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## **Subcommittee on Fiscal Imbalance of the Standing Committee on Finance**

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**Friday, February 18, 2005**

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**Chair**

**Mr. Yvan Loubier**

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Friday, February 18, 2005

•(1035)

[*Translation*]

**The Chair (Mr. Yvan Loubier (Saint-Hyacinthe—Bagot, BQ)):** Welcome.

[*English*]

Good morning, everybody. I want to thank you for being here for the Subcommittee on Fiscal Imbalance.

I will allow you 20 minutes for your opening statements, and then we will give an opportunity to the members to ask some questions.

We will begin with Mr. David Chaundy, senior economist for the Atlantic Provinces Economic Council.

Mr. Chaundy.

**Mr. Charles Hubbard (Miramichi, Lib.):** Sir, before we begin, just for the record, it might be good for you as chair to explain the purpose of the committee. We have the press here, and it certainly would be good for others to know exactly what our purpose is, why we are in Halifax, and what we are doing across the country in terms of what we call the fiscal imbalance. Especially, I read the local paper here this morning and I think the municipalities are as much concerned with an imbalance of revenues and taxation, and expenditures, as the provinces might be.

Maybe just for the record, we should tell the people of Atlantic Canada what the purpose of this committee is and what it hopes to see as an outcome.

[*Translation*]

**The Chair:** Mr. Hubbard, your comment is very relevant.

The subcommittee was struck after the House ordered the Standing Committee on Finance to consider the issue of fiscal imbalance. It is a type of inequity that has developed between the two orders of government, the federal government and the provincial governments, in terms of their fiscal capacity.

Last year, in Ontario, they posted their first reasonably substantial deficit of \$10 billion. The situation is precarious in several provinces, as it is in Ontario. In Quebec for example a \$2.5-billion deficit has been forecast this year. The provinces are faced with incompressible and increasing expenditures in the areas of health care and education, for example. Health care spending is increasing on average at a rate of 7 or 8 per cent annually due to an aging population.

It is all very well entering into side deals over transfer payments every couple of years with the federal government, but the provinces

never manage to catch up in terms of fundamental services to the citizens like health care and education.

The House has asked us to travel throughout Canada and to hold sessions in Ottawa in order to hear testimony from specialists and from people who, on a daily basis, have to deal with the problem of fiscal imbalance. By this, I mean those people involved in the education and health care sectors. We must also, above all, hear testimony from provincial governments. In this way, we will attempt to find long-term solutions to this problem.

Over the course of Canada's history, there have been several conferences, including one in 1964 in Quebec city and another in 1971 in Victoria, where a new tax deal was negotiated with the federal government. The 1964 conference led to a substantial transfer of tax points from the federal government to the provinces in order to fund health care and education initiatives.

Perhaps it might be time to revisit this exercise instead of entering into one-time agreements that solve nothing over the long term. And that is the purpose of our consultations.

If that satisfies your, Mr. Hubbard, I shall now hand the floor over to Mr. David Chaundy.

Mr. Chaundy, you have 20 minutes.

[*English*]

**Mr. David Chaundy (Senior Economist, Atlantic Provinces Economic Council):** Thank you very much for the opportunity to appear with you this morning.

I do send regrets from APEC's president and CEO, Elizabeth Beale. She has family commitments today and is unable to appear.

Because some of you may not be familiar with APEC, the Atlantic Provinces Economic Council, let me begin by explaining exactly who were are.

APEC is an independent, non-partisan research and policy institute. Its objective is to promote the economic development of the Atlantic region of Canada. We accomplish this by analyzing and monitoring current and emerging economic trends and issues. We communicate these results to our members on a regular basis. We consult with a wide audience, including people in government, our business community, and others, and we disseminate the research and policy analyses to these different groups, advocating the appropriate responses by the public and the private sectors.

APEC was founded in 1954 and last year we celebrated our fiftieth anniversary. We are a federally incorporated non-profit organization primarily financed by membership subscriptions, by sponsorship contributions, funded research and conferences.

We have 400 members across the Atlantic region and in Canada, drawn largely from the business community, from universities, as well as provincial and federal governments.

We are based in Halifax with a very small research staff, but we do often work with regional and other academics in undertaking examinations of various research topics.

As I mentioned, last year we did celebrate our fiftieth anniversary as an organization, and as part of that process we produced an economic strategy document—which I did distributed some copies of—entitled “An Agenda for Growth and Prosperity in Atlantic Canada”, which highlighted some of the progress the region has made in recent years as well as some of the ongoing challenges. There are specific references in that context to the fiscal situation and the role of the federal government transfers.

We then followed this up with a two-day economic policy conference in Moncton at the end of September, the Atlantic Economic Summit, again to further stimulate debate and discussion on the policies that are required to help this region to progress.

So I wanted to begin my remarks by framing this topic in the context of the economic situation in Atlantic Canada. Again, most of this material, if you want to refer to it, would be covered in the strategy document.

The Atlantic provinces have made huge strides in the last decade. We have seen firms take advantage of increased access to international markets. We have seen new investment and output, most notably in the offshore oil and gas industries, but these industries do remain very volatile and the prospects at the moment, especially for Nova Scotia, are quite uncertain.

As a result of improved economic performance, we have seen improved labour market performance in terms of employment growth and participation rates. As a consequence of the general improvement in economic situations, we have had a reduced dependency upon the federal government transfers to persons, to businesses, and government, although some of these are also a result of policy changes.

Yet the region still faces substantial economic challenges. The region has fairly low levels of innovation and commercialization, relatively low levels of investment in research and development, a very limited number of firms that are specialized in ICT and science and other knowledge-based sectors. Although some of our firms are very innovative and world leaders in their field, we do not have substantial and large clusters of activity in these sectors.

We have also seen our employment growth concentrated very much in low-wage industries, which would include things like call centres, tourism, and retail. Again, within each sector, there are high- and low-value-added activities. As a result, our productivity in Atlantic Canada is well below the national average. Our productivity in Atlantic Canada is close to 80% of the Canadian average for New Brunswick and Nova Scotia, and we have actually seen a decline in

relative performance since the mid-1980s. Newfoundland and Labrador would be the exception here, where the oil and gas industry has really boosted its productivity, but outside of that sector there are still significant challenges.

Partly reflecting this, what the prospects for economic activity are, we have seen substantial out-migration of some of our young and best-educated people. Projections that we and other organizations such as Infrometrica have done do project slow economic growth for the Atlantic region over the next two decades compared to the rest of the country.

• (1040)

In combination with this, we have seen—as we do across the country—certain demographic pressures, especially related to the aging population. We do have very slow population growth in Atlantic Canada on an historical basis and going forward. This is combined with significant aging of the population, which has huge implications, especially in terms of health care costs.

We also have a significant rural population in this part of the country, which raises acute issues for delivery of public services, such as health care. And we do see considerable efforts by governments in this region to consolidate some of those services—in Newfoundland, and in New Brunswick most recently. But these do raise quite substantial opposition in the rural communities, and also require additional capital expenditures to build new regional hospitals.

As a result of this weaker economic growth and rising cost pressures, we already see the implications within the provincial finances. The four Atlantic provinces, along with Quebec, have the highest debt levels and debt service costs in the country relative to GDP, with Newfoundland and Labrador and Nova Scotia having the highest levels.

In provincial budgets last year, own-source revenues increased or were projected to increase by less than 3% in nominal terms. But that also includes the effect of measures to reverse the personal income tax cut in Nova Scotia, as well as various measures to raise about \$53 million across the region in user fees.

So revenues are weaker than the growth in nominal GDP. But on the expenditure side, most of the increase has been channelled into health care, where spending increased by 4.5%; spending on education was up by less than 2%; and all other current government spending was cut 1.7% across the region. It would have been even higher if you were to exclude Nova Scotia; without it, the cut would have been about 3%. And that included substantial government job cuts in New Brunswick and Newfoundland and Labrador; and continuing reviews of expenditure are designed to create further savings.

Projections done by the Conference Board and others suggest that these fiscal situations, particularly between the provincial governments and the federal government, will intensify. The committee has already referred to the work of the Conference Board of Canada, but that analysis looked at the provincial governments as a whole.

Work that Professor Joe Ruggeri did for APEC a few years ago indicated that the deficit situation would be much more serious in the four Atlantic provinces relative to other parts of Canada. A more recent study by Professor Ruggeri on New Brunswick indicates that this is an ongoing situation, even allowing for the recent agreements on equalization and health care that were made last fall. His analysis does indicate that New Brunswick is facing a serious structural imbalance; that it will face increasing deficits; and that it can pretty much struggle through the next decade, but is going to face increasing deficits after that, largely as a result of its rising health care expenditures driven in large part by its aging population. Federal revenues are expected to grow faster than provincial revenues, but that's a smaller part of the issue.

Given that context of the economic and fiscal situation, our concern is that economic competitiveness in the region could be undermined by lower levels of public services, especially in education and human capital, which are so important if we are to develop the region's potential and be able to provide the skilled workers needed to support new growth and new industries. Alternatively, the region may be compromised by higher levels of taxation, which will undermine its competitive position relative to some other parts of Canada.

We did highlight these issues in the strategy document, and I will refer you to pages 14 and 17 in the English version, which specifically talk to those issues related to federal transfers and our recommendations that these issues need to be examined.

Certainly, the Canada health and social transfers and other different transfers play a key role in reducing the vertical fiscal imbalance. Federal transfers, including equalization, account for about 35% of provincial revenues in Atlantic Canada. This is down considerably since the early 1980s, but it's still a substantial amount that governments in this region rely on to provide their public services.

As I've already mentioned, there is clear evidence of an existing imbalance and indications that the situation will grow over time. In this regard, we do need to examine options that might address this, which may include examining the basis on which those transfers are made, and whether a per capita basis is sufficient to allow for the different needs within some of these different expenditure groups, or whether we again need to re-examine the tax base and which levels of government received certain amounts of tax revenue to support some of these public services

• (1045)

In terms of equalization, which it is important to include in this context, I am not an expert on public finances, so I am not going to articulate the very strong arguments that have been made for the importance of the equalization program, but it's a program that does need to work for both levels of government, and there have been concerns about changes that the federal government has made on its

own, imposing solutions and a new framework upon the provinces that may not be in their interest.

Certainly there have been important issues with the previous equalization program that has been in place, related to the five-province standard that was instituted, various issues related to the coverage, measurement issues in that program, as well as the volatility and uncertainty of the payments, which do create substantial issues, especially for small provinces such as we have in this region. Revisions to population estimates and requirements to repay those, again, can create serious problems for the provincial governments.

But looking forward, in the new framework that the government is intending to proceed with, there are serious concerns about whether the fixed pot and the 3.5% escalator built into that is going to be sufficient to equalize the fiscal disparities even across the country. There is uncertainty about how those allocations are going to be made and the process that is under way. So again, there are legitimate concerns about whether the equalization program is going to be able to fulfill its original intent.

In conclusion, the federal transfers are a critical source of revenue for the Atlantic governments, enabling them to provide public services such as health and education. The Atlantic provinces, despite their economic progress, do face serious economic challenges and budgetary issues that certainly could be undermined by any reductions in federal transfers or changes to the way those programs are allocated. We need to look at and examine innovative ways to address some of these issues with respect to expenditure revenues that the two different levels of government have.

These issues are certainly important, they are complex, and they do require careful analysis of proposed solutions. We certainly wish the committee well as they examine this topic and make their recommendations.

Thank you.

[Translation]

**The Chair:** Thank you very much, Mr. Chaundy.

We will now move on to Mr. Crowley.

Welcome, Mr. Crowley. You have 20 minutes.

**Mr. Brian Crowley (Economist, Atlantic Institute for Market Studies):** Mr. Chair, I would like to thank you and the members of the parliamentary committee for having invited me to testify before you today.

• (1050)

[English]

Perhaps I might take a moment and say a word, as well, about my institute.

The Atlantic Institute for Market Studies is a public policy think tank based in Halifax. We are celebrating our tenth anniversary this year. We started 10 years ago with one \$15,000 cheque. We have a \$1.3 million budget this year. We have tremendous support from the business, professional, and university community around Atlantic Canada.

My chairman emeritus is Purdy Crawford at the institute. Our current chairman is David Mann, who has just retired as chairman of the board of Emera, which is the holding company for Nova Scotia Power, among others. Many members of our board would be known to you. They are very prominent members of the business and professional community.

We have a research advisory board that is made up of prominent academics from around the country and includes a Canadian Nobel laureate, Bob Mundell, who teaches at Columbia University.

We started out as a think tank dealing almost exclusively with Atlantic Canadian issues, but over the years we have expanded our remit to deal with issues that are national in scope. I, for instance, was a member of the Mazankowski committee in Alberta, the Premier's Advisory Council on Health,

[*Translation*]

which was the equivalent of the Clair Commission in Quebec.

[*English*]

We have published extensively on equalization, on health care, on education, on accountability and responsibility in the provision of public services, and on a wide range of other issues.

I'll just mention that in the international think tank community we have received a lot of recognition for our work. We are one of only three think tanks in the world to have won the Sir Anthony Fisher memorial prize, which is the top award in the think tank community internationally, for excellence in think tank publications and activities.

So with that by way of background, Mr. Chairman, let me delve a little bit into this fiscal imbalance question that brings us together here today. I have circulated a paper that we pulled together fairly quickly following our receipt of your invitation to be here, and I am going to try to summarize what I think are the main points of the presentation.

Now, a case has been made, Mr. Chairman, by a number of commentators on provincial government that there exists a fiscal imbalance between Ottawa and the provinces, by which I think they mean there is a mismatch between what the two levels of government are called to do under the Constitution, on the one hand, and the fiscal resources that they currently enjoy to carry out those responsibilities, on the other. In other words, Ottawa has too much cash relative to its responsibilities, and the provinces too little, and furthermore, the excess of cash at the federal level is the cause of the fiscal shortfall at the provincial level.

Now, before we rush to find solutions to that problem, it's important to determine whether the premises that define that problem are in fact correct, and I intend to make the case this morning, Mr. Chairman, that those premises are faulty, that the provinces have adequate resources at their disposal, including room to raise taxes, that Ottawa's surpluses are the proper reward to the federal government for its fiscal virtue, and that Ottawa's improved fiscal position is in no way at the expense of the provinces. While it is certainly the case that Ottawa taxes us too heavily, that is not an argument for Ottawa to transfer its excess tax take to the provinces, but rather for Ottawa to stop taking so much money from taxpayers.

If provinces want more money from taxpayers, they should have to raise it through taxation and be democratically accountable for that decision.

Here is the argument behind that summary.

Let's look first at fiscal transfers from the federal government. It seems to me that the starting point for this discussion is to look at who the winners and losers are under Canada's current fiscal arrangement. In the chart in the presentation I have distributed, we have compared each province's contribution to federal revenues and then offset that contribution to federal revenues against federal transfers and other spending into each of those provinces. That allows us to calculate which provinces are net contributors and which are net payers. Based on each province's proportion of the gross national product, we can accurately estimate the relative contribution to federal revenues that comes from each province.

If you are looking for the table, Mr. Chairman, it is the one on page 3, at the top.

Ontario, Alberta, and British Columbia have consistently been net contributors to federalism, with the addition of Saskatchewan from time to time. All other provinces, including Quebec, have been consistent net gainers.

