Budget Paper D

UPDATE ON FISCAL ARRANGEMENTS

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Manitoba

UPDATE ON FISCAL ARRANGEMENTS

CONTENTS

INTRODUCTION

Canada's system of fiscal arrangements is important to every province and territory. Federal transfers help to ensure provincial and territorial governments are able to fulfill their constitutional responsibilities and provide core services such as health care.

With total transfer protection, combined major transfers to Manitoba have remained virtually flat since 2009/10. In fact, during this time they have actually declined by 11% when adjusted for population growth and inflation.

Federal-provincial/territorial fiscal arrangements have become a defining feature of our federation. The federal government made a commitment in both its 2006 and 2007 budgets to work with provincial and territorial governments. In Budget 2007, they committed to "building a stronger federation… built on a vision of open federalism and respectful relations, where governments collaborate effectively to deliver results for Canadians." (page 106).

Unfortunately, these promises have been followed by a series of unilateral changes that are acting to erode important fiscal arrangements that support the things that matter most to Manitobans.

Manitoba continues to believe that a fair and adequate system of transfer arrangements is necessary to support all Canadians, and that these arrangements must be maintained through meaningful discussion among orders of government.

Canada's Premiers have demonstrated their commitment to working together to achieve effective fiscal arrangements. At their January 2012 meeting, Premiers agreed to the following principles, which have guided their ongoing work on fiscal arrangements. These principles were confirmed at the Premiers' July 2012 meeting.

- to find solutions that work for the benefit of all Canadians in all provinces and territories;
- that every province and territory must be able to provide its citizens with reasonably comparable levels of public services at reasonably comparable levels of taxation;
- that no jurisdiction should be made worse off; and
- that Canada's fiscal arrangements should be a win-win for all Canadians regardless of where they live.

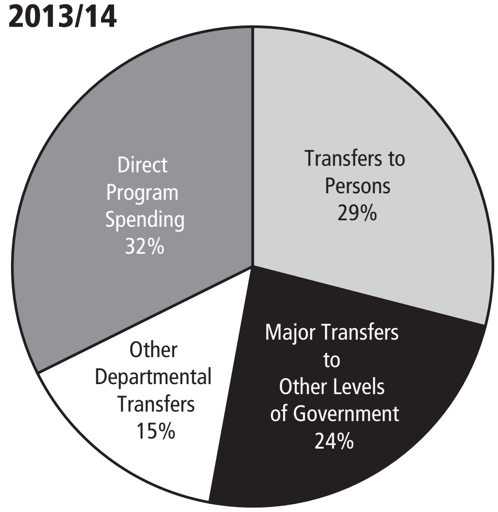
Source: Council of the Federation (2012) communiqué, "Fiscal Arrangements"

CURRENT TRANSFER ARRANGEMENTS

In 2013/14, just over one-half of total federal program spending ($134 billion) is targeted for transfers to persons and for major transfers to other levels of government. Transfers to persons include payments for the elderly, Employment Insurance (EI) and children's benefits. Transfers to other levels of government are made primarily through the major transfer arrangements: the Canada Health Transfer (CHT), the Canada Social Transfer (CST), Equalization and Territorial Formula Financing (TFF).

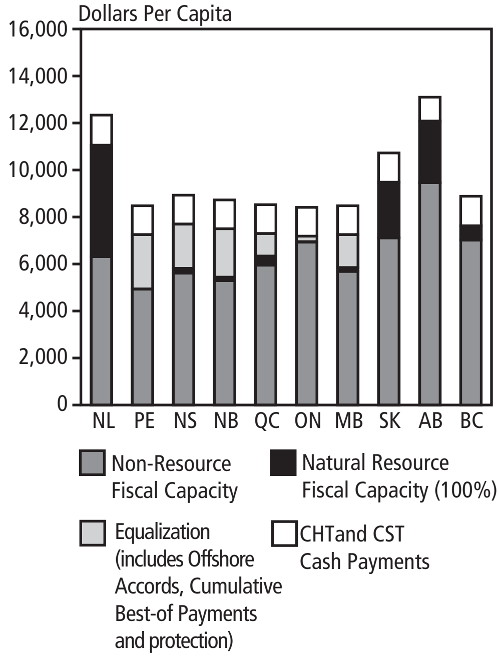
Another $37 billion in other transfers are administered directly by federal departments and agencies, often on a cost-shared basis, requiring matching funding from provinces, municipalities and other parties. These other transfers support economic growth and labour market development through investments in areas such as infrastructure and skills training, and also help cover natural disaster costs that could otherwise overwhelm provincial budgets.

