, depending on the economic circumstances in play in that particular year. So notwithstanding the fact that we get the highest per capita in entitlement, our actual amount of money that we get in absolute terms is easily the smallest in the country.

In terms of how important equalization is to each province, this shows the entitlements as a percentage of budgetary revenue by province in the current year and indeed, we do have the highest dependence on equalization as a revenue source. Although it has been, as the minister, I'm sure, showed you, has been sliding in recent years. But it's the highest in the country. Newfoundland and ourselves were sort of in competition for quite awhile in this little race, if you will, and Newfoundland's entitlements have dropped quite considerably with their oil revenues in just the last four or five years.

Another slide shows you how equalization fares in terms of the sort of total amount of money being committed by the federal government over time. And it's our concern is that the way the formula is calculated, particularly with the five province standard being relied upon, you can see that there's just been a continuous drop in the percentage of entitlements as a percentage of GDP. The same thing shows up as a percentage of the federal revenues too, and there's been a precipitous drop in the entitlements as a percentage of GDP since the year 2000/2001.

One of the factors behind this is the fact that Stats Canada, as you know, lowered our population estimates for the 2001 census and 2002. And this had a large effect on equalization entitlements as well. The provinces who receive equalization tend to be provinces with very, very slow growing populations.

In terms of the sort of things that have been a concern to us, we have been arguing for many, many years that the federal government should raise the standard from the five province to the ten province and they've been unwilling to do that. We were also concerned that in the 1999 renewal, the federal government was looking more to save money in equalization rather than to assist provinces with their fiscal problems and they actually have reduced one of the revenue sources by 50 per cent which had quite an impact on us. It's costing us roughly \$10 million a year in lost equalization because of that decision.

Provinces can share the federal concern but the volatility of the program has a really, a disastrous effect on our finances and has a disastrous effect on the federal finances too. And they're concerned about that as much as we're concerned about ourselves. But we all agree that the imposition, holding the—this recalculation of payments every so often, these eight entitlements causes us a lot of distress. And in addition, we feel that many elements of the program are such that the definitions create a volatility that is probably something that we could avoid. So there is a kind of a general concern that something should happen here, and they have—if you can just move on.

Okay, this gives us an idea of what's being going on with equalization for Prince Edward Island in this volatility element. The red line shows the revenues of equalization recorded in our public accounts going back to 1982-83. The blue line, the blue bar shows you the first estimate that we get. This is the number that we get that starts our budget cycle for the coming year and in 04/05, it's the number there.

The grey line shows you the estimate that eventually was used to finalize that particular year and I could refer you, for example, to if you go back to '91-92, you can see the blue line was considerably above the grey line. Now the blue line we would not have seen until two to three

years later. This is shown as in '91-92, but we wouldn't have actually seen that revealed until around '93-94, '94-95. And the red line kind of demonstrates the volatility we've had in this program because of the changes in the entitlements themselves, the volatility of the estimates and the re-estimation process that goes in, in all these prior year adjustments.

You can see, there was a very large decline in our revenues in equalization between 01/02 and 02/03 as a result of that. And similarly, there were significant upturns and downturns. The thing is all over the place. It's very hard to budget.

This is my last slide and it just simply, it just lets you know that the renewal process that went into the April 1st, 2004 formula did include significant measures to try to reduce the volatility of payments although those will not really come into effect until 05/06 and 06/07, if they ever come into effect. The federal decision was to average out payments and not to work on the basis of a very preliminary number which would then be subject to change.

But in terms of some of the measurement problems that we had identified during the last renewal period, many of them are going to be adopted but very, very slowly which is of concern to us. I should give you an example. For example, they changed the way the mining tax base is defined. And in Prince Edward Island's case, I don't think we have a very large mining sector here. But the way they defined it, it picked up a lot of numbers for us for peat moss production which I don't think is a very large revenue source for the province, if it is at all, and that cost us equalization. And as we sit here, those sort of definitions causes problems that will be changed but it's going to have to wait two or three years to be changed under this renewal package. Those are the sort of things that are going on.

Dr. David McKenna (PC): Would that be retroactive?

John Palmer: No, they wouldn't do it retroactive. The federal government now, and I think the minister will talk about this in more detail, has just as of two weeks ago come forward with a new proposal which would completely redefine equalization as we know it, beginning in 06/07 and would provide them with a lot more discretion to

make decisions on how the program will be functioning. That is the conclusion of my presentation. Thank you.

Ron MacKinley (L) (Chair): Alright, we'll start with Richard and come right up the line. Anybody got any questions, we'll just go right up the line.

Richard Brown (L): Oh thanks, Mr. Chairman, yes, just one question. I have the equalization, the Federal/Provincial Fiscal Arrangements Act that governs this program from Ottawa, and it does have 33 categories - Personal Income Tax, Corporate Income Tax, Tax on Capital Gains, Corporations, Tobacco Taxes and that. Can you provide this committee with the spread sheet of those 33 indicators and where we are on each indicator on a national average?

John Palmer: Yes.

Richard Brown (L): So we can determine what revenue sources are down or where we are failing when it comes to our sister provinces. Like if they're generating more money from forestry revenues, or oil revenues and stuff like that, so we can indicate. I've been asking for that for a number of years and I haven't got it yet. There must be something in there.

John Palmer: I don't think I received that request actually, Richard.

Richard Brown (L): In the House. It's a constitutional issue we're arguing that we deserve this money. Make no mistake, Mr. Chairman, I want as much money as I can get out of the federal government. I want my fair share of what I can get out of the federal government, but I don't want a handout. I don't think any Islanders want a handout here, Mr. Chairman. I want to make that clear up front because there will be members that says, you don't want equalization. I think that Islanders want their fair share when it comes to this, Mr. Speaker. We don't want our sister provinces indicating that we are a basket case and that we can't make it on our own in this province. Because I think if Islanders had a chance, we could make it on our own. And if we had some good economic policy in the province, we could get out of the equalization doldrums, Mr. Chairman.

Just one quick question, in 1999, you're saying that equalization has dropped off since, but if you

look at the federal government's numbers here, they seem to be transferring their money to CHST. You now, money has been taken out of equalization and put into CHST. Now that has been an agreement that was been done by the first ministers back then. They agreed at that time, you know, we need to improve CHST and that's where the focus should be. The federal government is doing what the first ministers want. And at that time, when I was in the Legislature, Mr. Chairman, I did argue with the premier, you may get what you want. If they start transferring money from equalization into CHST, then we have to split that money up between 31 million . . .

Ron MacKinley (L) (Chair): Mr. Brown, have you got a question for the presenter, like I got no answers here.

Richard Brown (L): Okay, no, go on.

Ron MacKinley (L) (Chair): That's why we got a presenter here before us.

John Palmer: Is that a question?

Ron MacKinley (L) (Chair): Yeah, is that a question?

Richard Brown (L): Question, yeah.

Tape No. 2

John Palmer: I think our province and all provinces have been consistent throughout the health care discussions going back several years now and looking for the ten province standard on improvements as well as the health care line.

Richard Brown (L): So if we had the ten province standard, we'd still only have ten billion. Like what we're saying here, we want the ten standard province, we want the ten province standard but that—we want to force Ottawa into putting more money into the equalization pocket. So do we want to, like go back into deficits on the federal level?

John Palmer: I think I'm going to let the minister deal with this.

Richard Brown (L): But how much would that cost the federal government to go to a ten province standard?

John Palmer: We feel that they have sufficient revenue source.

Richard Brown (L): Where at? So you don't want to reduce the federal debt then? Because the federal debt reductions are saving us interest money and bringing interest rates down across the country. We don't want that?

John Palmer: I think we'll see evidence that show, but we think the federal government can afford to do this.

Honourable Robert Ghiz (L): Thank you, Mr. Chair. I think the point that Richard just raised there is a good point and that is, if we do happen to put the federal government into a deficit position again and they do start running deficits and our interest rates do in fact, start to increase, that's going to impact probably in a worst manner, the amount of money that we're paying on our \$1 billion debt here on Prince Edward Island. So I'm looking forward to seeing the proof of how much the federal government can afford because you know, we just signed a world class deal for Prince Edward Island in health care and I know that that's going to take a lot of money out of the federal government.

I've just got a couple of questions here and perhaps you're not the one to answer and if you're not, you can tell me to ask the questions to the minister. But I know that when you're out there and looking at the situation of equalization across the country and looking at what's going on in the different provinces, you have different provinces making arguments. For example, you have Newfoundland and Nova Scotia saying that they believe they're entitled to more of their natural resource revenue. You talk about the 30/70 split. I was in Ottawa when they were up every week looking to get 100 per cent of that and of course, they were being rejected every time. But they would make the argument that they believed for them to catch up with the rest of the country that they should be entitled to 100 per cent of that whereas the federal government's argument would have been, well in fact, you do get, I think it's 30 per cent of it. And you kind of want your cake and eat it too, was their argument.

So in other words, you would be jumping ahead of the rest of the country. And it wouldn't be really fair for Prince Edward Island because we don't

have natural resources. So in fact, I remember when Stephen Harper came down to Prince Edward Island during the federal election, he said that he's going to look at making equalization better for Atlantic Canada and I remember the premier was there, and he said he was happy to hear that Stephen Harper was going to address equalization in Atlantic Canada. And the next day when he was in Newfoundland, he said how he was going to change equalization in Atlantic Canada was he was going to give 100 per cent of the natural resources back to Atlantic Canada which—how much would that have helped Prince Edward Island? Zero.

John Palmer: I think our, I mean the minister can talk to some degree but I think our--this 70/30 on natural resources kind of goes back a long history of it, but it's always been our feeling that if the federal government wants to offer special provisions to provinces, it shouldn't be done through equalization. It should be done through offshore quotas or whatever. The program itself should be left to run so that provinces like ourselves, do not get impinged upon in terms of the entitlements.

Honourable Robert Ghiz (L): Okay, so there's a reason why Nova Scotia and Newfoundland, they can't get an agreement from the federal government because even Prince Edward Island won't even agree to those agreements but.

John Palmer: Well if they can do it outside the program.

Honourable Robert Ghiz (L): Exactly, outside the program but we won't allow them to do it within equalization. So Nova Scotia and Newfoundland, they have argued—Quebec is now arguing on a per capita basis. Everything I've seen so far and at the very end of your presentation there, you mentioned how the minister is going to come forward with a plan and I'm looking forward to hearing the minister's plan, but I think what the problem has been for the last number of years is we just basically said, we want more equalization money. We don't say that we want it for this reason or for that reason or we're entitled to it for this. We just say we want more money. At least, the other provinces say, we believe we deserve more of our natural resources or we believe we deserve it on a per capita basis. I personally, like Richard, don't want handouts but

I want what we're entitled to and I think we have unique arguments to make here on Prince Edward Island and I hope, I'd help the minister go up and demonstrate that a per capita basis is not really fair for Prince Edward Island because we are our own province, so is Quebec. But we have to provide our citizens with all the same services as the Province of Quebec. So by doing it on a per capita basis, we're never going to be able to provide the same level of service that a province with a much larger population can do.

So I think, my advice here and I realize that you're the bureaucrat and you take your direction from the minister and you do the best you can do, and at the same time you give advice to the minister but my advice is to give advice to the minister on making legitimate arguments and not just say, we want more money. Because if you go to the federal government and you say, we want more money, they're not going to do anything.

I've just got a couple of other little points but one was just kind of a little thing that I caught on there and that was when you mentioned that there's no negative equalization. I'm sure Alberta probably argues that a little bit to a certain extent. And I think, and at the end you kind of mentioned something, but it is the poorer provinces that receive equalization, is it not? So if we're not doing as well as the other provinces, we're going to receive equalization payments, correct?

John Palmer: But as you saw, it was the five province standard.

Honourable Robert Ghiz (L): Exactly.

John Palmer: The point is that Alberta doesn't get reduced because they're above the five province standard.

Honourable Robert Ghiz (L): No, exactly. Now I've got one last question since you deal with fiscal management. This was just something that I picked up in the *Globe and Mail*, a couple of weeks ago from Saturday, September 25th, and it says, "Provincial governments in Ontario, Quebec and Prince Edward Island face rating downgrades if they fail to improve their finances over the next few years, analysts at Dominion Bond Rating Services Ltd. said yesterday. In a presentation to clients, they said, Ontario's debt and I believe it's Quebec's debt are in trouble. Ryan MacGraw said

PEI faces the same possibility if it cannot get a handle on its rising debt."

And I'm just wondering how we're doing with regards—if you're the wrong person to be asking?

John Palmer: Yes, wrong person.

Honourable Robert Ghiz (L): You're the wrong person? Okay, well I'll raise that with the minister when he comes forward then.

Ron MacKinley (L) (Chair): Mr. MacAleer.

Wes MacAleer (PC): I just have one question. I realize that there's some difficulty in terms of defining the amounts that can be provided in terms of entitlements because of the delays in statistics and so forth. So you define the period that you're talking about, do we have a calculation of what the province would have been entitled to, PEI, under a ten province standard over any period of time?

John Palmer: Oh yes.

Wes MacAleer (PC): What is it? Like you tell me what it is.

John Palmer: Just the ten province standard, it's a varying number as well because if you bring in Alberta and all the other provinces, then they would probably take the (Indistinct) standard and of course, the oil and gas revenues are very important to particularly, Alberta. So the ten province standard will move very much more in line with oil and gas prices. But what was the last calculation that we had, that we put in the budget address?

