

**Presentation to the**  
**House of Commons Standing Committee on Finance**  
**Subcommittee on Fiscal Imbalance**

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**By**

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## **I. Introduction**

Thank you, Mr. Chair.

On behalf of the Official Opposition Saskatchewan Party, welcome to Saskatchewan.

Thank you for including Regina in your consultation on Canada's Fiscal Imbalance, a public policy challenge that is very important to Saskatchewan.

There are many federal programs that contribute, or in some cases, are supposed to contribute, to the achievement of a fiscal balance in our country including:

- The Equalization Program;
- The Canada Health Transfer;
- The Canada Social Transfer;
- Agriculture Supports;
- National Infrastructure Programs;
- National Highways Programs;
- Environmental Supports Related to Kyoto Implementation; and
- Employment Insurance.

While all of these programs merit consideration in any discussion about Canada's fiscal imbalance, I will focus my comments this morning primarily to just one program – the federal equalization program.

However, I do want to acknowledge that progress is being made on the imbalance that continues to exist in health and social transfers.

More needs to be done and I am confident more will be done on this file.

But the recent changes in structure and funding represents a good start in dealing with a huge fiscal imbalance that has developed with regard to health, education and social assistance funding over the past two decades.

And I would also note that progress is being made with regard to infrastructure investment, particularly in the most recent federal budget with the notable exception of a woefully inadequate commitment by the Government of Canada to fund its share of the maintenance and construction costs related to national highways through Saskatchewan, namely the Trans Canada Highway and the Yellowhead.

Unfortunately, one area where almost no progress is being made from Saskatchewan's perspective is agriculture safety net programs.

Saskatchewan has more than half of the arable land in Canada.

And, while we have made some headway in diversifying our economy, agriculture continues to be a dominant industry.

The refusal of Canada to consider changes to the current 60/40 cost-sharing of federal/provincial agriculture support programs means that Saskatchewan taxpayers pay about five times more on a per capita basis than most other jurisdictions to access those programs.

That's not fair and it certainly contributes to the growing fiscal imbalance especially when considered in conjunction with the serious structural problems plaguing the federal equalization program.

Therefore, any solution to mitigating Canada's fiscal imbalance must include a commitment to treat Saskatchewan fairly with respect to funding of agriculture safety net programs.

## **II. The Case for Reform of the Equalization Program**

I was struck by the definitive mandate of your subcommittee.

According to the information provided to our office, your subcommittee is here to find solutions to the fiscal imbalance that exists between the federal and provincial governments.

Nowhere is the fiscal imbalance more obvious and injurious than in Canada's equalization program.

From Saskatchewan's perspective, the equalization formula is fundamentally flawed in at least three areas:

- inclusion of non-renewable oil and gas revenues;
- the use of national proxies to measure Saskatchewan's mining tax base; and
- the use of a five province standard to establish the average fiscal capacity of all ten provinces.

I will address each one of these three areas in more detail and make some specific recommendations for both short term and long term change.

But, first I want to talk in more general terms about the nature of the changes that should be made to the equalization program.

Equalization has always been on the national political agenda in Canada.

Addressing the unique interests of Canada's regions was an integral part of the confederation debates of the 1860s and it has dominated the national political discourse ever since.

A formal program of equalization was established by the federal government in 1957.

Since 1982, equalization has been a constitutional requirement of federal government policy.

By now, after many meetings across the country, committee members will have had Section 36(2) of The Constitution Act, 1982 read back to them many times.

So, I apologize for the repetition.

But, it is important to establish the foundation for our discussion.

Section 36(2) of the Constitution Act commits the federal government to make “*equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.*”

So, it is more than a little ironic that, since the changes to the equalization formula that were implemented in 1982, the program has become not much more than a welfare trap from which Saskatchewan has not been able to escape.

At the same time, the propensity of successive federal governments to negotiate side deals with some provinces to address the structural weaknesses of the equalization formula instead of looking for a long-term solution that is fair to all provinces has further weakened the program.

Today, the equalization program is not achieving the Constitutional promise it was designed to keep.