Planned Federal Program Spending, 2013/14



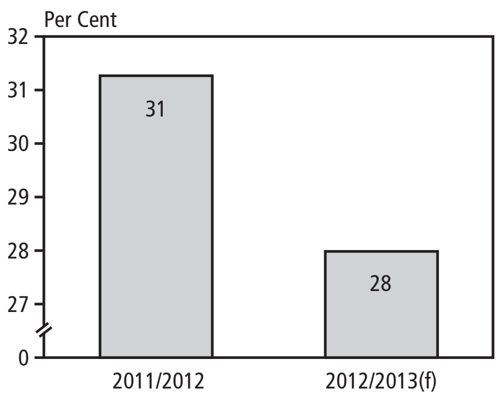
Source: Finance Canada

Source of Provincial Government Fiscal Capacity, Per Capita, 2013/14



Source: Finance Canada

Total Federal Cash Transfers to Manitoba as a Share of Total Provincial Revenue



f - Forecast

Source: Manitoba Finance

Major Transfers to Provinces and Territories

Major transfers are an important source of revenue for all provinces and territories. They help maintain Canada's system of health and social programs, while acting to reduce fiscal (revenue) disparities between, and within, the various orders of government. All provinces and territories receive the CHT and CST, and all provinces have received Equalization at one time or another. These transfer arrangements are governed by federal legislation set to expire on March 31, 2014.[1]

Manitoba expects to receive $3.4 billion in major federal transfer payments (CHT, CST, Equalization and total transfer protection payments) in 2013/14, unchanged from 2012/13. This includes $1.1 billion in CHT for health care support (equal to about 20% of the province's total health care spending) and $443 million to support provincial expenditures on post-secondary education, social assistance and social programs, and programming for children including early childhood development and early learning and child care.

The province will also receive $1.8 billion in Equalization in 2013/14 and $7 million in total transfer protection (TTP). TTP ensures no province receives less in combined CHT, CST and Equalization than it did in the prior year.

TTP payments have played an important role in helping stabilize year-over-year revenues for Manitoba following the recession in 2008 and 2009, and the major flood in 2011. They also helped ensure Manitoba could provide stimulus funding as partners under the federal Economic Action Plan.

Manitoba has received $659 million in TTP since 2010/11 to keep the province flat at 2009/10 combined major transfer levels. However, on a per capita basis, Manitoba's combined major federal cash transfers (including TTP) in 2013/14 are actually 4.5% lower per Manitoban than they were in 2009/10; factoring in inflation over the same period, major federal cash transfers have declined 11.0% per Manitoban.

[1] See Appendix 1 for a full description of major transfers to provinces and territories.

Major Federal Transfer Entitlements, Manitoba, 2009/10 to 2013/14

	2009/10	2010/11	2011/12	2012/13	2013/14
			(Millions of Dollars)		
Canada Health Transfer	903	950	1,001	1,060	1,121
Canada Social Transfer	392	404	418	431	443
Equalization	2,063	1,826	1,666	1,671	1,792
Total Transfer Protection	0	175	276	201	7
Total Major Transfers	3,358	3,355	3,361	3,363	3,363
Per Capita Allocation (dollars)	2,758	2,720	2,688	2,658	2,633

Source: Finance Canada

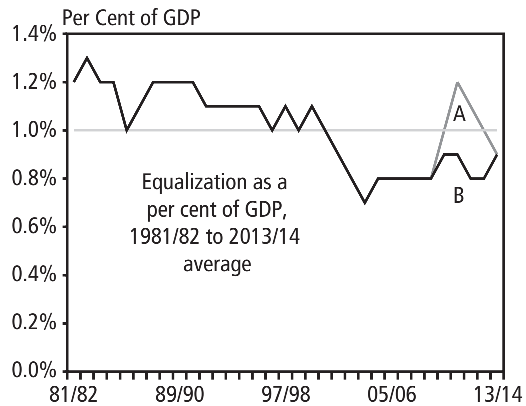
Recent Changes to Major Transfers

The federal government introduced changes to the renewed Equalization Program, which took effect in 2009/10. The key change was to set growth in total payments to the provinces to the rate of growth in national nominal GDP. The Expert Panel on Equalization and Territorial Formula Financing[2] had recommended against this approach. The impact of this change on Equalization has been significant, reducing potential payments by approximately $16 billion since it was implemented, compared to what would have been paid under the 2007 Program.