Nigel Burns: 41 million.

John Palmer: In the budget address of this year, we put in a calculation at that time around \$41 million additional money per year for PEI in equalization.

Wes MacAleer (PC): Over what period though?

John Palmer: One year, that would raise our entitlement from the current level of 245 by another \$41 million a year.

Wes MacAleer (PC): For one year? Okay, do we

have a calculation, let's say, five years. What part obviously, that would be 41 million (Indistinct)

John Palmer: Actually the minister has got some information on that particular point as well.

Wes MacAleer (PC): Okay.

Ron MacKinley (L) (Chair): Mr. Bagnall.

Jim Bagnall (PC): Wes just took one of my questions away, but I noticed when you were going through, you were talking about the five standard, five province standard, the ten, and there's always the perception out there that the richer provinces are paying for the poorer provinces. When I was looking at your presentation, you don't believe that's the case. Can you explain that?

John Palmer: Well, it comes out of--the program is funded through federal revenues across the country. And if you pay income taxes to the federal government, everybody, every corporation, everybody that pays federal tax dollars is paying into equalization. The only difference is that Alberta and Ontario don't see any money coming back to them as a provincial support. And so I should say, some countries have a different system. They actually do reduce revenues for some states or provinces. Germany does this and take that money and say, okay, we want say, Alberta to have less money so we give that money to provinces like the Maritimes. Some countries do that in order to equalize.

As you can see, if the purpose of equalization is to have everyone equal, it doesn't really work. Because you've got at least two provinces that are way above everyone else. The best thing that equalization could be said to be done right now is that it equalizes everybody who gets equalization more or less. There are some variations but the principle is that equalization receiving provinces all end up at the five province standard, but all provinces are clearly not equalized.

Jim Bagnall (PC): Okay, so my understanding is why are you wanting to go from ten provinces standard, we're going from five provinces and you're saying we should be at ten. Is that part of--why, that has changed, right? So why did it change? Is it part of just the government making a change to balance their books or has the change

been made to, is it away from the constitution? Are we away from a constitutional issue here, why that change was taking place? Should it be ten provinces? Should it be five provinces?

John Palmer: I think the quick answer to that is that when in 1982, when the movement was made from a ten province standard to a five province standard, Alberta's population, its economic wealth and so on was nowhere near the degree to which it is today. And what we've seen over this period of time, is just this huge increase in Alberta's fortunes and as we all know, I think in my own case, children going to Alberta, the whole idea of equalization is that all provinces should have roughly the same revenue sources so that they're not going to be economically deprived as well as socially deprived. But the case doesn't work for Alberta. Alberta is there and it's become very, very wealthy and our concern is that we should put them into the formula so that it would raise all of the equalization receiving provinces closer to, say Alberta's standard. It would still be a lot less than Alberta has now. It would move us in that direction.

One of the principles of equalization is to prevent a situation where people are actually being drawn to different provinces because they can't provide the public services, because they don't have the wherewithal, that you have an artificial migration effect. This has been documented quite a bit and I think the case would be pretty clear that Alberta, as an outlier, does draw the--sucks in the population from the whole country because of their resources.

Ron MacKinley (L) (Chair): David.

Dr. David McKenna (PC): Yes, I was wondering on your chart there, on the GDP there, I guess I was led to the impression that when the federal government in 1999 said that equalization would be tied in with the GDP and that looks like equalization is dropping with the increasing GDP. Is that my understanding from that slide there? And can you explain that a little bit more?

John Palmer: That one?

Dr. David McKenna (PC): That one there, yeah.

John Palmer: You can see that from about 1984 to 2000 that as a percent the total GDP was

around 1.1 per cent. So through that period, that long, long period, it actually kept pace with the economy. And then since 2000, it's fallen off. Yeah, it's our understanding that—and that would be one of our points that in fact, the federal government said that the program should be growing with GDP and it hasn't kept pace. We would agree with that. They should of.

Dr. David McKenna (PC): They should?

John Palmer: As a percentage of federal payout, it's gone down considerably too.

Dr. David McKenna (PC): Oh yeah.

Ron MacKinley (L) (Chair): Wayne.

Wayne Collins (PC): Just one question about the year 1999, that was a renewal year, was it for their program?

John Palmer: Yes.

Wayne Collins (PC): How pivotal a year was that? You've talked about changes. I mean David mentioned a commitment to keep up with the GDP which hasn't taken place. What else happened in 99, that impacted on the equalization program?

John Palmer: Well the good thing that did happen was that the ceiling that was—there was a ceiling imposed going back to 82 which was then substantially dropped in 99/00 and if you recall, the treasurer of the day was Pat Mella and she argued precipitously with the federal government that the ceiling offended the whole program's purpose. They simply capped the payout. They said it should not be above a certain point. So the prime minister of the day did eventually say, okay, we'll remove the ceiling which he did for one year, 99/2000. And then he said, after that the program should grow with GDP and that's the point, it didn't.

Wayne Collins (PC): It didn't?

John Palmer: No, it is our feeling that they were looking for economies in 99 which we felt were inappropriate, the federal officials.

Ron MacKinley (L) (Chair): Wilbur.

Wilbur MacDonald (PC): Thank you, Mr. Chairman. I just want to make a statement about Richard's statement. If we had better economic policies in the province, we wouldn't need equalization. I suggest to you, Sir, that since 1950, all governments haven't had better economic policies than this province, otherwise we wouldn't be where we are today. Not only have we done it, so has the other provinces, unfortunately. Equalization will always be a part of PEI because for reasons, we have no natural resources. We are on an Island. We have a limited population and therefore, a limited tax base.

Richard Brown (L): So did Ireland.

Wilbur MacDonald (PC): So did who?

Richard Brown (L): Ireland.

Wilbur MacDonald (PC): Ireland has a larger land base. We have a very small land base to take it off and I think equalization will always be part of it. I don't think we should blame past governments on economic policy. I think it's fairly reversed and I think this province made a dramatic change in about since the second world war. But I'm really interested in your meetings with the federal government and the other provinces. I would think that all ten provinces are present. Is Alberta present even though they—do they participate?

John Palmer: And the three territories.

Wilbur MacDonald (PC): And the three territories. You've indicated that it is a federal government responsibility. Does the federal have to take into consideration what the provinces want?

John Palmer: No.

Wilbur MacDonald (PC): Not at all?

John Palmer: It's simply a consultative process where we have an opportunity to bring materials if we think that something should be changed to the table. The bottom line is they can chose to do what they wish at the end of the day.

Wilbur MacDonald (PC): And in your conferences when you're discussing, do you have

votes?

John Palmer: No.

Wilbur MacDonald (PC): It's all done by—you make your presentation and the feds, the federal decides then whether to accept that or not.

John Palmer: Basically, yes.

Wilbur MacDonald (PC): That's the way it is. Is also the federal, they announce how much money is going to be put into it. There's no discretion on that or if they say it's ten million or nine million, so your meetings then with the thing must be very hard to handle by times? Are you frustrated by times?

John Palmer: We don't always get what we want, let's put it that way. I think our main concern is, as Mr. Brown says, to make sure that the program runs fairly, that there are not things that are being put into the formula that would impinge upon a reasonable calculation of what people's, each province's fiscal capacity is. And naturally, if we figure something in the formula which is detrimental to Prince Edward Island, we'll make sure that point is raised and hopefully corrected.

The case of peat moss is a case in point where we were very concerned that because we have some peat moss production on PEI, it shouldn't be costing us lots of equalization and there will be a change made to it because the federal government did agree to that, but it won't be happening for some years which is the frustrating part. In the meantime, we're losing money because of that.

Wilbur MacDonald (PC): Because of that?

John Palmer: How much are we losing on that, Nigel?

Nigel Burns: In transfer about 4 million a year.

John Palmer: Four million a year.

Wilbur MacDonald (PC): Is that right?

John Palmer: Because of the way the thing is calculated. These are huge amounts of money that can tell on these small calculations.

Wilbur MacDonald (PC): Do you try to bring it, like for example Nova Scotia and Newfoundland, you'd have to agree with them, trying to get their oil off of that? Have you tried to take some parts of our economy off of it? Like for example, agriculture would be major, of course. Is that possible?

John Palmer: The discussions at the technical level which is where I'm at are more along the lines of—I'll give you an example. There's an effort right now to recalculate the equalization from motor vehicle licensing and so on. That's part of the formula. We find that when they look at some of the data that I get from Statistics Canada, it doesn't seem to correctly portray our situation.

In fact, it shows we have a lot of cars and the more cars you have and the more trucks and so on, it seems like it would impinge upon our equalization entitlement and so we would go into some detail to find out whether the data they're using is correct, where it comes from, and whether or not there are problems with it. And they do have a lot of data problems in trying to make sure that every province is properly measured. So that's where we get in. We say, look, this particular measure doesn't work properly.

Wilbur MacDonald (PC): So then they come up with all the data themselves.

John Palmer: They would like to be sure that the data is common across the country for each province.

Wilbur MacDonald (PC): Right, so that's part of your responsibility?

John Palmer: Very much so.

Wilbur MacDonald (PC): Thank you, Mr. Chair.

Ron MacKinley (L) (Chair): I want to thank you, Mr. Palmer, you can return any of the questions that are asked of you, if you want to send it on to the assistant clerk here. I want to thank you for coming before us.

Richard Brown (L): I have one quick question, Mr. Chairman.

Ron MacKinley (L) (Chair): Alright.

Richard Brown (L): You said there was a big adjustment done last year or the year before and it was mainly based on population adjustments, correct? Is that correct?

John Palmer: Well the population re-estimation that occurred following the 2001 census, as you could see, the whole calculation is based on per capita, five province per capita multiplied by our population so if you move those populations estimates, they have a big effect on us, yeah.

Richard Brown (L): So in 2000, what was Stats Canada was saying, what we were at 140, 142?

John Palmer: Yeah, we were up to about close to 140,000 people we had thought and then that was reduced, I think to 138.5 or something like that and that had a large impact on us.

Richard Brown (L): But your own division knew that those population figures were high?

John Palmer: No, we wouldn't have known this, no.

Richard Brown (L): By the birth and immigration and migration.

John Palmer: No, we have to rely on Statistics Canada numbers for this.

Richard Brown (L): So we don't challenge Stats Canada each year on their population?

John Palmer: Well again, we do challenge Statistics Canada if we think their measurements are incorrect.

Richard Brown (L): Just one, on the 33 revenue sources that are used for the formula, if we have a windfall or a thing in one of those 33 items, is it dollar for dollar?

John Palmer: It can be worse than dollar for dollar.

Richard Brown (L): What do you mean?

John Palmer: We can actually lose more than one dollar because we lose money in equalization at national average tax rates. If our own tax rate on something is less than that, we'll lose more

equalization than we gain in revenues.

Richard Brown (L): So one of our items there is revenue from race track to taxes; revenue from lottery ticket sales; and. . .

John Palmer: Casinos and. . .

Richard Brown (L): . . . and casinos and like that. So if we're going to make an extra five million next year on the casino, will that be coming off our equalization, based on that theory?

John Palmer: It depends on the base measurement for that particular category.

Nigel Burns: Its muted impact. . .

Richard Brown (L): It's one of the items.

John Palmer: It's one of the items but it's not a dollar for dollar one, I don't believe.

Richard Brown (L): What would you say it is?

John Palmer: I'm not sure what it is.

Nigel Burns: I don't have that one. . .

Richard Brown (L): But would we lose if we increase our revenue and capacity in that area?

John Palmer: It's not the revenue that counts, it's the base. If the base that's in the measurement of revenues for that particular area shoots up for Prince Edward Island, then. . .

Richard Brown (L): Well, it's going to go up 25 per cent.

John Palmer: Well, we'll lose some to some degree, yes.

Wilbur MacDonald (PC): Could I, Mr. Chairman, just like that's an interesting point. In agriculture, for example, if our agriculture is down like it was or it shoots up back up because it's a great year in potatoes, does that affect this thing?

John Palmer: Oh yes.

Wilbur MacDonald (PC): And do we lose dollars for that?

John Palmer: If to the degree that agriculture, you know, farmers are buying equipment or whatever that has sales taxes in it or anything like that, I mean, a better case in point frankly, is when the bridge was being built. During the construction of the Confederation Bridge, our sales tax revenues went up. The base that we measure it went up for sales tax and so on. We lost equalization because of that.

Honourable Robert Ghiz (L): So if our economy does better, our equalization goes down?

John Palmer: Relative to these five provinces.

Honourable Robert Ghiz (L): Exactly, so. . .

John Palmer: So if they're all doing well. . .

Honourable Robert Ghiz (L): . . .but we still want to see our province do better.

John Palmer: Of course.

Ron MacKinley (L) (Chair): I just have one question for you. I didn't have any but I have one now. If we were building a bridge, the Confederation Bridge, our sales tax we got on cement, I guess, or whatever it was, income went up, is that correct what you're saying? Why couldn't we exempt that bridge when it was being built and then we wouldn't have had the impact on our—like let's face it, Islanders are paying for that in sales tax and taxes. That's tax on top of tax. So if we exempted that from the sales tax when our bridge was being built, it would be in theory, it would be made cheaper to cross it and it would be better for PEI. Could we have done that? And what would have happened if we did it, I guess is the. . .?

