



House of Commons  
CANADA

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

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SFIS • NUMBER 015 • 1st SESSION • 38th PARLIAMENT

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**EVIDENCE**

**Monday, April 18, 2005**

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**Chair**

**Mr. Yvan Loubier**

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Monday, April 18, 2005

• (1320)

[English]

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

Welcome, Mr. Schroeder, to the Subcommittee on Fiscal Imbalance, and thank you very much for accepting our invitation to discuss this important issue. You will have 15 minutes to introduce your opening statement, and after that we will have a question period with members of, I hope, every party in the House of Commons. Only the Liberal member is absent.

Mr. Schroeder.

**Mr. Vic Schroeder (As an Individual):** Thank you. I'll try to stick to the script.

Thank you for coming to Winnipeg, and thank you for giving me the opportunity to address your committee.

I'm the chair of Manitoba Hydro-Electric Board, an organization that in addition to generating, transmitting, and distributing electricity to all of Manitoba, is also the owner of the gas distribution utility serving the majority of Manitobans. I'm also currently the vice-chair of the St. Boniface General Hospital, operated by the Catholic Health Corporation of Manitoba, and a practising lawyer. I was Manitoba's finance minister from 1981 to 1987.

I'll address the issue of the formula, who should decide on payouts and formulas, give you some history on the background to formula and other changes, non-renewables, transferring tax points, and some thoughts on the necessity for equalization in the first place.

I am pleased to see that Parliament has decided to revisit the equalization issue at a time when the Government of Canada is not in fiscal crisis and the best forecast of our think tanks is that it is likely that in the coming decades federal finances are likely to remain more robust than those of the provinces whose populations benefit from the program. The fact that it is members of Parliament and not the finance ministry doing the review is itself important and welcome.

You are aware that in many other countries these types of arrangements are implemented in a much more impartial manner by various mechanisms other than the unilateral decisions of the federal ministry of finance, which has a huge conflict of interest in determining how much money is to flow under the program, weighing equalization against other spending priorities in other federal departments, tax and fiscal policies. It is true that it is the federal cabinet that ratifies the Department of Finance decision, but unlike with most issues, transfer payments have no departmental

champions protecting their turf in the way that federal line departments do through their ministers.

Without giving you any advice on the specifics of an appropriate mechanism, basically because I haven't fully thought it through, I urge you to consider a more impartial system for Canada. It is not a great deal more fair that a federal ministry with a huge self-interest in the outcome should be entitled to unilaterally set the formula than that the recipient provinces unilaterally do so. Independent commissions such as those utilized in Australia, India, and South Africa, adapted to Canada's specifics, are certainly worth a serious look.

We all tend to learn from our own experiences, and I'll briefly relate my view of equalization history as we experienced it from 1981 to 1987. First, on a positive note, it was entrenched in the Constitution of Canada in 1982, and you can all repeat the provision from memory. It is to ensure that all our provinces are able to maintain comparable levels of public services at comparable levels of taxation.

So why have we retreated from this objective? Comparability was initially determined by a broad measure of the fiscal capacity of all the provinces. Why? Because it is impossible to determine comparable fiscal capacity without determining precisely what the fiscal capacity of each province is.

Then came the worst recession since the Depression, along with high inflation, interest rates in the teens and higher, resulting in staggering deficits in the provinces and in Ottawa, prompting federal Finance to come up with a strategy of simply refusing to make the calculation of the fiscal capacity of all the provinces. Instead, the federal finance minister, over the objection of a united opposition, unilaterally imposed a formula that measured the fiscal capacity of only five provinces, resulting in reduced payments and the certainty that the recipient provinces would no longer have the comparable capacity that had just been enshrined. By definition, it would be either higher—not likely—or lower, which was the objective of the unilateral exercise and the result.

Why could they not simply keep the integrity of the program by leaving the formula in place and reducing payments, for instance, by a per capita threshold? That way it would have been crystal clear that the goal of the program is not in fact being met and the electorate could come to its own conclusions based on clear and accurate accounting.

Not satisfied with the damage created by this distortion, in the mid-1980s federal Finance came back for another bite, capping the amount payable from the already inadequate payments at a time when the recipient provinces especially were struggling and no longer able to provide services at levels of taxation comparable to non-recipient provinces. I might add that the finance ministers meeting at which this new assault was unveiled unilaterally by the finance minister was conducted in a hostile and mistrusting atmosphere unlike any meeting I have ever witnessed before or since, with the strongest, most bitter and angry responses coming from finance ministers of his own party who saw this action as a betrayal.

This was, however, a more transparent change than the one referred to previously, in that it did acknowledge implicitly that it was reducing payments to a level clearly below that required by the formula then in place to meet the goals of the program, rather than once more tinkering with the formula itself, as had been done earlier, to produce the desired result.

This is an issue that does affect the services that have-not provinces can deliver to their most vulnerable citizens, and when successive federal finance departments with far greater fiscal room force these cutbacks, local elected officials can only vent and do their best to reduce the cuts.

The impact of these and subsequent changes to the rules determining average fiscal capacity have led to a dramatic downward spiral in overall payments as proportion of GDP, not because the need has decreased substantially but because of a refusal to make a correct calculation to determine comparable fiscal capacity.

The federal finance department, through a variety of administrations, has refused to look for the real fiscal capacity of all the provinces because of the fear of what it will find. We need to replace the department with a body that will seek the real facts and return to a fair system. This is the right time, given Canada's current and projected fiscal strength.

I would suggest that insofar as fiscal measurements go, the fuller and more comprehensive the measures, the more accurate. The more accurate, the fairer overall.

Equalization is, however, only one source of revenue, and ultimately the issue of the fairness of program financing between both senior levels of government must be kept in mind. All of us are relieved that the issue of funding health care directly appears to have been resolved, but when this resolution is accompanied by reductions in post-secondary and other transfers, the end result remains the same. Therefore, I stress that Parliament needs to keep its eye on the entire package of transfers to ensure the finance department does not once again play the old shell game. Further, I urge that mechanisms be put in place to reduce the overall volatility of transfers so as to stop both the panic cuts from items such as new lower calculations of population growth, or sudden windfalls from new calculations of capacity.

Also, we need to place safety cushions under transfers for such items as social assistance, in case we experience another recession in Canada, which is an inevitability. The former CAP program did this,

but I understand its replacement leaves the burden of potential sharp increases on the provinces.

On non-renewables, some were apparently questioning whether non-renewable resources should be excluded. Why would we do that? Does the revenue from those resources not add to the fiscal capacity of the producing province? Given the hundreds of years of tar sands supply, any real depletion calculation of the total—as opposed to currently producing—energy reserves would be minuscule at best, and government current oil revenue is already reduced by depletion allowances. How many times should depletion be deducted?

On tax point transfers, Hugh Segal suggested on a CBC radio talk show yesterday, and I heard now this morning, that the problem of provincial fiscal capacities can be addressed by simply transferring tax points from Canada to the provinces. He's wrong. Transferring tax points will increase rather than decrease disparities between the fiscal capacity of the wealthier provinces and the equalization-receiving provinces, because one tax point will raise more money in Alberta, Ontario, B.C., and Saskatchewan per person than it will in the other provinces, again because of their greater GDP per person.

A fairer proposal would be for Canada, as another component of building fiscal fairness, to take back the tax points ceded to the provinces in the past, arranging for an appropriate provincial response that might vary, depending on local conditions, and refunding those retaken taxes to the provinces on a per capita basis, thus reversing the losses suffered by the equalization-receiving provinces from the earlier tax point transfer, in addition to their equalization losses, over the past several decades.

• (1325)

Further, the transfer of the entire corporate tax to Ottawa and its reallocation on a per capita basis would be far more fair than the current system, where a corporate tax point is worth far less in the Maritimes and Manitoba than in Ontario, which is home to our manufacturing and financial head offices.

Last, I'd like to address the viewpoint occasionally expressed that equalization is somehow unnecessary, even counterproductive in the view of a few. Leaving aside the fact that it exists within our Constitution, it is part of the glue keeping us working together.

I have a great deal of difficulty understanding why lower-income individuals and provinces are spoiled by having too much income, yet wealthy individuals and provinces will do better with more money from lower taxes. I have never seen a provincial government of any stripe make any decision against development based on equalization losses, and I doubt it has ever happened or ever will.

Our federal government is frequently called upon to make small and large strategic economic decisions. I was a youngster on a mixed farm producing sugar beets when I first became aware that such decisions can have negative as well as positive impacts. The St. Lawrence Seaway, financed by Canada and the U.S.A., resulted in greater foreign sugar competition, among many positive impacts, but had a negative impact on the farm, and maritime seaports were impacted.

It is a fact of Canadian history that Ontario is our industrial heartland. Federal policy since the national policy of Sir John A. has promoted this. Canadians purchase Ontario-made motor vehicles—Ontario has the largest automaker in North America. This is a result of the Auto Pact negotiated many years ago, giving access to the U.S. to Ontario and building a tariff wall around us, protecting the industry and making Canadians a captive market to the Canada-U.S. agreement.

The Auto Pact and the seaway were both unquestionably the right public policy decisions for Canada. The seaway gave impetus to greater manufacturing, grain, and other exports, as well as reducing consumer prices for imported goods. The Auto Pact would have been even better had it given Manitoba bus manufacturers unimpeded access to U.S. markets without the U.S. protectionist requirement—continuing to this day—requiring the buses to be partially constructed in the U.S., increasing costs and reducing income in Manitoba. Some skeptics even dare say that had central Canada been the centre of bus manufacturing, this little glitch would have been resolved. The effect is that we do not have the income we would otherwise have had, and our equalization needs are slightly greater.

Sometimes Canada makes the wrong public policy decisions, such as the CF-18. Sometimes we are not sure but have our deep suspicions, such as the decision to move the Air Canada headquarters. Sometimes one such decision results in a follow-up decision, as I believe the CF-18 did. Immediately on determining that an inferior bid from elsewhere had been accepted by Canada, our provincial government began an intense lobby to persuade Ottawa to build the new disease control centre in Manitoba. This was subsequently successfully concluded by the Filmon government. I expect history will show that we will create more—and more beneficial to humanity—economic activity for Manitoba from the centre than we could have ever obtained from repairing aircraft.

Each such decision by Canada, whether right, wrong, or neutral, nevertheless creates winners and losers. Quebec won on Air Canada and CF-18, resulting in reduced equalization payments from Canada to Quebec. There were no savings to Canada, as they needed to pay more to Manitoba than they would have had our fiscal capacity not been reduced by the transfer and subsequently not have increased by the amount of the contract payments.

On the other hand, the centre for disease control is—assuming, as I believe to be the case, that Ontario and B.C. were the only real competition—a win-win for Canada and for Manitoba. Our equalization payments are reduced because of the added fiscal capacity from the lab, and there's no offsetting payment to the other two provinces, unlike the case where the competing entities are both recipients.

● (1330)

The transfer of federal GST processing to P.E.I. appears to have been a similar success story, reducing equalization requirements there and bringing P.E.I.'s fiscal capacity closer to the average.

The Canadian Museum for Human Rights here in Winnipeg, in addition to its primary educational function, is a similar investment in Manitoba's fiscal capacity.

