Fiscal Coordination in Canada

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This presentation does not necessarily reflect the views of the Department of Finance
Snapshot of Canada

Provinces and territories
(date of entry into Confederation)
and % share of 2009 population of 33.6 million

British Columbia (1871) 13.2%
Ontario (1867) 38.7%
North-West Territories (1870) 0.1%
Yukon (1898) 0.1%
Nunavut (1999) 0.1%
Saskatchewan (1870) 3.1%
Manitoba (1870) 3.6%
Québec (1867) 23.2%
Newfoundland & Labrador (1949) 1.5%
Prince Edward Island (1873) 0.4%
New Brunswick (1867) 2.2%
Nova Scotia (1867) 2.8%
Alberta (1905) 10.9%
Highly decentralized Westminster federation, with roles of orders of governments shaped by:

1. **Constitution**
   - Sets clear federal-provincial roles and responsibilities
   - Provinces responsible for many key expenditure areas (welfare, health, education)
   - Both orders of government have access to, and full discretion over, most major revenue sources (e.g. income and sales taxes)
   - Provinces have ownership of natural resources and resulting royalties

*Both levels of government are highly autonomous:*
- Responsible to their own legislatures;
- Have wide range of taxation and borrowing powers
Roles and Responsibilities

Highly decentralized Westminster federation, with powers of orders of government shaped by:

2. Historical evolution of federal-provincial relations
   - Provinces were well-established political units prior to confederation
   - Substantial policy and administrative capacity
   - Increasing provincial use of available tax room and provincial autonomy of social programs post-WW2

In practice, Canada has evolved towards:
   - Shared legislation/regulation and spending power in many policy areas
   - Joint occupancy of most major direct and indirect tax fields
   - Relatively “equal partnership” of federal and provincial governments
High Degree of Fiscal Decentralization

Federal and Provincial-Local Shares of Own-Source Government Revenue: 1961 to 2006

Share of Total Own-Source Revenue

Federal

Provincial-Local

Source: Statistics Canada and Finance Canada calculations
High Degree of Fiscal Decentralization

Federal and Provincial-Local Shares of Government Expenditure, Excluding Inter-Governmental Transfers

Share of Total

Provincial-Local

Federal

Source: Statistics Canada and Finance Canada calculations
More decentralized than most federations

Expenditures

Federal share of direct spending

<table>
<thead>
<tr>
<th></th>
<th>Switzerland</th>
<th>Canada</th>
<th>Germany</th>
<th>Australia</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal share</td>
<td>37%</td>
<td>37%</td>
<td>41%</td>
<td>53%</td>
<td>61%</td>
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</tbody>
</table>

Revenues

Federal share of own-source revenues

<table>
<thead>
<tr>
<th></th>
<th>Switzerland</th>
<th>Canada</th>
<th>Germany</th>
<th>Australia</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal share</td>
<td>45%</td>
<td>45%</td>
<td>65%</td>
<td>60%</td>
<td>66%</td>
</tr>
</tbody>
</table>

Fiscal Coordination in Canada
More decentralized than most federations

- Canadian provinces have the highest degree of tax autonomy among state-level sub-central governments in the OECD federations
- Each province levies its own taxes at its own rates – tax competition possible

### Tax-Autonomy of State/Province/Länder, 2005

<table>
<thead>
<tr>
<th>Country</th>
<th>Percent of State Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>81.4%</td>
</tr>
<tr>
<td>Austria</td>
<td>81.4%</td>
</tr>
<tr>
<td>Belgium</td>
<td>52.8%</td>
</tr>
<tr>
<td>Australia</td>
<td>46.8%</td>
</tr>
<tr>
<td>Canada</td>
<td>98.4%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>100%</td>
</tr>
</tbody>
</table>

Legend:
- Other
- Full or partial discretion on rates only
- Rates and reliefs set by central government
- Full discretion on rates and reliefs
- Tax sharing arrangement

More decentralized than most federations

Level of tax effort varies considerably across country

Tax effort for non-resource tax bases in 2008-09 (average = 100)

Source: Finance Canada
Management of Fiscal Relations

Despite decentralization, fiscal coordination essential given the importance of coherence in:

- **Taxation**: To ensure efficient tax system within jurisdictions (tax harmonization, federal tax collection)
- **Spending**: To avoid duplication, respect roles
- **Borrowing**: Each government’s credit-worthiness affected by others in the federation

Federal Government also has constitutional responsibility to ensure all provinces have capacity to provide comparable services to Canadians (Equalization)
Largely informal structures of coordination:

First Ministers meetings (PM and Provincial Premiers)
- No formal schedule or structure, convened on major issues (e.g. health care)

Finance Ministers Meetings
- Regular discussions of economic and fiscal issues; consultations in advance of federal budgets