Now, let's talk a little bit about Quebec, because Quebec is one of the provinces that are particularly concerned about this issue of fiscal imbalance.

If we compare equalization payments to Quebec first—on a per capita basis, so we are comparing per capita equalization payments to Quebec—with Quebec's net fiscal gains under the calculations that we have offered here, since the federal government balanced its books in 1997, they have been roughly the same. In other words, Quebec's status as a net fiscal gainer under the current regime is wholly due to its equalization payments. Under all other federal transfers, gains and losses cancel each other out. Now, this is quite different from the case in the four Atlantic provinces or in Manitoba, which experienced a similar trend but still had a per capita net fiscal gain that exceeded those provinces' equalization payments.

● (1055)

So just to be clear, Quebec's whole net benefit under federal-provincial transfers comes from its equalization payments. All other payments cancel each other out. With the exception of Saskatchewan, the other equalization-receiving provinces get net benefits that are larger than their equalization payments.

Now, does that illustrate the existence of a fiscal imbalance that harms Quebec? Well, let's work through this.

It does not indicate a fiscal imbalance that harms Quebec under the CHST. Since the CHST was adopted in 1996-97, Quebec has been one of only two provinces in the country—Manitoba being the other—that has actually received more than the national average of per capita payments, despite the fact that these payments are supposed to be strictly per capita. So Quebec is one of only two provinces in the country that has got more than the national average per capita under CHST payments.

Let's look to transfers to individuals—employment insurance and Canada Pension Plan principally. In that instance, all the provinces except the four Atlantic provinces are below the national average. So in other words, the four Atlantic provinces get more than the national average in transfers to individuals under employment insurance and Canada Pension Plan; the other six get less than the national average. But Quebec is the province amongst the six that comes closest to the national average. So far from being penalized by that system, if you exclude the four poorest provinces in the country, Quebec is the largest beneficiary of these transfers to individuals.

In any case, it would be difficult to argue that a province was getting shortchanged on defined benefit transfers like pensions, employment insurance, or seniors income support. There are provinces that have many more seniors than others, or have a larger proportion of EI recipients. So this brand of fiscal imbalance is not a result of federal-provincial relations; it is a result of social, demographic, and economic realities. Every provincial society is, to this extent, distinct.

Let's look at the fiscal burden that provincial governments impose on each provincial economy. By definition, we are going to exclude the costs of provincial government that are covered by transfers from Ottawa. We are going to look only at the direct fiscal burden on each province's taxpayers of provincial and local governments. We do this by looking at provincial-owned sources and local revenues as a percentage of GDP.

I think you will find this on page 4 of my larger brief.

Based on this measure, there is actually a clear divide between the more-developed and less-developed provinces. The two richest provinces, Ontario and Alberta, have provincial government fiscal burdens under 20% of GDP. There's a footnote there that I refer you to with respect to Newfoundland, which is in an unusual set of circumstances. Most of the other provinces group together in the 21% to 23% of GDP range, with Saskatchewan being the outlier amongst English-speaking provinces at 25.1%. The real outlier, however, is Quebec.

In most years, the size of Quebec's provincial and local governments as a percentage of GDP is much larger than in the other provinces, and it has remained largely stable. In fact, it has risen substantially over the period covered by this chart, and then fallen back to its starting point over the period covered by the chart, while the size of provincial government in most other provinces has declined, in the case of Alberta by as much as 4.3 percentage points of GDP.

Quebec's decision to have a larger public sector in the provincial arena than most other provinces is a perfectly legitimate democratic choice, but it does not establish that there is a mismatch between federal and provincial fiscal resources. It simply establishes that Quebecers appear to have a larger appetite for provincial government services, for which they should be expected to pay. It is certainly not an argument for taxpayers in other parts of the country to subsidize that political choice.

Let's talk about provincial debt as a percentage of GDP. With few exceptions, provincial debt-to-GDP ratios have declined over the last 10 years or so. Of course, in many cases this decline is largely

relative because their economies have been growing rather than because they've been shrinking their debt in absolute terms.

• (1100)

A similar trend has also occurred with the federal debt. Federal debt is down from a high of 68% of GDP to 41% of GDP in 2003-04, but it's important to note this still puts Ottawa amongst the most indebted governments in the country. Only Newfoundland and Labrador, Nova Scotia, and Quebec are in the same range, with Newfoundland and Labrador being way out in front. That's why it is perhaps more instructive to look at the rate of change in debt-to-GDP ratios rather than the ratios themselves—and that's the next chart, Mr. Chairman, which would be on page 6 of your brief.

With the exception of Alberta, all of the provinces experienced a much slower average decline in debt-to-GDP ratio than the federal government. There is no doubt that maintaining a sizeable provincial debt impedes growth and stifles own-source revenues. For highly indebted provinces, the solution is to get their books back into balance by either trimming spending or increasing taxes.

One reason the federal government has continued to enjoy robust surpluses is the fact that it has paid down \$60 billion in debt. That has not only improved the federal government's credit rating, it has also contributed to declining debt servicing costs, which have fallen by almost \$6 billion a year in the past few years. In other words—and this is a very important point—the bulk of the federal surplus is directly due to falling interest costs for Ottawa. Those falling interest costs, in their turn, are the reward for prudent fiscal management. This is not evidence of an imbalance of fiscal resources between Ottawa and the provinces.

Now let's look at growth in own-source revenues for the provinces. You will find this chart, Mr. Chairman, on page 7.

In my view, the *coup de grâce* to the fiscal imbalance argument is the growth in provincial own-source revenues. If there is in fact an imbalance between the federal and provincial governments, surely it would manifest itself as noticeably superior federal revenue growth. Our chart looks exactly at that question.

In any particular year on this chart, several provinces, frequently including the Province of Quebec, actually experienced more rapid growth in own-source revenues than did the federal government. If we average over the entire period covered by this chart, three provinces actually increased their revenues overall faster than did the federal government. The federal government's average was 4.9%, Alberta's was 6.5%, Nova Scotia's was 6.3% and Quebec's was 5.2%. The rest of the provinces experienced average growth in own-source revenues at a rate that was lower than the federal government's, but still significant. In other words, Ottawa's revenue growth rate, far from being the leader of the pack, was well within the pack.

What about downloading? The frequent assertion that the federal government's superior fiscal position is due to downloading to the provinces is, in my view, quite misleading. The 1995 federal budget marked the beginning of federal spending restraint, with the introduction of the Canada health and social transfer, the CHST, which I have already referred to, in the 1995-96 fiscal year. The second and third years of the CHST resulted in smaller transfers to the provinces than had been the case previously. For instance, the total CHST payment for 1995-96 was \$14 billion; however, federal transfers since then have increased dramatically, reaching \$24 billion in the 2003-04 fiscal year. This past autumn, the federal government negotiated both an enriched health and social transfer as well as enriched equalization. Total federal health and social transfers to the provinces will rise from \$27 billion per year next year to almost \$32 billion in 2009-10, and equalization payments will increase by a further \$2 billion over that same period, from \$12.9 billion to \$15.3 billion in 2009-10. In other words, Ottawa has, in our view, more than made up for a very brief period of downloading.

So if there is no fiscal imbalance, then what's the problem? The real problem stems from provincial policies that hinder economic growth and in turn have a negative impact on provincial government own-source revenues. High debt burdens increase the cost of government, requiring higher taxes to meet the needs of financing debt. In turn, these higher tax burdens stifle economic growth as individuals decide to live and invest elsewhere where taxes are lower. In effect, this becomes a vicious downward cycle that can put provincial finances in peril.

If the question is whether the federal government collects too much in taxes, I think the answer clearly is yes. However, the proper response to that is not to transfer more money to the provinces, because that is a move that, in my view, short-circuits democratic accountability. In principle, all the spending by government should be financed out of taxes levied by that government on its citizens so that it is answerable to taxpayers for the cost and quality of public services, as well as for the total cost of the fiscal burden those services create.

If the provinces wish to increase the resources they have available for spending on public services, they always have the option of making the case for tax increases to their own taxpayers. They can also pressure the federal government to lower taxes, and there is certainly a good case to be made in favour of that proposition. But in my view, any increase in spending by provincial governments should be financed by provincial taxes, and that is a separate issue from the one of whether Ottawa's tax burden is too high.

● (1105)

In conclusion, Mr. Chairman, whether in terms of relative debt burden, fiscal capacity, downloading, own-source revenues, or own-source revenue growth, the evidence that there is a fiscal imbalance between Ottawa and the provinces is very weak.

Provinces have cut their taxes over the past few years and presumably are equally free to raise them again if they wish to take the political heat for doing so. The fact that Ottawa has been a better fiscal manager of its resources than many of the provinces is not an argument for transferring the results of that superior fiscal discipline to the provinces, just as the fact that Ottawa's fiscal burden may be

too high is not an argument for giving some of those tax resources to the provinces.

The provinces have the means to fix their fiscal problems, and we see little reason why Ottawa should do the job for them.

Thank you, Mr. Chairman.

[*Translation*]

**The Chair:** Thank you, Mr. Crowley.

Your presentation was very interesting and quite different from what we have heard to date. Our purpose here is indeed to delve into the issue. Of course, there are counter-arguments to those you have presented.

I would now like to hand the floor over to my colleagues, and then I will ask questions of you myself at the end.

Mr. Hubbard.

[*English*]

**Mr. Charles Hubbard:** Thank you, Mr. Chair.

It is a little bit unusual that the government member would be asked first. In any case, I'd certainly like to follow up on some of these points we just heard.

Mr. Crowley, the research you have done for this presentation certainly seems to be very explicit, and it would almost appear your organization has researched this prior to your invitation to this committee.

What we've heard in Ottawa for the past number of months has centred around almost continuous complaint from opposition members—for example, about the so-called surplus we have. A lot of people in this country seem to feel our Minister of Finance has created almost.... Some, in fact, would almost put him jail, as creating a crime, because we have a surplus of \$8 billion or \$9 billion dollars in the past year. It would also appear some opposition parties would like to see that we not have a surplus, and I am very impressed with the fact that you point out, as we do, the significance of having a surplus.

It's very good also, Mr. Chair, that for the record this morning we see, in terms of debt-to-GDP ratios, that Ottawa—the federal government—has the worst ratio of any government among our 14 governments in this country. So it certainly enhances and.... We're having a federal budget on Wednesday, and I know our own committee has been very critical of the surplus. We, as a government, are in a minority in that committee, but we have a major initiative in trying to look at that surplus and in forecasting that surplus, and it seems the opposition parties are very critical of our minister's success in having a surplus.

Maybe, Mr. Crowley, you'd like to make some comments on that. You and I have not always agreed on all things in the past, and I know that your organization and APEC have certainly been very.... In fact, it goes back to my own days at University of New Brunswick. One of its main founders was a professor of economics there, at the time. It's very important, Mr. Chair, that these two organizations' concerns and their work for the economic improvement of Atlantic Canada are placed before us today.



Mr. Crowley, to go back over some of the main points you've made here, you've talked about the provinces. You know, I was really dismayed when, as soon as a new equalization formula was announced in Ottawa, some provincial premiers began to say, almost immediately, that they'd be able to cut their taxes. You probably noted that. Maybe you can make a few comments on the comments I just made, in terms of what your position would be.

Also, Mr. Chair, I am a little bit concerned here with... Equalization has been such a big factor in this country. Mr. Crowley, I'm not sure you want to leave the impression that it isn't a very basic responsibility of our federal government to equalize some of the wealth across this country, and I seem to get the impression—probably not from reading your report, but more from what you said, when you said something to the effect that provincial governments were masters of their own destiny and could increase taxes as they wanted to provide for their citizens, but overall....

I made a speech a week ago in the House. I pointed out—in terms of the way our country is established, in terms of the fact that so much of our industry and organization is in central Canada—that I believe our federal government has to raise revenues to enable it to equalize some of the fiscal differences across the country, and the capabilities of provincial governments to raise money.

So, Mr. Crowley, a few minutes; and then, David, I'd like to ask a few questions in terms of APEC.

•(1110)

**Mr. Brian Crowley:** I would like to thank the honourable member for those questions.

You've raised a number of points. I will just touch very quickly on them. If I have missed any or if you want me to go into more detail, please ask a supplementary question.

First of all, as I hope I made clear in my presentation, I do not think the surplus is a bad thing. On the contrary, I think surplus is an appropriate reward for the fiscal discipline that Ottawa has put in place over the past years, although I will also admit that I think that fiscal discipline is slipping, but we can set that aside for the moment.

I laud the federal government for their discipline in dealing with their debt. I pointed out in my talk that as a result of that fiscal discipline and the paying down of some \$60 billion worth of debt over the past few years, Ottawa has been able to free up \$6 billion for spending on public services or tax cuts or debt reduction, which is the creation of a virtuous circle in public finances in Ottawa. I think this is a huge advance for public finances in Ottawa. We can all have disagreements about whether they got there the right way, but I think we should recognize what a great achievement it is.

You asked me about equalization and the federal government's responsibilities for equalizing revenues across the country. I certainly think this is a fair point. I will tell you that I have very serious reservations about the way we do it. I have written quite a lot at the institute, and other authors have written quite a lot for us at the institute, about the perverse incentives that are created within the equalization system. I think there are better ways to achieve the result, but I would not quarrel with the principle. I think in a federal system we do have to ensure that Canadians in every part of the country have access to reasonable levels of public service, without

having to bankrupt themselves with excessive levels of taxation if they happen to live in a part of the country that has a lower tax base than perhaps some other parts of the country.

I don't know whether you want me to get into the question of how we might use federal spending more intelligently to develop the local economy. That was implied in one of your questions, but I fear it might take us rather far afield from the purpose of this subcommittee.

•(1115)

**Mr. Charles Hubbard:** Is my time complete?

[*Translation*]

**The Chair:** Mr. Hubbard, it is rare that I don't cut you off, so make the most of it.

[*English*]

**Mr. Charles Hubbard:** I know we're somewhat off the agenda when we talk about the fiscal imbalance, but we have to recognize the tremendous work that APEC has done for more than 50 years.

As for the booklet that we received this morning, we did receive this booklet, I believe, some time ago. It was distributed to members in Ottawa. There are some important points brought out in that booklet that might be worthy of being placed or emphasized on the record.

One is on the calculation of subsidies. We in Atlantic Canada are always accused of having our hands out and our pockets empty. In terms of the subsidies that are pointed out here that go to all parts of the country, APEC makes the point that our subsidies are lower than most other provinces.

They also point out the problems of rural areas, because Atlantic Canada has a large percentage of people living in rural areas. They point out that health and aging are factors in terms of the problems that are encountered in Atlantic Canada. They talk about output and productivity.

Overall, Mr. Chair, the ultimate objective of all of us in this country, and especially of this committee and members of the House of Commons, is to see economic prosperity across our nation.

Now, maybe Mr. Chaundy would like to emphasize some of the points that he has made here and offer to us, who are going back next week, some of his suggestions on how we as a nation could help out.

About five years ago we introduced, in fact in this very city, the Atlantic innovation fund. Yesterday in Ottawa the provincial ministers of education for the four Atlantic provinces were meeting with different parties to emphasize their needs.

We talk about transportation. We talk about the many concerns that we have here in Atlantic Canada.