John Palmer: Bear in mind, what Ottawa is trying to do is to find information that measures in a common way what's going on across all provinces. When the bridge was being built, it pushed up the numbers for construction expenditures on Prince Edward Island which is a statistics—that goes into one of our revenue bases and that's the sales tax is affected by it, so it's kind of out of our control. It's really how Ottawa views these major projects.

Ron MacKinley (L) (Chair): Yeah, but we control the tax system in the province though.

John Palmer: It doesn't control the revenue we get from equalization. The calculation hinges on these statistics.

Ron MacKinley (L) (Chair): I know that, but as you said, if taxes go up or we get more income in the province, then we lose in equalization. So if we're building a bridge or a major project like that, why wouldn't we exempt it from provincial sales tax, in theory, that would not generate a higher cost because it's being built for Prince Edward Islanders, because that's who gets the benefit of it. And if the contractor could build it without tax, he'd build it cheaper in theory. Instead of \$38 a crossing or 39, you could probably cross it at 33, I don't know.

John Palmer: Mr. Chairman, the call on what goes into those bases is not something we can—we can make an argument with the federal government but we can't determine how they put the numbers together at the end. If those numbers they feel are a reasonable reflection of what your taxing capacity is, they'll put it in. That's what they do.

Ron MacKinley (L) (Chair): We call what we tax here and what we exempt in our province.

John Palmer: But this representative tax system that I was mentioning earlier on is something which the federal government determines is equal across all provinces and it's their judgement as to what goes into that.

Ron MacKinley (L) (Chair): Well if you go to, like I'm talking about being more creative thinking, if you go to New Brunswick and you built the bridge over in New Brunswick and the taxes went to New Brunswick, the contractor would get them all back because they're harmonized PST and HST, so the tax would be tax exempt over there because we built it but in the province we're not. These are things I'm wondering about, like if the taxes for the bridge came to the province, well then, we're not PST exempt here. Where they harmonize their tax in New Brunswick and Nova Scotia, so in theory, their tax is paid and then it's all rebated back.

John Palmer: That is a good case in point, Mr. Chairman, when the bridge was being built, a component of the construction expenditures were distributed to New Brunswick and they did lose

equalization as well because of that so it affects each province the same way.

Richard Brown (L): Mr. Chairman, just one further question.

Ron MacKinley (L) (Chair): One more, and we'll have to cut it off.

Richard Brown (L): So I have the act here and you're right, section 11 and section 12 of the federal act exempts offshore petroleum products for Newfoundland and Nova Scotia from the equalization formula. Is Newfoundland...?

John Palmer: They're not in the five province standard, so they're not in the... .

Richard Brown (L): No, but I mean it exempts them from the revenue sources. It says, your offshore revenues will be taken into consideration upon election.

John Palmer: Treated separately.

Richard Brown (L): Yeah, okay, so they have exemption clauses or clauses in there. How can we argue that we want—like if we argue that we want a ten province standard, okay? Alberta will say and Ontario or Alberta will say, well if you're going to have a ten province standard, then you better take those clauses out and include Newfoundland and Nova Scotia's offshore petroleum products or offshore revenues in there. Would Newfoundland and Nova Scotia—I used to remember Nova Scotia and Newfoundland always had equalization, always arguing about it. And since they got those two accords in it, you don't hear too much from them anymore.

Matter of fact, Nova Scotia is recently, the finance minister was on the news there a couple of days ago saying that he's going to have a balanced budget, the forecast looks good and tax decreases because of the offshore. So do we still have them on board to be able to argue our points? Like do they want offshore exempt and they want the ceiling removed?

John Palmer: I'm not into the, to be quite candid, I think you'd have to pose the question to them, I'm not entirely sure what they would say. But they are definitely on the side of the ten province standard.

Richard Brown (L): Do we also have a floor? There was a ceiling. Is there a floor?

John Palmer: Yes, there is.

Richard Brown (L): So we would argue to remove the ceiling but not remove the floor.

John Palmer: But the floor was not the same as the ceiling. The ceiling was an imposition on top of the total payout. The floor is simply a measurement that would actually enhance your entitlement if you have a sudden drop in entitlement. And Saskatchewan has been the major beneficiary of that.

Richard Brown (L): Of the floor. Have we ever benefitted from the floor?

John Palmer: Once.

Richard Brown (L): We did? Okay. Thank you, Mr. Chairman.

Ron MacKinley (L) (Chair): Well I'd like to thank you for coming and the Honourable Mitch Murphy is the next presenter.

Tape No. 3

Part II - Honourable Mitch Murphy, Provincial Treasurer

Honourable Mitch Murphy (PC): Again Mr. Chairman, I'll take direction on how you want me to proceed. I do have about eight slides.

Ron MacKinley (L) (Chair): I think proceed anyway you want. They'll be questions afterwards. If that's okay with the committee?

Jim Bagnall (PC): Can we ask questions as we go along?

Honourable Robert Ghiz (L): I like to ask questions as we go along too.

Ron MacKinley (L) (Chair): Alright, if you want to ask questions as we go along, whatever.

Honourable Mitch Murphy (PC): Okay, well thank you very much, Mr. Chairman and members of the committee and I'm certainly pleased to be

here this morning to share some information about the province's position on equalization. I want to thank Mr. Palmer. I think he gave the committee a good overview of the intent behind the program and some of the mechanics on how the program works. Given that background, I want to concentrate a little bit more on the PEI position with regards to the 2004 renewal and also with regards to the meeting that the prime minister has called with Canada's premiers and territorial leaders for the end of the month and the position that PEI will be taking to those meetings.

We go to the first slide - equalization, in our opinion, is a question of federal spending priority. We do not think it is a question of the ability to provide equalization or equalized public services as outlined in the constitution. Now this is a slide that shows, I think in my opinion, and in the opinion of most informed Canadians that, as I say this judiciously, the federal government has been overly cautious in estimating the size of its fiscal surplus over the last little while.

Over the past decade, those surpluses have varied quite great from budget targets. Many private sectors and academic forecasters are projecting larger surpluses for the federal government in the coming years than those of the federal government has forecast. We've had—you're familiar with the Conference Board of Canada Report that was tabled in the Legislature in the spring, and even this year in the 2004 budget, there was a budgetary surplus that predicted a four million and that's after a contingency reserve.

However, the federal fiscal monitor has updated that to 7.6 billion in June. Accumulatively, what this chart represents is over a ten-year period. The federal government has either underestimated their deficits or their surpluses to the tune of \$78 billion. See, we will argue that the fiscal capacity there is to make meaningful changes to the equalization system to ensure that it meets the adequacy of the intent that's outlined in the constitution.

Jim Bagnall (PC): Just a question there, what are the private economists saying on this issue?

Honourable Mitch Murphy (PC): Well there is a majority of opinion from private sector economists that agree that the federal government has underestimated their fiscal surpluses, what

their first fiscal surpluses are going to be. Certainly, from the Conference Board of Canada to some academics in universities, some economic think tanks, all agree that the federal government has underestimated the surplus. Now, we're not saying that that's a bad thing. It's a good thing that the federal government is in a surplus position, having a strong Canadian economy and having the federal government in a strong surplus position is a benefit to all provinces and territories in the country. But we're simply making the point that the argument on fiscal capacity and we will argue that there is fiscal capacity to make some meaningful changes to the receiving provinces in the terms of equalization.

Federal priorities in equalization has been mentioned already in Mr. Palmer's presentation. During 1999, one thing that was left out I think that's important for the committee to know, provinces have consistently asked for the five province standard to be changed. And the other issue that we have asked for is a removal of the cap on revenue fees. During the 1999 renewal, there was a cap placed on revenue fees or user fees, if you will, of 50 per cent. And those would be things in PEI and other provinces such as motor vehicle tax, marriage licenses, et cetera, et cetera. The federal government has put a cap on those revenues. Now why that, impact's equalization is as follows:

In a measure of fiscal capacity, revenue items are used as some of those 33 items so they've capped what provinces can use in terms of calculating their fiscal capacity. With 100 per cent of the revenue items in there, you get a more accurate assessment of what actual fiscal capacity is in each province. Yet we've seen equalization has continued to decline as a share of GDP and of federal government revenues. National entitlements in 99/2000 were 10.9 billion. This compares to entitlements in 03/04 of 8.7 billion. That's a decline of 2.2 billion in that period.

In the 2004 federal budget, committed \$7 billion over ten years to municipalities in GST/HST relief. In addition, there is a commitment to share the federal gas tax with municipalities. According to the prime minister yesterday in replying to the Throne Speech, that's a commitment of about \$2 billion a year. Well, we certainly welcome and are supportive of the federal government's move to assist municipalities. Those of us on equalization

would like to point out that there has been a \$13.5 billion commitment to municipalities over five years. With the 2004 renewal package, there's been a \$1.5 billion commitment to improve equalization over the next five years. So we think it is more of a question of priorities and we do think the fiscal capacity is there.

Wayne Collins (PC): Mr. Chairman.

Jim Bagnall (PC) (Vice-Chair): Yes.

Wayne Collins (PC): I want to come back to that five province standard here imposed in 1982 and you mentioned the revenue cap of 1999, has your department been able to try to quantify in some way how both those measures have affected Prince Edward Island?

Honourable Mitch Murphy (PC): We have the numbers. We've lost about--I shouldn't say we lost--we would have received approximately \$156 million more between the years of, I don't have it for the full period, we just did the calculation, between the years of--do you have that, John?

John Palmer: This is roughly three million a year for the ten province standard and roughly \$10 million, we're losing about 50 million a year, 50 million a year.

Honourable Mitch Murphy (PC): Let's put that in context. This is just based on one year's entitlement and I think your question was asked over an average number of years. It really depends what the numbers are. But for example, if we take the years 1995 to 2004, 1994 to 2004, that ten-year period, the five province standard has--we would have received \$156 million more in revenues if we had had a ten province standard as opposed to a five province standard.

Wilbur MacDonald (PC): Could I ask a question, Mr. Chairman? On the two million yesterday--and this is getting off the subject a little quick, just a quick answer, what is the province's share of that? And how does that go? Does that go right down to say, small towns, the CIC's, for example?

Honourable Mitch Murphy (PC): Well my understanding of the commitment is that the federal government--this is an initiative of the Federation of Municipalities. The honourable

member from Charlottetown-Kings Square could probably comment on this as well because I think he probably attended a few of those initial meetings where the Canadian Federation of Municipalities pushed to have this happen. But my understanding is that there will be agreements signed between the federal government and the provinces because municipalities are creatures of the provinces in terms of legislation. But my understanding of the way it is going to work in PEI, and I think some credit has to go out to our municipal leaders in the province is that they've negotiated an agreement that does not see this flow strictly on a per capita base.

I think the agreement they've negotiated is that there would be a base payment to each province and then on top of the base payment, it would go on a per capita basis. My understanding is that the way it would work, yes, the City of Charlottetown, the City of Summerside, but it's not just a city agreement, small towns and villages across Prince Edward Island would also be part of the program as well. I'm not an expert on this city's agenda or the municipalities program, but that's my basic understanding of how it would work.

Wilbur MacDonald (PC): So would that include then a CIC?

Honourable Mitch Murphy (PC): I don't know the answer to that question.

Wilbur MacDonald (PC): Okay.

Richard Brown (L): Mr. Chairman, one question.

Ron MacKinley (L) (Chair): Go ahead.

Richard Brown (L): Back to the five province standard and the ten province standard, if we go to the ten province standard but the federal government still says there's ten billion in the pot, do we gain or lose on that? Like what I'm saying is, the feds say, look we're--provinces, you want a ten province standard, we'll give you a ten province standard but we're not going to increase the pot, the financing of this program. How much do we gain or do we lose and how will we get that on board if let's say, Quebec says, well we're going to lose on a ten province standard but still the same amount of money?

Honourable Mitch Murphy (PC): During the provincial/federal discussions that led up to the renewal package on April 1st of this year, we had unanimous agreement amongst the provinces that we would move to a ten province standard and remove the cap on revenue coverage. But your question is a good one and I would have to answer it this way. It would depend on the given year that we were talking about. For example, Mr. Palmer in his remarks indicated that the economy in British Columbia may have grown enough over the last three or four years and recovered enough from the softwood crisis that they may not be eligible for equalization next year. If that's the case, then the divisor for recipient provinces goes down. It goes down from eight to seven so theoretically, sensing that the national economy stays the same, then our equalization entitlement would rise.

So the answer to the question is, it would depend on what the factors were in any one given year but as a general principle, the ten province standard, what the ten province standard does, it raises the average fiscal capacity from what the five province standard does. Thus a greater difference between our fiscal capacity and the standard, thus a greater equalization amount.

Richard Brown (L): But my question is, would we gain or lose if the amount of money was still set—stayed the same, like if the feds said, look. . . ?

John Palmer: I don't think that that's on the table at this. . .

Richard Brown (L): Well let's say you go to negotiations—next week you're going to the negotiations and you're saying we want to take the cap off. So the federal government says, we will take the cap off or we will take the five—we'll go to a ten province standard.

John Palmer: Once you go to a ten province standard, you're then limited to the amount of money you get under a five province standard.

Richard Brown (L): Well, they want to balance their budgets, you know. Are we saying that the surpluses of the federal government over the last ten years is a bad thing?

Honourable Mitch Murphy (PC): No.

Richard Brown (L): If you talk to all the

homeowners out there right now that are getting a four, five, six per cent mortgage rate, that's the result of federal responsibility here of keeping the deficit low. David Dodge says it all the time, the chairman of the Bank of Canada. Reduce your deficit, we'll reduce your interest points.