Should Manitoba and Manitoba Hydro's negotiations with Canada and Ontario to provide a clean energy transfer succeed, Canada will have fulfilled a small but significant part of its Kyoto commitment with the closure of coal plants in Ontario, and Manitoba will have taken an important step up in its fiscal capacity, reducing its equalization requirements.

Perhaps there are other federal agencies or even departments that could be spread out in different have-not regions from have regions, bringing the fiscal capacity of the recipient up, reducing equalization payments, and probably saving substantially on the cost of doing business overall.

Perhaps there could be a concerted and deliberate federal public policy objective of placing new public investments in equalization-recipient areas, unless it can be objectively demonstrated to an appropriate body that another location is clearly superior. Each success would reduce fiscal imbalance.

At some point in the future, as in the past, current recipients will no longer require the payment, and some will need it that now do not. Make no mistake, equalization is of extreme importance to our nation's fabric. It is a program strongly supported by Canadians, and I believe by members of Parliament and your committee.

[*Translation*]

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

Mrs. Smith, you have five minutes.

[*English*]

**Mrs. Joy Smith (Kildonan—St. Paul, CPC):** Thank you.

That was an extremely insightful presentation, Mr. Schroeder. Thank you for it. I appreciate it very much. I found it to be very candid, and it had some very interesting aspects. A business mind is attached to this presentation, so thank you for that.

Only 2% of our resources are reflected in our fiscal imbalance, if you want to put it that way. We have hydro here in our province, which I consider to be our oil. Can you elaborate to this committee on how this resource could really help us in this fiscal imbalance initiative?

You stated in your paper that sometimes certain things play strategically, and certain provinces across our nation have benefited the equalization dilemma very well, as payments were given out. Could you elaborate on this? We've been known as a have-not province, and in all due respect I'm really tired of hearing that. I love our province and really feel we have a lot to offer.

• (1335)

**Mr. Vic Schroeder:** Thank you.

Manitoba has currently developed roughly half of its hydroelectric capacity. Of course, we're just starting on wind and other renewables, but really the hydroelectric is the big one. It's no secret we're in discussions with Ontario about a clean energy transfer, and it would result in the closure of coal plants.

When we say it's our oil, we have to be somewhat realistic in the comparison. I said it years ago, and you've said it, and I've heard other people say it's our oil, but let's put it in this context. This year the Government of Alberta is receiving revenues from its oil patch, taxes and revenues, of at least \$7 billion. I don't have the exact number, but I'm told it will probably be more than that.

The Province of Manitoba, in this current year, is hoping to have a profit of \$150 million from hydro, and that will be an offset in comparing to Alberta. The province charges water power rental rates, as the Province of Quebec does, and that's approximately \$95 million. It depends on how much water, and this year we've been blessed. Hopefully, the more tax we pay, the more profit Hydro will have.

Also, the province underwrites our debt. Our debt is probably over half of what the total provincial debt is. I don't really follow every other crown corporation that closely, but it's in the \$10 billion out of \$20 billion range. That money we look after from our ratepayers, but the province charges us a guarantee fee that is in the range of \$100 million a year. That shows up as well in the accounting for equalization, so without that, there would be that \$100 million missing, the \$100-million water rental missing, and another \$150 million from profits missing.

If we doubled our output we would do better. Of course we would do better if we had contracts ahead of time, because we would not be selling it internally, we would be selling it to external markets. But when you compare the potentials between Manitoba and Alberta, or even Manitoba and Saskatchewan, it's just not comparable. That doesn't mean we shouldn't be struggling every day to get to where we have as much of this development as possible. I know there are discussions going on between Ontario and Quebec at the same time, and I hope those succeed. Quite frankly, when you look at our grid, it's all north-south, and we ought to be looking at more east-west in this country. We're also having some preliminary discussions with our neighbours to the west of us.

**The Chair:** Thank you, Madame Smith. Thank you very much.

Mr. Bell, you have five minutes, please.

• (1340)

**Mr. Don Bell (North Vancouver, Lib.):** Thank you.

I notice on page 3 you say that you "urge that mechanisms be put in place to reduce the overall volatility of transfers so as to stop both the panic cuts in items such as a new lower calculation of population growth", etc.

Do you have some suggestions, from your experience, about what kind of mechanisms you would recommend?

**Mr. Vic Schroeder:** I don't have a specific mechanism. The problem is a provincial finance minister gets the phone call in September or October in a year, and suddenly 3% or 4% of their revenues have been lopped off—or the other phone call saying you've got 3% or 4% more revenue. It seems to me that we can't suck and blow on this. If we say there's been a mistake, as there sometimes is in the calculations, and it's picked up, then somehow there has to be a mechanism to gradually move that along in future years, both the upside and the downside. How that would be done, I don't know.

**Mr. Don Bell:** You're identifying the problem as you saw it.

**Mr. Vic Schroeder:** I'm just identifying the problem.

**Mr. Don Bell:** Then on the same page further down, you said: "I have a great deal of difficulty understanding why it is that lower income individuals and provinces are spoiled by having too much income yet wealthy individuals and provinces will do better with more money from lower taxes".

I read that a couple of times, and I don't think I fully understand it. Maybe I'm missing something.

**Mr. Vic Schroeder:** I may be misinterpreting the CD Howe Institute, but my impression is that they are saying that providing funds to the lower-income provinces impedes their progress. I thought Mr. Murray implied that this would prevent our moving from bad programming to good programming. What I was saying was that it's difficult to tell those who have less that taking something away will actually act as an incentive. Then we turn around and tell the successful that we will make them do better by reducing their taxes. So to one group we're saying less is more, while to another we're saying that keeping more income is a better thing.

**Mr. Don Bell:** You talked about the appropriate mechanism for making transfers into a more impartial system. You were saying that the federal ministry, with a huge self-interest in the outcome, is not so much more fair that it should be entitled to set the formula by itself. You also make reference to some other countries in which there are independent commissions. Do you have anything more to add on that?

**Mr. Vic Schroeder:** Not really. Clearly, it can't be the recipient provinces that make the decision.

**Mr. Don Bell:** You're talking about the federal ministry. But who makes the decision, the fox or the hens?

**Mr. Vic Schroeder:** That's a good analogy.

**Mr. Don Bell:** I won't say which is which, foxes or the hens.

**Mr. Vic Schroeder:** In most other instances, there's a champion sitting around the federal cabinet table. If Finance comes along and says, "Justice, you guys have had too much here, so we're going to trim you back a bit," then you're going to have the Justice officials properly briefing their minister and there will be a good, solid debate around the table. Well, that chair is empty when it comes to equalization and all of the other federal transfer programs. If I were the federal finance minister, seeing the pressure, I might have had my officials come along and say, "Here's the solution. Just pass it downhill". And I might have said, "You know, that sounds pretty good".

• (1345)

**Mr. Don Bell:** The federal system, to some degree, addresses this. I was in on the discussions within the Liberal caucus on the transfer of the gas tax. With my municipal background, I can tell you that although we were federal politicians there was a good deal of regional argument, regional representation, from the different provinces. Members were saying, "My province has problems that have to be addressed".

**Mr. Vic Schroeder:** Thank you.

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

[Translation]

Mr. Côté, you have five minutes.

**Mr. Guy Côté (Portneuf—Jacques-Cartier, BQ):** Thank you Mr. Chair. I do not think that I will need my whole five minutes.

Thank you, Mr. Schroeder, for your very interesting presentation. The fiscal imbalance is indeed a structural problem as you have clearly explained. It is also a decision-making and a political problem.

You mentioned the example of the Auto Pact in Ontario. This is a fine example of a case where a series of decisions led to the promotion of Ontario as a place to manufacture automobiles.

You are the chair of the Manitoba Hydro-Electric Board. My question has to do with an issue that surfaces fairly regularly in Québec. Take the oil industry in Alberta for example. Given that the Federal Government has invested in this sector, it can be argued that Manitobans and Quebecers have also indirectly invested in it. In Québec, the Province developed the hydroelectricity industry with little or no help from the Federal Government.

Did Manitoba experience the same situation in developing its hydroelectricity sector?

[English]

**Mr. Vic Schroeder:** Our earlier development of Manitoba Hydro was assisted by the federal government. Our electricity isn't where we need it; there are 700 or 800 miles of transmission lines from our north; it comes direct. Those transmission lines were owned by Atomic Energy of Canada Limited. We have bought them since; we paid rent for them initially.

The Government of Canada was actually a co-proponent of our Lake Winnipeg diversion and Churchill River diversion projects, which triggered the dam building from the 1970s on. We certainly don't see them having the same role now, although we do believe there should be—and I believe the federal government is prepared to come to the table—a role for the transmission of clean power east and west. I think they're interested in discussing that with Quebec as well.

[Translation]

**Mr. Guy Côté:** Thank you.

**The Chair:** Thank you, Mr. Côté.

Ms. Wasylycia-Leis, you have five minutes.

**Ms. Judy Wasylycia-Leis (Winnipeg North, NDP):** Thank you, M. Chair.

[English]

Thank you, Vic, for being here.

You should know, Mr. Chairperson, that Vic and I served in the Manitoba government together around the cabinet table back in the 1986-88 period. I had the privilege of learning a great deal from this Minister of Finance, who probably has one of the best handles on this whole area of anyone I've worked with, so I appreciate the time he's taken to be here.

What I want to talk about is your view on how we should actually address the fiscal imbalance as a committee. I'm raising this from a broader perspective right now, because while we may agree there's a fiscal imbalance, we run the danger—depending on how we address this—of feeding a whole move towards decentralization in this country, where we're pushing the federal government to be simply a cheque-writing agency.

I'm trying to pursue with you how we can actually address the concerns of the provinces. We all acknowledge the huge off-loading from the federal government onto the provinces, the arbitrary changes in the equalization formula, and the pressures right now on provinces to meet the needs of citizens while the federal government is sitting on these huge surpluses. What's the responsible thing for us to do as a committee in terms of recommendations so we're doing something for this country as well as redressing the imbalance?

•(1350)

**Mr. Vic Schroeder:** To begin with, Judy, thanks for the compliment. I must say I found that the best staff in government in Manitoba was located in the Ministry of Finance, as it was at the time in Quebec. They made ministers look better than they possibly were, and I think our ministry is still the strongest ministry in the provincial government. In fact, I started off as Minister of Labour and Minister of Finance, and the departments were like night and day, quite frankly; I can say that 25 years later.

In terms of the entire fiscal imbalance, I don't pretend I can even address the question. When I was called by one of the people in the finance department, they asked me to discuss equalization. That's the thinking I've come here with, knowing it's only one wheel on the car, and you need all of them to get things going. I'm sorry, I'm not going to be able to help you.

**Ms. Judy Wasylycia-Leis:** I appreciate that.

Having sat here all day talking about this, I'm starting to take it off in different directions.

You do address, though, part of this issue in your piece on tax point transfers. You identified the notion of simply transferring tax capacity as a problem from the point of view of nation building. I think that's a good place for us to deal with this topic. How do we actually deal with these divisions between the federal and provincial governments, which are growing daily? I see a crisis looming and I see us on the verge of throwing away those things that bind us together as a nation. How do we actually push this agenda of cash transfers and national programs in a way that will satisfy the concerns of Quebec and in a way that will ensure our federal government is more than simply a cheque-forwarding agency?