### **III. Short Term Equalization Reform**

Rather than addressing discrepancies in the ability of each province to provide a relatively similar set of services at relatively similar taxation levels when compared to other provinces, the equalization program has caused significant financial instability for some recipient provinces while triggering calls for changes to the program by non-recipient provinces and particularly the Province of Ontario.

The most recent ad hoc adjustments to the equalization program, the Atlantic Energy Accords concluded last month between the Government of Canada and the provinces of Newfoundland and Nova Scotia, are a good example.

These two agreements, while certainly no more than a short-term fix for the fundamental weaknesses in the equalization formula, are certainly a positive step forward for the two Atlantic Provinces.

And yet, the Premier of Ontario remarked on the day the Atlantic Accords were signed that, while he was happy for the People of Newfoundland and Nova Scotia, the Accords changed the country’s fiscal arrangements and short-changed Ontario.

We in Saskatchewan also acknowledged the value of the accords to the people of Newfoundland and Nova Scotia while making the legitimate point that Saskatchewan families deserve the same deal.

The Atlantic Agreements essentially allow Newfoundland and Nova Scotia to retain 100% revenues generated for their respective governments by offshore oil and gas.

The agreements also ensure that any reduction in equalization entitlements to Newfoundland and Nova Scotia triggered by offshore oil and gas revenues will be paid back to those provinces from outside the equalization funding envelope.

These important agreements recognize the serious flaws in the equalization program.

They recognize the economic challenges faced by Newfoundland and Nova Scotia.

And they provide a fair deal that will give both provinces the opportunity to build economic capacity and improve the quality of life of their citizens.

Members of the committee, I am sure you would agree that Saskatchewan families deserve no less than the same fair deal in the short term.

The Official Opposition strongly supports the position taken by Premier Calvert in calling for a Saskatchewan Energy Accord.

I am sure Premier Calvert and his officials made the same strong and reasonable case to the subcommittee this morning that our Finance Minister made when he presented Saskatchewan's request for a fair equalization deal to the Senate Committee on National Finance a few weeks ago.

I want to reinforce Saskatchewan's position.

We see it as a simple decision for the Prime Minister and his Liberal Government to make.

If Mr. Martin believes in fairness, he should immediately support Saskatchewan's call for an Energy Accord that allows our province to retain 100% of our oil and gas revenue without losing equalization entitlements.

If Mr. Martin believes Saskatchewan families do not deserve the same fair treatment his government recognized is appropriate for families in Newfoundland and Nova Scotia, then he will deny our province's request for a Saskatchewan Energy Accord.

In fact, the Prime Minister has already recognized Saskatchewan is not being treated fairly by the current equalization formula when it comes to oil and gas revenue clawbacks by providing some compensation to our province in the 2004-05 fiscal year and also increasing Saskatchewan's 2004-05 final equalization payment pursuant to Bill C-24.

But, neither of these payments addresses the structural problems in the current equalization formula that are so injurious to Saskatchewan families in either the short term or the longer term.

A Saskatchewan Energy Accord with terms similar to the recent Atlantic Accords would provide an effective and fair short-term solution.

I would also remind the subcommittee that during the 1960s, Alberta was also given the opportunity to use its growing oil and gas revenues to help build the economic base of that province without having its equalization payments confiscated during many years in which Alberta was an equalization recipient.

Today, Alberta has the strongest economy in Canada and has not required equalization payments for more than two decades.

Why does the federal government believe Saskatchewan's oil and gas revenues should be treated differently from Alberta in the 1960s and Newfoundland and Nova Scotia today?

#### **IV. Long Term Equalization Reform on the Road to a Fiscal Balance**

However, the People of Saskatchewan and all other provinces in Canada are best served in the longer term by a simplified, transparent equalization program that addresses Canada's fiscal imbalance on a more permanent basis through a formula that is fair to all regions of our country.

This point was effectively argued recently by the Conference Board of Canada in that organization's February 2005 issue of Executive Action and I urge all members of the subcommittee to take the time to read the Conference Board recommendations for long term change.

I appreciate that the mandate of your subcommittee pre-supposes a fiscal imbalance exists in Canada.

The Saskatchewan Party agrees.

Unfortunately, it appears the federal Liberal government does not.

In fact, the federal Department of Finance has published a document on its website entitled *The Fiscal Balance in Canada: The Facts*.