Honourable Mitch Murphy (PC): Nobody's arguing those points but we agreed that the fiscal position of the federal government is a healthy thing for PEI; it's a healthy thing for everybody in the country. There's no question about that. Our argument or our position at the meeting at the end of the month will not be that there is a cap on revenues. Simply because if we go back to what 36.2 of the Constitution says, "reasonably comparable levels of services for reasonably comparable levels of taxation". Okay, that in itself, putting a cap on payments, in my opinion, is certainly against the spirit of what is in 36.2.

Our position is that if we're going to meet the test of 36.2, then we have to, to the best of our ability, equalize the provinces' abilities to provide public services across the country. You know, if we look at the history of this, nobody is advocating that this equalization renewal be designed that it's going to drive the federal government back into a deficit position. That's bad for everybody. That's part of the reason in 1982, that the federal government of the day moved to put a cap or to go from a ten province to a five province standard because we know what happened during the 70's, during the oil prices and the fluctuation in prices and the program from a fiscal point of view for the federal government really was driving the debt and a large part, it was contributing to federal debt.

Our position today is now that the federal fiscal house is in much better shape than it was in 1982, we've been running, I believe, it's seven or eight consecutive balanced budgets with significant surpluses. It's time to have a look at equalization program again because equalization, in our opinion, is not meeting the test of the constitution. We are losing our ability to provide the same level of public services as those provinces that are not receiving equalization.

Richard Brown (L): But Minister, we always bring up the constitution and that section. If we firmly believe that equalization is not meeting the test of that clause, then why don't we make a reference to the Supreme Court and get it settled?

Are you and the other provinces willing to say, look Ottawa, you're not meeting your constitutional obligations. Let's make a reference to the Supreme Court and settle this constitutional issue once and for all.

Honourable Mitch Murphy (PC): Well, we've adopted the position that Canadian federalism was built on both levels of government, discussing their areas of common interest, discussing how they can work through the province during a legal route. I don't think it adds much to the debate or gets us much closer to where we need to be. I think—the view that we've taken is that there's only one taxpayer in the country and the federal government collects revenues. The provinces collect revenues. The bottom line is we all collect enough revenues.

Our argument is we have to have an equal distribution of those revenues so that people who have constitutional responsibilities provide services, have adequate resources to do it. For example, we certainly in the last session, we've had some good discussion in the Legislature on CHST, et cetera. The first ministers and the prime minister set down at what by all accounts from every corner of the table, whether it's the federal corner, provincial, territorial corner, they all signed the document agreed that that's how they collectively were going to move in that direction. And I think that's the approach that we need to be taking in equalization.

Richard Brown (L): But at the end of the day, if you're not happy with the formula that comes out, and I'm not talking about a constitutional challenge, I'm talking about a reference to the Supreme Court, we ask the Supreme Court, you know. We're not suing the federal government. We're not fighting them. We're making, like they're doing a reference right now. Like reference the federal court and say, are they meeting their constitutional obligations?

Honourable Mitch Murphy (PC): Yeah and again, we've never talked about that. Our preferred method is to negotiate with the federal government. One thing that we are in disagreement with is that there has been a suggestion that there be an outside advisory panel or panel of experts convened to look at the equalization program.

Our concern is that, yes, if you're going to give an opinion on it, that's fine. What we don't want to take place is that you're going to have an outside body, outside of the elected officials making representation or making decisions on programs that are so important to people of the country. We think that should remain in the domain of the elected officials, both federally and provincial.

Richard Brown (L): But that's what the courts are there for. When two parties disagree with each other based on a contract and our contract is the Constitution of Canada and there's a clause under there, the two parties disagree and we will refer to the federal court to settle the agreement. And instead of arguing day after day, after day, after day, let's get the reference done.

Honourable Mitch Murphy (PC): Well we're just getting into the position that we're going to advance at the meeting at the end of the month.

Richard Brown (L): What's equalization used for in the province?

Honourable Mitch Murphy (PC): Equalization on PEI mainly is used in the areas of health and education.

Richard Brown (L): So how much would be used in that area? Like we get 25 per cent of our revenue from equalization, so how much of that 25 per cent goes to help in education?

Honourable Mitch Murphy (PC): Equalization comes as a block of transfer. It doesn't come as a dedicated transfer. When the province receives it, it goes into general revenues. But if you look at the budgets of the Department of Health, I believe, around \$428 million in this year's budget booked; education is—what's the number in education—is \$223.8 million, so well over the 600, around \$650 million.

So if you looked at what the province raised in loan source revenues, you know, what is received in CHT transfers, CST transfers, then the bulk of what we would use equalization for would go into those two programs.

Richard Brown (L): Would you commit to any increases in equalization at this conference to be able to say, look it federal government, if you increase equalization to the provinces, we agree

that all that equalization will go into health and education?

Honourable Mitch Murphy (PC): Well it's happening now. For example, on PEI and nationally, the growth in healthcare budgets have averaged somewhere between six and seven per cent. In terms of real numbers, on PEI depending on whether you're in a—what you negotiated for collective agreements, et cetera, you know you're talking \$30-35 million. So extra money that we get down—it's just a matter of, do you use your own source revenue put in there or are you using equalization funding? But there's no question in my mind, the money is going to pay for that.

Ron MacKinley (L) (Chair): Mr. Ghiz.

Honourable Robert Ghiz (L): Are you saying that over, say the last ten years, that health and education spending have outpaced all other spending in the government?

Honourable Mitch Murphy (PC): Health has outpaced all of the departments, yes.

Honourable Robert Ghiz (L): Has education?

Honourable Mitch Murphy (PC): I don't have a percentage of the increase in education, but I know the growth in healthcare spending, in terms of—what you have to remember is that because health constitutes over 40 per cent of the budgetary allocation. In terms of real dollars increase spending, you know, a five per cent increase in health spending maybe more than a 10 per cent increase, say in the Department of Community and Cultural Affairs. The size of the budgets are relevant in determining the increase in expenditures.

Honourable Robert Ghiz (L): So it hasn't?

Honourable Mitch Murphy (PC): The first budget I worked on, the department—the budget that year, I believe was \$282 million for Health and Social Services. I believe the budget this year is \$428 million for those departments. So in terms of real growth, in terms of real dollars and expenditures, they've been growing at that rate over that three-year period.

Honourable Robert Ghiz (L): Well of course, that dollar, it's gone up but I was talking proportion

to everything else. And I know in '92-93, I believe that about 35 per cent of our budget went towards health.

Honourable Mitch Murphy (PC): And social services.

Honourable Robert Ghiz (L): Yeah, let's just say in '97-98, it was about 35 per cent; 00-2001, it actually dipped down to perhaps around 34 per cent. And I'll give you credit, this year it's supposed to be somewhere around probably 37.5 per cent. So relatively, over the last ten years, it's stayed the same.

Honourable Mitch Murphy (PC): No.

Honourable Robert Ghiz (L): You're not putting in, in relation to other expenditures, more money into healthcare.

Honourable Mitch Murphy (PC): Oh absolutely. Let me use this for an example and perhaps this puts it into some perspective. We've had debate in the Legislature and it's been said that well you know, we're receiving big windfalls of money from the federal government. Like Mr. Palmer indicated on one of his slides, the peaks and valleys and equalization entitlements, but I have a slide later on that certainly will show where we sit today in terms of federal transfers versus where we sat five years ago. And I think that will help answer part of your question.

Richard Brown (L): Just one other question. On (Indistinct) you're saying most of our equalization money goes to health and education.

Honourable Mitch Murphy (PC): Yes.

Richard Brown (L): That's great. So if we take this year's budget, we're getting 102 million, round it off and round it up and that is 16 per cent of our health and education budget, the CHST money. Like the premier is always going on or the premiers are always going on, the federal government is not meeting its commitment. It should go back to the Romanov figure of how much that we should be spending, 25—Ottawa should be giving 25 per cent. So if we take equalization and put that money, like it's going into health and education, what percentage is Ottawa contributing to it then?

Honourable Mitch Murphy (PC): Yeah, but I think it's very dangerous to do that for the following reason - is because then you're starting to use the equalization program for what it was not intended for. Let's remember that all provinces get paid on a per capita basis. It used to be CHST. Now it's broken down into the two components. Alright? Remember that equalization is not a revenue stabilizing program. It's a program for the provinces to allow them to provide comparable levels of public services like comparable levels of taxation. If we want to extend that debate, we could look at various provinces across the country and go from there and we could talk about the fairness on a per capita basis. And the Leader of the Opposition made a good point in his opening remarks and I want to get to a discussion on that why it's very important for PEI never to support equalization moving to a per capita basis.

Ron MacKinley (L) (Chair): Why don't we let Mr. Murphy continue his presentation and then ask some questions after because we're sort of getting bogged down here. Let him come out with his details and then we can question him. Is that okay with the committee? Okay, go ahead.

Honourable Mitch Murphy (PC): This here next slide is, we will argue and the provinces have argued that the federal government is using the savings from the equalization program to fund healthcare commitments. Since 2001/2002, the federal government has saved an estimated \$16 billion in equalization payments compared to what the program would have delivered if it grew with GDP since '99/2000.

Over the same period, the federal government has increased funding to the CHT/CST by \$12 billion. And it was asked in an earlier question on Mr. Palmer's slide, we were under the understanding from the premier's meeting on healthcare in 1999, with Prime Minister Chrétien who said that he would lift the ceiling for 1999 and from thereafter, equalization would grow at the rate of GDP. That was a commitment the Prime Minister gave the premiers at that time. So we're arguing that a lot of the new expenditures in health have come at the expense of equalization funding.

Equalization and CHST funding to PEI - this covers the years 2001/2002 to 2004/2005. As you can see from the chart, increases to CHST have not kept up with lost equalization to PEI. The

bottom line total in 2001/2002, if you take equalization and CHST, you get 371.2 million. The estimate this year in the budgetary estimates and this is before the adjustments that were put on October 15th is a total of 360.

Now in fairness, whatever the adjustments are on October 15th, and we expect those will not be positive adjustments for the province, we need to take into account the 9.3 million additional dollars that we will receive in 04/05 as a result of the Premiers and Prime Minister's Health Accord. So if those numbers were to stay static with no negative adjustment on October 15th, we could add 9.3 to the 3.60 which would still put us below the entitlement in 2001/2002.

The trends in provincial/federal revenue - the point's been made, it's a very valid point. We should continue to try and grow our own source revenues. Economic growth on PEI is what is going to enable us to provide public services to our citizens over time, and people will say that, you know, just relying on federal government programs such as equalization and other things.

Tape No. 4

Hon. Mitch Murphy (cont'd): Well, that's not the case and it hasn't been the case in the province for quite some time. We can go back to 1986 and we can see in 1986 where provincial own source revenues versus federal government revenues, the lines are starting to spread out in a Y. Where provincial own source revenues are continuing to be a greater percentage of our overall revenues and federal revenues are continuing to be a lesser percentage of our overall revenues.

Richard Brown (L): That's good.

Hon. Mitch Murphy: That's the point that I make. It's a very positive development and it counters the arguments of those people who say that provincial own source revenues are not becoming a greater part of the province's revenues. Indeed they are.

More up to date, on the 2004 renewal package, as I had mentioned earlier we had unanimous agreement amongst all the provinces that the renewal package would contain a ten province standard. We moved to a 100 per cent coverage on revenue fees, the cap would be removed and we had agreement on that at the table. That was presented to the federal government. As

mentioned earlier it is their decision at the end of the day and they choose not to support the provinces in that position.

One other thing that was troublesome in the 2004 renewal package as a bit of a carrot I think to smooth things over on the renewal package, there was a minimum top up of \$150 million put in the program. What disturbed us about that is the federal government decided to allocate that on a per capita basis as opposed to a share equity basis and that's troublesome. So as a result of the 2004 renewal that was signed on April 1, 2004 of this year we retained the five province standard, user fee coverage remained restricted. Now, there was a focus on the stability of payments and I think we need to recognize the fact that the federal government has taken steps in this renewal to respond to the provinces request to try and take some of the volatility or the wild swings out of equalization of payments. Our argument is that we would have been quite content if that volatility had of been put in place right away. But it's being phased in over a period of time so we will really see nothing concerning the volatility of payments for, I think, three years into the future.

The other thing that concerns me about equalization, from the reforms - in the mining property tax, they're just delayed, they're coming. It's good that we've acknowledged that that has to happen. But the last, the special arrangements to some favourite provinces and I think that the intent of equalization was not to give special consideration to some provinces as it comes to some of the 33 criteria that are used. I want to use the case of British Columbia. British Columbia said that, you know, on the property tax issue our property values are very high in the lower mainland of British Columbia. Some of the highest property values in the country so we should not have to account, okay, for our full revenue that we derive as a province from those property tax bases. Special consideration was given to British Columbia as a result of that. Now why is that problematic? Well it's problematic because it does not provide a true measure of the fiscal capacity of the province and it affects us in our equalization entitlement because it affects the five province standard because British Columbia is one of the provinces used in calculating the five province standard.

During the renewal of equalization several reforms

were identified and as I said it's the phase in period that concerns us but I think we need to give acknowledgement that the concerns have been heard on volatility. They are going to be addressed, although not as quickly as we would like, but nonetheless the federal government listened in that area and they deserve to have credit.