In that context as well, the equalization program is, I think you said, the glue that helps bind the sense of nation. How do we hang on to that in the face of the whole move away from that right now? What do we do as a committee that would be most helpful politically?

**Mr. Vic Schroeder:** First of all, as to the transferring of the tax points, what I was trying to get at was to make sure it was understood that simply transferring points from the feds to the provinces would in itself reduce the fiscal capacity of the least well-off provinces. Certainly, if you were just looking at fiscal capacity alone as a factor, then it would make complete logical sense to be transferring more of the capacity to the federal government, which would then equalize everything and send it out across the country.

There are other considerations, and I certainly accept that. For Quebec, there could be a view that it provides too little flexibility, although I'm not sure I understand that argument. That type of thing was addressed, for instance, in the latest health agreement. There was flexibility built into the agreement so one area of the country could be dealt with differently from another...so long as we're focused on solving the problem.

**The Chair:** Thank you, Madame Wasylycia-Leis. We will have another round.

[Translation]

Before I give the floor to Ms. Smith, I would like to ask a question myself. You made me smile earlier when you said that you had great

staff at the Ministry of Finance, which made Ministers look better than they possibly were. I have been listening to you for the past little while and not only are you very interesting and articulate, but you do not need anyone to back you up. You came here unaccompanied. Therefore, to pick up on what Ms Wasylycia-Leis was saying, I believe that you were a very effective Manitoba Minister.

You said earlier that we needed a mechanism but perhaps also an arm's length federal agency with a clear process for calculating equalization payments. This body would be somewhat like the commissions that exist in Australia, India and South Africa.

Last week, in Ottawa, we heard from Professor Watts of Queens University, who raised this very issue. I forgot to ask him the question that I am about to ask you.

Given that you have been an MLA and a minister, don't you think that creating such a body—and the same may be said for Foundations—would take away the right of parliamentarians to vet transfer amounts? Don't you think that it would also mean that the Government would no longer be held accountable for equalization payments calculated by this Commission that do not enable provinces to cover all their required spending? Do you not think that it might lead to further dissatisfaction?

•(1355)

[English]

**Mr. Vic Schroeder:** I would agree with you. We as a society do move certain issues out of government and into expert panels, be it the courts for the interpretation of issues such as our Constitution, or labour boards that have the expertise to deal with issues between labour and management. There are many such examples. The ultimate authority, of course, would have to be something one would want to reflect on. It's just that in our federal system, the way I've experienced it, we would go to the finance ministers meetings or the first ministers meetings and we would all have ample opportunity to have our views expressed, but ultimately he who pays the piper calls the tune, as they say, and I'm not sure that's the best way to go.

I hear what you're saying, and that's a valid point. Because I am not an expert in this area, and I said so right off the bat, I would ask the committee to possibly have somebody take a good look at the systems in those countries and at how they are dealing with that issue. It is important that there is political accountability for the decisions we make.

[Translation]

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

Ms. Smith, you have three minutes.

[English]

**Mrs. Joy Smith:** Thank you.



When we're talking about accountability, there's no doubt that equalization transfers have been and continue to be very important to Manitobans. There's no doubt about that. However, things happen that are beyond our control, and one of the things I've had a deep concern about, of course, is the surplus funds. It's not a small gap, as I said before. It's usually a huge gap between the announcement of surplus funds and in actual fact what there really is, and this does impact, I know, on the provinces, and other presenters today have backed that up.

The other point is the last-minute changes in the amount of equalization dollars received by the provinces from the federal government. Any fiscally responsible government will want to plan ahead. You have to plan ahead. There needs to be some stability on all the variables that come into play, like our flood that happened here in the province and those kinds of issues that we can't predict.

Could you comment, please, on these last-minute changes to the amount of equalization payments that inevitably seem to happen and on how that impacts? What can be done to ensure that doesn't happen? Do you have some ideas on that?

• (1400)

**Mr. Vic Schroeder:** In many ways it's worse now than in my day, because in my day we were allowed to run a deficit. There was another way out. In Manitoba, as in many provinces, we have balanced budget legislation, and of course, there are some ways around it in terms of emergencies and those sorts of things, but it's spelled out fairly specifically.

So the room to manoeuvre is less. I have to admit that I'm not a big fan of that, but time has passed me by and the population agrees with this particular approach, and that makes it all the more necessary not to be moving funds around against the provinces during a particular fiscal year. It's one thing to be forecasting ahead a few years so you have a little room to work on it, but once you've set your budget for the year, you've set your tax policy, etc., you're really in a position where it affects the current program for current real live people. We see that. In the hospital we're seeing that with administration decisions, because budgets from government have been reduced and that has meant that the regional health authority has had to reduce staffing, and they will pass it on. It comes to the hospital. We know it will come to the hospital and we have to grapple with that reality.

**The Chair:** Thank you, Madame Smith.

Monsieur Bell, for three minutes.

**Mr. Don Bell:** Well, thank you, Mr. Schroeder.

The question I was going to ask has already been asked. It was in terms of your approach to what could be done, based on your experience. You gave some examples in your presentation of how you thought some of the decisions could be an economic plus, such as how the disease control centre coming to Manitoba could generate more than what the CF-18 contract theoretically could have brought to the province.

The allocation outside of the equalization payments, outside of these one-offs, as they were referred to earlier, or the location of federal facilities in P.E.I. that you mentioned, and now the tourism centre going to British Columbia—the CTC—will have economic

impacts. There may be only 80 employees, but the spinoffs from that, because of the clustering effect and the other businesses that will associate as a result, can be a real boon.

I don't know to what degree you feel, from your experience, it is an instrument of government or whether it's a blunt instrument, but it's one that's in the tool bag, I guess.

**Mr. Vic Schroeder:** I think it can and should be used by the government. Just going back to the CF-18 and Air Canada, those could be absolutely correct decisions if the government said they have a vision for Canada. Part of that vision is that the aero-industry ought to be located in Montreal. That's fine, but let's articulate that. Then let's articulate what the vision for Manitoba is. What's the vision for other regions of the country? That way we can truly move ahead.

B.C. is a beautiful place. We all know that. It may be the best place for the tourism centre. Some of the maritime provinces are beautiful as well. Had it been located in one of those areas, or in Quebec City, it would have impacted—according to my theory—on Quebec's fiscal ability; it would have improved it, and it would have reduced transfer payments. It doesn't have that same effect in British Columbia.

• (1405)

**Mr. Don Bell:** Thank you.

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

[*Translation*]

Mr. Côté, for three minutes.

**Mr. Guy Côté:** Mr. Guy Côté: Most witnesses we have heard from have spoken of the transfer decisions taken unilaterally by the Federal Government. They have also told us that equalization has been distorted over time, by, among other things, one-to-one agreements. Naturally, there are political decisions involved and you have given some good examples.

If you were to make one suggestion with a view to redressing the fiscal imbalance, what would it be? It is not an easy question to answer, is it?

[*English*]

**Mr. Vic Schroeder:** I really believe it would have to be.... It is fundamentally important, when we're addressing the imbalance between the federal government and the provinces, that we not allow ourselves to be isolated into boxes and argue about one program versus another, but instead view the whole set of arrangements and try to set something up that monitors it, that truly can be a body viewing it from all angles, rather than having one federal department being the champion, being pushed. Every time there's a little crisis down there, the first response is always to pass it down.

Those are the two areas. There are two instead of one.

[*Translation*]

**The Chair:** Thank you Mr. Côté.

Ms. Wasylycia-Leis, you have the floor.

[English]

**Ms. Judy Wasylcia-Leis:** Thank you, Mr. Chairperson.

When the former speaker appeared before this committee, Mr. Stuart Murray for the Conservative Party, he suggested that Manitoba was at fault for not using our resources and making decisions that would put us on par with Alberta, as if there was a similarity between the oil and gas reserves that Alberta is sitting on and the hydroelectric power of Manitoba. That's not really the problem. The differences in our economies are based on Manitoba's inability to grow a competitive economy. I think he ignored the whole point of equalization and was probably making an unfair analogy.

From the perspective of a former finance minister and your work now in terms of hydroelectric power, could you put some of that into perspective vis-à-vis the equalization challenges ahead of us?

**Mr. Vic Schroeder:** Well, I was briefly the Minister of Energy when we built our last hydroelectric station. That was called the Limestone Generating Station. It's a 1,250-megawatt project, which we started off projecting would cost \$2.6 billion, and it came in at about \$1.5 billion.

To a large extent, that was because of a huge drop in interest rates, but nevertheless, we did not start that generating station, which added over 20% to our capacity, until we had a contract in place for a long-term sale of energy. I believe it would be irresponsible for us or anyone else to start a project for a large generating station without knowing where the power is going. We don't need new electricity for ourselves for at least another 15 years. Before we begin to prepare a project, on the one hand, we need a long-term agreement for a clean energy supply.

On the other hand, I go back to the \$7 billion versus several hundred millions of dollars in an ordinary year and add that Manitoba Hydro had a loss of \$460 million a year ago. Our backup isn't as good as Quebec's hydroelectricity in terms of the water levels. We can have dramatic drops, and we expect that once every 10 years or so. When that happens, it hits us very hard.

In a good year, we make \$150 million to \$200 million, and we make up for it over a period of time. But to compare us to Alberta, as some have done, as I've said, is unfortunately not realistic.

• (1410)

[Translation]

**The Chair:** Ms. Wasylcia-Leis, you have time for a fifteen-second question.

[English]

**Ms. Judy Wasylcia-Leis:** I can ask a little question.

That really leads to the final issue for me, and that is the question of how we as a committee recommend a proper formula for equalization. I think there's agreement that there ought to be a ten-province standard. Then the question is on what to do in terms of the revenue that is included.

It would seem to me that you're saying all revenue, including non-renewables, ought to be part of the formula. I think you said that

very clearly. In this present political climate, what's your sense of how we can actually make that a reality?

I know it was possible a few years ago. There seemed to be some agreement among the provinces to move in this direction. I think we've lost a bit of ground with these side deals. Do you have any advice on how to advance this position and on what might have to happen politically in order to effect this formula?

**Mr. Vic Schroeder:** Don't sign any more side deals; promise not to sign any more side deals in the future, and concentrate on all of the revenue. That includes Manitoba. Manitoba could make the argument on why you should take 100¢ on the dollar. I'm happy to see that Manitoba and Quebec have not been taking that particular road.

Other than that, when we go back to what was placed in our Constitution about providing reasonably comparable services for reasonably comparable levels of taxation, I think there is no rational reason why we would not include everything. We didn't say that we're not going to add in the richest province. We've already had the transfer of natural resources back in the thirties, and that's done, but there's no reason not to look at the total wealth of the various entities.

[Translation]

**The Chair:** Thank you, Ms. Wasylcia-Leis.

[English]

Mr. Schroeder, I would like to thank you very much on behalf of the members of the subcommittee. We have benefited from your experience and intelligence. Thank you very much.

We'll have a 15-minute break.

