

Submission
Concerning Bill C-18,
An Act to Amend the Federal Provincial Fiscal Arrangements Act

by the Hon. Pat Mella,
Provincial Treasurer
Government of Prince Edward Island

to the Standing Committee on Finance
Parliament Hill, Ottawa

April 26, 2001

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Good morning. I am pleased to be here to discuss Bill C-18, given the importance of the Federal Provincial Fiscal Arrangements Act to Canada and more particularly the implications of this amendment for the less affluent provinces.

I am also very pleased to be able to join with my colleagues from Nova Scotia, Newfoundland and New Brunswick in this undertaking. We have discussed the implications of Bill C-18 in depth, as have our Premiers, and we share grave concerns about the maintenance of the severe ceiling on Equalization that this amendment provides for. Our Premiers have communicated their concerns in a letter to the Prime Minister of April 17 2001.

I will preface my remarks by noting that every Government of Prince Edward Island has opposed the practice of imposing a ceiling on Equalization payments since its inception in 1982-83. We continue to maintain that the Equalization ceiling is contradictory to the principle of the program. Committee members should realize that the temporary relief that Bill C 18 provides from the ceiling for 1999-2000 provides clear evidence that the ceiling, as presently defined, has very major implications for future years.

As part of the agreement between First Ministers on September 11 2000, Bill C-18 lifts the ceiling on Equalization payments for the 1999-2000 year. It then re-imposes the ceiling, or cap, on entitlements for the years following 1999-2000, using the \$10 billion amount, adjusted for GDP for future years. It is now evident that the \$10 billion amount will force Equalization entitlements to lower levels, as a ratio to GDP, than it has ever been.

Whereas we welcome the removal of the effect of the ceiling on 1999-2000 entitlements, the imposition of the ceiling in 2000-01 and future years is likely to have draconian effects on the program.

Chart One identifies the level of the original ceiling if it were in effect in 1999-2000 and 2000-01, the new ceiling as it affects entitlements in 2000-01, and the minimum amount necessary in 2000-01 to meet the Prime Minister's commitment to Premiers of September 2000.

The 1999-2000 ceiling level is the numerical focus of this discussion as all federal ceiling proposals allow for growth in the program at the rate of Gross Domestic Product from that year onward. In

all cases the ceiling growth to 2000-2001 is 8.4 per cent, which is the official growth of GDP in 2000 as determined by Statistics Canada.

Prior to the legislative amendments to the Equalization program in April of 1999, the Equalization ceiling would have reached \$11.13 billion in 1999-2000, and this in turn would have grown with growth of GDP to a ceiling of \$12.06 billion in 2000-2001.

The new ceiling under Bill C-18 will force entitlements in 2000-01 to be no more than \$10.84 billion.

In August of 2000, all Premiers expressed the view that the Equalization ceiling was inappropriate and should be eliminated, in concert with improvements to the Canada Health and Social Transfer.

On September 11, 2000, Prime Minister Chretien met with Provincial and Territorial Premiers in Ottawa to resolve the continuing discord regarding health care and Equalization payments. At that meeting the Prime Minister issued a press release with the following commitment to provinces:

“The Minister of Finance will examine this issue further after consultation with provincial Ministers of Finance the Prime Minister agreed that necessary steps would be taken to ensure that no ceiling will apply to the 1999-2000 fiscal year. Thereafter, the established Equalization formula will apply, which allows the program to grow up to the rate of growth in GDP.”

It is a very clear commitment to ensure that the ceiling would be lifted for 1999-2000 and that thereafter the program should be allowed to grow up to the rate of growth in GDP. It was also agreed that the federal Minister of Finance would hold discussions on this issue.

Bill C-18 carries out only the first of these commitments.

The second part of the pledge is seriously compromised by leaving the ceiling at \$10 billion as the base for its estimation in future years.

The latest federal estimate of Equalization for 1999-00 is already \$10.792 billion.

As shown in Chart One, the program must be allowed to rise in 2000-2001 to at least \$11.7 billion, which is to allow for growth of GDP of 8.4 per cent from \$10.792 billion. Evidently this is impossible if the ceiling is fixed at \$10.84 billion in 2000-01, as occurs under Bill C 18. This allows for no growth in the program from 1999-00 to 2000-01, which is contrary to the Prime Minister's pledge.

It can be seen that by lowering the ceiling from \$12.06 billion to \$10.84 billion it is reduced by more than \$1 billion per year from previous levels. Such a major reduction of the ceiling is unprecedented in the history of the program. The new ceiling will represent only 1.04% of GDP, which is less than

entitlements, or the ceiling, have ever been in the history of the Equalization program.

Chart Two shows Equalization entitlements and the ceiling as a percent of GDP from 1982-83 to 2000-01, which clearly demonstrates this point.

Prior to the 1999 legislative changes, the Federal Department of Finance seriously underestimated the level of Equalization payments and consequently thought that a ceiling level of \$10 billion for 1999-2000 would be ample to allow for routine growth in the program. The Department also determined that the \$10 billion figure would be sufficiently high to adopt new technical measures that were put in place at the time.

The annual re-calculations of Equalization Entitlement yielded a far higher stream of payments than the Federal Department of Finance then estimated, largely in light of the strong economic growth that Canada has experienced. That growth has also had a major positive impact on federal revenues. As such the new ceiling of \$10 billion has become hopelessly inadequate to cover payments for the initial year of the legislative change, bearing in mind that the latest federal estimate for 1999-00 is \$10.792 billion, and is far too low for future years.