Honourable Robert Ghiz (L): Excuse me. I'll just interrupt here. I want to go back two slides, if you go back two slides. Right there. This here I find interesting because you kind of pick a year where there's the huge drop. Would you admit that?

Hon. Mitch Murphy: We actually picked following the last renewal.

Honourable Robert Ghiz (L): Okay, well what would the '99 -2000 equalization have been? Well, I'll tell you. \$241 million. Okay. So my question is in '99-2000 what was your surplus or deficit that year?

Hon. Mitch Murphy: I believe we had a surplus, a significant surplus.

Honourable Robert Ghiz (L): And then in, let's say '02-'03 what was your surplus or deficit that year?

Hon. Mitch Murphy: Well, I have to look at the numbers.

Honourable Robert Ghiz (L): I think it was a \$84 million deficit.

Hon. Mitch Murphy: But you're making the exact point that I'm making. Is that in years where equalization is adequate on Prince Edward Island then the province runs its books close to be balanced or in a surplus position. In years where there's wild volatility in the swings of equalization we've seen a deficit. It's not just during our administration. If you reflect back to the slide that Mr. Palmer showed and he talked about the prior year adjustments, 1990-91. Well the government of the day had to deal with that wild swing back in 1993 which saw significant money come out of the provincial economy because of that adjustment. So if you looked at the trend over time you would see in years where there's big adjustments the province has had deficit difficulties. In years where

there's positive adjustments the province has had either surpluses or close to being balanced. And that's the argument that we're making. We have to take the volatility out of it because from a budgetary point of view we can't have the wild swings in the numbers.

You'll remember the honourable member from Charlottetown-Kings Square and myself had a bit of a debate in the Legislature this spring about our numbers, federal numbers and I said we're using the federal number.

Richard Brown (L): Yes, he did.

Hon. Mitch Murphy: We're not going to fight over that anymore. They provide, federal finance provides the number, that's what we're using.

Honourable Robert Ghiz (L): You might have gotten another seat if you had of been doing that.

Hon. Mitch Murphy: That's what we put in the budget. Okay. But the reality is come next week on October 15th we're going to get an adjustment because they're going to go back, you know, two or three years. Our sense is that it's going to cost us about \$5 million. So that number is going to change. Now in some years as in '99 we got an adjustment. It was a big advantage for the province.

Honourable Robert Ghiz (L): It was \$11 million.

Hon. Mitch Murphy: No, it was more than \$11 million.

Honourable Robert Ghiz (L): No, '99 you estimated 230 and you got 241. I've got all the numbers here if you want me to tell them to you.

Hon. Mitch Murphy: But the point being is that I'm not arguing with your point at all. You're quite correct and that's what volatility of equalization entitlements have done to the province.

Honourable Robert Ghiz (L): But there are years, what I'm trying to point out, where you got similar numbers to what you got in those years but yet you were still able to run balanced budgets or surpluses and I'm just saying that, when you budget and it is unfortunate for you that there's some years what happens is your estimating, and it makes sense. It's like a household. If you

estimate that you're going to make \$60,000 a year in a household but at the end of the year you only get \$50,000, well you're obviously going to be in the hole \$10,000 and that's what happened to you on some years. But some years, like before the election you did use the wrong numbers, and therefore you ran huge deficits. But you have to go with what the federal numbers are and you want to know what, years where they made mistakes I'll back you up on it. I'll back you up on years where they made mistakes and you didn't make mistakes.

But I just want to go back to our point back here because you discuss a lot about the Constitution and the per capita and I agree with you 100 per cent and I personally think you should stand around those meetings and you should basically say, listen if you want to do this on a per capita basis, why don't you go back and change the whole Constitution. Because if you do a per capita basis, PEI shouldn't be a province. PEI shouldn't have four seats in parliament, PEI shouldn't have four senate seats. We shouldn't have our own supreme court here on Prince Edward Island. The Constitution was set out to make each and every province equal and allow them to deliver the same sort of services. And you should be able to win that per capita argument and I'm just saying as Leader of the Opposition and member from a different political party than you, if you needed any help whatsoever in looking for support on that I'll be there for you.

The other issue that I wanted to make was, you talked about favourite provinces and working outside deals and I personally think PEI is in the best position, out of all the provinces, to work outside deals. You know, if you've got any type of constitutional support or constitutional debate or anything going on it's going to be the cheapest thing in the world for the federal government to get Prince Edward Island onside. Yes, we'll support you on this. We only need maybe \$50 million a year. You know if they want to make a side deal with Quebec or British Columbia or Ontario it's going to cost them billions. So if you're going to work out any side deals I think PEI is in the best position of them all so you should be able to work something out.

Hon. Mitch Murphy: I guess the point I was making on that is that if we're going to be true to the program then we should let the program run

and there should be no side deal for us nor there should be no side deal for any provinces in the country. But anyway if that looks like the way it's going we're certainly not going to say that we don't want to be part of any deal if that's what it takes to get the extra revenues.

Ron MacKinley (L)Chair: All right, just before we go to Wayne there, you talk about side deals, when Pat Mella was provincial treasurer she was crying about not getting enough money in equalization, which is normal, and Paul Martin and I, I talked to Paul about it too because they'd asked for help and he'd offered them a side deal but your province at that time, your Premier and Mella and the cabinet I guess didn't want any side deals. They wanted to keep it within the scope that it's in now. So we'll go to Wayne.

Wayne Collins (PC): I'd like to go to a slide that was out there earlier. I don't know if you can find it not. It showed the relationship between . . .

Hon. Mitch Murphy: If I may, back to the Chair, I've just got a couple left. I'll finish up and then you can move on.

Wayne Collins (PC): Okay, fine.

Ron MacKinley (L)Chair: All right.

Richard Brown (L): Oh, I thought you were going to ask him about that side deal.

Ron MacKinley (L)Chair: Well we sort of had agreement here we were going to ask questions as we went along and then we sort of agreed that we wouldn't ask questions, then everybody sort of jumped in.

Wayne Collins (PC): Thank you, Mr. Chair. I'll wait.

Hon. Mitch Murphy: (Cont'd) This is similar to the slide that Mr. Palmer had in his presentation the only difference being I wanted to show the difference between a five province standard and a ten province standard. Here are some numbers that people had asked about earlier and I knew that we'd done some work on this. The impact of not having a 10 province standard has deprived the Atlantic provinces of an estimated cumulative loss in the order of \$8 billion since the five province standard was put in place in 1982. Based

on February estimates provided in February 03 the estimated loss for the region in 04/05 because of the five province standard is over half a billion dollars.

New federal proposal that was floated at the First Minister's meeting in September and basically this is what the federal government is saying, they want to fix the federal payout annually. They want to grow the program payout by 3.5 per cent after 05/06. They want to eliminate the program in favour of a panel of experts to advise on allocation after 05/06. And adding money in 04/05, in 05/06 as an offset to long term restrictions in the program. We opposed all of these for the following reasons:

The federal proposal to set a floor amount of \$10 billion for 04/05 with no province worse off than what their entitlement was in February of this year. The difference between the formula and the floor amount will be shared among receiving provinces according to their percentage of payout determined by the formula. In 05/06 the amount will be \$10.9 billion and will grow at a rate of 3.5 per cent annually there afterwards. We do not know whether the growth in the program will be on a share basis or on a per capita basis. Now here's why that's such a significant item to PEI. On a per share basis our share is about 2.6 per cent rounded off. On a per capita basis our share is about 0.85 of one per cent rounded off. So a significant difference in what the allocation would be.

As I mentioned earlier an advisory panel or somebody to have a look at the program, expert's advice, the senate chaired by Senator Lowell Murray probably had the most comprehensive look at this program back in 2000. They had experts in from all across the country who voiced their opinions on equalization and the Senate made a report in a series of recommendations on what should happen to the equalization program. They had committee hearings again. I'm certainly not opposed to that but what we are opposed to is taking the decision making away on the this program from the elected officials and that's why we don't agree with the federal proposal to put it to a panel.

Grow the payout by 3.5 per cent or in other words have 3.5 per cent as an escalator. Well, part of the problem with that, and it's a two-way problem, is that in years where the GDP has strong growth

then there is federal fiscal capacity to do that. But in years where there is not strong GDP growth we questioned the sustainability on that. We think it should be more related or tied into GDP and then it's favourable to both parties that are involved.

Where are we now? Well, the federal proposal for equalization is public. They have posted it on Finance Canada's website. We're a little discouraged that they put that position out in advance of the First Minister's meeting in October. But we will be going to the meeting, as you have read in the paper, the four Atlantic premiers have met and they have endorsed a common position from Atlantic Canada. I will meet with my counterparts in the region tomorrow just to go through some of the meat on the bones of the Atlantic proposal. So we'll be going to the meeting wanting equalization to stay on a per share or share allocation basis and we do not believe that putting a cap or ceiling on equalization will meet the test of the program but we're also cognizant of the fact that the program also has to meet the federal government needs. We can't have it back in 1992 where the program was going so wildly it was having a major impact on federal revenues. It's got to work for both levels of government. So that's what we will argue when we go to the meetings the end of the month.

Thank you, Mr. Chair.

Ron MacKinley (L)Chair: Yes, thank you, Mr. Minister. Don't you think the fact that they're going to go the private independent panel means that the federal government is not going to come through with what you're looking for? I mean that's pretty well . . . if you look at you people and your hospital report up and shut the hospital down you used somebody else to do it. Government seems to don't want to make the decisions themselves. I'm not knocking your government for it or anybody. If you look at, get an independent report that sort of backs up the government of the day's ideas.

Hon. Mitch Murphy: My sense is that, you know, there was a very comprehensive look made at equalization. What concerns me, Mr. Chair, is that—and I don't know if it's just fancy words in a throne speech or not—but the throne speech said there'd be basically the most comprehensive review of the equalization program in 47 years. Well, we're not asking for major changes in the equalization program. What we're asking is that

the program be addressed so that it's adequate to meet the constitutional needs. Now, in fairness, do I know what the Prime Minister meant when he said, you know, the most important reform in 47 years? No, I don't. That will be the discussion that he'll have with the Premiers at the end of the month.

Our point being is that, yes, there are some people that argue against the Atlantic provinces being involved or not only us but the recipient provinces receiving equalization. And this is what we would say about that. You know, the point was made here today. Obviously it's our obligation and it has been happening for the last 20 years in the province where we've seen good growth of provincial own source revenues. But I would answer the question this way. What happens, you know, to those people who would argue that, well, you know, should do away with equalization because it's distorting the economics and where people are living in the country and where economic activity is taking place. My response to that is this, is that equalized, no, nobody at this table said that but there are some that make that argument. But the point being is that what it enables us to do is that equalization enables us to provide a comparable level of public services which is important when you're trying to attract business or people to move. It's important when you're trying to keep some of the people at home, create some employment, etc, etc.

I agree our goal here, as all province's goal is, is to make equalization a shrinking portion of the provincial revenues. And that has to be the attained goal. But while we're on that journey then we need to be equalized. You know Leader of the Opposition said constitutionally, you know, a province of Canada with all the rights and responsibilities to go with that. So that's our point that we'll be making. If anybody wants to have a debate about whether or not there should be an equalization program, well, let's have the debate.

Honourable Robert Ghiz (L): How is your suggestion going to work out if you're looking at staying with the numbers over the long period of time? And just the part, you didn't like the 3.5 per cent growth but that would give you predictable levels of income. How does your system that you want give you the predictable levels of income?

Hon. Mitch Murphy: It was more than just an

escalator. It was using . . . the federal government said, for example, we would look at entitlements over a three year period. We will argue that a five year period would be more of an equalizer.

Honourable Robert Ghiz (L): You can budget five years ahead of you.

Hon. Mitch Murphy: No, not necessarily. Let's say for example if we go back to the last census adjustment. Okay, instead of having to deal with \$41 million in one fiscal year . . . we're not disputing that we received the money. We received it and we spent it but after the final figure for that year was made they said you were overpaid by \$41 million. So instead of having to account for that all in the one year they would average that out over a period of time and it wouldn't have such a dramatic impact on one year's budget.

Ron MacKinley (L)Chair: Mr. Bagnall?

Jim Bagnall (PC): I have a couple of questions. We mentioned earlier there about per capita, changing to per capita. What would that reflect in dollars coming to the province from 2.6 down to .85? What dollars would we lose should that . . .

Hon. Mitch Murphy: It depends on what the standard is for that year but if we go back and we look at this year, for example, it's a difference of about \$30 million.

Jim Bagnall (PC): Another question I had. We just got a big new health deal. Everybody got X number of new dollars into our health system this year and my understanding, our equalization is down. So what is that going to do in total dollars coming to the province? Are we going to get as much revenue, federal dollars coming this year, as we had in the past? Or we going to be up or down?

Hon. Mitch Murphy: I can't answer that question at this time for a couple of things. First of all we know that we're going to get additional CHST, CST dollars. The Premier and the Prime Minister agreed on that. I think our allocation for this year is about 9.3 million additional dollars. What we don't know . . . we know that based on the discussions that have happened at the First Minister's meeting on health care, the discussion that happened around equalization, that in theory

if it works, that we could receive an additional \$21 million in equalization. However, we also have to . . . that does not account for what's going to happen on October 15th when there will be a prior year adjustment to our numbers. Now, John and officials in his department, their best thought is that we will lose about \$5 million because the adjustment that is going to occur . . . am I in the ballpark, about \$5 million?