• (1410)

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

• (1430)

**The Chair:** Thank you very much for being here on time.

We have as witnesses Mr. Paul Thomas, a professor from the University of Manitoba, and Monsieur Neumann, CIDA adviser to the Ministry of Finance and Economic Planning of the Government of Ghana.

Welcome, sirs. You will have 12 minutes each to express your points of view, and we will then proceed with a question period by members of the Parliament. Welcome to the subcommittee.

Monsieur Thomas.

**Professor Paul Thomas (Duff Roblin Professor of Government, St. John's College, University of Manitoba, As an Individual):** I agreed to go first, although speaking about federal-provincial fiscal relations ahead of Ron Neumann is a bit like talking about floods in front of Noah, or something like that. He has much more firsthand experience with the topic than I do. Once upon a time, early in my career, I was a very junior public servant in the Government of Manitoba, worried about things like tax sharing and equalization and shared-cost programs. So I'm coming back to this topic after some time away.

Let me begin by welcoming you to Winnipeg and Manitoba.

I also welcome the opportunity to provide some opinions on the important issue of the appropriate balance between the constitutional responsibilities and fiscal capabilities of the two orders of government in Canada. I want to suggest to you that historically Manitobans and their governments have held to a distinctive and relatively consistent view of the federal system and how it should operate.

I think our distinctiveness has come from Manitoba's position as a province in the middle. We're in the middle in several senses of that word. We're in the middle geographically, because we're right at the centre of Canada. We're in the middle economically, because we're neither affluent as a province nor desperately poor; I guess we're more lower-middle class. We're also in the middle socially, as we're a bilingual province with a significant aboriginal population, and a highly multicultural province. Finally, we're in the middle politically, because the most successful provincial governments in this province have been moderate and pragmatic in their approach, both within the province and within the context of the federal system.

So these features of the Manitoba context have caused Manitoba governments to play a mainly constructive role in federal-provincial relations. Manitoba governments historically have not been hung up on protecting their constitutional responsibilities at all cost. They have recognized that federal policy leadership and federal financial support can increase the capacity of the provincial government to deliver high-quality programs that improve the everyday lives of Manitobans. Manitoba governments have allowed, and even encouraged, the use of the federal spending power in areas of exclusive provincial jurisdiction. Even when frustrated by unilateral federal decisions to cut back financial support or modify joint programs, Manitoba governments have not wanted to throw the baby out with the bathwater, to use that expression. They have recognized that the irritants of federal-provincial negotiations are usually a small price to pay for such tangible benefits as better health care, social services, and educational programs, etc., which are in part made more affordable by federal financial transfer payments.

There's a general acceptance amongst informed commentators today that there is a vertical fiscal imbalance between national and provincial governments. Provincial spending obligations are seen as not being matched by access to sufficient tax room or adequate federal financial transfers to allow provincial governments to balance their budgets over the longer term. Several points need to be made about this analysis.

First, treating provincial governments in aggregate ignores the significant differences among them in terms of their individual revenue-raising capacities. Manitoba is a "have-less" province compared with Alberta, which has the economic and financial strength to go it alone in many program fields. In correcting vertical fiscal imbalances, we should not compound the problems of horizontal fiscal imbalances, or the differences among provincial governments in terms of their expenditure needs, which vary by program field and fiscal capacity, i.e. by their relative ability to raise money from different taxation sources.

There are two choices for the national government if it wishes to respond to the current perceived problem of a vertical fiscal imbalance.

The first choice would be to grant the provincial governments more tax room, thereby allowing them to pay more of their own program costs. In my opinion, this approach involves at least two problems: it will lead to a more fragmented and competitive tax system that favours the richer provinces, and secondly, it will worsen the problems of interprovincial disparities in financial capability and programming.

The second choice is to increase federal financial transfers in order to close the gap. This is a difficult option in political terms. After several decades of growing strength at the provincial level and much talk of provincial rights, the suggestion of encouraging national policy leadership through the use of the federal spending power will not be welcome in most provincial capitals.

● (1435)

Unilateral and abrupt changes to joint programs made by the national government, often for short-term, politically opportunistic reasons, have deeply frustrated provincial officials, even in a province like Manitoba, which has historically been committed to cooperative planning, delivery, and evaluation of programs.

I just mention in passing that in 1994 Indian and Northern Affairs Canada changed its policy and no longer paid for a whole set of social services. It meant, in effect, a \$25-million impact on the social assistance budget of the Province of Manitoba. That's one of many examples where Ottawa has changed its support without prior consultations with the provincial governments.

This frustration has led to attempts to restrain the use of the federal spending power by constitutional amendment. The Government of Manitoba was leery of placing strict limits on the use of the federal spending power during the rounds of constitutional negotiations of the early 1990s because Manitoba feared the loss of federal financial participation in existing and future joint programs.

When the attempt to impose constitutional restrictions on the federal spending power failed, the provincial governments proposed an alternative, called the Social Union Framework Agreement, in 1999, which was to cover the main programming fields where joint activity was taking place, as well as establishing rules to govern the future use of the federal spending power. What the national government eventually accepted in terms of limits on its freedom to spend in provincial fields did not go far enough to satisfy the Government of Quebec, so that province refused to sign the deal.

In practice, SUFA, the Social Union Framework Agreement, has not come close to living up to the hype that launched it. It has largely failed as a mechanism to manage federal involvement in areas of provincial jurisdiction for three reasons: first, the refusal of both elected and appointed federal officials to respect the commitment to advance meaningful collaboration; second, the unwillingness of some provincial governments to be held accountable for efficient and effective delivery of programs financed with federal transfers; and third, the non-participation of the Government of Quebec has been a problem for the operations of SUFA.

Historically, Manitoba governments have supported a strong national government. In particular, they have resisted changes to the tax system that would financially weaken the national government to the extent that it could not support shared-cost programs. They have also opposed constitutional rules that would unduly restrict the freedom of the national government to spend in areas of provincial responsibility. For Manitoba, there should be no constitutional prohibition on federal generosity towards the provinces, even if that generosity comes at times with strings attached, provided those strings can be negotiated.

During the 1990s, this historical orientation of successive Manitoba governments changed somewhat. Under the Progressive Conservatives, who governed this province from 1988 to 1999, there was much talk from the premier and the finance minister about the need for Ottawa to cede more tax room to the provinces and for a widespread disentanglement of the existing interlocking activities of the two orders of government. This shift in position reflected the cumulative frustration of dealing with national governments that changed directions and priorities. More specifically, the drastic cuts in federal transfer payments made as part of the so-called program review exercise of 1994 to 1996 at the national level put additional strain on the financial position of the Government of Manitoba, which itself had adopted tax cuts and a tough balanced budget law.

Two general points arise from the review of these events. First, it is crucial to recognize the importance of trust, based on consistent, predictable, and fair behaviour. Trust among politicians and intergovernmental officials from the two orders of government is important to achieving national and provincial policy goals. Second, the events of the mid-1990s illustrate how the overall financial positions of particular provincial governments are affected by their own taxing and spending decisions, not just by the actions of the national government. We need to continue to recognize that the provincial governments are free to levy pretty much any form of taxation they wish, and they, of course, largely set their own expenditure priorities.

The long-term benefits of tax cuts are not disputed by economists, but at least in the short run they represent forgone revenues that could be used to finance rising expenditures, say in the health field, where all provinces have continuously called for more federal spending. With health spending increasing in some provinces at 8% annually and health now accounting for over 40% of total spending in many provinces, there is the legitimate question of whether enough is being done to control expenditures.

● (1440)

Health care is the number one policy concern of Canadians, and there are powerful societal forces and organized interests driving increased spending. However, health care spending is crowding out expenditures in such other provincial program fields as education, social services, municipal governments, and the environment. This in turn creates an opening for the national government to spend in these fiscally starved areas, as exemplified by millennium scholarships, child care, homelessness initiatives, and direct transfers to municipalities. Ad hoc and short-lived federal interventions into provincial policy spaces to seize political opportunities will not serve the federation well. We need better rules and procedures to govern federal interventions and to deal with situations where there is a failure to disagree—and I'll come back to this point in my conclusions.

Another sign of the financial strains within the federal system is the debate over the future of equalization. From its simple beginnings in 1957, this national program has become a grotesquely complicated set of provisions and formulae for the calculation of financial transfers from the so-called "have" to the "have-not" provinces through the Government of Canada. It is important to note that this program is under the control of Parliament. It does not involve interprovincial generosity toward less fortunate provinces. Many detailed changes have been made to the equalization formula as a result of the provision for five-year renewals. These changes have been made at times without provincial agreement.

In my opinion, the most significant changes were made in the 1982 renewal. Without going into great detail, the key changes involved a move to the so-called five-province standard for calculation of equalization entitlements and the decision to include non-renewable resource revenues in the calculations. Put simply, these changes were meant to control federal costs of equalization and to ensure that the province of Ontario never qualified to receive equalization. As a lower-middle-class province, Manitoba was one of the hardest-hit provinces in terms of the loss of unconditional equalization dollars.

Historically, Manitoba governments have taken the position that equalization is not a program like the others. The principle of redistribution of revenues from relatively affluent to poorer provinces is seen as expression of a fundamental Canadian belief in equality of opportunity regardless of where people live. The national government may have the constitutional and legal right to change the terms of equalization over the objections of the provincial governments, but unilateral action and lack of good-faith bargaining violates a fundamental bargain within the federal system.

There needs to be more protection for the principle of equalization and the practice of equalization. Such protection should be both substantive, for example, no unilateral modification to the formula that drops payments to recipient provinces by a certain percentage; and procedural, for example, some specified notice and comment period for new federal proposals and a deadlock-breaking mechanism.

I'm going to skip a couple of paragraphs here just for the sake of time, Mr. Chair.

Recent deals with the Atlantic provinces over retention of revenues from offshore energy development have led the Government of Saskatchewan to insist on similar protection against future clawbacks of equalization payment. More recently, Ontario has complained about a \$23-billion shortfall. Taken together with other trends described earlier, there's a clear trend for all provincial governments to approach federal-provincial negotiations in a more narrowly self-interested manner. The two richest provinces, Alberta and Ontario, have been most open in their challenges to the existing financial arrangements. At an earlier point in the history of Canada, a Quebec premier talked about profitable federalism, which left the impression outside of that province that Quebecers' loyalty to Canada depended ultimately upon some kind of positive bottom-line calculation.

The federal system cannot, however, be judged solely by public finance or accounting criteria. A balance sheet approach to deciding whether a particular province is a net beneficiary from being part of the federal system is narrow and misleading. It ignores the interdependencies and shared benefits that are part of the overall operation of federalism. Even analytically it is impossible to prove without some highly debatable assumptions that any one province would be better off outside of Confederation.

So I make the point that talk of winners and losers in this context is good rhetoric, but it's poor analysis. And Canadians generally, I think, are fed up with the spectacle of governments battling over balance sheets and constant intergovernmental bickering. They want governments to work together to achieve positive results. However, their fiscal knowledge in terms of who levies and delivers which service is abysmally low. Even their knowledge of the fiscal position of their own governments is highly limited.

My conclusion is that government should not strive for some illusory goal of perfect balance between revenues and expenditures for each order of government. Rather, there should be an acceptance of interdependence and the need for mechanisms to deal with intergovernmental tensions.

