



Fiscal Federalism and the Future of Canada
Selected Proceedings from the Conference – September 28-29, 2006

Strengthening Canada's Territories and Putting Equalization Back on Track: The Report of the Expert Panel on Equalization and Territorial Formula Financing

Foreword

In September of 2006, Queen's Institute of Intergovernmental Relations hosted *Fiscal Federalism and the Future of Canada*, a conference organized by the then IIGR Director Sean Conway, Peter Leslie and Christian Leuprecht. Given that several of the

Al O'Brien, *Strengthening Canada's Territories and Putting Equalization Back on Track*:

- Macroeconomic approaches to measuring fiscal capacity
- Whether to introduce expenditure need to the equalization formula
- Mechanisms to improve the stability and predictability of payments
- Measures to assist in evaluation of the overall level of support for Equalization and Territorial Formula Financing
- Whether to create a permanent independent advisory body.

Our mandate was to address inter-provincial fiscal disparities in the context of Section 36(2) of the Canadian Constitution, which commits the Government of Canada to ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

In the case of TFF, our terms of reference also indicated “that the Government of Canada is committed to ensuring that citizens living in the Yukon, Northwest Territories and Nunavut have access to basic services, reasonably comparable to those available to other Canadians,” paralleling the constitutional objective of

Al O'Brien, *Strengthening Canada's Territories and Putting Equalization Back on Track*:

program to changing economic and fiscal circumstances.

Undoubtedly the most contentious issue regarding the measurement of fiscal capacity is the treatment of revenues from provincially-owned natural resources.

Al O'Brien,

I believe that Canadians support the objective set out in Section 36(2) of the Canadian constitution, and that the Equalization and TFF programs play a critical role in the effective functioning of Canada's decentralized federation and the competitiveness of the Canadian economy.

I also believe that the Expert Panel's reports provide a balanced and workable basis for putting Equalization back on track and strengthening Canada's Territories.

ANNEX A

Putting Equalization back on track -- Recommendations from the Panel

1. *A clear set of principles should be adopted to guide future development of the Equalization program in Canada.*

Returning to a Rules-based, Formula-driven Approach:

2. *A renewed Equalization formula should be developed and used to determine both the size of the Equalization pool and the allocation to individual provinces.*
3. *A 10-province standard should be adopted.*
4. *Equalization should continue to focus on fiscal capacity rather than assessing expenditure needs in individual provinces.*
5. *Equalization should be the primary vehicle for equalizing fiscal capacity among provinces.*

Improving the Equalization Formula:

6. *The representative Tax System (RTS) approach for assessing fiscal capacity of provinces should be retained.*
7. *Steps should be taken to simplify the Representative Tax Systems (RTS.)*
8. *A new measure for residential property taxes should be implemented based on market value assessment for residential property.*

9. *User fees should not be included in Equalization.*

Striking a Balance on the Treatment of Resource Revenues:

10. *In principle, natural resource revenues should provide a net fiscal benefit to provinces that own them.*

11. *Fifty percent of provincial resource revenues should be included in determining the overall size of the Equalization pool.*

12. *Actual resource revenues should be used as the measure of fiscal capacity in the Equalization formula.*

13. *All resource revenues should be treated in the same way.*

14. *A cap should be implemented to ensure that, as a result of Equalization, no receiving province ends up with a fiscal capacity higher than that of the lowest non-receiving province.*

Improving Predictability and Stability:

15. *The current approach for determining Equalization entitlement and payments should be replaced with a one estimate, one entitlement, one payment approach.*

16. *Three-year moving averages combined with the use of two-year lagged data should be used to smooth out the impact of year-over-year changes.*

Assessing Equalization:

17. *The federal government should track and report publicly on measures of fiscal disparities across provinces.*

Improving Governance and Transparency:

18. *A more rigorous process should be put in place to improve transparency, communications, and governance. This is preferable to setting up a permanent independent commission to oversee Equalization.*

ANNEX B

Territorial Formula Financing: Recommendations

The Panel considered all the ideas and options presented during its consultation process and developed a comprehensive new approach to TFF. The Panel's recommendations are:

1. Replace the fixed pool under the New Framework with a formula-driven approach, providing three separate gap-filling grants to the territories.

While a legislated, fixed pool provides greater financial certainty for the federal government and a predictable and growing source of funds for the territories, the downside impact on the territories outweighs the benefits. It's important to have a program that reflects the differences among

comprehensive measures of expenditure needs and costs in the territories, the Panel believes this would be a complex and extensive process and may not result in a

ANNEX C: Streamlining Revenue Bases

Old Revenue Sources and Tax Bases	New Tax Bases
Personal Income Tax Payroll Taxes	Personal Income
Business Income Capital Taxes	Business Income
Property Tax Miscellaneous Tax	Property Taxes
14 Resource Revenue Categories*	Actual Resource Revenues

- Sales Taxes
- Tobacco Taxes
- Gasoline Taxes
- Diesel Fuel Taxes
- Vehicle Licenses
- Commercial Vehicle License
- Alcoholic Beverages
- Hospital and Medical Insurance
Premiums
- Race Track Revenues
- Insurance Premiums
- Lottery Tickets
- Other games of chance
- Preferred share dividends