Richard Brown (L): We're waiting for that (indistinct)

Hon. Mitch Murphy: I don't know. But, you know, my official just informed me that it may not be good news on October 15 so what that will mean is instead of the 21 additional it may be down to 16. There still will be additional dollars. It just may not be the amount. It depends on what the adjustment is on October 15th.

Ron MacKinley (L)Chair: Mr. Collins?

Wayne Collins (PC): I'd like to go back to that slide if I could because I want to continue some of the remarks, the question that Mr. Bagnall was talking about earlier. That's it. Yes, CHST and equalization and I know that it's not a dollar for dollar tradeoff. We're seeing on this graph, are we not, equalization generally going down, CHST payments going up from 02/03, right?

Hon. Mitch Murphy: Yes.

Wayne Collins (PC): Now, the receiving provinces, people receiving equalization, are they in a sense carrying a lot of the burden for the increase in that health care expenditure here? I hesitate to say "have-not provinces", let's say the receiving provinces carrying the load for increased health care spending in Canada?

Hon. Mitch Murphy: I think that's a fair comment if you look at what those two programs have done over the last little while. Certainly the equalization pot, you know, has shrunk relative to the 1999 commitment the Prime Minister made and certainly the CHST funding has increased. Equalization, you know, if we were going on a per capita growth, would be about \$16 billion available. There has been about \$12 billion in new spending for CHST.

Now, I should also point out what the difference is for the province. I think for every billion dollars

that's available in CHST or now CHT/CST, our share was about \$4.4, \$4.3 million and for every billion dollars that's available out of the equalization pot it was around twelve and a half, 13 million . . . 26, yes, sorry, I was thinking of something else. So it's quite a difference. So that's why obviously we make the share equity argument.

John Palmer: Could I make a comment on this?

Ron MacKinley (L)Chair: Sure, go ahead.

John Palmer: A lot of the federal decisions concerning health care up until the meeting of September of this year, to go back, if you recall a lot of the commitments have been from surpluses at year end. They've used money in 02/03 to pay for 03/04. There's been a lot of that. A lot of those surpluses in those year, and I can't recall the exact year—there was one year, which year was it there was \$4.7 billion worth of surplus, something like \$4.7 billion worth of surplus being earned by the federal government, I think it was 03/04 and in that year because equalization entitlements have fallen so catastrophically and that was the year when there was money put into health funding and it was actually using the previous year's money. It was money coming out of the surplus in the year. So there is a very direct relationship between the equalization entitlement losses and the health care increases.

Honourable Robert Ghiz (L): But when the health care increases go up and offset what goes up in equalization, say from the federal government's perspective, the other provinces could benefit and PEI loses. So we're losing to the provinces that have.

Wayne Collins (PC): We're subsidizing the increased expenditures in health care across the country, in competing provinces.

Hon. Mitch Murphy: The other thing I'd like to make the committee aware of is back in August I asked, or I shouldn't say I, John and I asked a gentlemen by the name of Robin Boadway from Queens University to prepare a paper on how well equalization is reducing fiscal disparities in the country. Now, I think it's safe to say that Mr. Boadway is, if not the, certainly one of the most respected academics when talking about equalization. Now I haven't received the final

copy. I just have a draft copy but I will receive the final copy sometime before the end of the month and I will undertake to furnish the committee with a copy of Mr. Boadway's work because he really looks at PEI in the context of the equalization system and I think that may be beneficial for the committee members to have.

Ron MacKinley (L)Chair: Mr. McKenna?

Wayne Collins (PC): I just had one last question.

Ron MacKinley (L)Chair: Go ahead, Wayne.

Wayne Collins (PC): The upcoming meetings in October, our First Ministers on Equalization, how critical will the outcome of that meeting be for the continued viability of Prince Edward Island as a province? Such a profound question but really this is very important, this equalization formula, this program, that it be continued on an entitlement basis and not on a per capita basis. How critical is it that we have an outcome favourable to PEI?

Hon. Mitch Murphy: I think it's a very crucial meeting simply because it makes up, you know, somewhere in the vicinity in a given year about 25 per cent of provincial revenues. So obviously it's an extremely important meeting but, you know, it's also an extremely important program for right now eight provinces that are receiving entitlements, for seven provinces. You know, and there's no question in my mind the federal government views it as an extremely important program as well or we wouldn't have heard about it in the Throne Speech, there would not be a meeting between the Prime Minister and the First Ministers to talk about this and other fiscal arrangements. So I think everybody's going with the spirit of, you know, we can improve the program. We also have to be realistic that, you know, no one side can lose out of this. It has to work for both people. And there is an argument, as you seen in the paper, amongst the provinces. I think with the exception of Quebec all other recipient provinces are adamant that this stay on a per share basis. And you know we will not support what seems to be Quebec's position that they want the difference between the floor and the top up to be on a per capita basis. Yes, they gain but everybody loses. There is a debate going on there.

But, you know, in fairness let's recognize that the Prime Minister, you know, we don't have First

Ministers meetings every day on every topic. We've had one in health and the premiers, First Ministers, have asked for this so we're having one the end of this month and I look forward that it be a favourable outcome for PEI. But it is an extremely important issue.

Tape No. 5

Ron MacKinley (L) (Chair): Mr. McKenna.

Dr. David McKenna (PC): I want to go back, Mr. Minister, to the special deals for the special provinces. Now I know that the Accord for Nova Scotia, and Newfoundland was discussed probably ten years ago. The latest one is the Saskatchewan one, I believe. Is it something to do with uranium or potash? It's a special mining deal, I understand. Is that what it's all about where they got an extra \$150 million?

Honourable Mitch Murphy (PC): I'm going to ask John to respond to that just because he's more familiar with that particular one than I.

John Palmer: The rather extraordinary set of circumstances but we were informed one day by our federal finance friends that Professor Tom Courchene who is actually a colleague of Robin Boadway's of Queen University had written a paper one day saying that Saskatchewan basically was being denied a certain amount of equalization because of the way the formula was working and then the next day, they gave them \$120 million.

Richard Brown (L): We should write a paper.

John Palmer: That's way we—I shouldn't say that—but it was, I have never seen any, in all the 25 years I've worked in this program seen the federal government respond to this. The comment that I got was that Mr. Goodale's riding is in Regina and he's very, very, very sensitive of this. The arrangement that's been on the table for the discussion in September on health was very favourable to Saskatchewan in terms of the 04/05 arrangement, very favourable.

Dr. David McKenna (PC): Is it based on potash or something like that?

John Palmer: It was based on the fact that their oil and gas revenues more than potash. The oil and gas revenues that they have are not

favourably treated and they felt. . .

Richard Brown (L): That came up during the election, too, on. . .

John Palmer: What was amazing was the response that the federal minister took.

Richard Brown (L): . . . Stephen Harper wanted that in too, because when he was in Newfoundland, he said Newfoundland will get it, Nova Scotia and Saskatchewan.

Dr. David McKenna (PC): So I mean it just looks like a precedent, we got all these special deals and of course, the previous finance minister was looking for a special deal for Quebec on per capita. I mean it just seems to be whoever the finance minister is, it makes it more favourable for their province. That's what it looks like the trend is going that way then.

Ron MacKinley (L) (Chair): Well it is.

Dr. David McKenna (PC): Obviously, it must be.

Ron MacKinley (L): Anyway, we'll go with one more but we have another presenter to come on here.

Richard Brown (L): Just a couple of questions then.

Ron MacKinley (L) (Chair): The committee could always call Mr. Murphy back. I'll give you one more question.

Richard Brown (L): On your chart, you seemed to use the year 2001/2002 or 2000, one of those years, 248 million, you used a favourable year. Of that year, could you go back a couple of slides there. Yes, 282 - how much of the 282 was part of your adjustments?

John Palmer: In 01/02, Nigel can help me with this, I think our entitlement—it's not as easy as you might imagine. We'd have to go back and see what was our entitlement for 01/02 that was available to us in that year, but I think it was around 270, was it, Nigel?

Nigel Burns: It was 259.

John Palmer: Say 260.

Richard Brown (L): Okay, 22 million of that is part of your adjustment.

John Palmer: I would think so.

Richard Brown (L): Okay, and that's the year we set up 22.5 million, I think it was that year. And that's the year you set up for special funds. You got 22 million that year more than you anticipated. That went into a special fund. And then the next year, you got another 22 million, which is pretty good budgeting. I got to give the former finance minister and the whole caucus credit here because they transferred the same identical amount into the special funds, two years in a row and most people thought, oh that's still just the money, 22 million. They got another 22.5 million from the feds and transferred that in which brought it up to 45 million in the fund. Real good accounting on Michael O'Brien's part and he should be given a lot of credit for that one because, but it didn't sneak by us.

John Palmer: There was no sneaking. . .

Richard Brown (L): Oh no, I know, but you had to dig pretty hard for it. It was pretty good. I had to wait for the blue book to come out, Public Accounts, to explain it. Anyway, if you take the five-year trend there and you equalize, you add it up and average it, it's 248 million is the average over those years. So we're still pretty good.

Just one other question, your previous chart there. Could you go back where you showed equalization going different, now here is all I want to get. We have 2000/2001 from the federal website, we have cash for CHST at \$18 billion, 300 million. This year, it's 22 billion, 550 million. In 2001/2002, equalization was ten billion, 290 million and this year, it's 9 billion, 666 million. Your chart seems to be showing the difference is not there. But the difference. . .

Honourable Mitch Murphy (PC): But remember, the difference in the two pages, the PEI and the two programs, one is 4.4 per billion and the other is 26 million.

John Palmer: The reference here, Mr. Brown, is if the equalization had grown with GDP, according to the prime minister's commitment.

Richard Brown (L): Oh, so this is not actual then?

John Palmer: This is what it would have been if it had of been. . .

Richard Brown (L): Oh, it's not actual, but actual is a bit different on the chart.

Honourable Mitch Murphy (PC): Yeah, the actual equalization numbers, you know, are still trending down.

Richard Brown (L): No, this year you're back up to 9.6 billion.

Honourable Mitch Murphy (PC): No, we're back up, well that's at the first ministers' meeting on health, we're back up to ten because they guaranteed the. . .

Richard Brown (L): Ten, yeah, so just one quick question, in 2001/2002, it was ten billion, and then the next year it was 8.7 billion. Was that an affect of a formula or was that just an arbitrary deduction from the federal government? Like our economies grew. Economies were going pretty good at that time, all of us. And I'm just saying, did Paul Martin at that time, say I'm cutting a billion and a half out of the fund? Or did the formula work out that that's what it should be?

John Palmer: It's a combination of the two. I mean, there is the—over the working, there is an addition of—as noted, there was a decision temporarily to reduce some of the revenue costs that has been fairly well.

Richard Brown (L): So how much of an affect?

Honourable Mitch Murphy (PC): Well ten million dollars a year for us on average of the cap on user fees.

Richard Brown (L): I guess but it's . . .

Honourable Mitch Murphy (PC): But it's economic circumstances too like the softwood lumber crisis from BC. BC is usually not a recipient province but because of that impact, that triggered them. Now it looks like and everybody thinks that probably this year, they will become a contributing province again or I shouldn't, that's a

wrong phrasing, they will not be a recipient province.

Honourable Robert Ghiz (L): And then we'll get more money.

Richard Brown (L): (Indistinct)

Ron MacKinley (L) (Chair): Alright, I'll give you one more and that's it.

Jim Bagnall (PC): This is, Mr. Minister, this is actually not related to your presentation this morning. I want to thank you very much for coming in with these figures and information for our committee today. My question is it's kind of related to the deal that was signed with the racetrack. My understanding that contract has been signed?

Honourable Mitch Murphy (PC): Yeah, one of them has and one of them hasn't. But I guess if the question you're leading to is that there was some question, I think, some members of the committee last week expressed a desire for me to come here. I'd be quite willing, if asked, to come and talk about the race track and the agreement with Atlantic Lotto, sure.

Jim Bagnall (PC): That was my next question. So would you be prepared to come and disclose the figures and the deal of the...?

Honourable Mitch Murphy (PC): Yeah, I've always said it's public information. It was one of timing but things are underway and I think that everything will be signed by then. So if it is the wish of the committee for me to appear, I'd be more and happy too.

Jim Bagnall (PC): So we can work out a date. You'd be prepared to come before our committee?

Honourable Mitch Murphy (PC): That's up to the committee. I'd have to be here when requested.

Jim Bagnall (PC): Thank you.

Ron MacKinley (L) (Chair): Alright, I want to thank you very much for coming. And we'll move on to our next presenter.

Part III - Dr. Robin Neill, Adjunct Professor of Economics, UPEI and Carleton University

Ron MacKinley (L) (Chair): Alright, Mr. Neill, it's good to see you here to present your ideas. If it's okay with the committee, we'll let Robin present his brief and then we'll ask questions after his brief is done. Is that okay with the committee?

Jim Bagnall (PC): Mr. Chair, before you—I was just wondering—I know that when we discussed this at our last meeting, we had this report from the equalization program from the Atlantic Canada, from APEC, this one here. And we had asked at that time for the author of this report to come in and appear before our committee. I understand that. . .

Ron MacKinley (L) (Chair): That will be brought up under new business today.

Jim Bagnall (PC): No, this is part of this presentation.

Ron MacKinley (L) (Chair): No, but he's no doing it.

Jim Bagnall (PC): Are you doing a presentation based on this report that we've asked for?

Dr. Robin Neill: No, I'm not.

Jim Bagnall (PC): That's what I've been trying to find out.