In it, the federal government argues there is no imbalance.

As evidence, the paper argues that both the federal and provincial governments have access to the same major sources of revenue.

The paper also notes the provinces have exclusive access to some very lucrative tax bases including some non-renewable resource revenues.

However, the paper fails to mention that, in Saskatchewan, the federal government has been confiscating between 90 percent and 108 percent of our non-renewable oil and gas revenue for the past five years.

In effect, Saskatchewan is not being given access to its oil and gas resource revenues.

It is worth noting, as Saskatchewan's Finance Minister did in his brief to the Senate Committee, that over the same five year time frame, the provinces of Newfoundland and Nova Scotia have been able to retain more than 100% of off-shore oil and gas revenues.

I question how that kind of disparity, created by the equalization formula, contributes to achievement of a fiscal balance which is the very purpose of the federal equalization program?

It is also hard to understand how the same federal government paper could go on to argue the equalization program delivers a fiscal balance between provinces.

In its current form, the equalization program does no such thing.

Another powerful argument for making fundamental changes to the equalization formula is that, while Saskatchewan has become poorer relative to other provinces including its neighbor in Manitoba over the past decade, Manitoba's equalization payments have been going up while Saskatchewan's equalization payments have been going down.

How is it that Manitoba and also British Columbia, both with faster growing populations, stronger job creation records and a higher per capita income than Saskatchewan, have experienced increasing equalization payments while Saskatchewan's equalization payments have shrunk?

And how does the federal government conclude that an equalization program that generates these kinds of results is somehow contributing to a fiscal balance between Saskatchewan, British Columbia and even Manitoba?

Mr. Chair, I have to tell you that, as the Leader of the Official Opposition in Saskatchewan, these dubious arguments from the federal government are troubling to say the least.

While it is possible to design an equalization program that addresses the fiscal imbalance that **absolutely** exists in Canada, our current equalization program is not getting the job done.

It does not pass the test of fairness.

Nor does it achieve its constitutionally established goal.

As I indicated at the outset of my remarks, if the Government of Canada wants to establish a fiscal balance in Canada between the federal government and the provinces as well as between the provinces, then the place to start is with a major overhaul of the equalization program.

### **A Return to the Ten Province Standard**

Last month The Official Opposition Saskatchewan Party Finance critic, Ken Cheveldayoff, wrote to Federal Finance Minister Ralph Goodale proposing three long term changes to the equalization program that will go a long way toward addressing Canada's fiscal imbalance in general and addressing the unfair manner in which the formula treats Saskatchewan in particular.

First, the Saskatchewan Party supports moving from the current *five province standard* for calculating average fiscal capacity to the *ten province standard*.

The constitutional requirement of the equalization program is to ensure all provinces have "sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

However, the federal government's decision in 1982 to use of a five province standard to establish the average fiscal capacity of all ten provinces has had the opposite effect by artificially reducing the entitlements of recipient provinces.

Over a number of years, artificial reductions in Saskatchewan's equalization entitlements due to application of the five province standard have forced a combination of tax increases and public service funding reductions that contributes to a broadening of the gap between "have" and "have not" provinces.

In other words, the application of the so-called representative tax system (RTS) since 1982 using a five province standard has exacerbated Canada's fiscal imbalance as it relates to Saskatchewan and turned the equalization program into what amounts to a welfare trap.

### **Exclusion of Non-Renewable Oil and Gas Revenues from the Equalization Formula**

Another decision taken by the federal government in 1982 was to include 100% of non-renewable resource revenues in the equalization calculation.

Saskatchewan families have paid a massive price for these two decisions.

Since 1982, Ottawa has been calculating Saskatchewan's fiscal capacity relative to other provinces including our significant oil and gas revenues.

At the same time, Alberta's vast oil and gas resource revenues have been cut out of the calculation.

At risk of simplifying a very complex program, the net result has been that the equalization formula overstates Saskatchewan's relative fiscal capacity and then claws back virtually all of our oil and gas resource revenues for distribution to other recipient provinces.