And with it, Mr. Chaundy—away from the fiscal imbalance—maybe for the record we could just have a little better emphasis on what you see as some of the solutions that could be provided for improving our economy here in Atlantic Canada.

**Mr. David Chaundy:** Thank you for the questions. I think in the document we published last June, which I've shared with you this morning, we explicitly examine that issue and what we think the federal government could do specifically. I made specific comments on the importance of fiscal finances and our concerns in that regard.

The principal recommendations we made in that report to improve the prospects for growth and prosperity really focused on three areas. One related to innovation. There was a proposal there to improve the Foundation for Innovation, to strengthen our capacity to develop on the science and technology side, which is where we are weak. That is the area where the fastest growth is occurring. A recent analysis this week that Stats Canada published shows very fast growth in high-knowledge firms. In that sector Atlantic Canada is not doing as well relative to the national economy. That's the area where we really need to try to strengthen our base to help existing firms improve their capacity to innovate and invest, and also to help develop and support our new industries. Certainly the Atlantic innovation fund is one tool that can help there. I think we have had concerns about the process involved in that, which is referenced in the report.

In principle, we support measures that would help strengthen the Foundation for Innovation to allow firms to make investments to develop new technologies, as many of our firms are doing. We had three winners of the Manning Innovation Award two years ago, all from Atlantic Canada. So we certainly have the capacity here for innovation, but I think we would like to see stronger measures. We are looking at a possible study now to examine how even the existing federal programs to help support technology could be strengthened and refined to benefit the firms in Atlantic Canada.

We are also working on a paper on transportation highlighting the role that transportation policy plays. But in terms of the other principal recommendation we focused on in terms of investment and ways we could stimulate and encourage investment in Atlantic Canada, especially through our larger firms, we've seen significant investment in the offshore oil and gas industry. Some of our forest products firms have also been making substantial investments to help improve their productivity and move into value-added activities. There are significant challenges that the region faces, but these are some of the adjustments that need to take place.

In the seafood processing sector they're facing very significant competition from Asian countries, and China in particular. A huge appreciation in the Canadian dollar has impacted their revenues, and there's a need to look at ways we can strengthen and improve productivity, even in some of those traditional industries as well.

Finally, our third recommendation relates to regional economic policy and regional programs. They need to refocus on innovation in growth and productivity without abolishing current programs. They need to really refocus and target them so they are more effective in promoting regional development in this region.

• (1120)

**The Chair:** Thank you, Mr. Hubbard.

Thank you, Mr. Chaundy.

[Translation]

**The Chair:** Mr. Côté, please.

**Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ):** Thank you, Mr. Chair.

Gentlemen, thank you for your presentations.

If you agree, I will make a number of comments and ask some questions, and then I will ask you to answer one at a time.

Both your presentations were interesting, but they demonstrate two almost diametrically opposed points of view. This is somewhat understandable. As most economists know, you can make numbers say different things.

Last fall, an agreement was entered into on the way equalization operates. At that time, several provinces, for various reasons, were unsatisfied. The agreement was imposed upon them by the federal government. More recently, a number of side deals were concluded with Newfoundland and Labrador and Nova Scotia. I am very glad that these provinces have a side deal, but do they not beg the question : are side deals a symptom of an equalization system that isn't working well and that is accentuating the fiscal imbalance and any inequities that may exist?

There has been a lot of talk of funding needed for health care, which—and I don't think I am exaggerating the matter—siphons away money from the provinces. This is a matter that goes beyond the scope of the fiscal imbalance.

I agree with you on one matter: all Canadians should not necessarily have to pay for decisions in areas that come under the jurisdiction of the provinces or Quebec. The problem is that the federal government, for a long time, has invested in areas of jurisdiction that are not its own because it has a lot of money. We all remember the example of various programs that were co-funded right down the middle by the federal government and the provinces. Today, the federal government only funds 12% of education costs.

The provinces are required to provide various services to the citizens. The federal funding that existed 10, 20, 30 or 40 years ago is no longer there. Is this not a sign of a fiscal imbalance? One order of government invests in an area of jurisdiction, under the pretext that in fact it is an area of shared jurisdiction or that it is helping the provinces, but over the years, the federal government gradually reduces its funding. Meanwhile, citizens still have the same needs, but the province no longer has the necessary fiscal capacity to deliver the service and yet ends up having to foot the bill. Either the province has to reduce the level of service or increase taxes. Don't you think that this is partly the federal government's fault?

You talked a lot about this government's lack of fiscal discipline. We should indeed be glad that there are surpluses. But that is not the problem. The problem is that the surpluses are hidden and that they come out of the blue, unexpectedly.

I will not refer back to all the figures because they have been talked about a lot. For example, the Conference Board. We have all seen the figures. For the next five years, Mr. Goodale forecasts a real surplus of \$29.5 billion, and yet he predicts \$31.5 billion in economic prudence and for the rainy-day contingency fund. Doesn't it seem illogical when a government forecasts a higher amount in economic prudence and for a contingency fund than for the actual surplus? But the minister let the cat out of the bag in committee. He said that everything was as it should be and that if this money was not spent, it would be used on debt retirement.

It is all very well and good to pay down the debt, as Mr. Hubbard knows, but the minister must not hide the amount he intends to spend on debt retirement in economic prudence or the contingency fund. Rather, he should make it a separate budget item and leave it to parliamentarians for discussion.

Is this not a sign of a fiscal imbalance? I would not go so far as to say that the federal government is hiding money, because you can see the figures in the books, however the money isn't written in under the appropriate budget item. It is being used for other purposes.

• (1125)

Mr. Crowley, you said something that exasperated me a little, but perhaps I didn't understand properly. There was mention of "downloading". You stated that transfer payments decreased substantially during the 90s and hit rock bottom in 1995-96 before increasing thereafter. You stated:

[English]

"have increased dramatically, reaching \$24 billion in the 2003-2004 fiscal year".

[Translation]

However, on the last page, where there is a reference to transfer payments on a per capita basis, it states that in 1993-94, per capita transfer payments totalled \$1,502, while in 2002-03 they were \$1,505. I cannot see much of a jump in the figures. Are you able to enlighten me in this respect?

By the way, I think that it is unfortunate that our Conservative Party colleagues weren't able to be here today. They brag about advocating for provincial interests, and yet they are not here today. This is unfortunate. I just wanted to mention that, Mr. Chair.

**Mr. Brian Crowley:** Thank you, Mr. Chair. Thank you for all your questions. I counted about ten. I will try my best to answer them all.

To start, I was sure that the issue of offshore agreements would be raised. Even if this is not directly related to fiscal imbalance I hope you will allow me to make a brief aside on the matter.

If I have understood you correctly, you were asking me if these special agreements were a sign that the transfer payment system was not working. Is that correct?

Well, I do not think that is the case with these special agreements. Rather, I think they are the result of a different type of reasoning that has nothing to do with fiscal imbalance. The reason these agreements have come about dates back to agreements entered into by

Newfoundland and Nova Scotia and the federal government for the development of these offshore resources. In these agreements, it was stipulated and accepted by the federal government that these two provinces would be the primary beneficiaries of these resources. That led to a whole debate on what the definition of primary beneficiary was. At the beginning, primary beneficiary meant that there was a special agreement on the impact of equalization and royalties from these resources. But the special agreement was not enough in the eyes of the provinces, because it did not mean they would get to keep 100 per cent of the royalties.

Now, there is a case that has been made by my institute on several occasions and that I accept, that is, that royalties from non-renewable natural resources are a vastly different form of revenue to income tax, sales taxes, etc., because they come from the sale of assets by the provinces and not as a result of the creation of economic value. Therefore, they should not be included in the equalization formula.

That concludes my digression, because this is not really the topic of our discussion. I think that there is an argument for that type of reasoning and so, as a result, I do not think these agreements should cast doubt on the whole transfer payment system in general.

If I am not mistaken, you also asked me if I felt the federal government had a tendency to interfere in provincial areas of jurisdiction when it had too much money to dispose of.

• (1130)

**Mr. Guy Côté:** That is correct.

**Mr. Brian Crowley:** The answer is yes. However, that is a vastly different question to that of whether or not a fiscal imbalance exists between the two levels of government.

You said that when the federal government's pockets are lined with money, it looks for ways to spend it, and often ends up doing so in provincial areas of jurisdiction. You are in fact completely within your rights to complain about that. But in my opinion, the federal government has the constitutional authority to do so, but it should not do so, or at least not to the extent that it does. I would reiterate that this question is not the same as whether or not there is a fiscal imbalance between the two levels of government.

**Mr. Guy Côté:** More specifically, I would like to know if the federal government, instead of investing in areas of provincial and Quebec jurisdiction, wouldn't be better served vacating tax space so that the provinces and Quebec can appropriately deliver their services. I am not asking if they invest in areas of jurisdiction which aren't their own, because quite simply they do, as you yourself said. But shouldn't they free up tax space?

**Mr. Brian Crowley:** Yes, but I think that statement needs to be qualified. If indeed the federal government has more money than federal taxpayers believe it should, well then it should give this money back to federal taxpayers. It is a political matter. The question is, just what are federal taxpayers willing to tolerate in terms of federal taxes?

In my opinion, federal taxation is too high. So I agree with you: the federal government should reduce the tax burden. However, you are asking whether this money should be directly transferred to the provinces. Now on that, I don't agree. If the federal government were to give up a portion of its tax revenue, it should quite simply give this money back to taxpayers, and then it would be up to the provinces to explain to their taxpayers how they justify asking for the money that the federal government has given them.

I do not think that it is up to the federal government to give this money directly to the provinces because it has a democratic responsibility.

• (1135)

**Mr. Guy Côté:** Actually, I was not necessarily talking about increasing transfer payments to the provinces when I talked about vacating tax space. However, this seems to be very much what you are talking about. The federal government could free up tax space by transferring tax points or by some other means, but not necessarily by increasing transfer payments to the provinces.

**Mr. Brian Crowley:** I agree with that.

We may have time to bring up one last matter. You referred to hidden surpluses. Once again, I agree with you. I heaped praise on the federal government for its efforts to maintain fiscal discipline. Now I am going to retract this praise, at least partly so, by saying that the way the federal government has outlined its fiscal strategy leaves a lot to be desired.

I already stated that it was necessary, from a democratic standpoint, for the provinces to convince their taxpayers that their policies are sound and that any increase of their tax burden is warranted. In the same vein, the federal government needs to be completely transparent about its fiscal strategies, and be completely open and honest, when the budget is tabled, about the surpluses that it will forecast for the end of the fiscal year.

There should be a proper parliamentary debate on what should be done with these surpluses. And to use your words, which are not necessarily the ones I would use, the government should not hide its surpluses elsewhere in the budget and end up announcing a much higher surplus at the end of the fiscal year. Because then, the debate on what to do with that money is cut short, and the money often ends up going to foundations that are at arm's length to the federal government and are therefore not subject to parliamentary oversight. In my opinion, this is outrageous.

So I think I have struck a balance between the praise and the criticism I have for the federal government.

**The Chair:** Thank you, Mr. Crowley. Thank you, Mr. Côté.

Mr. Stoffer.

[English]

**Mr. Peter Stoffer (Sackville—Eastern Shore, NDP):** Mr. Chairman, *merci. Bonjour à tous.*

I apologize for being late. There was quite a snowstorm in Ottawa this morning.

Mr. Crowley and Mr. Chaundy, thank you very much for coming today. When I was asked to come down to sit in for my colleague

Judy, she indicated that I should mention the fact that there is a tremendous imbalance between government and Canadians on the fiscal side. So I have a few questions for you.

I appreciate your straightforward, easy-to-read summaries here. They're really good.

Have you had an opportunity to make this type of presentation to the premier of our province yet? It would be very interesting to see what he'd say. It would be an interesting debate.

**Mr. Brian Crowley:** I'll send him a copy.

**Voices:** Oh, oh!

**Mr. Peter Stoffer:** It would be interesting to see what provincial or territorial leaders, and for that matter the large municipalities, would say about a report of this nature.

I'm just rather incredulous that you would say they are good fiscal managers. If you sit with Sheila Fraser for a while you may have a difference of opinion on that. Look over the years at the gun registry, the money funnelled to foundations, to Gomery travel—and now we find millions of dollars in Labrador; it's supposed to be going to help kids and it's not. We can go on and on.

Then I look at how they got some of these surpluses over the years. You know about the unemployment insurance fund and the money that was taken for other than what it was intended. A lot of veterans, if they were sitting here now, would probably take exception to the fact that over \$13 billion of superannuation money was taken and put into general revenues. So when you do that, it's easy to become a good fiscal manager and not really explain to the Canadian people how you really got that surplus.

I appreciate the fact that the federal government has decided that its books need to be in order. Every government and every Canadian needs to live under that fiscal prudence. But when you do it on the backs of those we consider to be some of the most vulnerable in our society, we have to challenge that.

In this regard, if you were the finance minister now and if February 23 were Brian Crowley's day or the AIMS institute's, and you had a dollar surplus at the end of that budget, what would you do with it?

• (1140)

**Mr. Brian Crowley:** Well, Mr. Chairman, Mr. Stoffer asked a bunch of questions and then asked one at the end. I'd like to—

[Translation]

**The Chair:** Mr. Crowley, perhaps you provided a lot of answers in your presentation.

**Mr. Brian Crowley:** May I make a number of points very quickly?

[English]

The honourable member made excellent points with which I would not disagree. In fact, I agree, just to be very clear.

With respect to the federal government's mismanagement of various specific spending areas, of course, every government has things it should be proud of and things it would rather not talk about. And we could talk about whether this government has a worse balance of things that it's proud of and things that it's not proud of than any other, but I think we shouldn't confuse political disagreements about specific kinds of spending with the macro fiscal management picture.

I was giving the federal government a bouquet on macro fiscal management, which I think they're entitled to. If you want to get down to the micro level, have they always spent the money in a way that was justified and got good value for Canadians? Of course the answer is no. Sometimes they do; sometimes they don't. I'm not disagreeing with that.

We talked a little bit about...I think "dishonesty" is too strong a word, but let's say the lack of transparency of the federal budgeting process. I think that goes directly to your comments about, let's say, the EI fund.

I think the federal government has been less than honest about what's happened. Now, a lot of people seem to think, oh, it's terrible, they've taken all this money from the EI fund. That's actually not my problem. I think what has happened is that, in effect, the EI premiums are now a tax that covers not one purpose but two. The EI premium has now become partly a premium to finance actual unemployment insurance; it has also become a payroll tax.

It is a payroll tax, and I think the federal government should be honest about this. They should split it. They should take the part of the premium that is a genuine EI premium, that's required to finance the EI system, and that should go into that fund and stay there. The rest of the money is a payroll tax and should be going into general coffers, and they should have to defend that position to Canadians. They're not being totally honest about what they're doing.

As to your question about if I were Minister of Finance, I thought you were my friend, and I don't know why you'd wish such a thing on me. But if I were the Minister of Finance and if I had a dollar or two to spend on things at the end, I'd have to say that I would be looking for tax relief for Canadians.