Ron MacKinley (L) (Chair): No, he's not.

Richard Brown (L): Doesn't both chairmen get together?

Ron MacKinley (L) (Chair): No, he's not. He's doing this strictly on his own.

Jim Bagnall (PC): That's alright, I just wanted to ask the question because that was why we had put out the invitation to the author, so that's fine.

Ron MacKinley (L) (Chair): Go ahead, start.

Richard Brown (L): Oh, he's the author?

Jim Bagnall (PC): No, he's not.

Dr. Robin Neill: Thank you very much. This

microphone, I take it is not so that you can hear me but so it can be recorded, so I won't worry about that. Mr. Chairman and members, I have a few brief statements here. I think I have read this report that you have mentioned but it was sometime ago so I'm not basing my presentation on that.

Some overview of the equalization program - In 1867— you were asking, you will receive a hard copy of these comments, the secretary has them and she will pass them out afterward and this is so I will have your attention while I'm talking.

Richard Brown (L): It's pretty hard with us, I think.

Dr. Robin Neill: In 1867, transfers from the federal government were payments on an unitary central government to subordinate jurisdictions, much as the province makes transfers to municipalities. After about 1887, they were transfers to jurisdictions, sovereign over their own spheres. Now transfers were used to induce provinces to enter the confederation or to keep in those who were already in. And they were also used to meet the demands of regional party patronage. That is to say that the transfers had constitutional and political purposes.

In the last years of the 1930's, at the time of the Keynesian revolution in economics, the transfers were rationalized on the grounds of equity. You see, there's always been transfers from the federal government to the provinces and the question, what are you doing here? In late 1930's, they were rationalized on the grounds that they were to ensure equal government services to all citizens of the federation and this is what was written into the constitution in 1982.

Rationalization in the 1930's notwithstanding, the constitutional and political purposes of the transfers have remained effective and they have diluted equity in the system. Economic efficiency has never been a goal of the transfers. Consequently, neither equity nor efficiency underpins the reality of equalization transfers.

Economic efficiency is precluded by the fiscal imbalance in the system, one government taxes and the other government spends. The federal government is blamed for the tax and the provincial governments are praised for spending

the money and this has two consequences. First, the federal government inevitably taxes and transfers less than the provinces want. It's built into the system. And second, the costs and benefits of the system residing in different jurisdictions are never measured against one another to assess the system's overall efficiency.

Economic efficiency is further precluded because the payments inhibit citizens from moving from low income regions to high income regions. That is from low productivity regions to high productivity regions. Economic efficiency is further precluded because the payments encourage provinces to deplete their tax bases with a high tax effort. And they do this because payments are larger when tax efforts are higher and tax bases are smaller. It would be a nice question for students.

Does the equalization payment cause inequality or does inequality bring about the equalization payment? Now I know the answer to that one. And that is there is inequality in the provinces to start with. However, a good student would have a lot to say on both sides of that question.

Again further, a clear meaning of the constitutional requirement would require a definition of reasonably equal. Is it reasonably equal expenditures or reasonably equal results? Given the importance of overhead and government's services, the cost of reasonably equal results is much higher in low population density areas. So economic efficiency is not being achieved and neither is political equity and the latter is evident, I think, it would be less than ten province standard for judging what is reasonable in government services. So perhaps the matter could go to the Supreme Court for a judicial decision on the meaning of reasonable and also on the meaning of what's a government service. If you take it from the equalization and put it in CHST, it's still all for government services.

So I would say I hope they don't send this to the Supreme Court because in my perception of the judges of the court lack judgement and they seem to be hell bent on destroying the unity of this country and reducing us all to a common level of poverty. But that's my perception.

On the whole, I think equalization is a good idea. I favour it. But I think its implementation can surely be improved and it would be beyond I think what

you've asked me to do to make the suggestion as to how it could be improved. Those are my comments, gentlemen. If you have any questions or further comments.

Ron MacKinley (L) (Chair): We'll start with Mr. MacAleer.

Wes MacAleer (PC): Have you advocated a simplification of the formula like the single macroeconomic indicator like adjusted personal income?

Dr. Robin Neill: No, that might be a good idea and I should think that that would be considered. I would advocate carrying out equalization through the tax half rather than the expenditure half. That is to say provincially differentiated federal taxation. Now there are a number of reasons for advocating this. One is that it does eliminate the fiscal imbalance which is a major cause of inefficiency. But what it also does, it ensures that less money will pass through government bureaucracies. The money will stay in the province rather than going to the federal government and coming back. I read the newspapers, as you do, and it seems to me money passing through federal bureaucracies just gets lost.

Honourable Robert Ghiz (L): And provincial.

Richard Brown (L): And city.

Ron MacKinley (L) (Chair): Mr. Ghiz.

Honourable Robert Ghiz (L): Thank you. So I think you kind of indicated that as we change through history the way we transfer money to the provinces has somewhat changed as well. And today, would you say that we would be in a better situation to perhaps re-look the whole way equalization is delivered to the provinces?

Dr. Robin Neill: I think that was my point.

Honourable Robert Ghiz (L): Yeah, but would you then say that for example, I can see it now if we did do something like that, Alberta would basically be up in arms and would be in a situation where they could be like Quebec was five or tens ago and would want to be separating. Would you see a lot of difficulties within provincial relations if something like that did come about?

Dr. Robin Neill: I would think, yes, but what you're doing because you think so too, and you are corroborating my point that political considerations are a factor rather than equity and efficiency in the present system. By political considerations, I mean keeping people in the province, keeping the provinces happy, doing what Quebec needs to keep it in, doing what PEI needs to keep it in and these matters are not matters of either equity or efficiency. I'm not suggesting for a moment that they are not important.

Wayne Collins (PC): Mr. Chairman.

Ron MacKinley (L) (Chair): Yes, Mr. Collins.
Wayne Collins (PC): Could you expand a little bit on your definition, your perception of economic efficiency when you talk about it in the context of the equalization payment?

Dr. Robin Neill: Well I think I made three points and the basic point of economic efficiency is that when you match the costs against the benefits, the benefits should be greater.

Wayne Collins (PC): And you were saying in your presentation that you, correct me if I'm wrong, but you feel that under the present situation, the present type of regime of equalization that benefits are not measured right now.

Dr. Robin Neill: They're not measured in the same jurisdiction. The benefits are measured in the province and the costs are measured in the federal government and so the federal government reduces the quantity and the provinces want more. If you don't get that matching of costs and benefits that would be necessary to say, this system is efficient.

Wayne Collins (PC): We do have things such as healthcare outcomes and understandings of wait times in various provinces for different types of procedures. You know the healthcare system we look at, we compare our education systems in terms of how far advanced our children are at junior high or high school level. We have a host of national yardsticks that we try to come up with, when we talk about delivery of government services, certainly health and education are foremost among them. And we do measure them, do we not - measuring the benefits?

Dr. Robin Neill: You would know better than I

whether these things are adequately measured or whether the measures are prejudicial because they are made by different people, whether these measures are measures of efficiency. For example, when I say we don't know whether a reasonable provision of a service means that the result will be the same or the cost will be the same. There's a very big difference and do these standards clarify these differences? Well you've got a host of standards, gathered by a host of people and I certainly am not in a position to say that these standards are equally applied. From what has been said today, I don't think they are. I think political considerations are involved, and Newfoundland doesn't pay taxes on its resource revenues now, I think. Is that correct?

Unidentified: 70/30.

Dr. Robin Neill: At least it doesn't reduce its equalization. Well you know, this is not fair. So all these standards do not really affect the functioning of the system.

Wayne Collins (PC): If we were to place economic efficiency as a real strong motivator here in terms of the equalization program, where would it lead us eventually down the road? I mean if everyone is gravitating right now in droves, we see this migration westward to Alberta. Many young Islanders are moving out there again laying the seismic lines this winter. You know, by the hundreds, it's amazing. We've got some everyday, there's people from the Maritimes heading west. It used to be to Ontario. But they're going to where the jobs are more plentiful and employment and such.

If we were to just function under economic efficiency, is it conceivable that, I mean, everyone would be off in Alberta or Southern Ontario or the lower mainland of British Columbia and the rest of the country would be like a wasteland.

Dr. Robin Neill: There would be no one here to suffer.

Wayne Collins (PC): Is that the kind of Canada you want, Sir? Do you want a Prince Edward Island with a couple of hundred people?

Dr. Robin Neill: You do not want a dissertation on the kind of Canada that I want because it doesn't look like the one that we've got. This

consideration is a minor consideration. I'm currently interested in a concept called Atlantica. You may have heard of it. It's the economic unity of the Maritimes and New England. And the strength of this thing as both a cultural and economic proposition.

Ontario is very interested in joining with Michigan and upstate New York. There is a similar movement on the west coast to establish a Cascadia in British Columbia, and Oregon and Washington. Because circumstances in 2004 are certainly not the circumstances of 1867. Now you can say that we would rather have Canada as we are now and pay the price. That's good, then pay the price.

Wayne Collins (PC): I see and I will and I respect your ideas that you want to pursue this Atlantica idea or Cascadia or whatever, but I haven't given up on improving this Canada yet.

Honourable Robert Ghiz (L): (Indistinct) this direction already?

Dr. Robin Neill: Oh, we're moving in it constantly.

Honourable Robert Ghiz (L): Like what we've got right now, the Atlantic premiers and the New England governors, you know and Ontario, they do the same thing with their counterparts and in the west they do.

Dr. Robin Neill: And technological circumstances are such that quantity efficiently define the country in 1867, it certainly does not obtain. And I have no objection to people deciding that we will go against what is economically and technologically efficient in order to maintain this country. If that's your judgement, do it.

Ron MacKinley (L) (Chair): Mr. McKenna.

Dr. David McKenna (PC): You mentioned earlier about a definition for reasonable or definition for government's service and you said maybe the Supreme Court can decide that but it wouldn't go that way. Have you got a definition yourself that you could use for that? Have you come up with one?

Dr. Robin Neill: Oh no, no.

Dr. David McKenna (PC): You don't.

Dr. Robin Neill: A government service is a service that the government provides. Well that's a government service and reasonable is virtually a meaningless term.

Dr. David McKenna (PC): Obviously, it looks like it is.

Dr. Robin Neill: But you know then you would have to send that to the courts and the courts would decide what's reasonable. I hesitate to think of what the result would be.

Dr. David McKenna (PC): Thank you.

Richard Brown (L): Mr. Chairman.

Ron MacKinley (L) (Chair): Mr. MacDonald and then Mr. Brown.

Wilbur MacDonald (PC): I was interested in your comments on the Supreme Court, would you like to expand on that?

Dr. Robin Neill: Why I think they have no judgement?

Wilbur MacDonald (PC): Yes.

Dr. Robin Neill: Or what do I mean by that?

Wilbur MacDonald (PC): Yes.

Dr. Robin Neill: I mean that I think they have been literalist. When you get the copy, you'll find that I did not write this down. They have been literalist in their interpretation of the law rather than making judgements that are good for the country as a whole. And that is a simple proposition.

Wilbur MacDonald (PC): I'll not ask you to expand anymore. Thank you.

Dr. Robin Neill: And that's as much as I am going to expand on that.

Honourable Robert Ghiz (L): Well you'll have to change the constitution if we're going to have a different interpretation of what's in the constitution, would we not?

Dr. Robin Neill: Well we are in the process of moving from being, moving from parliamentary sovereignty to being a republic and we have not completed that movement so that we still have elements of feudal monarchy being exercised, perhaps by the PMO or by whoever and by a sovereign parliament. When parliament rebelled against the monarchy and I think it was a glorious revolution in 1688, they didn't abolish the royal prerogatives once they got a hold of them, they kept them. They wouldn't let them go and that has affected Canadian—that's the difference between American government and Canadian government. We have a sovereign parliament which exercises the feudal prerogatives of a crown.

Now with the addition of a Supreme Court and with the rising power of the Supreme Court as a result of moving it to Canada from Britain and as a result of having a Bill of Rights, parliament is now no longer technically sovereign and it must do what the law says. It's now below the constitution in these matters. It is not sovereign in these matters but the movement toward that is very slow and that's the painful thing about sending something off to the courts to get a decision than rather having the public make a decision on it. We're somewhere in between there, eventually.

Tape No. 6

Dr. Robin F. Neill: (Cont'd) But then you see if you're going to have a court which is supreme how can you have it appointed by a sovereign parliament, it's parliament acting through the prime minister, appoints this court. So the matter of a check on a sovereign parliament is sideswiped or, you know, you get around this thing by appointing a court that will agree with you. Not that that isn't done in the United States anyway but you see we are in a different position with respect to this. I don't know if that answers your question.

Ron MacKinley (L)Chair: Mr. Brown?

Richard Brown (L): One quick question. You're an economist. What can PEI do to improve its economy, you know, to get off equalization I guess or to put, you know, from an economic point of view can we change our tax structure? Frank McKenna is advocating a maritime tax credit system for the Maritimes, corporate tax credit. Or is it a good idea that we eliminate corporate tax on PEI?