• (1445)

I note in the paper I've given you that there are many political and administrative forums in existence to allow for communication, negotiation, and harmonization of actions in the field of fiscal federalism. There are a variety of mechanisms that have been adopted over time to resolve deadlocks when the two orders of government reach an impasse. There's been a significant amount of creativity in this regard, which has added to the overall flexibility of the federal system.

Let me conclude with the following comments. There's never been a golden age of perfect balance between expenditure obligations and taxing powers from which the present federal system has sharply departed. Calculations of vertical fiscal imbalance are not "pure science". They are based on assumptions about the economy, trends, and expenditures at each level of government, and all of these assumptions are debatable.

For some time, federal and provincial governments have committed themselves to clarifying responsibilities, avoiding overlap and duplication, and embarking on the path of disentanglement in order to achieve greater effectiveness in spending and strengthened accountability. However, there will always be interdependencies, there will always be the need for joint endeavours, and there will always be some blurring of accountability. Even in a democracy, public accountability should not always trump political and administrative values such as responsiveness, fairness, and equity in the overall operation of the federal system.

There is probably no political support going back to the pre-1977 arrangement of 50-50 shared-cost programs. Those programs were the main instruments of an era of cooperative federalism. The provincial rights mentality is now too strong to allow for extensive federal involvement in provincial affairs. However, there should be a recognition of the legitimacy of the right of the national government to propose new shared-cost programs and rules for determining whether there is a provincial consensus in favour of such programs. From both an equity and efficiency standpoint, this is a better approach to closing the fiscal gap than transfers of tax points, which will only widen the existing horizontal fiscal imbalances among the provinces.

Equalization, I would argue, is not a national program like any other. Its constitutional status and unconditional nature reflect its fundamental importance to national unity and to equality of opportunity. Unilateral and abrupt shifts to the formula for equalization should be avoided. Provincial governments must be directly involved in the broad-based review of equalization proposed by the federal finance minister.

The issues of federal-provincial fiscal relations are fundamentally political, not constitutional or legal. Public finance analysis can contribute to shared understanding, but it is no substitute for political leadership and creative accommodations of divergent interests. Negotiations leading to collaboration may be difficult and time-consuming, but they represent a central feature of Canadian federalism. There is no guaranteed procedural or organization fix to resolving such disagreements, just the willingness to persevere and be inventive.

It would be helpful if all governments sought agreement on the numbers regarding the fiscal imbalance. For example, it is time to drop the description of tax points as a federal contribution, in recognition of the fact that provincial governments have been levying and collecting such taxes since 1977. Provincial governments must accept in a more real way the obligation to report on the use of federal dollars in terms of the outputs and outcomes produced in the policy field, where there is joint involvement. Such reporting is necessary to provide Parliament and the Canadian public with the assurance that national tax dollars are being spent as intended and that value is being obtained from such expenditures.

Finally, the issues of fiscal federalism are highly complicated, but underlying the technicalities are value judgments about what kind of country Canadians want. As the most representative democratic institution in the country, Parliament must be involved in the review and approval of any new deal worked out through the processes of executive federalism.

In the 1980s a similar parliamentary task force, the Breault committee was appointed and did one of the best reports ever on federal-provincial fiscal relations. They added considerably to public knowledge as they toured across the country talking about these issues. I reiterate my point: the availability of federal transfer payments has meant that you can get a better education, better social services, and better health care in Manitoba. Once in a while, it looks frustrating and annoying to watch the spectacle of government disagreeing in public. But it's healthier to have the better programs.

Thanks very much.

• (1450)

**The Chair:** Thank you, Mr. Thomas. You've had 19 minutes, but I am very flexible because we don't have any other witnesses. I have the obligation to give Mr. Neumann 19 minutes because of you.

**Prof. Paul Thomas:** I set a bad example everywhere I go.

**The Chair:** Mr. Neumann, go ahead, please. You have 19 minutes.

**Mr. Ronald Neumann (CIDA Advisor to the Ministry of Finance and Economic Planning, Government of Ghana, As an Individual):** Thank you, Mr. Chairman.

I could go on beyond 19 minutes. I prepared a 20-page paper for you which I understand is still being translated and will be made available to you in due course.

For my opening remarks today, I just want to draw a few highlights from the paper, and then I also want to give an illustration of the on-the-ground dimensions of the issues that you are dealing with, because we sometimes get into theoretical discussions too much and not enough into the practical impacts of it.

The committee asked for evidence-based comments, and certainly I believe there are structural fiscal imbalances between the individual provinces and territories—the horizontal imbalance if you want to call it that—and between the federal and provincial and territorial governments, the vertical imbalance.

I have provided a chart in my presentation that indicates that the provinces and territories, excluding Alberta, had been in deficit for all but one year in the past several decades. The federal government

on the other hand has had eight consecutive surpluses and projects surplus budgets for the next five years.

Looking at the differences between the provinces, there is a paper by Richard Bird and François Vaillancourt—I think both of them have appeared before this subcommittee—called “Reconciling Diversity with Equality: The Role of Intergovernmental Fiscal Arrangements in Maintaining an Effective State in Canada”. It documents the productivity and income differences between provinces, and it documents, interestingly, how they converged on a per capita basis after the implementation of equalization and other social transfer programs in the fifties and sixties, but then they began to diverge again with energy price spikes.

I think this data that they provided is strong evidence that equity and growth go well together, and it debunks the idea that equalization is somehow a welfare trap. The greater the equity, the stronger the growth.

Both kinds of imbalances threaten Canada's social and economic progress because they impede the appropriate allocation of resources to social programs as well as to provincial and municipal infrastructure.

The federal government argues that there is no imbalance because provinces have access to the same tax basis. However, public spending that would rely on unequal provincial tax bases would be lower than if the bases were equitably distributed. We end up with tax rates most appropriate for the most affluent provinces and services that are underfunded in all the regions without the strongest tax basis.

Canada, prior to 1957, had very poor social programming. Then we built our social safety net to international standards using both the federal tax base and an equalized provincial tax basis. However, since 1992-93, as shown in my paper, we have again relied increasingly on unequal provincial tax bases and an inadequate five-province standard for the equalization program.

The result has been that our public program spending as a proportion of GDP has fallen by 22% and is now falling to the lowest rung among the G-7 countries and indeed among most of the industrialized countries of the world. Our percentage of GDP spent on public programs is 33% below that of France, 25% below Germany, 20% below the U.K. We are almost at the level of the United States and Japan in 2004, and I wouldn't be surprised if in 2005 we're at the very bottom in terms of our public spending. We can't have a sound universal public health care system, first-rate elementary, secondary, and post-secondary education systems, adequate and well-maintained municipal infrastructure, family supports, and a war against child poverty with such a low level of public spending.

Also, disparities that exist between provinces impact negatively on productivity growth and economic development in the regions. Canada is strongest when all the regions are strong.

We have the tools in Canada to rectify these conditions. We have an obligation to the equalization provisions of the Constitution, and we have the financial resources to address the imbalances given the federal surpluses at the present time.

• (1455)

To start with, there needs to be a revitalization of the debates on fiscal federalism using the structures and mechanisms supporting negotiations on intergovernmental fiscal issues. These include regular meetings of first ministers and finance ministers, and their supporting entities.

When I first joined the Department of Finance and first became involved in federal-provincial relations, I early on attended a meeting of the deputy ministers of finance. It was called the Continuing Committee of Officials. That was the longest-standing committee of officials that existed. It was a very strong committee. It met regularly. It provided good advice to ministers. It had a number of subcommittees that reported to it. One of them was the economic and fiscal policy branch, which probably, if it were in existence over the last 10 years, would have been able to identify up front the fact that there were growing federal surpluses and that the budgets weren't exactly reflecting the true economic and fiscal situation of the country. That subcommittee is virtually non-existent these days. It usually meets after the budget and just takes on information, rather than providing information and providing a dialogue. It's the same with the Fiscal Arrangements Committee; it is not anywhere near as active as it used to be.

Anyway, despite this fact, the recent agreements arising from the first ministers meetings in 2004 may signal a welcome return to cooperative federalism, and I believe this spirit needs to be nurtured. This comes after a period, from 1961 to 2001, in which transfer revenues as a proportion of provincial revenues declined by 54%. You heard this morning Mr. Murray, the leader of the opposition in Manitoba, talk about Manitoba's growing reliance on equalization. In fact, transfer payments have declined by half as a proportion of provincial revenues over that 40-year period between 1961 and 2001. However, the 2004 arrangements, especially with respect to the equalization program, were highly flawed, and even those arrangements are further damaged by the 2005 offshore arrangements.

It has reached a point where the equalization program may even be increasing rather than decreasing disparities among certain provinces. This, in my view, would constitute a violation of the constitutional commitment and may open the door to litigation on the issue, which I think would be a great tragedy for Canada if it should ever happen. These matters should be resolved through discussion and not through litigation, in my view.

There are some proposals I could put forward, which I do in the paper. Consideration could be given to the development of a single program to address both types of fiscal imbalance, such as used in Australia. This program would provide payments to all the provinces, including Ontario and Alberta. Alternatively, maintaining the Canadian pattern, which has an equalization program separately and other transfers to address imbalances, requires the explicit consideration of the effort given to address the imbalances among the provinces and territories and their local government, and the

effort given to address the vertical federal-provincial-territorial imbalance. Not enough attention is paid to maintaining that balance between the two types of programs.

The equalization provisions of the Constitution must be respected. This requires a full recognition within the formula of all revenue sources used by provinces to finance public programs, whether derived from income or wealth. I want to emphasize that subsection 36(2) of the Constitution cannot be satisfied, in my view, if revenues used by provinces to finance public programs and arriving from non-renewable resources are excluded from consideration. Reasons for excluding those revenues from the equalization formula, some of which have been presented to the subcommittee, are not valid and must be rejected. In my paper I give reasons for this.

Consideration could be given to excluding some of the resource revenues placed in heritage funds until such time as they're used to provide public programs.

• (1500)

There are other means than equalization to address imbalances. If there is a resort to tax transfers to the provinces, then Canada must have an effective system for equalization to offset unevenly distributed provincial tax bases.

Alternatively, another way to address the problem is that this country could rely more on federal taxation accompanied by higher levels of other transfers to provinces. There could also be some shifting in the tax bases that are used, from bases that are highly inequitably distributed to bases that are more equitably distributed. In this regard, in particular, if there were a move to transfer the corporate income tax base to the federal government in return for something like more of the GST-PST taxes—those are more equitably distributed, while the corporate income tax is highly inequitably distributed—there could be a lessening of equalization and a more fair distribution of tax room.

In my paper I give reasons why I believe the most appropriate formula for equalization would be based on a representative tax system, as opposed to a macro formula. There would be full inclusion of all revenues, and a standard that was adequate, affordable, and based on the circumstances of all ten provinces. Certain macro formulas exclude resource revenues in whole and part. They can't take into consideration things like a progressive income tax system. They can't take into account the exportation of taxes, and so on. That's why I'm saying it should be a representative tax system, with full inclusion of revenues, and a standard that is affordable and based on the circumstances of all ten provinces.

Finally, the formula would need to be responsive to emerging conditions and not be a fixed-sum total. I don't think you can have a fixed-sum total that would do the job for equalization.