You mentioned that there is a fiscal imbalance between Ottawa and citizens. I think that Ottawa still takes too much money from citizens, and I think, at the end of the year, it ends up with a bunch of money whose spending they have not justified to Canadians. That's what the budgetary process is for. That's where you make the case for why you need the money and what you're going to spend it on. You are answerable to the elected representatives of the people in that budgetary process.

I think when you end up at the end of the year with a bunch of money that clearly, by definition, was in addition to your needs for the programs that you promised Canadians to deliver, in my view there are only two legitimate uses for that money. One is tax reduction and one is debt reduction. I think the federal government has been doing a good job on debt reduction, but I think they have been falling behind on tax reduction.

I think it would also be in part a response to the fiscal imbalance argument if the federal government were to clear out of some of its,

in my view, excessive tax burden. That's a room that the provinces can decide to occupy if they wish, but I feel quite strongly that they must make the case to their provincial taxpayers for that.

● (1145)

**Mr. Peter Stoffer:** And part of the imbalance, Mr. Chairman... Mr. Crowley indicated that if the federal government had surpluses, it should be for two things: tax reduction and debt reduction. But in the Halifax area here, we see a tremendous investment opportunity in terms of our coast guard, our military, our port infrastructure. A certain group of well-thought-of and very high-profile people have a concept called Atlantica, something that I fully support, which is to get proper transportation routes into the northeastern United States. That requires a huge investment of not just government money but private money as well.

So shouldn't a third part of this so-called imbalance be to look again at our investments, at what we've allowed to deteriorate over the years because of various cost-cutting measures or reallocation of funds, and not just hand cash to the so-called Atlantic provinces, but bring development—military, coast guard, our ports, our roads? That would add tremendous opportunities, as Mr. Chaundy said. We talk about investment in science, and research and innovation in education, and that is very vital, but at the same time our infrastructure requires massive amounts of investment as well.

**Mr. Brian Crowley:** Well, I'm sure David Chaundy will have comments on this. I'll just very quickly say that clearly there is a very strong case to be made for investment in genuine infrastructure.

Now, that being said, we have lots of experience down here with money intended for infrastructure being in fact captured for purely political purposes, so I always have to throw in the caveat that if we're going to make the case that the federal government should be spending this money, we must subject that spending to some serious tests to make sure they represent genuine long-term investments that create a stream of benefits for the region and the country and are not just political. We don't want any more bridges to nowhere and that sort of thing, because that doesn't benefit anybody except the politicians who control it.

You asked me what I would do with the surplus, and I told you I think one of the reasons I would do those two things is because the way to create long-term sustainable growth in the ability of government to deliver needed public services is to reduce the debt and build the economy, and in my view the federal government gets more than enough money to deliver the public services it needs to deliver already. You made the point yourself: they don't always spend it very wisely. I'd like to see them spending it all wisely before we give them more of it, and I would like to see the growth in revenue for the federal government come from two sustainable sources: long-term growth in the economy and a reduction in debt service cost, because we've been retiring debt.

That's why I think tax reduction and debt reduction are the right things to do with the surplus.

● (1150)

**The Chair:** Thank you very much, Mr. Crowley.

Thank you very much, Mr. Stoffer.

[Translation]

Before handing the floor to Mr. Hubbard for a second round of questions of two minutes each, with your permission I would like to comment on Mr. Crowley's presentation. I will take off my chairperson hat and put on my economist hat.

Mr. Crowley, I have some doubts about the federal government's performance when it comes to managing public finances. Now, I'm not saying this to be mean nor to be partisan, this is just what I have found to be the case.

Since 1996, there have been cutbacks of more than 40 billion dollars to the Canada Health and Social Transfer, which is intended to fund health care, education and income support for the least well-off families. The federal government has taken \$45 billion from employers' and employees' contributions to the employment insurance fund. These two items together account for approximately 80% of the surpluses posted over the last couple of years. It is all very well to say that the federal government has been a good manager, but in reality, it got others to do the work: on the one hand, employers and employees in the case of the employment insurance fund, and on the other hand, the provinces, which have received reduced transfer payments to pay for primary health care and education in particular.

We have just completed a study on changes to federal government operating expenditures since 1997, that is from the time when substantial surpluses started to pile up. We realized that federal government operating expenditures—and Mr. McCallum agrees with this point, as he just conducted an analysis and wants to make expenditure cutbacks totaling 10 billion dollars over the upcoming years—have increased by 6% annually, which is three times faster than the rate of inflation.

This shows that from a management point of view, the federal government got others to do its work, without looking in its own backyard to determine whether its own management practices could be tightened up.

Furthermore, and this is my question, you talked earlier about federal taxpayers. Federal taxpayers are also provincial and municipal tax payers. We are talking about the same person here. This one and only person receives health, education and other provincial government services.

Once a problem has been identified, you can call it fiscal imbalance or whatever you want. You can even call it fiscal pressure, like Mr. Martin does, who has a terrible aversion to the concept of fiscal imbalance. But that is not what is important. Each and every year we note that there is a substantial increase in surpluses. A Conference Board study, commissioned by Mr. Goodale—we are not the ones who asked for it, Mr. Goodale did—states that there will be cumulative surpluses of 160 billion dollars over the course of the next 10 years. And yet, the provinces, due to the unbelievable pressure placed upon them in the area of primary health care and education, will be faced with a deficit of about 60 billion dollars. And these are conservative estimates.

What will we do then? Perhaps you don't believe in the fiscal imbalance, but most people are not even really aware of the fact that there is a fiscal imbalance. What they want, are long-term solutions.

What should we do? What are your solutions in order to relieve provincial governments, which bear this responsibility?

**Mr. Brian Crowley:** Mr. Chair, you have asked me more than one question. I will attempt to answer all your questions. If I happen to forget one, please let me know.

I repeat, we must not confuse two very distinct concepts. Now, you talk about the federal government's macroeconomic management. The federal government's fiscal status has radically changed since 1995. We may disagree with the strategy that the federal government used to get where it got, but at the end of the day I think that the outcome was positive and remains so.

Now, should the federal government act differently over the matter of employment insurance premiums, transparency about federal surpluses, etc.? The answer is an unequivocal yes.

• (1155)

**The Chair:** You just said that it would be preferable for the federal government to transfer the tax burden to the provincial governments and to the unemployed, 60% of whom were excluded. You just said that it would be preferable for the government to do that.

**Mr. Brian Crowley:** No, I said that we could disagree with the strategy adopted by the federal government for restoring financial health, but that the outcome, in terms of macroeconomic management, was favourable. I was very clear.

We may disagree on the employment insurance account, etc., but that is making the issue macroeconomic, and I believe that the fiscal imbalance is also a macroeconomic issue. You cannot prove that there is a fiscal imbalance between the two levels of government by saying that sometimes the federal government does not spend its money well. That is not the same thing.

If you say that the federal government does not always spend its money well, and that the federal government should receive less because it is not responsible enough with the money it receives, I agree entirely. However, that argument does not prove that there is a fiscal imbalance between the two levels of government, which is the topic of our discussion today.

I do not know what more I could add.

**The Chair:** Mr. Crowley, I would like to ask you a technical question before giving the floor to Mr. Hubbard.

In your table on the size of provincial governments, did you include the special abatement for Quebec?

**Mr. Brian Crowley:** What page are you on?

**The Chair:** I am talking about the table on the size of the provincial governments and on their revenues as a percentage of GDP. You conclude that for Quebec, it was 26.6 per cent in 2003-2004. Does that include the abatement?

**Mr. Brian Crowley:** I believe so.

**The Chair:** You believe so.

**Mr. Brian Crowley:** I need to check, but I believe so.

**The Chair:** I would like you to check, because it could change the scenario somewhat. We might notice, in the case of the Quebec government, that it is much higher than the national average in terms of size.

**Mr. Brian Crowley:** I will have to check, and I will get back to you on that.

**The Chair:** I would appreciate that. Thank you, Mr. Crowley.

Mr. Hubbard.

[English]

**Mr. Charles Hubbard:** Thank you, Mr. Chair.

We had two excellent presentations this morning. Mr. Côté mentioned that the Conservative Party, with four members on the finance committee, two on this committee, and over 90 members in the House, were not able to come this morning to Atlantic Canada to hear the presentations. It really is disappointing that they weren't here.

We've alluded to a lot of things in terms of our past budgets and tax dollars and what they're used for, and how we had about one dollar in three going towards servicing the debt back in the early 1990s. Today it's less than one in four. We can't forget that we had the greatest single tax reduction that this country has seen in the 2000 budget.

I know that presenters, and certainly Mr. Côté, have said there's room for the provinces to take up some of the slack. If you look at the rates for individuals and for corporations, they have all been reduced in the last five years. So there is room for provincial governments to move in if they see fit.

Mr. Côté, in some of your comments, we have to remember that the greatest subsidy the Province of Quebec has in terms of terms of the economy, from another province, is in the Churchill Falls deals with the Province of Newfoundland and Labrador. They paid a tremendous price for that deal when they were on their knees trying to become an economy back in the 1960s. Let's not forget that.

In terms of our two presenters today, we have a budget next week, on Wednesday. We've heard various initiatives that could improve the economy of Atlantic Canada. Maybe in a short minute each, Mr. Chaundy and Mr. Crowley could tell us what they would look for in that budget and what they could see as best improving the future of our four Atlantic provinces.

The time is short. Perhaps if they could put that on the record, it might be something that we could look for on Wednesday, Mr. Chair.

• (1200)

**The Chair:** You have one minute, Mr. Crowley.

**Mr. Brian Crowley:** Very quickly, Mr. Chairman.

Thank you for the question.

Assuming that the federal budget lays out essentially the federal government's political priorities for the year and is therefore larger than purely budgetary policy, the two most important things the federal government could do would be, first, to begin to shift away from a reliance on spending programs like ACOA as the chief instrument of regional development, and move more towards tax-

based instruments. I have made the argument elsewhere, and won't repeat it here, about why tax-based instruments are a superior form of regional development policy than regional development agencies, partly because they would get the politics out.

Secondly, I would like to see a commitment by the federal government to fixing the regulatory problems that plague the offshore industry. We have seen a significant withdrawal of offshore exploration efforts, particularly in Nova Scotia. I think the offshore still represents the best economic opportunity for the entire region we have seen in a generation, and that the industry is being driven away principally by a non-competitive regulatory regime compared with other offshore areas. That is something within the federal government's ability to fix.

**The Chair:** Thank you, Mr. Crowley.

Your time is over, Mr. Hubbard.

Monsieur Côté.

[Translation]

**Mr. Guy Côté:** I will not react to what Mr. Hubbard said earlier, as that would lead us to another debate.

Naturally, when we talk about fiscal imbalance, the real issue is knowing what fiscal imbalance is, if it really exists and what causes it. I think that we have listed a number of the symptoms.

Above and beyond the fiscal transfers in various areas, and equalization, there is the government's money management. The employment insurance program is a good example. Access to employment insurance has been reduced. Less than a quarter of all people applying for employment insurance benefits, namely young people and women, have access to them. What are the consequences of that? Not having access to employment insurance benefits, these people must live on social assistance, which is funded by the provinces. That is an example of fiscal imbalance, in my mind.

A great deal has been said about the offshore agreements. Do you think that Quebec should benefit from the same treatment in the case of dividends from Hydro Quebec?

**Mr. Brian Crowley:** Mr. Chair, that is a very interesting question. In my opinion, the answer is no. I believe that the fundamental idea here is that revenues from non-renewable resources are by definition something that happens once, and that is it, whereas revenues produced by hydroelectricity are, by definition, renewable. It is revenue that can be counted on for many years. Royalties on non-renewable resources are excluded, because the province sells its assets to obtain the royalties, whereas when electricity is sold, the province is selling something that is constantly renewable and that will generate revenues in the long-term period. That is very different.

**The Chair:** Yes, Mr. Stoffer.

[English]

A question, for two minutes.

**Mr. Peter Stoffer:** Thank you very much.

I remember when I was in school that there was a discussion of macroeconomics and microeconomics, and a teacher explained to me that macro was when you win the war and you walk away, and micro was when you have to kill and rape and pillage everyone in order to get that victory.

With the fiscal imbalance regarding Canadians, if you looked at what a lot of Canadians had to go through to achieve this, the federal government still takes the credit for it. At the same time—and I know I show my NDP roots here—during the late nineties, I remember some very profitable companies reporting some very profitable numbers, some very, very decent numbers, and I don't think too many Canadians were able to get excited by that sort of turnaround.

What I'm hoping for in this budget, especially as I come from here—and I'm not sure if you agree.... David mentioned very clearly the threat from China and other emerging markets to our jobs. People are starting to be very concerned about the jobs factor right now. I was hoping—and I don't know if you agree—that this particular budget should be focusing not just on issues of the environment and everything else, but also on the stability of the jobs that we already have in this region and the opportunity to create new jobs through scientific innovation, research, and education.

I'm just wondering, if you were giving advice again, how you would achieve that in the fiscal framework that we have now?

• (1205)

**Mr. Brian Crowley:** Well, I think we have already stressed some of the key parameters that we think are important that do relate in this region to issues around productivity, around investment, and around innovation and technology, and I certainly think that is where I see the focus.

The response to the competitive pressures from countries such as China is sometimes to move into higher-value-added activities. We do have companies that are competing and we have even seen some of our fish companies being able to deal with some of these issues, but they are certainly facing pressures. But I think we have also seen in the past that some federal programs to help support productivity or innovation are not always able to be fully accessed and utilized in this region because of either firm size constraints or various other issues.

So I certainly think we do favour the idea that some of those national programs that might help in some of these areas do need to be examined to see if they are effective in helping companies in this region take advantage of them, so they can improve their productivity, invest, and improve their technology competitiveness, so that they can compete in the world economy.

[Translation]

**The Chair:** Have you finished?

[English]

On behalf of the members of the committee, thank you very much for the presentation.

**Mr. Charles Hubbard:** Can they not conclude their remarks as witnesses? Might they have just two minutes?

**The Chair:** No, Mr. Hubbard, it is too late. I'm sorry.

**Mr. Charles Hubbard:** It's too late?

**The Chair:** I will reserve a lot of time for you this afternoon.

**Mr. Charles Hubbard:** In all fairness, I think they should have a few minutes to conclude, as witnesses before our committee. It would be reasonable, and I certainly would forgo my soup for ten minutes for their conclusions. No?

**The Chair:** No, it will have to be this afternoon, Mr. Hubbard.

**Mr. Charles Hubbard:** You are a tough chair!

**The Chair:** The time is over by 10 minutes. We are late by 10 minutes.

I am sorry, but I will have a lot of time for you—

**Mr. Charles Hubbard:** No, no but for our two witnesses, who made very good reports, and they should be able to conclude before our—

**The Chair:** Mr. Crowley, I am sorry, you have two minutes, and Mr. Chaundy too. I am sorry.

**Mr. Brian Crowley:** Well, I am not going to take two minutes, Mr. Chair. I am simply going to say that the burden of my presentation today was to cast doubt on the notion of the existence of a fiscal imbalance between the federal government and the provinces, not to defend all the spending decisions of the federal government or to suggest that all the strategies they used in order to achieve the great macroeconomic victory of a balanced budget and paying down the debt were perhaps the best. But I think we need to recognize that the federal government has shown that it is possible within Canada for governments to exercise fiscal discipline and fix their own fiscal problems.