Dr. Robin F. Neill: Well, as I said, the provincially differentiated federal taxation, how you would work out the deals and details on that would be a long tedious thing and I think that that's probably a better way to go. There is no perfect way to go. I think equalization is here to stay on the grounds that when you have . . . if you were to have an efficient federal system all the constituent units would be the same. They would have the same size and the same economies and they would all look alike. But that historically has not happened. All our constituent provinces are different and so, you know, you can't treat them the same. We are not going to have the economic clout that Ontario has simply because the population is so small, overhead costs are so very important. You know when you've got a small population you can't have all the specializations that you would like to have nor can you afford the overhead costs. So if we are to remain in Confederation there will have . . . and all citizens are to be treated alike, there will have to be something like equalization. And so I don't think economic policies are going to be able to eliminate the less well off provinces from a need and a right too. If we are to be citizens in this country then we should have this. And I don't think (indistinct).

Ron MacKinley (L)Chair: Mr. MacDonald?

Wilbur MacDonald (PC) : I'd like to go back to your, and I don't think we should let it go without some little discussion on it, the idea that the Maritimes . . . did you say in an economic base?

Dr. Robin F. Neill: Economic and cultural.

Wilbur MacDonald (PC) : And how would you describe that in a broader base then –economic and cultural without still leaving our two countries separate and distinct?

Dr. Robin F. Neill: Every province, with the exception of Prince Edward Island, trades more with the rest of the world and that's mostly United States by a big per cent, more with the rest of the world than it does with the other provinces. Interprovincial trade is about 20 per cent of Canada's GDP. Foreign trade is 40 per cent. So economically we are a part of a continental unit and our connection, and the connections all run north and south and ours is with Maine. Now Maine and New Hampshire, and it's debated how you would define. I would define Atlantica as

everything in the drainage basins of the Connecticut River and up to the Restigouche. So that all that business that drains into the Atlantic, and that's why we are, along with New England, relatively less well off than the rest of North America because New York went up the Hudson River and got to the west and penetrated the Central Plain and Montreal went up the St. Lawrence and they just cut this area off and we have no access. Or we did not have the ease of access that those areas had to the Great Central Plain and so we are common with New England as a very distinctive geographical and economic unit and similarly I think because the agricultural frontier in the Maritimes moved up from New England and one needs to remember that.

Although the Acadians were here first they were expelled and the planters came in and then the Loyalists came in. I know people came from Scotland and Yorkshire and Ireland but the frontier of agriculture activity came from New England and it was the American Revolution. We choose not to go along with that. We decided on having a sovereign parliament for reasons . . . why . . . rather than becoming a republic. As we integrate with the United States centuries later because the economies are now pulling together we are forming a type of government like theirs. I've gone beyond your question. You might want to ask it again.

Wilbur MacDonald (PC) : That's fine. I've had some experience with the North Eastern Governors, who seem to be quite receptive. I know that, for example, Quebec has in their Speaker's office, have 10 people alone who deal with the United States and nothing else. So there is some movement there. Do you see the United States, the New England States, as receptive to something like that? Or is that, at this stage in point is it just an idea or has it (indistinct)?

Dr. Robin F. Neill: In deference to the maintenance of Canada, I don't think the United States is going to accept us as politically a unit of the United States. But certainly economically we can integrate and there will be what's called I think, transnational agreements which really constitute the North American, political structure for a North American economy. Canada will still be here. The United States will be still there. But these treaties and agreements will form a kind of virtual government so that we become one, to that extent

we become one political unit and one economic unit divided along north-south lines.

Ron MacKinley (L)Chair: Well, I want to thank you for coming. It was quite interesting.

Dr. Robin F. Neill: Thank you for waiting through lunch.

Ron MacKinley (L)Chair: No problem. Now our next subject is discussion of Shawn Murphy and Colin Younker are available to meet with the committee on Monday, October 25th at 2:00 p.m.

Wes MacAleer (PC): Mr. Chairman, can I have your permission to interject here.

Ron MacKinley (L)Chair: Do whatever you want to do.

Wes MacAleer (PC): I think your comment is a good one. I don't want to disagree that that should be discussed. But given the extent of the discussion here, the information we've gotten, particularly the point made by the Leader of the Opposition here that there's a need to deal with this issue. It will be dealt with October 26th with respect to the equalization formula. I'd like to propose a motion if you would.

Ron MacKinley (L)Chair: Go ahead. A motion is always in order.

Wes MacAleer (PC): It's very simple but it's a very important issue which seems to be the dividing line here between what we would like to see as a province and that which is being proposed by others. So it would read something like this:

Whereas equalization is a key component of Prince Edward Island's provincial revenues;—which I think we've all agreed—

And whereas Section 36.2 of the Constitution Act of 1982 guarantees that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation;

Therefore be it resolved that this committee support the province of Prince Edward Island's position that equalization entitlements remain on a "share allocation" basis and the adequacy of the

program be addressed.

I move . . .

Honourable Robert Ghiz (L): I need a copy of that. Can I borrow your copy for a little bit?

Ron MacKinley (L)Chair: We don't need a seconder for that.

Wes MacAleer (PC): Huh?

Ron MacKinley (L)Chair: We don't use seconds. No, not in this committee. We . . . I'll second it myself. No, we don't need a seconder. A motion is always in order at a committee meeting.

Honourable Robert Ghiz (L): It's a very good motion. I'll tell you the only problem I have is in "Whereas equalization is the key component of Prince Edward Island's provincial revenues" — I don't like the sound of that. It should be "Whereas equalization is the key component of the Canadian system of equalization across the country or of providing equal services across the country". Because it's making us sound like we're totally dependent on equalization. So I agree totally with the premise of it. I have a problem with the first whereas.

Ron MacKinley (L)Chair: So what do we do? Do we pass this motion?

Wayne Collins (PC): That's just a fact. It's a key component—25 per cent of our revenues.

Honourable Robert Ghiz (L): Do you want to go around everywhere else and say thanks for all your revenues (indistinct) federal government?

Ron MacKinley (L)Chair: If I could have a question for the promoter? If I could just have a question for the promoter. You're making a motion here. What are we going to do with this motion? Are we going to fax it off to the finance minister?

Richard Brown (L): You're going to go to Ottawa with it.

Ron MacKinley (L)Chair: Just wait now.

Wes MacAleer (PC): I'm just trying to get a

consensus among the . . .

Ron MacKinley (L)Chair: We already agreed to it. I mean we all want the most money possible from Ottawa.

Richard Brown (L): I think it should be sent to somebody like the Prime Minister.

Ron MacKinley (L)Chair: Let's do it. Send it, take the motion, send it to the Prime Minister. We back the Minister, we want as much money as possible from Ottawa we can get.

Wayne Collins (PC): That's not what we're saying. We're saying we want the equalization to remain on a shared basis rather than a per capita basis and that is the crossroads of a turning point (indistinct) . . .

Ron MacKinley (L)Chair: We agreed to that. We've already agreed to that.

Wayne Collins (PC): That's what I'm saying. You're saying you want as much money from Ottawa . . .

Ron MacKinley (L)Chair: (Gavel) We do. If you want to go back to the whole problem started back when the Tories took power. They went away to Ottawa and the provinces sat around the table and they changed the CHST money to increase it and that was by per capita, the province agreed to it, the province of PEI. I questioned this right in the House there. Pat Mella and the minister of health was there, Mildred Dover I believe at the time. She said she didn't agree with the Premier. So they agreed to that formula with the condition that the provinces would work to improve equalization for the have not provinces like ourselves which was really never done except they raised the cap for one year. So it, for instance it goes by the amount of money, CHST is set out on population which gives us about 4.5 per cent of the dollars that come, where equalization we get 25 or 6 per cent of the dollars that come by way of the formula. So we don't want that formula changed. I think everybody in the province will agree with that. That's what the resolution states and the minister states here is we don't want that formula changed. If you look at all the federal programs that come here to the province, whether it be BSE or whatever for cattle, we get about 4 to 5 per cent of that comes in the formula to us because it's

basically on your population. And that's how it's set out. We have it sort of locked in.

So I think Mr. MacAleer's resolution is good. I think we'll approve it right quick.

Honourable Robert Ghiz (L): I'm just going to put forward a . . .

Ron MacKinley (L)Chair: An amendment to it and we'll get it off to whoever. I'm not saying they're going to listen to us but I mean the thing is they didn't listen to our committee on agriculture when we recommended \$100 for every cow-calf. Even the province didn't listen to that, the government here didn't listen to it. I don't know if the federal government is going to listen to it but we'll send it off. It's a good idea. So we'll have your amendment on it. Make your amendment.

Honourable Robert Ghiz (L): I'm kind of working on it with the promoter of this motion and he's just kind of working on it now.

Richard Brown (L): While he's working on this, Mr. Chairman, can somebody explain to me. We're saying we want to continue it as a share component and a share basis and not a per capita.

Ron MacKinley (L)Chair: Yes. On a per capita rate we get a lot less.

Richard Brown (L): But as we see in the equalization formula right now we take our indicators across the country, we take our 33 indicators across the country and see what the deficits and the positives are of each province and then we get a percentage of that or we get an amount of that and we multiply it by a per capita. So are we saying we're taking out that multiplier—a per capita multiplier?

Wayne Collins (PC): That's not the way I understand it. We have a share basis right now as the minister pointed out this morning. Is it 2.6 per cent and if we go to a per capita share it will be decreased to 0.8? Is that correct?

Richard Brown (L): No, no. What he means there is every time the federal finance minister comes out and he ups his equalization and all that, I take his percentage too. 2.5 per cent of whatever increase we get—whatever increase, 2.5 per cent of that and our population is .07 of Canada. So

the two of them right now are equal if you take our formula. What I'm scared of, if we go from a per capita to what our share is now in the total and our population goes up then we're saying, no, no, we still want .07 per cent of the fund and our population is up then the feds will say, well you wanted a share. You wanted your percentage fixed. We've fixed your percentage on the total and not on a per capita basis. I'm afraid here, you know, before we vote on this . . .

Dr. David McKenna (PC): I know Quebec will benefit tremendously by going per capita and they're going up and up and up. That's why they're arguing for it. Obviously they're not on our side any more and we're going to keep going down, down and down by the new formula they're coming up with.

Ron MacKinley (L)Chair: Have we got the motion? What are you going to do? Are you changing your motion?

Wes MacAleer (PC): No, not essentially. But the opening statement I will read it again.

Ron MacKinley (L)Chair: Well, a motion, we either have a motion or we don't have a motion.

Wes MacAleer (PC): Well, for the motion . . .

Ron MacKinley (L)Chair: Amendment to the motion.

Wes MacAleer (PC): Amendment to the motion.

Ron MacKinley (L)Chair: All right. Put the amendment on.

Wes MacAleer (PC): It says

Whereas equalization is a critical component to maintaining an equal Canadian society from coast to coast to coast;

Unidentified Committee Member: Three coasts.

Wes MacAleer (PC): Yes, three coasts.

Ron MacKinley (L)Chair: So are you deleting any of your previous motion?

Wes MacAleer (PC): No. The rest of it remains

the same.

Honourable Robert Ghiz (L): The first whereas.

Wes MacAleer (PC): Just the first whereas.

Ron MacKinley (L)Chair: So you're deleting the first whereas. All right. So delete the first whereas and add this new whereas.

Wes MacAleer (PC): I'll give this to her.

Ron MacKinley (L)Chair: We've got to have the motion in order. We can't be just picking stuff out of the sky here.

Jim Bagnall (PC): Can you read the whole motion?

Wes MacAleer (PC): And whereas Section 36.2 of the Constitution Act of 1982 - that remains the same.

Therefore be it resolved that this committee support the province of Prince Edward Island's position that equalization entitlements remain on a "share allocation" basis and the adequacy of the program be addressed.

Ron MacKinley (L)Chair: All in favour of the motion.

Honourable Robert Ghiz (L): Well, we first have to vote on the amendment because I think Mr. Collins was against the amendment when he heard he was changing it.

Ron MacKinley (L)Chair: No, Wes deleted his amendment. He just came in with a new motion. All right, we'll vote on the amendment. All in favour of the amendment signify by saying aye.

Committee Members: Aye, aye.

Ron MacKinley (L)Chair: All those in favour of the motion as amended?

Committee Members: Aye, aye.

Ron MacKinley (L)Chair: All right. Motion carried. The Clerk will now see that this is given to the proper authorities. And I think all the finance minister will agree it's quite proper.

Richard Brown (L): Under your letterhead, Mr. Chairman, Chairman of the Public Accounts. It goes out under your letterhead.

Ron MacKinley (L)Chair: Oh, yes, we know that. Now the next one here is Shawn Murphy and Mr. Younker. Shawn Murphy and Colin Younker. Are you available for the meetings on October 25th at 2:00 p.m.

Wilbur MacDonald (PC) : Yes.

Wes MacAleer (PC): If you want us here, we'll be here.

Wayne Collins (PC): That 2:00 p.m.?

Ron MacKinley (L)Chair: 2:00 p.m., that's what it says here. I'll leave it up to the Clerk to arrange it.

Jim Bagnall (PC): Yes, we're acceptable to that.

Marian Johnston (Committee Clerk): Does the committee want anyone else?

Dr. David McKenna (PC): I had a suggestion before and the minister mentioned it too. I called the Clerk last week. I thought Senator Lowell Murray would have been, apparently he's one of the experts in the country on this whole topic and probably very favourable to the Atlantic region's side of the point of view and he is from Cape Breton, I understand. Senator Downe gave me his name last week as a name we should have considered. Maybe we could wait until after . . .

Ron MacKinley (L)Chair: Let's do these two people and then see how we make out and then we'll decide where we go from there.

Jim Bagnall (PC): Sounds good.

Ron MacKinley (L)Chair: Meeting adjourned.