Other transfers may also be useful in addressing imbalances, in addition to addressing other important areas of public policy. I think they work best when they respect the division of powers within the Constitution. Perhaps the development of these programs should adhere to the principles and practices incorporated in SUFA. They may incorporate asymmetrical elements and opting-out provisions.

Finally, changes to the actual division of revenues through taxation measures should be done in a coordinated manner amongst the provinces and with the federal government. The harmonization of provincial corporate income tax rates within a narrow band, or the transfer of corporate tax to the federal government, would lessen a major concern about economic distortions arising from the current fiscal imbalance. In general, less reliance by provinces on unequally distributed tax bases would also reduce the need for equalization and other transfers.

In my paper I conclude with these and a number of other proposals that could be considered for recommendation by the subcommittee.

On Saturday in the *National Post* there was an article by Michael Ignatieff that raised an alarm and suggested that we needed a royal commission on intergovernmental fiscal relations in Canada. He suggested the ad hoc approach being followed in Canada over the past number of years was inadequate for the task. I don't know if I agree with him about a royal commission, but I do agree we have to get away from the ad hoc nature of the changes we've been through in the last number of years.

I have presented a long paper, written in my best bureaucratic language, which I learned from my 33 years with the Manitoba government. But I'm no longer a Manitoba government bureaucrat, so I want to take a little bit of licence and, with your indulgence, just spend a couple of minutes laying out a scenario that may illustrate the issues and the gravity of the issues that may arise over the next little while.

Let me preface this with an assurance that this is not meant to denigrate the Alberta government in any way. I believe they've been very responsible stewards of their wealth. To date, they haven't tried to become a tax haven. I don't believe they have provided undue subsidies to attract businesses to the province. I don't think they have built firewalls, despite all the talk in Alberta about firewalls.

• (1505)

So here's the scenario.

In 2005 oil rises in a super spike to \$100 a barrel, driven by exploding demand in China and India and by unsettling events in countries such as Nigeria, Venezuela, Russia, and some Arab countries. In 2006 natural gas prices follow, doubling. In 2007 Alberta is putting together its budget, and it realizes it doesn't need to collect either personal income tax or corporate income tax to balance its budget, to put money away for less buoyant times, and to pay for all its spending. It declares a temporary tax holiday on these sources, which is extended year after year, much the way the temporary income taxes were originally extended year after year, because oil and gas prices do not revert to the previous low levels.

During the rest of this decade, the economies of Ontario and other provinces that don't have such resources are suffering from the

effects of a high Canadian dollar. Manufacturing businesses extract a series of concessions from workers to keep their plants open. Financial enterprises, particularly in Ontario and in Winnipeg, Manitoba, consider moving to Alberta. This is promoted by senior executives who make six- and seven-figure salaries and who see great advantages in not having to pay personal income tax. It's a pretty easy sell to their boards because, after all, there's no corporate income tax either in Alberta at this stage.

From 2010 to 2015 Calgary enjoys a spectacular boom, doubling in size to two million. The commutes to work extend to an hour and a half from the new suburbs. The Canadian economy is not doing badly, but most of the growth is in the three western provinces. Ontario and Manitoba grow very slowly, hurt by the high Canadian dollar, which benefits from strong cash inflows from the oil and gas industries and lower wages and migrating industries.

Unfortunately, behind the unwashed windows of the vacant office buildings in Winnipeg, tens of thousands of children, predominantly poor and aboriginal, are growing up angry. Neither the federal government nor the provincial government is helping, the federal government because long ago they decided urban aboriginals were not part of their core business, and the provincial government because they felt they couldn't raise taxes and increase that tax gap between themselves and Alberta.

So the children turn to gangs that specialize in drugs and prostitution to find their way out of poverty. The affluent people in these areas have left the neighbourhoods. They didn't stop in the Winnipeg suburbs but went right on to Calgary, which adds another half million people to its population, and the gangs take their trade across Canada to wherever there are paying customers.

In Winnipeg in 2019, on exactly the 100th anniversary of the Winnipeg General Strike, the first of the urban riots occurs. Three city blocks are razed to the ground.

In 2020 the troubles are repeated and they spread to other urban centres. Even Toronto, during one of the periodic electricity blackouts, suffers a "black day in July". Canadian peacekeeping troops are called in to restore order and avert the situation that happened in Detroit five decades earlier.

In 2025 the Alberta gas fields decline in production so severely that Alberta starts to draw on its heritage funds. The coal seam gas that could replace it can't compete with the ever more efficient electricity production from a combination of wind and hydro power. By 2035 the heritage funds are low, and the seven million people in Alberta once again start paying PIT and CIT.



I believe we can have a better scenario than that in Canada without all that disruption and grief to many Canadian citizens, and this subcommittee can provide some of the answers.

Thank you.

• (1510)

**The Chair:** Thank you very much, Monsieur Neumann.

[Translation]

We will now move on to questions from members, but before we do, I should like to add something to your 2020 scenario. In April 2005, it was suggested that the Federal Government create a Royal Commission of Enquiry on Taxation. The Government refused and in so doing, saved itself 50 million dollars. However, a mere subcommittee, costing a hundred times less, has succeeded in coming up with solutions to ensure that your 2020 scenario never happens. You might want to use that to supplement your narrative, which, by the way, is very interesting. I am a fan of Isaac Asimov and I felt that I was listening to a none too cheerful vision of the future.

Mrs. Smith, you have five minutes.

• (1515)

[English]

**Mrs. Joy Smith:** Thank you.

It's a lot to take in, to hear both of your presentations, Mr. Thomas and Mr. Neumann. I found them unusually insightful and very steered toward problem solving—very candid. I didn't see any political swing of any substance such as what you will often hear. I was extremely interested in them because I found both of you put a lot of very knowledgeable thought into problem solving on this dilemma.

But it seems to me there is one thread I kept hearing in both of your presentations, and basically it's something I've heard all afternoon. That is, number one, when you have transfer payments, when you have surpluses that are announced—and I've said this before this afternoon—when you then get the surprise that those surpluses are much more than anticipated, and then when you get ad hoc announcements being made—and “ad hoc” came out quite a bit in your presentation, Mr. Neumann—it really throws the balance of everything off.

Clearly, what I heard from both of you is that equalization payments are a given here in the province of Manitoba, and I liked your term “have-less”. I hate it when people say we're a have-not province. I don't think we are a have-not province. I think we've done many wonderful things in this province.

But when you get right down to the needs of the people, there has to be a way of dealing with equalization in such a way that it really works, and with no surprises.

I was wondering—and either one of you can answer this, because both of you gave such comprehensive papers—when you were talking about the liaison between the provinces and the federal government, have you thought about the logistics of actually how we could get the provinces together to have an agreement and have a

vision for looking at all of Canada instead of at just one individual province?

All of us are territorial. I admit I'm territorial here in Manitoba. There's no other province as wonderful as Manitoba. But for the purposes here of our committee, it's incumbent upon us to look at the national level and to address the question of fiscal imbalance. We need to be doing that.

Obviously you two are very well equipped to give us some advice on that. If each of you were to take a turn to expand on what I have said, I would be so grateful.

Thank you.

**Mr. Ronald Neumann:** There are a number of things I could say. One is that in the last decade there's been a strengthening of the interprovincial dialogue. In the past this had led to a number of consensus positions on fiscal imbalance that were supported by all the provinces, Alberta and Ontario, the wealthier provinces, and Quebec and all the other provinces as well. This included more money for health care, and associated with that there was to be consideration of a ten-province standard for equalization with full revenue coverage.

This was the agreement. These kinds of agreements can be reached among provinces. They're difficult at times. Sometimes they can't be reached. But even if the provinces themselves came up with these consensus positions—and maybe they could do more of it through the Council of the Federation that has been set up—they would need to get the federal government to join them and to agree.

Maybe a better way, or an equally valid way, is to reinvigorate the mechanisms that had served us so well for the previous fifty years, which have fallen into disrepair through the 1990s and early into this century. Those were the regular meetings of first ministers, regular meetings of finance ministers, and all the supporting structures that went with them. There was good dialogue, and there was the ability to agree and disagree around the table based on data and analysis that had been jointly prepared in advance of those meetings.

• (1520)

**Prof. Paul Thomas:** I have just a brief comment.

Ron has more firsthand experience of these intergovernmental forums in recent time than I have. I make the somewhat glib comment in the paper that if committees alone could solve these problems, we'd have perfect harmony. Hotels and airlines would never run deficits, because there's a lot of intergovernmental travel that goes on. All federal systems feature an extensive array of committees and forums in which to hold debates and so on.

As an outside observer, I've watched the provinces going to western provincial meetings. Once largely social occasions, they have now become working meetings. That's pretty much across the board now, so there is more commonality among provincial positions. The Council of the Federation, I think, is the culmination of that process.

I would say this as well. When there's a major renewal of the fiscal arrangements, as I said in my opening remarks, I think Parliament should be involved. Individual provincial governments are not supposed to forsake the fundamental interests of their citizens. They're expected to go there and lobby, but they're also speaking on behalf of a government entity—namely, in this case, the Government of Manitoba—whereas you represent individual citizens for the purposes of national policy-making. That's a different representative mandate from the one a provincial government has.

You may not have the profile that a premier has when he speaks in public, but you have a role to play. I think these agreements, before they're finalized and come into Parliament as legislation, should be the subject of parliamentary hearings so that interested groups in the social policy fields, the environment and so on, can have a chance to speak to Parliament.

If we had a more legitimate Senate, which is a whole different topic, then the Senate might play a role in terms of protecting interests that may not get captured by the provincial government, which has its own budget to protect, whereas you listen to the geographical constituencies and policy communities that are out there. That can be helpful, I think, in pushing the actors and the players in executive federalism to come to an agreement.

Again, we have deadlock-breaking mechanisms of all sorts. We've been very inventive in that way, more than most federal systems. Again, I'm not sure we're short of those mechanisms. We need more political will. Parliament putting pressure on the politicians who participate in the intergovernmental arena would be helpful, I think.

**The Chair:** Thank you, Madame Smith.

Mr. Bell.

**Mr. Don Bell:** Thank you.

There is a lot of information here.

The summary would have been a good one to have as well, Mr. Neumann. One of the issues I was interested in, and on which we've had comment today, was the inclusion of non-renewable natural resources in some kind of formula. On page 11, where you've done the Q and As, the view and response, in glancing quickly at it, you believe they should be included. Is that the bottom line?

• (1525)

**Mr. Ronald Neumann:** Absolutely.

**Mr. Don Bell:** Okay, I'll simplify the answer. I'll have a chance to read it in depth. I tried to skim it, but the speed-reading course I'm taking isn't quite working yet.

My other question is for Mr. Thomas.

When you were going through your presentation you skipped the paragraph at the top of page 5. The reference here is that we have the new equalization formula, with the funding floor of \$10 billion and the growth rate that's been built in of 3.5%. And I think an earlier presenter showed that this 3.5%, by not reaching the GDP, will actually result in a decline—you need to be closer to around 4.5%.