I want to underline again that I do not think that the fiscal challenges of the provinces can be properly fixed, from either an economic point of view or a democratic accountability point of view, by further transfers between Ottawa and the provinces. I think the existing transfers are sufficient to cover any deficits in fiscal capacity on the part of the less developed provinces. There is a case to be made for reducing the federal government's fiscal burden, not to transfer it to the provinces but to give it back to taxpayers, and if the provinces want to make a claim on those tax revenues, let them make the case to their provincial taxpayers.

**The Chair:** Thank you very much, Mr. Crowley.

Mr. Chaundy.

**Mr. David Chaundy:** Thank you.

I certainly haven't seen the analysis that Mr. Crowley has presented. I don't have a copy of the paper, so I don't want to comment on the specifics without taking a closer look at it, but I don't think we would be in agreement with some of the arguments or premises in that analysis.

But I think we do need to take a forward-looking view. Mr. Crowley's analysis tends to focus on what has happened in the past. I think the concern...in the analysis that we have seen, the issues are forward-looking and they specifically do relate to issues like health care and some of the expenditure sides that I don't think Mr. Crowley really touched on very clearly.



But certainly we do see the provinces in this region making efforts to improve their financial situation and manage the pressures that they are facing. I addressed that in my presentation. They are making efforts to cut expenditures, but they are faced with this health care challenge, which does limit their capacity to take more innovative steps to improve their economic competitiveness.

So I think there are some substantial issues here that do need careful analysis, and there are certainly issues related to these transfers and whether transfer of tax points would be better. But again, that doesn't have equal benefits for all provinces, so some of those issues do need to be looked at.

Thank you.

• (1210)

**The Chair:** Thank you very much, Mr. Chaundy.

On behalf of the members of the committee, thank you very much for your presentations. They were very interesting, and it is always a pleasure to see you here. Thank you very much. Merci.

We will resume at 1:30.

• (1210)

\_\_\_\_\_ (Pause) \_\_\_\_\_

• (1325)

**The Chair:** Good afternoon, everybody. Thank you for being here for the Subcommittee on Fiscal Imbalance.

I will allow you 30 minutes for your opening statements, and then we will give an opportunity to members to ask questions.

Welcome, Mr. Minister and Mr. Palmer.

We have the finance minister of Prince Edward Island, Honourable Mitchell Murphy; and Mr. John Palmer, director, economic and statistics, federal and fiscal relations. I hope you will enjoy the presentation this morning. Thank you very much.

To begin, I would like to explain in French the mandate of the subcommittee.

[*Translation*]

The sub-committee was created pursuant to an order of reference from the House of Commons. We have until June 2 to produce a report and make recommendations to correct what we call the fiscal imbalance between the provinces and the federal government.

Mr. Murphy, I do not need to explain all of the financial pressure you are under. You have a mandate from your fellow citizens to provide front-line services. This pressure will continue to rise. In the years to come, people's needs will continue to increase, as will the federal government's surplus, if we go by the Conference Board study commissioned by Mr. Goodale. It predicts a surplus of \$160 billion over the next 10 years, while public finances in the provinces will face pressure that could lead to deficits of about \$60 billion.

We are looking for analysis, but also some recommendations for long-term solutions to this problem of fiscal imbalance so that you can provide better service to your fellow citizens.

Mr. Murphy, Mr. Palmer, welcome. It's a pleasure to welcome you.

[*English*]

**Hon. Mitchell Murphy (Provincial Treasurer, Government of Prince Edward Island):** Thank you very much, Mr. Chair.

I will apologize beforehand for my lack of expertise in the French language and that my comments will be in English. I want to thank you, Mr. Chair and members of the committee, for the opportunity to be here today.

Before I begin I want to bring regrets from our premier, who I believe has corresponded with you. He wanted to be here personally today to address this issue, because it is of such importance to Prince Edward Island and other provinces within Canada, especially those that are recipients of equalization.

We welcome the opportunity to discuss this subject in advance of public debate on such a critical fiscal issue. I will address at the end of my presentation, and perhaps through some of your questions, responses to the presentations you had this morning, but let me start by saying this. I do this presentation as an elected public official who sits around the table trying to deliver public services to citizens of Prince Edward Island. I do not sit in a corporate boardroom with analytical skills from afar. It is I and others like me who have to answer constituents' questions on why they have to wait a year and a half for a hip replacement, or why there's five hours of waiting time in the emergency rooms. That's the perspective I come from: a front line perspective.

I would say that all provinces have an interest in this subject, but Prince Edward Island has a special interest in view of its small size and its dependence on federal transfers. The chart called "Federal Transfers as a Percentage of Provincial Revenue, 2002" shows how we compare with the other provinces.

P.E.I. is the most dependent of all the provinces on federal transfers, largely because of our lack of natural resources. Approximately 37.5% of all provincial revenues are from federal transfers. These are dominated by equalization. At \$280 million this year, equalization is the province's single largest revenue source, compared with our second largest revenue source, which is provincial income tax of \$178 million.

Notwithstanding the problems of federal dependence, that situation has been changing over time. One can see that as a percentage of our provincial revenues, federal dollars have been reduced significantly, from over 50% in 1979 to, as I mentioned, around 40% today. This trend matches the upward movement of incomes per capita as well, rising from 60% of national per capita income in 1961 to 83% of national income in 2003.

We see the fiscal imbalance in two dimensions. In a vertical dimension there is a need to ensure that the mix of revenues between the two levels of government is appropriate to their respective spending responsibilities. I would add that from the Constitution the provinces have the spending responsibilities in the two highest areas of spending, health care and education.

In the horizontal dimension—that is, amongst provinces or between provinces across the country—there is a need to ensure that revenues across provinces are also adequate to sustain public services for all Canadians. If either balance is out of kilter, it will result in unnecessary social hardship in some quarters, economic inefficiency, and inappropriate policies.

It is evident to us that both the vertical and horizontal balances need correction. The Conference Board of Canada's projections clearly show that over time one can expect growing surpluses federally, while provinces struggle to support vital services. Instead of providing long-term, thoughtful solutions, the federal government has chosen to use its fiscal power to undertake ad hoc decisions and conclude bilateral deals.

● (1330)

I would say this is further exacerbated by the fact that we have a five-province standard. So when you look at this chart showing the fiscal position of the provinces and territories relative to the federal government, please note that a five-province standard in equalization at present excludes the province of Alberta and it also excludes the Atlantic provinces. So when we look at the provinces' deficits over that period of time, that also includes the huge surpluses that will be run by provinces such as Alberta.

The 2004 study by the Conference Board, which looked at relative fiscal prospects of the federal, provincial, and territorial governments over the next 17 years, concludes that given policies in place, the federal government will enjoy large and growing surpluses while provinces and territories in the aggregate would face persistent deficits.

The role of provinces and territories has been increasing over the long term and is expected to continue to rise in the coming decades, largely driven by growing health care needs and increasingly costly social programs generally. In 1991 the provincial share of public spending in Canada crossed from below 50:50 to exceed the federal share, and today the ratio is close to 125%.

The federal government still refuses to acknowledge that there is a fiscal imbalance. They have used their fiscal power to focus on one-off deals such as gas tax for cities, early childhood development, and offshore financial arrangements. I object not to the necessity of these programs but to the methodology of delivery.

Financing health. Federal financial arrangements for health have largely come from unbudgeted surpluses through trusts and one-time payments, and in large measure from savings from reductions in equalization. For P.E.I. the net effect is that federal transfers have barely expanded and in constant dollars are still below 2001-02 levels. Additional federal dollars for health have not been the product of a planned transfer of fiscal resources from the federal to the provincial level, but in large measure payments from federal surpluses at year end in the form of trusts. The latest example is the waiting times reduction program, which will be made at the end of the month.

The use of trusts at year end and in-year additional spending decisions allows the federal government to artificially lower its measured surpluses. The federal Auditor General pointed this out in her most recent report.

In 2004-05 an expected \$11 billion surplus will likely be recorded as less than \$500 million once the offshore money, health trusts, and health reform additions are taken into account. Federal surpluses, prior to these in-year supplementary allocations, accumulated to \$85 billion from 1997-98 to the present.

The savings in reduced equalization, had it grown as expected from 2000-01, was \$14.7 billion, while CHST and health funding increased by \$14.1 billion. Equalization entitlements collapsed since 2000-01, and this drop in entitlements essentially funded the bulk of the increased money in the health care accords. As an example of these savings, the federal government has budgeted in the order of \$12.3 billion for equalization in 2003 for 2004-05, which subsequently dropped to \$8.9 billion. The October first ministers meeting raised this to \$10 billion plus prior year increases for Saskatchewan and British Columbia.

This table shows the balance of federal moneys to P.E.I. in recent years. Without the first ministers accords, the total in 2004-05 was \$360 million, still less than the amount in 2000-01. In constant dollars the federal transfers are still below the level of four years ago, even with additional accord moneys. Yet the health accords oblige the provinces to undertake expensive reforms within the health system. So that is to say the health accords at the federal level require significant additional expenditure at the provincial level.

● (1335)

We believe that the federal government must recognize that it has a growing structural surplus, and this power should not be used to coerce provinces into expanding programs that are within their domain against their will. Revenues must match spending responsibilities as defined by the Constitution. After all, there is only one taxpayer.

In Robin Boadway's paper "How well is the Equalization System Reducing Fiscal Disparities", he states:

Equalization should facilitate the decentralization of fiscal responsibilities to provincial and local governments, which is a defining characteristic of federations. It should do so in a way that does not compromise the discretion of these orders of government to pursue their objectives as they see most fit.

Turning to horizontal concerns, the fiscal resources of provinces are highly varied. P.E.I. presently has the most limited financial resources, Alberta has the most. The equalization program has provided the counterbalance, but its principles have been violated in recent years. The new equalization arrangement is very troublesome after 2004-05.

Using data from the equalization formula, we can measure overall fiscal capacity per capita at standardized tax bases and rates. P.E.I.'s fiscal capacity before federal transfers is less than \$4,500 per person. This is only 43% of Alberta's. Any transfer of fiscal authority from the federal to the provincial level should respect the additional needs of provinces such as Prince Edward Island.

I would remind the committee once again that resource-rich provinces such as Alberta and, we hope, Newfoundland and Labrador and Nova Scotia are not in the equalization formula to set a national standard for fiscal capacity.

Resource-rich provinces are receiving special treatment. The offshore accords and special arrangements for provinces such as Saskatchewan and B.C. indicate federal thinking. The new fiscal arrangements mean that the responsiveness of equalization to changing fiscal circumstances will be difficult to accomplish. To do this, the act must be changed.

I will explain my thoughts. This is not a condemnation of the accords that were reached by the provinces of Newfoundland and Labrador and Nova Scotia. This is an illustrative example of how bilateral agreements jeopardize the principles of equalization. Prince Edward Island has taken the position that development of Atlantic Canada is good for the region, and we wish those provinces of Newfoundland and Labrador and Nova Scotia the best of success as they move forward with the new accords. But we raise this today to illustrate to this committee how not following the principles of equalization increases the fiscal disparity within the country.

As a result of an academic paper by Tom Courchene, "Confiscatory Equalization", the present federal Minister of Finance raised Saskatchewan's equalization by \$120 million, but when P.E.I. complained about the treatment of its sand, gravel, and peat moss production in the equalization formula, it was deferred as a renewal item to be changed "in due course". We lost \$4 million per year because of this.

B.C. received special treatment for its property tax revenues in 2004-05. The 2004-05 accords preserved both these provinces' entitlements, notwithstanding that they should now be have provinces; that is, they have fiscal capacity above the five-province standard, yet they continue to receive equalization.

Both also received special consideration in 2004-05 to offset the impact of rising oil revenues on prior year adjustments. In the case of Saskatchewan this was worth about \$600 million, and it was about \$200 million for British Columbia. The new act states the amount each province will receive in 2005-06. That amount will grow at 3.5% unless the act is changed.

- (1340)

In my opinion, the offshore arrangements make a mockery of the idea of equalizing fiscal capacities per capita across provinces, but the concept had already been forfeited when the 2004 first ministers meeting arrangements on equalization were struck.

The chart shows the likely situation Newfoundland will enjoy in 2006-07. One might also note the favourable treatment afforded Saskatchewan. For P.E.I. to reach the Newfoundland level of fiscal capacity in 2006-07, our equalization would need to be supplemented by approximately \$350 million per year.

You should also note, again, that the five-province standard that excludes Alberta and Newfoundland from the calculation artificially lowers the standard, further penalizing equalization-recipient provinces.

**Offshore accords:** Under these agreements, the Government transferred all royalties...from the offshore resources to the...two provinces....

It would be unfair to taxpayers in...other provinces to provide an even more generous treatment to offshore revenues in calculating Equalization....

Its effect would be to disadvantage those provinces that have few natural resources in comparison with those that have many.

I took this quote from the July 2001 PCO website of the Government of Canada. I'd like John to distribute a copy so members of the committee can have a copy. Yes, it's still on the website; it's from a paper called "In Defence of Equalization". Obviously federal thinking on equalization has changed since 2001.

So we think the balance is wrong. Under present arrangements we will see an accelerating exodus of business and young population and extreme difficulties in providing basic health and social services to an increasingly elderly population. Why? Because public services will slip and taxes will be increasingly uncompetitive.

The imbalance must be corrected. Fiscal balance not only impacts public services, it impacts economic competitiveness. By way of example, if the fiscal capacity of our sister provinces increases, they will be in a position to make decisions concerning things such as public spending and taxation; they may want to lower their tax regimes to become more competitive. If they are in the position to do this, that's a wonderful thing for them, but for the provinces that do not have the income coming in from natural resources, of course it makes it much more difficult for them to reciprocate if that indeed does happen.

How to correct the imbalance? We believe there must be a steady shift in fiscal resources from the federal level to the provincial level, combined with steps to ensure that the horizontal balance is also corrected. Provinces that are deficient in natural resource bases require additional resources, not less. Some provinces with excess revenue sources may not require this shift.

Growing equalization at 3.5% is not the answer. It is not clear how the new equalization panel appointed by Minister Goodale will function, but I would say this: the federal nominees are hardly experts in equalization. It is evident that special arrangements for Saskatchewan, B.C., Newfoundland, and Nova Scotia are highly suggestive of federal thinking on equalization into the future. Provinces with natural resources are clearly being favoured.

The impact of natural resources on relative fiscal situations is clear. Alberta has very low levels of taxation for its own people. We cannot ignore the immense fiscal resources that can come from natural resources, and we are concerned that a new equalization into the future will do just this. A move to macro formulas would result in disaster for provinces without natural resources.

I'll provide a further explanation. I think it is wrong to believe that natural resource revenues should be given special treatment in equalization, and I will use a comparison of the provinces of Prince Edward Island and New Brunswick to illustrate my point.

• (1345)

Neither has large revenues from natural resources, certainly none from oil and gas. However, there is a theory or school of thinking across the country that says we should do away with the 33 calculations that are used to calculate equalization entitlements. Well, we should not do that, and in the case of P.E.I. and New Brunswick I want to explain why. If you exempted those natural resources from the calculation of fiscal capacity in those provinces that have natural resources, then what we would do is artificially set the real fiscal capacity of each of the provinces.