In some years, as was demonstrated by Professor Thomas Courchene and supported by many other respected academics and equalization experts, Saskatchewan has experienced oil and gas related clawbacks in equalization payments in some years that were greater than the oil and gas revenues actually collected by the province.

In effect, the federal government has confiscated most, if not all the benefit of our non-renewable oil and gas revenues and then sent those revenues to other provinces.

Saskatchewan's Department of Finance has estimated that if oil and gas revenues were not counted in the calculation of equalization payments, Saskatchewan would have received another \$4.2 billion from the program over the past ten years.

I would ask the members of the subcommittee, and particularly those representing the federal Liberal Caucus – how does confiscating 100% of the benefit of a tax base that is clearly within the jurisdiction of Saskatchewan contribute to achieving a fiscal balance as the Federal Department of Finance contends is the case today?

Clearly, any formula, equalization or otherwise, that allows the federal government to confiscate virtually all of the oil and gas revenue that rightfully belongs to the people of Saskatchewan is fundamentally flawed and needs to be fixed.

The federal government must also recognize that non-renewable resource revenues, like oil and gas revenues, should not be treated as a permanent source of provincial income.

The development of non-renewable resources is, by definition, a short term proposition. This is especially true of oil and gas.

Once the resource has been recovered, sold and consumed, the province receives no further value from it.

I see it as a fair proposition that the exploitation of a non-renewable resources should be accounted for as the sale of an asset.

In this context, non-renewable resource revenue in general and oil and gas revenues in particular, should be removed completely from the calculation of equalization payments.

So, the first two steps in changing and fixing the equalization program are to return to the ten province standard for calculating equalization payments and then, at the very least, exclude non-renewable oil and gas resource revenues from the calculation.

### **Use of Federal Proxies to Estimate the Fiscal Capacity of Saskatchewan's Mining Tax Base**

The Saskatchewan Party also supports the position of Saskatchewan's Department of Finance that the use of federal proxies to determine the revenue raising capacity of Saskatchewan's mining tax base should be withdrawn in favour of the four individual mining tax bases, namely Potash, Asbestos, Coal and Other Minerals, used prior to 1999.

The use of federal proxies to estimate provincial entitlements from mining operations has proven to be questionable at best.

As members of the subcommittee may know, Saskatchewan's mining sector accounts for about 15% of mining activity in Canada.

Yet, Saskatchewan Finance officials indicate that the equalization formula in place since 1999 attributes 40% of Canada's mining tax base to Saskatchewan.

The result is that Saskatchewan's equalization payments have been reduced by an average of \$70 million every year since 1999 because of the inclusion in the calculation of what amounts to imaginary mining revenues.

Again, a change to the equalization formula forced on Saskatchewan and based on the supposition that it would strengthen the program has instead punished Saskatchewan families and further contributed to a growing fiscal imbalance.

## **V. Summary of Long Term Recommendations for Change**

To summarize, the Official Opposition Saskatchewan Party urges the subcommittee to recommend three long term changes to the federal equalization formula that will restore fairness and address the fiscal imbalance that exists in Canada today:

- 1) use of a ten province standard to determine relative fiscal capacity of each province for the purpose of calculating equalization entitlements;
- 2) exclude non-renewable oil and gas revenues from the calculation of equalization entitlements; and
- 3) return to four separate mining tax bases instead of using proxies to determine the fiscal capacity of the mining sector in each province.

## **VI. Conclusion**

I want to conclude by emphasizing that, for Saskatchewan, the first critical step in finding a solution to Canada's fiscal imbalance is the immediate negotiation of a Saskatchewan Energy Accord that allows Saskatchewan the same opportunity to retain 100% of our oil and gas revenues without an equalization penalty as was recently afforded the provinces of Newfoundland and Nova Scotia.

The Atlantic Accords represented an important short-term step in addressing Canada's fiscal imbalance as it relates to those provinces.

Those agreements are clear recognition the equalization formula in its current form is seriously flawed.

The Atlantic Accords also recognize the economic challenges faced by Newfoundland and Nova Scotia.

And they provide a fair deal that will give both provinces the opportunity to build economic capacity and improve the quality of life of their citizens.

Members of the subcommittee, Saskatchewan families deserve no less than the same fair deal.

Thank you for the opportunity to address your subcommittee.