You're acknowledging here that there is the opportunity for greater predictability, which is one of the things people have been talking about, getting a longer perspective in terms of the funding and

moving away from the ad hoc or surprise announcements. You're acknowledging the fact that the finance minister has come up with his promise of independent review and you're suggesting that there should be some provincial governments...and then you also want a parliamentary committee to commit to a review.

The point I'm getting at here is that this sounds like you do see some benefit to what's being proposed or to the actions being taken by the federal government.

**Prof. Paul Thomas:** Yes. Because I've been away from this for some time, and I've come back to it on short notice, I didn't get a chance to look at the way these calculations would play out over a number of years.

It seems to me that with all of these formulas you have a conundrum, or a dilemma. You want fiscal discipline and predictability, so you want to be able to say, with some predictability, that this revenue stream will continue over a number of years. Yet as Ron Neumann noted, you also want the system to be responsive to changing economic and financial circumstances of government. It's a bit like baby's porridge in the famous fable. It can't be too hot or too cold; it has to be just right. How do you rig the formula so that you get the reflection of the economic circumstances of the day and the financial conditions of government? We've opted for a five-year time horizon for renewal, so the formula basically is intact for that period.

If the federal government wants to unilaterally change something, it can, and it has done that in the past, over the heated objections of the provincial governments. When you look at program review cuts, Ottawa actually applied budgetary restraint more severely to its own spending programs than it did to joint programs, and that was when the provincial government here used to complain very loudly about the \$18 billion, or whatever, was lost as a result of the program review exercise. Ottawa also cut, quite significantly, its own expenditures.

If I were a member of Parliament, I would say two things. First, I don't want to be left with national defence, the post office, and the RCMP as national policy responsibilities that barely touch the lives of Canadians. You need to be involved in more significant policy fields than that. Secondly, as a national parliamentarian, I would want to have some assurance that the money I'm transferring to provincial government is being spent for the designated purposes. I would also want to have some reasonable indication, given all the difficulties, that I'm getting value for money, that I'm getting some additional benefit in terms of improved health outcomes, educational outcomes, or social policy improvements, and so on.

I take the role of Parliament in all of this very seriously. There are all sorts of ministerial conferences that go on over this, but Parliament has pretty much been shut out of it, and this is an area where Parliament should.... It's so important to the life of the country that Parliament should not be brought in at the eleventh hour, either to cheer or to boo at the outcome of an intergovernmental process. Parliament should have more chance to influence—not real control, but influence.

[Translation]

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

Mr. Côté, you have five minutes.

**Mr. Guy Côté:** Thank you Mr. Chair.

I would like to thank Mr. Neumann and Mr. Thomas for your presentations. I would also like to suggest that you add to your scenario the fact that Québec will gain its independence some time in the future. However, that is an issue for another day!

Mr. Thomas, I am certain that you will not be surprised to hear that I agree with much of what you have said here today but, by the same token, I deeply disagree with some of the notions you have expressed. You have put forward a real grab-bag of ideas. Indeed, you have given us much food for thought.

I am somewhat surprised to hear you say that there would probably be no political support today for a return to a 50-50 cost-sharing formula. I cannot claim to speak for the Québec government, but I think that if a proposal were made to bring transfer payments for health and education back up to 50 p. 100, there would be political support for such a move in Québec. I do not doubt that the Liberal government in Ottawa would not agree, but I think that there would be political support for such an initiative among the provinces.

Having said that, to a certain extent, you draw a link between federal spending in areas falling under Québec's jurisdiction and the need to increase the accountability of the provinces to the federal government.

Two questions come to mind.

Firstly, doesn't that protect the provinces from the unilateral decision that you have mentioned? Indeed, there is nothing stopping the Government from withdrawing from the funding arrangement almost at will.

Secondly, would it not be much more effective in terms of transparency and accountability if all taxpayers knew that a specific amount of health care funding came from the Province? That would avoid situations... In the mid-1990s, the federal government withdrew from funding but it was the provincial governments that paid the political price since they had little wiggle room available to them. I am sure that the same thing happened in Manitoba as occurred in Québec and in other provinces for that matter.

Do you not think that contrary to what you have said, it would be more effective for the federal government to withdraw from areas of provincial jurisdiction? Wouldn't that lead to greater transparency and accountability?

• (1530)

[English]

**Prof. Paul Thomas:** I have a couple of quick responses.

Yes, I think in the health field provincial governments have become so desperate for additional resources to spend on health care—the highest priority of Canadians—that they might accept federal transfers with strings attached again. But if you ask them that across a broad range of policy fields, they would probably take a different perspective. I'm not sure in post-secondary education whether they would welcome Ottawa giving grants indirectly or directly to universities and colleges in this country.

So I think the response would be selective. And you also have to remember that it also depends on the national government's willingness to use that granting mechanism.

Regarding transparency and accountability, those are virtues that everyone has to be in favour of. But the real question is how you achieve meaningful accountability. Increasingly, in a joined-up world, the actions of the two orders of government interact with one another and produce outcomes. If you say that the federal government, in spending in its areas of responsibility, has an impact on what happens in the provincial field, then you're going to have to find some way to ensure that they harmonize their activities.

We know now, with the Health Council of Canada and the annual report on indicators of health, for example, that you can get a glimpse of the provincial population in Manitoba and how its health status is improving or declining across a range of indexes and how health services are being delivered. The sad news is that very few Canadians are aware of those reports. Very few use them, and when you ask Canadians what level of knowledge they have about which order of government does what in the federal system, they're blissfully unaware. They don't know and they don't care, quite frankly. It's not their job to sort out the intricacies of federal-provincial relations. That's your job, in fact. They see that you should do that—the politicians should do that—and should leave them alone.

I don't think this goal of strengthened accountability, which Tom Courchene and others have been arguing for through extensive disentanglement of the two orders of government, is going to bring us to some sort of nirvana, where everyone will have just the right amount of tax authority and just the right expenditure obligations; they'll do their thing over here, and another order of government will do their thing over there, and we'll be able to point the finger at one level of government and say, "You did that alone, therefore you're to take the credit or the blame for it". I don't think that's going to happen in practice.

And quite frankly, if I had to give up a little bit of accountability to have access to improved health care services, I'd take the health care services any day of the week.

**Mr. Ronald Neumann:** I would add just a wee bit to that.

I'm a little more optimistic about the level of awareness of the Canadian citizenry. Let's look at 1995 and the large cuts by the federal government, and yes, the consequences did initially fall on the provinces, but ultimately the Canadian public became more aware that there had been two orders of government supporting it, and that one had withdrawn a significant amount of money and the other one was maintaining their support. Gradually that message got through, and gradually the federal government started to address the issue. It felt some responsibility. It felt some heat from the Canadian public, and eventually it came around and the deals of 2000 and 2004 were struck.

The Canadian population may not have all the details, but given enough information and some time, I think they can sort through the issues of which government is doing what, even when it's a shared jurisdiction.

• (1535)

**Prof. Paul Thomas:** I would make a quick additional point to that.

Australia was ahead of Canada in terms of collaborative arrangements in intergovernmental fields, where there's a mandatory obligation to report on outcomes. So in health, social services, education, housing, and disability policy, the Commonwealth government, the national government, gave money to the state governments but insisted, as a price of that transfer, that they report on what progress was being made.

I have an article here from the *Australian Journal of Public Administration* from March 2003, which reports very discouraging news about the willingness and ability both to use that information to hold governments more accountable and, even more important from my point of view, to use that information about joint programming to improve that programming.

Presumably you report not just for the sake of reporting; you report because you hope you'll notice problems arising in these program fields, and the paying government, the national government, will say to the state, "You're falling behind in terms of literacy, and we'd like you to give us a plan for improvement before we make our next state commonwealth deal with you". To me, that would seem a more constructive approach than naming, blaming, and shaming governments and pointing their fingers at one another.

[*Translation*]

**The Chair:** Thank you, Mr. Côté.

Ms. Wasylycia-Leis.

[*English*]

**Ms. Judy Wasylycia-Leis:** *Merci, monsieur le président.*

Thanks very much to Paul Thomas and Ron Neumann for what was probably the most comprehensive brief we've received anywhere on our voyage across the country. A special thank you to Ron Neumann, who made a trip back from Africa, where he's working on a CIDA project, just for this hearing.

Both of you have addressed some things we're all agreed upon. First, you considered the critical nature of the fiscal situation or fiscal balance in Canada. Secondly, you looked at equalization as something that's vital to our nationhood, the glue in the federation.

That's something that doesn't seem to be relevant or alive in Ottawa at all. There's no sense of it there. We come out here and we get the sense of a crisis and we feel it. But in Ottawa it's not relevant; it's not apparent; it's not present at all. The federal government does not want to recognize either the fiscal imbalance or the problems created by side deals. If there's anything we've learned today in Manitoba, it's the danger of ad hoc decision-making.

I'd like to hear recommendations from both of you for our report, since you both have said that a lot rests on our work. I'd like to divide it into a few areas.

One is the role of Parliament and what we can recommend in that regard. How do we become more than a rubber stamp for inadequate equalization deals, like the one we just had to sign on to, or these side deals that are pretty hard to vote against because of how they transpire? I'd like some views on what we could do to change the institutions around Parliament to make it more effective in this area.

Secondly, it seems to me the other big area is federal-provincial cooperation, which both of you have mentioned as being in a pretty dismal state, with very few regular meetings between finance ministers. We're in a time of wrangling, and there doesn't seem to be any way out.

Thirdly, there's the question of the fiscal policies of the federal government. Ron, you mentioned the drop in the amount of GDP that goes to programs and the need to address this as part of what we do with respect to equalization, transfers, and the whole fiscal imbalance. We still have a huge federal surplus that is largely going towards tax cuts or debt reduction, with only a minimal amount going to increasing the share of GDP for programs.

What would you recommend on that front? How do you respond to the questions about the solutions being offered—the Council of the Federation, a panel of experts, a royal commission? What about some of the other solutions for finding our way through this maze of problems?

• (1540)

**Mr. Ronald Neumann:** As far as the process goes, if the Council of the Federation can entice the federal government into a dialogue with it, and if the Council of the Federation is indeed cohesive, then that's one way to go.

Personally, I put greater faith in the mechanisms that were there in the past, where the federal government and all the provinces and territories sat around one table, and that means a revitalization of these mechanisms that served us well in the past. That involve first ministers meetings called on a regular basis, and finance ministers meetings that are regularly scheduled pre-budget, somewhere in the middle of the year so that you can take stock and plan for the next round. The committees would share information, share analysis, and provide a forum for putting forward different policy options and the consequences of them, so that it's well understood by all parties. You bring together as much of the brain power as you have to apply to these issues, and you bring in all the different perspectives of all the different regions and provinces. Once you bring that together, you have a better chance of arriving at a reasonable consensus.

Certainly the collection and dissemination of data is not a good as it used to be. Paul has talked about some new types of data on indicators of actual outcomes of policy. But we also don't have much in the way of a macroeconomic scenario that is shared amongst governments—what that truly means for the federal fisc, what it would mean for the provinces. So we don't have a good understanding of what the existing situation would be. Nobody has looked at the consequences of \$100 a barrel for oil. I've just made something up as I went along. Nobody has looked at that. It could be a reality, and it could be a reality within a year, and nobody knows what the consequences are.