So imagine this scenario that would leave out the oil and natural gas revenue stream from the province of Alberta. They do not calculate that in their fiscal capacity, yet they receive that revenue, which allows them to have a lower tax regime and provide more public services to their citizens. Provinces like P.E.I. and New Brunswick do not calculate that in our capacity now because we don't have it. So all of a sudden you lower the national standard and the discrepancy becomes smaller; therefore, equalization payments to non-natural-resource provinces become smaller. You actually grow the fiscal capacity greatly instead of narrowing it, which is a goal of equalization.

I want to share with you this chart we've done up just to give you another comparison and a highlight of the point I'm trying to make with regard to natural resource revenues and why they must be included in equalization. This is a comparison of Alberta's tax effort on provincial revenues and program spending per capita. This table maps what Alberta's tax regime would generate relative to each province's tax base. These are from 2004-05. The non-existent sales tax and low tax rates generally would generate only 68% of provincial revenues on P.E.I. That is to say, if we applied Alberta's tax regime in the province of Prince Edward Island, we would only receive 68% of the revenues we're presently receiving. It would mean for us, on a budget of \$1.1 billion, giving up \$211 million a year in revenues.

There is a comparison for the other provinces down there as well, so you can pick the province you represent and see what your province would lose in revenue if you applied Alberta's tax regime in your particular province.

Yet we know that Alberta's expenditures and programs are somewhat higher than the national average. Alberta is also earning massive surpluses. The main reason for this is its natural resource revenues coupled with the high incomes they earn there.

So how do we go about correcting the imbalance? Here are a few suggestions.

A shift in tax points from the federal level to the provincial level is an option so long as the horizontal impacts are taken into account. We must bear in mind that a move to transfer fiscal resources from the federal level to the provincial level has very uneven effects and demands appropriate measures to support poorer provinces.

Perhaps there is a need to do so selectively. Perhaps we should look at the revenue side of the federal equation as well as the transfer side, and I think there is a question to be asked: is the federal tax treatment of oil and natural gas revenues overly generous? A tax point transfer would benefit Alberta significantly more than other provinces because of its high incomes. Boadway again argues that one should examine federal taxation of sectors concentrated in Alberta to attempt to offset this enhanced balance.

This is an interesting slide because it shows federal taxation regimes in various provinces. Federal taxes by province as a percentage of GDP are highest in P.E.I., at nearly 18%. This result is caused by a mix of types of industry that compose GDP in each province. The natural resource sector is subject to major federal tax advantages compared to, say, manufacturing and services. The percentage for P.E.I. in the years prior to 2002 was closer to 20%. As I showed in one of my opening slides, we are more dependent on federal transfers than any other province in the country, but we also lose more of our GDP to federal taxes than any other province in the country.

• (1350)

This is an interesting chart, which shows the balance of federal spending and revenues. If we graph federal spending per capita by province and revenues per capita by province against GDP, some interesting patterns emerge. The province with the least GDP per capita is P.E.I. We're at the left end of that chart. By contrast, Alberta is at the other extreme of the chart. While it is true that federal spending per capita on P.E.I. is higher than for the other provinces, it is not out of line with the trend line given our low GDP per capita. But in the case of Alberta, federal spending is very high in relation to its GDP. In fact, in per capita terms, it is on a par with Ontario and B. C. Newfoundland also appears with a high level of federal support relative to GDP. In the case of federal revenues, Alberta is actually on the low side, as are Newfoundland and Saskatchewan, while P.E. I. is on the high side. So there appears to be a definite relationship between resource-rich provinces and unequal federal tax treatment.

Another way to describe this chart is that the blue line represents federal expenditures per province, and the red line represents federal revenue. It seems that Ontario is almost in balance, according to this information from Stats Canada. But on P.E.I. our argument is that we're above the red line, which means we're slightly above the national average in having taxes collected by the federal government, but we're slightly below the national average when it comes to federal expenditures, even though we have the highest transfer amounts in the country.

Finally, Mr. Chairman, I would conclude with a reminder to this committee that equalization is a unique program in this country. It is the only federal program that is enshrined in the Constitution of the country. Subsection 36(2) states:

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.

We must remind ourselves of the constitutional commitment. We are asking ourselves whether the present government has forgotten this.

To summarize, we would say this: Prince Edward Island feels it is essential to restore the appropriate fiscal balance across Canada. This must be taken into account for both vertical and horizontal fiscal imbalance.

The growing federal surplus cannot be ignored. It should not be used for ad hoc deals.

There is no evidence that the federal government has taken its role seriously on this issue. In fact, I have never heard Minister Goodale admit that there is a fiscal imbalance. The attitude must change for the good of the country. The balance of federal spending and its revenues must be both taken into consideration.

With that, I thank you for your attention. I would be pleased to entertain any questions you may have, Mr. Chairman.

● (1355)

**The Chair:** Thank you very much, Mr. Murphy and Mr. Palmer, for that great presentation and very rational explanation of your point of view.

We will proceed with questions and answers, starting with Mr. Hubbard. For the first round you have eight minutes, and I will get the time for the conclusion.

**Mr. Charles Hubbard:** I had better watch this very closely, Mr. Chairman.

I watched the great meetings they had on health and equalization. Back in September and October, your own premier seemed to salute the tremendous arrangements that were made and the happiness he had in making these arrangements. Would you have made this same presentation at the end of October? Has your tune changed since the accords have been reached with Nova Scotia and Newfoundland and Labrador?

**Hon. Mitchell Murphy:** In the discussion around the first ministers' table, and around the finance ministers' table for that matter, provinces—certainly P.E.I., as I said in my remarks—are not taking issue with Newfoundland and Nova Scotia being able to negotiate an offshore agreement. Coming from Atlantic Canada, we can certainly appreciate the pressures that are on those governments and the extra fiscal resources they would require to move forward. Our concern is that we did not know at that time that those arrangements would have an effect on the equalization formula, and they certainly will have a major impact on it.

What you've seen across the country since those accords were signed is that not only Prince Edward Island but I believe every province, perhaps without exception—certainly equalization-recipient provinces—has asked for the same consideration because of the impact special arrangements are having on the equalization formula.

With the health care accords that were reached in the fall, premiers negotiated with the Prime Minister. We certainly said at the time, and still say today, that we are pleased to get the extra support for health care in Prince Edward Island. There's no question about that. We offered our congratulations to the Prime Minister for doing that at the time. However, I want to put that in perspective.

As I said in my chart, we can go back to 1977 with established programs financing, and cost sharing at that time was about fifty-fifty in the health care sector. With the new accords that were signed last fall, provincial spending on health care on Prince Edward Island is about 74%. The federal level is now at 26%. So there has been progress made—let's not deny that—and we appreciate that progress. But since I've been in government, since 1996, the health care budget has grown at about 7% a year, and that's a challenge—not just for provincial governments but for federal governments as well—and it leads into a bigger discussion, I think, about the fiscal sustainability of the health care system in the country as it's presently constituted.

But did we know in the fall what impacts special arrangements were going to have on equalization? No, we did not.

● (1400)

**Mr. Charles Hubbard:** When we listen to Premier Hamm here in Nova Scotia, or probably Williams in Newfoundland and Labrador, they refer back to a 20-year-old agreement that was made with an accord on the offshore, and I think there is, at least from some people's perspective, a view that they don't want to put the two things in the same basket.

But moving on to equalization itself, it appears that most of the equalization formula and the benefits that the provinces that get money have are tied indirectly to the big power generator of economic activity, which is the province of Ontario. When we talk about a formula, it appears that if Ontario does well as opposed to the other groups, there are great benefits to provinces like New Brunswick or P.E.I., but if Ontario falters, then you are placed in a more difficult position. Is that the kind of argument we have here on the table?

**Hon. Mitchell Murphy:** No, I agree with your observation, Mr. Hubbard. I think you're bang on. And because we have a five-province standard as opposed to a 10-province standard, when the Ontario economy fluctuates even a little, we certainly feel the ripple down here because of the way equalization is presently constituted.

We have worked with Minister Goodale to take some of the volatility and fluctuation out of the equalization payments. We had suggested several things, such as averaging either clawback of entitlements or additional entitlements we weren't expecting over a period of time. There are a number of methods that can be used to take out the volatility of those payments. We will always argue, and we have always maintained, that the best way to take out the volatility of the equalization system is to return to a 10-province standard. We think we need a 10-province standard to meet the test of the Constitution with regard to that.

So you're absolutely right, because we have a five-province standard and Ontario is such a big part of that standard, when the Ontario economy fluctuates it has big impacts on the rest of us.

The other point I would make on that is that in 2004-05 and 2005-06, the volatility was taken out by fixing the amount that was in the pot to be distributed for equalization. In 2004-05, the current fiscal year we're in, that's at \$10 billion, and in 2005-06 it's at \$10.9 billion. Then it is set to go at 3.5% thereafter. So the volatility for the next couple of years is fine. I know what my equalization number is for the upcoming budget. I have received that, and it's not going to change.

There has been a panel appointed to look at how they are going to distribute equalization after the 2005-06 fiscal year. That is of grave concern to me and all my colleagues in equalization-recipient provinces because of the push by some people in the system, some political parties—my own national Conservative Party—who are arguing about removing resource revenues from the formula. That would be a disaster for provinces that do not have resource revenues.

● (1405)

**Mr. Charles Hubbard:** On the 3.5%—I'll go back to the question I asked—

**Mr. Peter Stoffer:** On a point of order, Mr. Chairman, would he be able to repeat what he just said about what his national party said?

**Hon. Mitchell Murphy:** We disagree with the national party on their stance over removing resource revenues out of the equalization formula. In our analysis, it would be a disaster for those provinces that do not have rich natural resources.

**Mr. Charles Hubbard:** Going back, then—and I asked this question when we were debating this in committee—the promise in two of these arrangements to accelerate by 3.5% per year is really quite an acknowledgement, and hopefully it will be sustainable over a long period of time. But it's certainly more than growth, and it certainly gives our provinces some greater assurance that they can see that they can meet increasing costs, and I hope this has been appreciated.

But I would also like to move on to the idea of the expert panel. I forget the exact wording in terms of how an expert panel was to be set up, but you seem to be critical of the appointments to date. Our committee, Mr. Chair, debated appointments yesterday morning. I'm not sure those names would come to this committee, but what grievance would you have with the people presented so far? I have not seen the names. What are your concerns that this committee or the greater committee might want to investigate?

**Hon. Mitchell Murphy:** We have been privy to the names, I guess, as a courtesy of the federal minister. I will not discuss anybody in particular, but I will answer your question relating my concerns.

My concern is that when you're looking at somebody to look at a program that is as important to the country as equalization, we should be looking to appointees who have some expertise in the area and understand the importance of equalization across the country. I would never argue that we should not appoint people who have various opinions on the subject. That's democracy, and that makes for healthy debate. My concern is when people are appointed who come to the table with little background or expertise or, conversely, having already expressed a strong opinion on the uselessness of equalization.

That is my concern, and I see that in some of the nominees to this panel.

**Mr. Charles Hubbard:** Mr. Murphy, have those names been vetted with you?

**Hon. Mitchell Murphy:** No, those are Minister Goodale's appointments. We do not have any input into his appointments.

I must say that in addition to the four federal appointments at our last federal-provincial finance ministers meeting, the provinces and territories also get to name, as a group, two members to that board. I believe those names have been passed on to the federal minister. So we have a panel of six who are going to look at the way equalization should work after the 2005-06 fiscal year.

[Translation]

**The Chair:** Thank you, Mr. Murphy.

Mr. Côté.

**Mr. Guy Côté:** Thank you very much, Mr. Chairman.

Thank you for your presentation, Mr. Murphy. You spoke very clearly and very specifically about the impact of the fiscal imbalance on your province.

As I said earlier this morning, beyond this somewhat fuzzy concept of fiscal imbalance, it is important to remember why there is a fiscal imbalance. It did not happen overnight. The policies of this government created the fiscal imbalance. I will not go back over all of the measures that created the fiscal imbalance, as you are undoubtedly very aware of them.

Earlier, you mentioned the section of the Canadian Constitution that states that the purpose of equalization payments is to provide the provinces with sufficient revenues so that they can provide reasonable services. You said that your province was quite satisfied with the recent agreements on equalization, but that the specific agreements with Newfoundland and Labrador and Nova Scotia had disturbed the delicate balance that existed.

You said that you were not part of a think tank, that you were on the front line and that you were accountable to your citizens. We are very happy for the people in Newfoundland and Labrador and the others that have reached specific agreements. What effect can these specific agreements have on your fiscal capacity and all the means available to you to provide services to the people of your province, as opposed to New Brunswick, for example?

● (1410)

[English]

**Hon. Mitchell Murphy:** Well, I'll try to answer. There are a multitude of questions in there, but I'll try to answer them like this.

I didn't say we were satisfied with the equalization renewal or agreement that was signed in the fall. In fact, we were told in the spring of 2004 by the federal minister that we were not going to negotiate the next five-year agreement, that this is what the agreement was and this is what it was going to be. It's a 100% federal program. They make 100% of the decisions. So they do not need our endorsement. It's a bill passed in the House of Commons, in which you sit.

In the fall, I believe, because of concerns expressed by first ministers from across the country, Ottawa came back to the table to discuss equalization. We are not satisfied with what was negotiated in the fall of 2004, but at the end of the day, it is a federal government program, so you sign on to get the money. It's that simple. And when you're facing the fiscal challenges that we are...we did that.

There was fiscal imbalance before the offshore accords were signed. The fiscal imbalance has existed, I believe, for quite some time. We can go back, and nobody argues with the necessity of now Prime Minister Martin, but then Finance Minister Martin, getting the federal fiscal house in order. He should be acknowledged, and I would applaud him for that. Do I agree with the methodology used? Well, no, that's a discussion for another day. But it had to be addressed to get the country back on track, and he addressed it. However, since that time, as part of addressing that, we received a 33% cut in federal transfers as our contribution to addressing the federal deficit.

When health care costs are growing at about 7% a year, we're just now back from a federal fiscal transfer position slightly beyond what our transfers were in 1993-94—I think we may be \$15 million or \$20 million above. But think about what happened in the meantime to health care costs, to education costs, to other costs. So fiscal imbalance existed long before the offshore accords were signed.

I want to be clear again, because I'm not in the province of Nova Scotia to criticize them for negotiating an agreement. As an Atlantic Canadian, knowing a bit of their fiscal situation, I'm happy they got that arrangement, because it's going to help their citizens. I'm happy for the people in Newfoundland and Labrador. My point here is that, as a result of those agreements, it does increase the fiscal disparity.

Perhaps as a concrete example, as the fiscal capacity widens between provinces, some provinces have a greater ability to provide public services—let's say, in recruitment of health care professionals, doctors or nurses. They can afford to pay a little bit more than those provinces with lower fiscal capacity, so they're more competitive at attracting those people who are providing public services. They have the fiscal capacity perhaps to lower their tax regime, to become more competitive from a taxation point of view. They want to compete with other provinces, and perhaps they want to compete with the northeastern U.S. It gives them a greater ability to do that. That's the difficulty when you get into the heart of the equalization system.

It's like a mixer at the sink and you turn the beaters on high speed. That's a bit of what has happened. If we're going to move forward to address fiscal disparities both vertically—between federal and provincial governments—and horizontally across the country, then we have to get a return to a formula-based assessment on a 10-province standard.