Meetings of senior officials
- Regular meetings on fiscal, tax, budgetary and transfer issues

No formal decision-making power
Fiscal Transfers

Federal Transfers as Share of Spending / Revenue

Major Federal Transfers to provincial governments

- **Equalization ($14.4 billion)**
  - To address fiscal disparities among the 10 provinces
  - Cash payments; formula driven

- **Territorial Formula Financing (TFF, $2.7 billion)**
  - To address the special needs of the three northern territories
  - Cash payments; formula driven

- **Canada Health Transfer (CHT, $25.4 billion)**
  - A dedicated transfer in support of health care
  - Cash and tax payments; equal per capita total allocation

- **Canada Social Transfer (CST, $11.2 billion)**
  - A block transfer in support of post-secondary education, social programs and programs for children
  - Cash and tax payments; equal per capita cash allocation

Source: Public Accounts and Finance Canada calculations
Fiscal Transfers have evolved over time

- Major transfers have evolved from conditional grants to block funding, with new accountability frameworks.
- Rely on existing accountability regimes of provincial-territorial governments, including audit, evaluation and direct reporting to citizens.
- Major federal transfers are largely unconditional, but tied to national standards written into Federal statutes.
Large fiscal disparities among regions in Canada by OECD standards, largely due to distribution of natural resources.

Equalization partially reduces disparities by redistributing federal revenues to bring all provinces up to “national average” level – based on national average tax rates.
Decentralized structure can pose challenge to ensuring fiscal discipline:

– Unconstrained spending power at both levels – potential for overlaps in spending

– Very limited federal leverage over provincial spending.
  - Little conditionality of federal transfers (too small, concerns about role of federal government)

– Result: federal and provincial debt/GDP burdens were among the highest in OECD as recently as the mid-1990s
  - However, debt burdens declined significantly in wake of mostly balanced budgets (federally and in most provinces) from the late 1990s until the recent recession…
    … though Canadian provinces still remain among the world’s largest sub-sovereign borrowers
Fiscal Discipline

- Government Budget Discipline has improved over last 30 years
- Canadians now expect balanced budgets

Aggregate provincial/territorial and federal budget balance as a percentage of GDP

Source: Statistics Canada and Finance Canada calculations
Causes of Increased Fiscal Discipline

**Intergovernmental coordination?**
- No formal coordination mechanisms/constraints

**Self-imposed constraints (balanced budget legislation)?**
- Do exist, but have not provided hard constraints

**Credit market discipline?**
- Implicit federal guarantee priced into provincial credit cost

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% spread over US Treasuries, 10-year bonds, Canadian federal and provincial governments
June 1999 to June 2009

Standard & Poor’s
Credit Ratings
(as of June 2009)

<table>
<thead>
<tr>
<th>Province</th>
<th>Rating</th>
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<tbody>
<tr>
<td>Canada</td>
<td>AAA</td>
</tr>
<tr>
<td>BC</td>
<td>AAA</td>
</tr>
<tr>
<td>AB</td>
<td>AAA</td>
</tr>
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<td>SK</td>
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<td>NL</td>
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Cultural shift following indebtedness of early 90’s

- Domestic & international pressure allowed for major budgetary re-balancing
- Ongoing public expectations for stronger budgetary balances

Link between provincial debt and tax rates

- High degree of provincial revenue-raising autonomy means provincial taxes raised well before federal action would be required
- Creates public demand for sound provincial budgetary management

Relationship between provincial debt and tax effort
Fiscal Coordination in Canada

Fiscal Discipline: Financial Reporting

• Federal/Provincial governments are publicly accountable in legislation

• Each jurisdiction has its own
  • Annual budget document, voted upon by legislature
  • Public Accounts
  • Auditor general

• Crown corporations / Government Business enterprises also have audited financial statements
Fiscal Discipline and Accountability

Public Accounts of each order of government include

- Audited fiscal statements
- Conform to general accounting practices (include debt charges, claims against crown, and contingent liabilities)

- **Budget documents contain fiscal forecasts and spending plan for upcoming year**
  - Federal forecast based on private sector forecasts
  - Enhances credibility and transparency
Recent recession resulted in temporary return to budget deficits for federal and provincial governments, due to:
- Automatic fiscal stabilizers (e.g. employment insurance)
- Fiscal stimulus measures over two years (3.8% of GDP)

Stimulus measures unlikely to affect medium-term budgetary discipline:
Over longer-term, fiscal discipline in Canada will be even more crucial, given:

- Aging population - smaller personal tax base
- Rising health care costs – provincial responsibility; taking larger share of provincial budgets
- Productivity challenges

Will require concerted efforts from all levels of government to ensure fiscal discipline

Could lead to more federal-provincial coordination to strengthen Canadian economy