So we have to revitalize those if we're going to run the country effectively and arrive at any kind of consensus on how to move forward.

**Prof. Paul Thomas:** I have a quick couple of comments.

I don't like the idea of a royal commission. It would be good for political scientists like me, because I'd probably get a research contract or two out of it, but that's not the aim of this exercise.

If I were giving advice to the Minister of Finance, I'd have somebody in the large house called the Department of Finance draft a long discussion paper of the pros and cons of different options; put it out in Parliament; give it to a small roving committee to go across the country; invite provincial representatives to come to offer their perspectives on it; and write a report, based as much as possible among committee members—all party members—on a consensus that went through the issues. That's the way to do it. I would have a significant research staff, a research capability for that committee so it can do independent work. I would call upon the expertise of the academics in the field and the think tank representatives who are experts in that—retired public servants like Ron Neumann, with lots of expertise. That way you mobilize support.

It's a bit like the pre-budget consultation exercise. These are crucial decisions for the country, and they go far beyond the internal calculations of the formula. They're about what we want the country to stand for, as I said earlier.

On federal-provincial collaboration, it would be helpful if we had shared understanding of what the data is. Most data is dumb data. It doesn't speak for itself; it has to be interpreted, and different people see it different ways, but it would be helpful. At least we'd have the same numbers to start from. Statistics Canada does a good job on a lot of things that flow into the intergovernmental arena, but officials below the political level have an important role to play in reaching common understanding of that information and bringing that consensus into the hands of ministers.

Ron didn't give you his opinion, because I think he did earlier, about the size of government in Canada today relative to other countries in the world. Those measures are always debatable, but I would say generally that the numbers he cites reflect my understanding of where Canada is as a country in terms of the role for government.

We came through some seriously hard times during the 1990s. We cumulatively made a big impact; we solved the financial deficit, but in the process we created a social deficit in many ways—not intentionally, in a way that somebody wanted to make it harder to

have enough child care places and so on, but because we had to do things financially at the time.

We've come out of that now. Canadians, after a decade of living through that, have come out with diminished expectations of government, and we've also come out of it with the word “deficit” as almost our last dirty word, as if everyone's afraid to utter it. Whether you have a balanced budget law or not doesn't seem to matter; no government is prepared to tell people they're prepared to invest for the future by running a deficit, and that maybe over the cycle of a government—five years in office, or something like that—they might see a balance.

Those are the political realities, and people at the centre of government presumably have to make those calculations. It's coming increasingly to our attention that things are being left undone and people are being harmed because we haven't spent enough. We've got to spend smart, and that means the two orders of government can't afford overlap and duplication and inefficiencies, so they've got to work together. That's where the pooling of political and financial risk is important. That's what governments can do.

It means people in less fortunate provinces, like Manitoba, get the benefit of greater equality of opportunity. We're not talking about equalizing everybody; we're talking simply about providing basic services so people can have an opportunity in life. When we have minorities like aboriginal people here, it's a serious public policy challenge, and Manitoba, quite frankly, can't respond to those challenges and opportunities on its own financial resources.

• (1545)

[*Translation*]

**The Chair:** Thank you, Ms. Wasylycia-Leis.

Before we wrap up, I would just like to take advantage of the opportunity that Mr. Neumann has given me to talk to the issue of aboriginals. I think that Mr. Thomas also referred to them in his conclusion.

In 1982, I had the opportunity of visiting Winnipeg several times. I spent five days here that winter and I realised just how cold it can get in this city in the depths of January. I later returned at about this time of year during the debate on the Crow subsidy. At that time, I was working for Agriculture Canada. I did a lot of walking around Winnipeg.

Yesterday afternoon, I went out and about again. I retraced my steps along all the streets that I found so interesting then - and still do, by the way: Main Street, Portage, etc. I noticed that things were quite different from 1982. I was especially struck by the number of young people and First Nations that I saw. I have had several conversations with Judy's colleague, my friend, Pat Martin since we both sat on the Aboriginal Affairs committee for two and a half years.

Last evening, it occurred to me that if anybody is a victim of some form of fiscal imbalance, it is aboriginals. They have been dispossessed of their lands and resources. They have no right to tax revenue from resources that used to belong to them. They have often been forced to leave their traditional lands where there were significant oil and forest resources.

Last evening, it occurred to me that the aboriginal issue should perhaps be part of our debate on the fiscal imbalance. In speaking of independence, we should ensure that lands be ceded to First Nations to allow them to flourish. We should also be considering sharing sources of tax revenue.

I would like to know your thoughts on the matter. Do you not think that this would be a way of encouraging the young and not-so-young aboriginals that I saw yesterday evening, to return to and develop their own lands, and in so doing recover their lost dignity? In a nutshell, do you not think that this would enable them to lick their wounds and to look to the future?

•(1550)

[English]

**Mr. Ronald Neumann:** Thank you for the question.

Before I joined the Department of Finance, I used to work in the aboriginal area, and I worked up north, in northern Alberta and in northern Manitoba, for a long time.

I don't think strengthening the reserve system is likely to yield long-term benefits. The pressures in the world are such that futures are found in urban areas more than outside of urban areas. There isn't a lot of land currently not being used that would be suitable for increasing the productivity of that group.

When I worked in the Pas and Lac La Biche, Alberta, we talked about how there was no violence. There was poverty, but we said we were raising a generation of young people who might turn angry, and that when they came to the city there were going to be problems. Now we're seeing those problems in Winnipeg, and we're seeing a great number of deaths, and we're seeing a great deal of other problems. And they're not going to stay within the aboriginal community forever, either; they're going to spread out, just as they did elsewhere.

Expenditure need is a hard concept to get your head around—how to calculate it in terms of a formula—so we tend to shy away from it, but if there is a case for expenditure need within the equalization program, I think that should be the number one area we're looking at with respect to aboriginal people in terms of adding another factor into the equalization program to take care of those problems and opportunities, as I think Paul said. Our future in Manitoba depends a great deal on the future of the aboriginal people, and we have to turn the current situation around. I think it is possible, but it will take some upfront cash and some programming, and we can't forget them.

So if we look at a province like Manitoba, fortunately there are opportunities in education, and we can do a lot more in education to bring them into the mainstream of the labour force. There are health issues. Diabetes is just one example: there's an epidemic of diabetes amongst our aboriginal people. That could be a factor within a formula.

When you look at the justice system, unfortunately the aboriginal people are far too highly represented in the police work, and in the courts, and in the corrections system. That has to be recognized. If you look at social welfare, sometimes the caseloads are 60% aboriginal versus a 15% share of the population.

All of these factors could be considered, and then presumably there would be additional resources to begin to address these problems. If we don't, I really do fear the scenario that I laid out, that there would be discontent of the magnitude you saw in inner cities in the U.S. four years ago.

•(1555)

**Prof. Paul Thomas:** I just want to make a couple of quick comments.

First, we shouldn't paint a portrait of the aboriginal population, both on reserve and in the city, as all socially disadvantaged and dysfunctional. There is a growing urban middle class particularly that is doing very well. There are more and more aboriginal people completing high school, going on to university and colleges, and contributing very significantly. We shouldn't allow the image to leave the room that altogether it's depressing news.

The progress has been measurable. We've seen it year after year in the numbers. There are 55,000 to 75,000 urban aboriginals in the city of Winnipeg now, depending on the count that's being done, and there have been targeted programs by the federal government with provincial participation.

I was a researcher and did a paper for the Aboriginal Justice Implementation Committee. It looked at the responsiveness of the federal and provincial policy system to the needs of urban aboriginals, and we are making some headway. We're doing significant things such as single-window delivery of services, so that when you walk in, on Main Street, as you said, Mr. Chair, you can get instant reference to the right location in government to find the services you need.

But then you get sad stories, such as the one that was featured in a paper by one of my graduate students the other night, about the status and situation of disabled aboriginal people. Off reserve, they are really trapped between the two levels of government, and they are, in many senses, doubly and triply jeopardized by the system. They are often women. They don't fall within provincial jurisdiction or federal jurisdiction, or they become the source of disputes between the two.

In 1994-95, as part of the program review, Ottawa changed the way it calculated its support for disabled aboriginal people. It meant a \$25-million hit on the provincial social services budget. So who are the losers in that? The province tried to pick up the financial slack, but it didn't have the financial wherewithal. There has to be consistency and predictability in terms of longer-term commitment to some of these programs that are set up.

I think you should say something about the place of aboriginal people in this province and other provinces, but I don't think you want to intermingle issues of fiscal federalism with the issues of self-government, quite frankly, and how self-government is going to be financed. That's a whole other set of negotiations with groups and organizations that often claim to be outside the constitutional framework of Canada and want to negotiate on a nation-to-nation basis. So I think it would be better to leave that aside.

We already have in this province, and it should be noted, provincial-municipal tax sharing. A tiny percentage of personal income tax revenues and corporate income tax revenues are shared, no strings attached, with the City of Winnipeg and with the other approximately 200 municipal entities. We're the only province in the country that has that form of tax sharing. If you get another order of government—an aboriginal order of government—tax sharing, you're going to have different tax bases and different tax rates and transfers. If it's complicated now, it could be more complicated.

[*Translation*]

**The Chair:** That was not really what I was getting at with my question. You have just given me a list of all the problems that the Winnipeg aboriginal community might face, issues such as health—Mr. Neumann alluded to this when he mentioned diabetes—; crime and multi-drug use; lack of funds for education and youth training.

For instance, aboriginals have a vested interest in any transfer of federal money to address these issues and in any specific initiatives by the provinces, whose responsibility it is to improve the lives of their urban aboriginal communities. That is the reason why I said that First Nations are an integral part of the process of addressing the fiscal imbalance.

[*English*]

**Prof. Paul Thomas:** Let me add one other point quickly.

When I did this paper for the Aboriginal Justice Implementation Committee, they called a meeting of all deputy ministers to come and hear my presentation. Most times, deputy ministers don't turn out to listen to me all that often. They all came. Why? Because the provincial government of Premier Doer is highly committed to aboriginal issues, with two ministers of aboriginal heritage and the Speaker of the legislature. Deputy ministers get the message that this is a high-priority policy file for them to look after. There are training

agreements with the federal government. There are housing arrangements. There are educational arrangements.

It is always, though, this kind of water torture process of negotiating these over and over again with Ottawa. They often have short-term time horizons, so you can't make a commitment longer term. Often the aboriginal side of the table is represented by fledgling organizations, underfunded and lacking in organizational capacity. If you tell them that they're not going to go beyond one-year or two-year funding, what's the future for them to come to the table? Already the aboriginal leadership is stretched thin; they have so many commitments to make.

But you shouldn't leave this province with the impression that there haven't been efforts to engage in collaboration. This government particularly has been highly motivated to work with the aboriginal community.

Diversity in the public service is another big push in this government. They want a report card that shows headway being made in the recruitment, retention, and advancement of aboriginal people in the public service.

● (1600)

[*Translation*]

**The Chair:** Far be it from me to think that, Mr. Thomas.

It only remains for me to thank you. It is already 4:05pm.

[*English*]

On behalf of the members of the Subcommittee on Fiscal Imbalance of the Standing Committee on Finance, I would like to thank you. Congratulations on your excellent presentation.

Thank you very much.

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