•(1415)

[Translation]

**Mr. Guy Côté:** Perhaps you mentioned it in your presentation, but how would your province's budget be impacted if we were to return to a 10-province standard for the calculation?

[English]

**Hon. Mitchell Murphy:** It depends on the particular year you're in.

As Mr. Hubbard pointed out in his question, equalization entitlements are based on economic performances of a certain set of provinces—right now, all the provinces in the country, with the exception of Alberta and Atlantic Canada—and there's a national standard set. So if our economy performs poorly and the national economy performs well, our equalization entitlements go up. If our economy performs at or above the national economy, then our equalization entitlement goes down. But we can manage with that, because that means our own source revenues are higher, and it allows us to continue to provide that level of public services.

[Translation]

**The Chair:** Mr. Palmer.

[English]

**Mr. John Palmer (Director, Economic and Statistics, Federal Fiscal Relations, Government of Prince Edward Island):** Using numbers from 2003-04, it's \$41 million.

**Hon. Mitchell Murphy:** I will give you an example from fiscal year 2003-04. On a 10-province standard, Prince Edward Island would have received \$41 million more in equalization.

Let's have some other comparisons. New Brunswick would have received \$223 million more in equalization. Quebec would have received \$2.2 billion more. Newfoundland—this is before the offshore agreement—even under the present agreement would have received \$154 million more.

So in a lot of years, a 10-province standard would have a big impact, especially recently because of the rising price of oil and because fiscal capacity of a province such as Alberta is growing so rapidly. That means, in the equalization entitlements for the other provinces, as the gap widens, the entitlements grow.

[Translation]

**Mr. Guy Côté:** You have clearly explained why transferring tax points would not be advantageous for your province, even though it is very precious for Alberta, Ontario and Quebec.

Am I mistaken in saying that for Prince Edward Island, a calculation based on a 10-province standard would not be the ideal solution, but could help resolve a large part of the problem?

[English]

**Hon. Mitchell Murphy:** I think it's very difficult to ever get a perfect formula. To make equalization work well for everybody is very difficult.

However, going to a 10-province standard based on the national economy, the logic of the argument is then this: that you're being equalized up to what the national average is, and while provinces might complain about that, I don't think their complaints would have as much validity as they have today, because after all, P.E.I. could not ask to be equalized above the national standard.

However, by artificially lowering the standard with a five-province standard, it becomes problematic. We did have a 10-province standard at one time. It was changed back in 1982 for the simple fact of what we're seeing today. There were huge increases in oil and natural gas revenues. So it was deemed at that time that equalization became too expensive. Part of controlling the cost of equalization was lowering it to a five-province standard.

We would argue that the country was in a different fiscal position at that time than it enjoys today and that the fiscal capacity certainly exists to return to a 10-province standard.

• (1420)

[Translation]

**Mr. Guy Côté:** Thank you very much.

**The Chair:** Thank you, Mr. Côté.

Before giving the floor to Mr. Stoffer, I would like to tell you that I just ate the most delicious fish and seafood soup in the world. I am very tempted to invite the representatives of the other provinces to appear before the subcommittee here in the Maritimes. What do you think about that?

[English]

**Mr. Peter Stoffer:** Any time, Monsieur Chair.

[Translation]

**The Chair:** Go ahead, Mr. Stoffer.

[English]

**Mr. Peter Stoffer:** Alexa has allergies to seafood; she couldn't eat that, but I can. So you're more than welcome.

Thank you very much for your presentation, gentlemen, and thank you for coming into Halifax for this.

I have just a couple of questions for you. This is the unique thing about a committee. A committee hears representations from all sides and then has to come up with some form of recommendations or a report, and they try to get that report unanimous in order to carry a little bit more weight within whatever ministry they wish to take it too. I have a feeling this one may be a bit difficult because of the morning presentation and what we hear now.

But I would like to ask you a couple of questions and ask if you agree with this. We received this from the AIMS Institute: "The provinces have the means to fix their fiscal problems, and we see little reason why Ottawa should do the job for them." Do you agree with that statement?

**Hon. Mitchell Murphy:** No.

**Mr. Peter Stoffer:** Okay. No, that's fair enough. That's why we ask it.

They say, "the bulk of the federal surplus is directly due to falling interest costs for Ottawa, which in its turn is the reward for prudent fiscal management. This is not evidence of an imbalance of fiscal resources between Ottawa and the provinces."

**Hon. Mitchell Murphy:** We anticipated that question for our presentation, and that's why I included a slide on federal spending priorities in your handout. The slide shows equalization, in blue, and CHST transfers, in mauve or purple. Our argument is that the

increases in federal transfers to the provinces for health care and education have largely come at the expense of other programs such as equalization.

I'm not going to dispute the fact, as I alluded to earlier, that we need to acknowledge that the job on the deficit needed to be done and it was done. The fiscal position that the country was put in as a result of getting deficits under control and beginning to pay down debt has certainly helped with interest rates, which has helped me immensely, from a provincial treasurer's point of view.

We rolled over some long-term debt that we had from the early 1980s at 14% and 15%. We were able to roll that over at slightly over 5%. We wouldn't have had the ability to do that unless the interest rates were low. So I agree partly with the second observation, but not totally.

**Mr. Peter Stoffer:** Do you believe in the particular statement on page 2 of your testimony that "the provinces have adequate resources at their disposal (including room to raise taxes)"? Do you believe that?

**Hon. Mitchell Murphy:** Well, I'll give you the facts from our jurisdiction. We have the highest provincial sales tax in the region. We have one of the highest corporate rates of tax in the region. Personal income tax revenue makes up our largest source of revenue after equalization, etc., so our tax regime is extremely high.

Again, I'll relate back to Alberta. We have about 43% compared to Alberta.

I'll relate back again to the point I was making on structuring other deals such as the offshore resources and how that has an impact on equalization. Hypothetically, the province of Nova Scotia, our sister province, has improved its fiscal situation. As I've said and will continue to say, we don't see that as a bad thing for Nova Scotia. Their citizens certainly deserve those public services, but what will it do for us as their fiscal capacity increases? It will put pressure on our government, which has less fiscal capacity in the area of providing public services than in other areas.

• (1425)

**Mr. Peter Stoffer:** Well, you talked about our fiscal capacity in the province of Nova Scotia. I only want to put on the record that I have lived in Nova Scotia. The Conservative Party took over this province in 1998. Our debt has increased by \$2.2 billion since they took over the affairs of this province. So even though they may now have their fiscal house in order, under their watch the debt has increased by a couple of billion dollars. That is not good for any province.

But I want to ask you—

**Hon. Mitchell Murphy:** Well, I learned a long time ago, as a minister from P.E.I., that I don't want to get into fiscal discussions with other jurisdictions, especially when I'm travelling outside the province.

**Mr. Peter Stoffer:** I only have one more comment, and you can answer on whether you agree or disagree with it. Again, this comes from the AIMS institute: "Ottawa's improved fiscal position is in no way at the expense of the provinces."

**Hon. Mitchell Murphy:** In 1995 our transfer payments were cut by 33%.



**Mr. Peter Stoffer:** Should I take that as no, you don't agree with that?

**Hon. Mitchell Murphy:** I think their improved fiscal position is a result of a number of factors. Cutting equalization and other fiscal transfers to the province is one of them.

**Mr. Peter Stoffer:** One of the concerns I have, especially if you only use Atlantic Canada as an example, is on the amount of money that has been taken out of families and communities from the withdrawal of the EI fund itself. My colleague Yvon Godin, who's from northern New Brunswick and who is our unemployment insurance critic, has raised the issue time and time again. I don't have the figures for P.E.I., but I know that in Nova Scotia alone it has been to the tune of hundreds of millions of dollars over the years. It used to go to workers, their families, and their communities, but now that money is gone. Workers don't have that money to spend. Small business doesn't have that money to receive.

It would be interesting to know what the impact has been on Prince Edward Island since the EI cuts happened. What amount of money was taken out of Prince Edward Island due to the changes in unemployment insurance?

**Hon. Mitchell Murphy:** It would be a drop of about 33%, so \$343 million is the figure.

**Mr. Peter Stoffer:** So \$343 million has been extracted out of P.E.I. because of EI changes?

**Hon. Mitchell Murphy:** That's correct.

**Mr. Peter Stoffer:** I don't doubt that, but you know, this is why I... Although Mr. Crowley is not here—and in fairness to him, he always says the word “provinces”; he uses the plural; he doesn't specify which ones. But I sometimes question, when you get things of this nature, that they look at the full picture of what happens, when the government did what they had to do, and the methodology of what they did, because it hurt an awful lot of people in that regard, in order to get the big picture. And I think sometimes they forget the little picture, in terms of what happened in the provinces.

**Hon. Mitchell Murphy:** It certainly did hurt, you know.

I would say that as a provincial government, our responsibility is to grow the economy, to grow our own-source revenues. Our goal is to become less dependent on federal transfers, and the main beef I have with Mr. Crowley's comments this morning is that you cannot snap your fingers and change the system overnight.

I do think increased economic development in the region—Mr. Stoffer, you referred to it as “jobs” this morning—is becoming increasingly important. Creating wealth and economic activities causes our own-source revenues to grow, but the challenge in it is... Do I believe all citizens in the country, regardless of their geographic location, are entitled to reasonably comparable levels of public services? Absolutely. Should it be done at reasonably comparable levels of taxation? Yes, it should, because when you get out of balance, as we are now, it puts provinces like Prince Edward Island and others in a situation of questioning how to continue providing the same level of public services, given their economic growth or their ability to grow economically. We are going to grow economically; we are, but the rate of providing those services is growing faster, so in the transition we still need to depend on a system such as equalization.

We hope that someday, like some... Saskatchewan and B.C., for example, this year have officially become have provinces. I despise that terminology; there is no such thing as a have province and a have-not province in the country. They are now not receiving equalization, so their fiscal situation is improved. We will continue, as all provincial governments will, to try to do that, but in the meantime, you just cannot abandon the principle of providing public services.

Can I balance the books on P.E.I. this year? You can always balance the books by cutting expenditures, but governments also have a responsibility to provide basic levels of public services to their citizens. Our big expenditure is in health care. We'll spend \$450 million, \$460 million, \$470 million—I don't know; the budget is not finalized—but that is about 46% of our spending. So do you want to close two or three hospitals and lay off 500 health care professionals? It's a pretty good chance to balance the budget. Is that a responsible thing to do as a government? Absolutely not.

• (1430)

[Translation]

**The Chair:** Thank you, Mr. Stoffer.

Mr. Murphy or Mr. Palmer, your table on page 26 talks about trends in federal government revenues and expenditures. I would like you to explain why the trends for Quebec and British Columbia are well below the trend for federal expenditures. What explains that situation in your table?

[English]

**Mr. John Palmer:** I'm sorry, we only picked up the very last part of what you were saying there.

These numbers are actual data we've put together using Statistics Canada material for 2002, otherwise known as the provincial economic accounts, and they have a consistent set of numbers on expenditures and revenues by each province.

I can only surmise. I can't tell you exactly what's going on with these numbers, because they're very large numbers reduced per capita, but I can surmise.

When we look at the federal expenditures—these include all the transfers, including transfers to provinces such as equalization and unemployment insurance, as well as federal activities such as military spending and head office.... There are a lot of things in those numbers.

So it could be that one of those components for Quebec—I don't know which one—is somewhat lower than the average.

**Hon. Mitchell Murphy:** Yes. I suspect that because it's so all-inclusive, that's why the numbers are where they are. For example, I don't know if there would be any military spending on P.E.I. versus some federal military spending in Quebec.

[Translation]

**The Chair:** Thank you.

Mr. Hubbard, you have five minutes.

[English]

**Mr. Charles Hubbard:** For five minutes? We're doing better.

**The Chair:** Are you happy?

**Mr. Charles Hubbard:** You had better ask me afterwards.

There are a couple of things. First, I am a bit appalled at your statement here on receiving a 33% cut in the year 1995 for P.E.I. I wonder if you could supply our committee—not today but maybe.... We could look into that, certainly, Mr. Chair. But it rather appalls me that you lost one-third of the CHST in equalization moneys. So could you do that?

Secondly, regarding the 10-province standard, you seem to have some figures on that—which you probably used to argue that in Ottawa last September–October—but I certainly would like to see that and to see how it would affect our federal responsibilities under the 10-province standard, and how it would affect the other provinces.

My colleague brought up the EI.

[Translation]

**The Chair:** Just a minute, Mr. Hubbard.

[English]

Just a minute, Mr. Hubbard. Were you talking about equalization or the transfers for health and education?

**Mr. Charles Hubbard:** Well, the first question goes back to the program in 1995. In the second question, he referred to a document. I would assume it was the document that was used in arguments last September and October, when you were having discussions with our federal ministers and the 10 provinces to present a case for stronger....

•(1435)

**Hon. Mitchell Murphy:** Just so I'm clear, yes, we do have that information. It would be in the public accounts of the province, and that can be supplied to this committee.

**Mr. Charles Hubbard:** Thank you.

We move then to the EI. EI has a lot of factors built into it, the changes that occurred, but the most significant factor is the changing economy. In terms of Canada, back in 1993 we'll say, we had unemployment rates in the vicinity of 10% or a little bit better, and today it hovers around 7%. In my own province, we're glad to see that right now it's at around 10%.

So to measure EI in terms of expenditures, I would like to see the day when literally there is no transfer of money for EI, when everybody has a job, which I think has to be the.... And I say that to your colleague Yvan. We have to fight for economic improvement and greater opportunities for our people.

I'm a bit taken aback, too, with your figure of losing \$300 million. Now, this must be over a period of time with EI.

**Hon. Mitchell Murphy:** The question Mr. Stoffer posed to me was how much has been lost from the last federal changes. And I was simply giving him a statistical answer.

**Mr. Charles Hubbard:** Would this be for a nearly-10-year period, for about eight years?

**Hon. Mitchell Murphy:** I believe it's between eight and ten years, yes.

**Mr. Charles Hubbard:** And your own EI statistics now in P.E.I.: has it improved, and from where to where? Do you have that information?

**Hon. Mitchell Murphy:** Yes. When I was first elected in 1996, we were over 16%. We're now between 11% and 12%. It goes down. It has dipped down as low as 10% during the summertime when we're at our peak employment, but at this time of year it fluctuates between 11% and 12%.

**Mr. Charles Hubbard:** So in terms of workers in the system—

**Mr. John Palmer:** Could I just quickly respond?

**Mr. Charles Hubbard:** In terms of workers in the system, how many new jobs or how many—

**Hon. Mitchell Murphy:** There's been about 10,000 new jobs from 1996 to 2004.

**Mr. Charles Hubbard:** John has a point too.

**Mr. John Palmer:** The most radical changes that were made to the unemployment insurance program were made around 1993, I believe. That was the first—

**Mr. Charles Hubbard:** Oh yes.

**Mr. John Palmer:** There were other changes, but that was the one that cut back on the weeks of benefit and increased the weeks of work to get the benefit. And in that period, 1993 to 1994-95, there was a 33% drop in unemployment insurance benefits.

Subsequent to that, we've had an improvement in employment, but in that period—and that was the same period when we were dropping the EPF money, the CHST—it was really tough.