The solution is to abandon the ceiling altogether, or re-base it to a level which allows for growth to the rate of growth of GDP, as the Prime Minister committed.

I offer the Finance Committee two possible amendments to Bill C-18.

First, that Bill C18 be amended to state that :

1. Subsection 4(9) of the Federal Provincial Fiscal Arrangements Act be repealed.

or,

Second, that reference to the amount of “ten billion dollars” in 4(9)(b) of the amendment, be reworded to “the Final Estimate for 1999-00”.

The former amendment would remove the ceiling from the program. The latter amendment will provide that the program be allowed to expand, at a maximum, to growth of GDP. This is not my preferred course of action but it *at a minimum* respects the First Ministers’ agreement of last September. I might note that this amendment is in keeping with past federal action to adjust the ceiling base to actual entitlements in the first year.

Acceptance of the proposed amendments to Bill C18 will go far in renewing the respect that my province has for the federal government’s commitment to the principles of Equalization.

I am deeply concerned at the implications for the quality of public services and the ability to have competitive taxation levels in my Province, should the ceiling remain in place in future fiscal years.

Prince Edward Islanders have a right to a similar level of health care, education and economic infrastructure as residents of any other province.

As well, entrepreneurs in Prince Edward Island must be able to pursue opportunities in national and international markets from a level playing field. It may come as a surprise to know that Prince Edward Island led the nation last year in provincial employment growth - reflecting export led success in leading edge industries such as aerospace, metal fabrication and bio-chemical innovations. We are working hard with our private sector to ensure that sustainable economic growth continues. However, economic growth can only occur when businesses in Prince Edward Island are able to access reasonably comparable services at reasonably comparable levels of taxation.

Private sector success will mean that in time our dependence on Equalization will shrink. We must offer a competitive tax regime to Island workers and businesses to ensure this happens.

I cannot stress enough the role that Equalization plays in narrowing fiscal disparities among provinces.

The special role and status of the Equalization program is clear in Canada's Constitution. Section 36.2 reads:

Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

If there were no Equalization program, this year the PEI government would be able to deliver only \$3,915 in services for each Prince Edward Islander from own source revenues, if taxes were at national average tax rates. The federal government- through the Equalization program- raises that amount to \$5,766 for each resident, an increase of 47%. This is still less than that available to more affluent provinces. By comparison, the Government of Ontario, which does not receive Equalization, would have \$6,301 for each of its residents, using those same tax rates. This is a difference of \$535 per person, after Equalization. That is \$75 million for Prince Edward Island. The gap between PEI and Alberta is even more extreme.

The fiscal gap between provinces will be worsened when the ceiling applies, as is most likely in future years under Bill C-18.

The leveling that occurs through the current Equalization program is substantial. In fiscal year 2000-2001, Equalization transfers of \$269.7 million to Prince Edward Island represented 28 per cent of the government's total revenues. Equalization payments are approximately equal to our combined spending on Education and Transportation in any given year. Without these transfer payments, the level of public services that could be delivered on Prince Edward Island would be rudimentary at best and certainly not comparable to any national scale.

Based on conservative estimates, my Department has calculated that the provisions of Bill C-18 will reduce Equalization Entitlements to Prince Edward Island by some \$9 million in respect of 2000-01. To put this number in perspective, \$9 million is more than the Province spends on Technology and Development, or Fisheries, Aquaculture and Environment functions annually. The loss of \$9 million to my government is worth more than the personal income tax rate reductions that the government put into effect in the past two years.

The very real increase in fiscal disparities that will occur have clear negative consequences for competitiveness and equity in the federation.

In a joint paper released at the 1999 Annual Premiers Conference, all Premiers agreed that Equalization serves to improve the country's economic performance by ensuring that businesses across the country can compete in domestic and international markets without having to relocate to find the lowest tax bill. On a related theme, I would like to point to the work of one of Canada's leading economists, Professor Robin Boadway, of Queen's University who for years has documented the case of economic inefficiencies that result from people re-locating simply to take advantage of lower tax rates.

In terms of equity the Canadian Constitution provides that all Canadians should receive reasonably comparable treatment from their provincial governments - in terms of services like health and education at comparable taxes - regardless of which province they live in. With Canadians becoming increasingly mobile across the country, this is not an academic consideration. They know in very concrete terms how long it takes to get a family physician in Prince Edward Island, they know what condition their roads and public buildings are in and they know how much tax they pay. They know what the average Canadian is entitled to and they know when they aren't receiving it.

In closing I should note that the Federal Finance Minister is aware of my concerns, which I have documented in correspondence. The Department of Finance appears preoccupied with controlling the costs of Equalization, notwithstanding the need to uphold the fundamental principles that are at stake. It is incongruous that the federal government would choose to so severely restrict the program when federal revenues are so strong. We estimate that the ceiling may impact the program in the order of perhaps \$380 million per year, though it is difficult to know the precise amount.

I am most disturbed by the apparent lack of federal concern for the consequences of this restriction on support of the less affluent provinces. My Premier had expected that meaningful discussions would be held on an appropriate ceiling level in order to allow entitlements to grow to the rate of growth of GDP, following the Prime Minister's statement of September 11 2000.

I urge Committee members to endorse the proposed amendments to Bill C18.

Thank You.