**Hon. Mitchell Murphy:** Well, I accounted for that in my answer. I know the number was larger, but we've had improvements, so that was accounted for.

**Mr. Charles Hubbard:** So both governments, yours and ours, have done something to hopefully improve the economy?

**Hon. Mitchell Murphy:** There's no question. Part of the \$343 million is the result of changes. Some of it is the result of increased economic activity.

**Mr. Charles Hubbard:** There are two other points. With health care you see a 7%.... I think former Premier Frank McKenna said this health care expenditure was like a gorilla. You say now it's nearly 50% of your total expenditures, and you point out that you think it's going to grow at 7%. Really, in terms of a lot of our Atlantic provinces especially, this has been the biggest single cause for budgets to suddenly be changed so much.

Are there any solutions to this?

**Hon. Mitchell Murphy:** Well, it's a good question, a question a lot of us at both levels of elected officials have been pondering and trying to think about. Part of the growth on P.E.I.—and I don't think it's dissimilar to the situation in some particular regions of other provinces or in other provinces as a whole. Most of the cost of the health care system occurs as people get older. Our population, compared with the national average, is an older population that will get older over the next 15 to 20 years, as a group. We will have particular challenges, because that's where most of the expenditure comes. We have looked at and talked about a number of things that perhaps may need to occur in the health system across the country. If I had the answers, I would be a very valuable man and certainly better paid than I am now.

•(1440)

**Mr. Charles Hubbard:** You're right. Time is really getting very short, but I wanted for the record, if I could go for half a second—

[*Translation*]

**The Chair:** Thank you, Mr. Hubbard.

[*English*]

**Mr. Charles Hubbard:** —to say that this is a great concern for us in Atlantic Canada—

[*Translation*]

**The Chair:** Mr. Hubbard, thank you.

[*English*]

**Mr. Charles Hubbard:** —and if it is an imbalance now, Mr. Chair, it's going to get worse.

**The Chair:** I was very generous with you and very nice with you. Come on.

**Mr. Charles Hubbard:** I want to get it on the record that this is a growing concern.

[*Translation*]

**The Chair:** Mr. Murphy, you talked about a 50 per cent reduction in transfer payments for health and education starting in 1995. It is because the allocation criteria were changed. The criteria for distributing funds under the CHST were changed. For example, the needs requirement was replaced by a population requirement. Changing that criteria put your province at a considerable disadvantage. Am I mistaken?

[*English*]

**Hon. Mitchell Murphy:** In addition to the monetary loss in the transfers, I think small jurisdictions always carry a heavier burden when transfers are done on a per capita basis, simply because you require certain infrastructure, whether it's physical infrastructure or human resource infrastructure, to provide a health care system. So straight per capita funding is always more challenging for smaller jurisdictions. That certainly has had an impact as well.

[*Translation*]

**The Chair:** Thank you, Mr. Murphy.

Mr. Côté.

**Mr. Guy Côté:** Thank you very much.

Allow me to correct Mr. Hubbard's sophistry, not to say his intellectual dishonesty. In an ideal world, employment insurance

would not be necessary, because we would have full employment. It would be wonderful, but we do not live in an ideal world. If drastic cuts were made not only in Prince Edward Island, but in all provinces, it was not because of their phenomenal and extraordinary economic growth; it was because this government reduced access to the program by increasing the number of hours needed to qualify and by decreasing the number of insurable weeks.

There is a reason for the \$46 billion in the employment insurance account. That money went into the government's general revenues, not into workers' pockets. So in that regard, Mr. Hubbard, I think things will be fine.

Mr. Murphy, here is my question. One of the methods used by the federal government that I believe is a direct cause of the fiscal imbalance we are currently facing is that by using unrealistic, not to say surrealistic forecasts, the government ended up at the end of the year with an unexpected surplus that was directly applied to the debt, thus reducing interest payments, etc. Doing that year after year enabled the federal government to clean up its finances. We have to be glad about that, but we cannot approve of the method the government used. Consequently, year after year, the federal government's financial resources increased. I do not know your province's debt-to-GDP ratio, but would it not be wise for the federal government to stop paying down its debt and to invest in transfer payments to the provinces, in equalization?

[*English*]

**Hon. Mitchell Murphy:** As finance minister I would never say it's a bad idea to pay down debt, because paying down debt of course frees up some money for program spending.

But your second point is a valid one. There's only one taxpayer in the country, and we need to look at services that governments provide to make sure tax dollars are directed at the government that provides the services.

I think the vertical fiscal imbalance is out of step right now. The federal debt-to-GDP ratio is decreasing. That helps us all. National interest rates are staying where they are. That helps us all. However, the big growth in program spending is occurring at the provincial level, because we have the constitutional responsibility for the big growth areas of health care and education. I do not feel that enough of the taxpayers' money is going to address those areas, and because they are mainly provincial responsibilities, a lot of provincial spending is required. To correct the vertical imbalance, we think we need to see more sharing of that taxpayer's dollar with the provincial governments who have direct responsibility for those services.

•(1445)

[Translation]

**Mr. Guy Côté:** Tell me if I am wrong, but I have the impression, given interest rates and the debt-to-GDP ratio, that the federal debt costs less to manage than the provincial debt. Do you think it is normal for the government with the lower-cost debt to try and reduce that debt using back-door methods, especially when the provinces have to manage debts that are, unfortunately, often on the rise, because the cost of managing the debt is higher due to the interest rates obtained by the provinces? I fully understand your position when you say that our government must pay down its debt, but don't you think that once they reach a certain ratio, it is no longer necessary to invest massively to reduce the debt? There comes a time when economic growth is such that the weight of the debt is less and less of a burden. Do you think that the federal government has reached that point?

[English]

**Hon. Mitchell Murphy:** I think the country is as strong as its parts are. Those parts are the provinces and territories. We all fought the federal debt, because we all did our part. Whether it was as provinces taking less in transfer payments, individual Canadians, people dependent on programs, everybody played a part as a Canadian in wrestling that under control.

Now it is under control. I think the federal debt-to-GDP ratio is around 40% and falling. The debt-to-GDP ratio in P.E.I. is around 33% and rising. So we're out of balance, because what's happening is that one level is taking in, I think.... I'm not going to use the word "more" resources, but the resources that are being taken in are not distributed equitably to where the costs of services are.

If we go to the Conference Board of Canada's report, it's been stated publicly that the federal government would like to see the debt-to-GDP ratio get to 25%. That's a laudable goal. I think the question is one of timing. How quickly do you have to get there if the other levels of government are seeing their debt burdens increase?

I'll come back to the point that as a taxpayer, when I file my taxes some of it goes off to Ottawa and some of it stays in Charlottetown. It really is the taxpayer's debt. Whether it's held at the provincial level or whether it's held at the federal level, it's the taxpayer's debt. But the difficulty in our debt increasing, of course, is that my debt service costs go up and I have less money available for public programs. And my debt service costs are going up. They are going up in a lot of provinces. To get back to the point, we think it's out of balance.

Equalization is only one component of federal-provincial fiscal arrangements. There are other transfers that take place. But because it means more in P.E.I. than anywhere else in the country as a source of revenue, it's the program that is especially important to us.

[Translation]

**The Chair:** Mr. Stoffer.

[English]

**Mr. Peter Stoffer:** Thank you.

Mr. Murphy, I was intrigued by the indications that your government does not agree with its federal counterparts that resource revenues should be taken out of the equalization formula. Have you had an opportunity to share that opinion of yours with Premier Hamm, or Bernard Lord, or Danny Williams? It would be interesting to see what your three Atlantic counterparts, who are all under the Conservative banner—though I don't want to sound political when I say that—think of that statement.

•(1450)

**Hon. Mitchell Murphy:** I don't know what they think of that statement, Mr. Stoffer.

I think all members around the panel can appreciate the reason we have the position we have, as I tried to explain today, and especially those who come from provinces that do not have those revenues.

I think we need to put the revenues in perspective as well. In Nova Scotia's case, we're not talking about revenues from the offshore anywhere like the revenues in Alberta. They're not getting, as a percentage of their provincial revenues.... It helps all right, but it doesn't cure all ills, so to speak. But we've taken that position, because what it does to us is this. I'll give you this example. Let's say we did not have to calculate in our fiscal capacity any of the revenues we received from agricultural production on P.E.I. That would lower our fiscal capacity from \$4,500 down to, say, \$2,500. So our equalization entitlement would go up by \$2,500 per citizen. That would not be in keeping with the spirit and the standard of the equalization formula.

The point we're making is that when you start exempting things from the formula, usually provinces that do not have those exempted things pay the consequence.

**Mr. Peter Stoffer:** In your upcoming Atlantic premiers conference, is it anticipated that Mr. Binns and you, for example, will be pushing the 10-province initiative for equalization? If this is your pursuit, it's always helpful to have allies on your side. And again, it would be interesting to see what your Atlantic counterparts would support in this initiative.

Do you have any indications that they too would support that?

**Hon. Mitchell Murphy:** In the fall of 2003 and the spring of 2004, at the federal-provincial-territorial ministers of finance meeting, we passed a resolution as finance ministers unanimously supporting the return to a 10-province standard.

**Mr. Peter Stoffer:** That was 2004, though.

**Hon. Mitchell Murphy:** Yes, that's correct.

**Mr. Peter Stoffer:** That was earlier and long before these offshore deals and everything else.

**Hon. Mitchell Murphy:** Well, nothing has been communicated to me from my Atlantic counterparts indicating they've changed their position. Certainly it had been the position of the finance minister in Quebec, who I understand was replaced today. It was the position of the finance minister in Manitoba, a recipient province as well. It was the position of the finance minister in Saskatchewan, and it was the position of the finance minister in British Columbia at that time. Whether their opinions have changed because of what's happened in the interim, I don't know.

**Mr. Peter Stoffer:** I just have a general statement for you. Allan Gregg wrote an article recently in the *The Walrus* magazine indicating that with these offshore deals—which I fully support—for the provinces of Nova Scotia and Newfoundland and Labrador, the federal government may lose its ability in the future to deliver such things as national standards for health care and education, etc., or that these deals will even be at the cost of the unity of the country itself in the long run.

Do you believe these things may happen down the road, as Ontario is now starting to argue for more individual funding and Saskatchewan is arguing for more? And I can only anticipate that other provinces will probably do the same in the future. Do you see that trend happening? I know I'm just speculating, but—

**Hon. Mitchell Murphy:** No, it's a good question. I think equalization was enshrined in the Constitution in 1982 because it was viewed at that time to be an extremely important program for the federation, based on the principle that certain regions of a country would do better than other regions of a country from time to time. But to balance that disparity, we would have an equalization program to redistribute some of the resources of the country.

I still think we need to get back to those principles that were set in place, because they have been violated due to some of the things that have happened. As I said in an earlier answer to Mr. Côté, it's not just the offshore agreements that have happened recently. For example, property taxes, which is one of the 33 components of equalization, on the Lower Mainland of British Columbia are given special consideration because of the high level of property tax rates there under the agreement. There has been special consideration given to the Province of Saskatchewan because of potash, and other reasons. Whenever you give special consideration you are interfering with the national standard of fiscal capacity.

On the difficulty with the five-province standard, it was problematic before, when Alberta wasn't in the calculation. It becomes more problematic now that another province, Newfoundland, where we expect the fiscal capacity to grow considerably, is also not in the standard. So when you take the two highest fiscal capacities and leave them out of the standard, do you truly get a national average fiscal capacity?

I would argue, as a former schoolteacher, the greater the numbers in the calculation, the more accurate the average. The difficulty is that we are leaving those provinces with high fiscal capacities outside of the standard. That's balanced off because we would have a lower fiscal capacity in P.E.I. and in New Brunswick. So we're in the standard as well. That has to be a consideration. You just can't take the cream in terms of fiscal capacities and everybody. If you're going to get a balance across the country, you have to include everyone in your calculation.

• (1455)

**The Chair:** Thank you, Mr. Stoffer.

[*Translation*]

Mr. Minister, when you talk about the 10-province standard, perhaps you should clarify that it is a 10-province standard including tax revenues from natural resources. If you take into account all 10 provinces, but Alberta demands the same treatment as Newfound-

land and Labrador and Nova Scotia, the standard will drop and you will lose in the exchange, in my opinion.

That was simply a comment. I will give you three more minutes to conclude your presentation. Unfortunately, time is flying by. I will do the wrap-up after that.

[*English*]

**Hon. Mitchell Murphy:** Thank you very much, Mr. Chairman and members of the committee, for the opportunity to share a few thoughts from P.E.I.'s point of view on the importance of equalization in correcting the fiscal imbalance.

I think the numbers in the fiscal imbalance speak for themselves. Equalization has to be one of the ties that bind. I think that right now it's not necessarily doing that, so we need to improve the system. Part of the way to improve the system is to return to that 10-province standard at the same time. I have spent a lot of time as finance minister on the equalization file, and I think the way forward is that we all have to realize there's only one taxpayer in the country.

I can understand why in 1982 the federal government of the day went to a five-province standard. If you look at the debt of the country at the time and at how much it was costing for debt service, you'll see that was a fiscal decision, and because of the huge growing capacity of Alberta, they had to get costs under control. I'm not here to make political comments. The deficit had to be addressed, and it was addressed. So the fiscal situation of the country has increased.

We also know that costs have increased in two sectors that are the purview of the provinces, health care and education. I'm not a person who gets hung up on whether the federal government wants to participate to a certain extent in health care or education. People argue that's in the Constitution. I'm not going to get hung up on it. I think we need to realize that we have to put more resources where the costs are.

At the same time, I realize that as a province we don't have some of the priorities the federal government has constitutionally. We're not responsible for national defence. We're not responsible for other things the federal government is responsible for.

But there is no question in my mind that the fiscal imbalance does exist. If we ask Canadians what are some of the most important things to them, they'll say a good health care system and education system. Obviously, as we move forward into the knowledge economy, we will want to upgrade our skills in the country to compete in the global economy. Those are huge investments and good investments. But the tax dollar that Canadian pays is not getting divided up into the areas where it's needed. I'm not going to sit here and say Ottawa needs to transfer all the money to the provinces. No. They have responsibilities and obligations as a national government. But there's a disparity in the country, and we have to address that disparity as we move forward.

I'll sum up by saying this. We've seen the reaction of provinces across the country in the last little while with regard to bilaterals and other deals being made that mess up the formula under the equalization system. I don't think it's a healthy thing for the country to have provinces saying, "I want a special deal. I want to negotiate this. I want to negotiate that". I don't blame provinces for doing it. They're all elected to represent their areas. But it's not a healthy thing for the country.

We have to get the fiscal imbalance fixed as we go forward. Hopefully, the panel that has been struck will have some recommendations and receive good input to get the balance right.

I wanted to come today to give you a perspective from this end of the country, because of course your committee will have great

influence as you report back to the House of Commons and the finance committee.

● (1500)

**The Chair:** Thank you very much, Mr. Minister and Mr. Palmer.

It was a pleasure and an honour to have you attend this meeting. On behalf of my colleagues, I would like to thank you very much.

**Hon. Mitchell Murphy:** Thank you.

**The Chair:** Congratulations to all the members and the team for this first and wonderful session.

Thank you very much.

The meeting is adjourned.

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