The four major statutory transfer arrangements (CHT, CST, Equalization and TFF) are governed by federal legislation set to expire on March 31, 2014. The federal government has historically consulted with provinces and territories prior to renewing or making significant changes to these arrangements.

In December 2011, the federal government announced its plans for the upcoming renewal of the major transfers without consultation. Under the unilateral federal renewal plans, annual growth in the CHT will decline significantly from the 6% previously set out in the *10-Year Plan to Strengthen Health Care*. Starting in 2017/18, growth in federal support will be determined by a three-year moving average of national nominal GDP, expected to be from 3% to 4% (with a minimum increase of 3%). The CST will continue to grow at its current rate of 3% per year. Both the CHT and CST are not due to be renewed again until 2023/24.

Equalization Payments and GDP: Annual Share and Long-Term Average

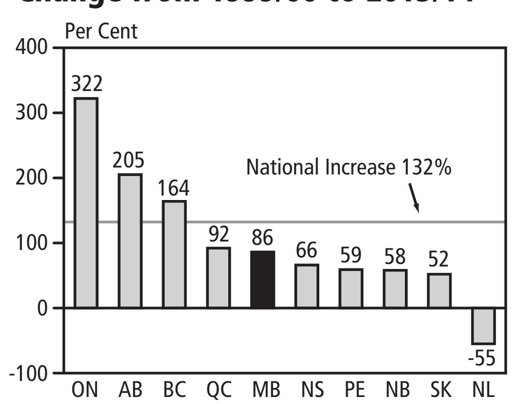


A = Level under Budget 2007 Approach

B = Level under capped November 2008 Approach

Sources: Finance Canada and Manitoba Finance

Major Federal Cash Transfers, Change from 1999/00 to 2013/14



Note: Includes Total Transfer Protection, cumulative "Best-of-Guarantee" payments to NS, and Offshore Accords

Source: Finance Canada

[2] In 2004, the federal government announced that it would undertake an "expert review" of Equalization. The Expert Panel on Equalization and Territorial Formula Financing considered a number of issues related to the allocation of Equalization among provinces and the treatment of various revenue sources, and in 2006, provided recommendations to the federal Minister of Finance.

At the December 2011 Finance Ministers' meeting, the federal government also announced the Equalization Program and TFF will continue to grow after renewal based on their current formulas. In 2012, all Ministers reviewed the technical work of officials in support of the legislative renewal of the Equalization Program. A number of small technical changes, which may impact allocations, will be implemented in 2014.

The federal announcement in 2011, more than two years before the 2014 renewal date, by-passed an opportunity for consultation, collaboration and co-operation between the levels of government, factors that have historically been critical to the success of the Canadian federation and to the development of effective transfer arrangements.

Implications of the Federal Government's Plan for the Renewal of the Major Transfers to the Provinces

At the January 2012 meeting of the Council of the Federation, Premiers appointed a Working Group on Fiscal Arrangements, led by Manitoba Premier Greg Selinger, and composed of Finance Ministers from all provinces and territories, to assess the impact of the federal proposals for the renewal of the major transfer arrangements. In July 2012, the Council of the Federation released the Working Group report, which showed that:

> "For health, the federal government's Canada Health Transfer (CHT) will be reduced by almost $36 billion, in total, over the 10-year period from 2014/15 to 2023/24 compared to the arrangements currently in place. This will bring the federal share of health care costs to less than 20 per cent, compared to about 50 per cent originally.
>
> In the shorter term, the 5-year period from 2014/15 to 2018/19, provinces and territories will receive, in total, about $23 billion less than under the current arrangements, with the CHT accounting for about $7 billion of the reduction and Equalization accounting for about $16 billion. The Working Group did not estimate Equalization implications beyond 2018/19."

Based on the results of the Working Group report, and the principles outlined by Premiers at their January 2012 meeting, the Premiers agreed that Premier Greg Selinger, Alberta Premier Alison Redford and New Brunswick Premier David Alward would chair a meeting of provincial and territorial Finance Ministers in Fall 2012 to continue discussions on options for fiscal arrangements.

Source: Council of the Federation (2012) communiqué, "Fiscal Arrangements"

Other Transfers to Provinces and Territories

The federal government also provides funding through other transfers to support services and other initiatives in a wide range of areas including: agriculture, universities, sports, Aboriginal development, official languages, culture, immigrant services, the environment, homelessness, health care, adult literacy, labour market and skills training, justice, and infrastructure. Federal departments and agencies are expected to transfer $190 million to Manitoba in 2013/14, mostly on a cost-shared basis. While not always as visible as the "major" federal transfers like the CHT, these transfers provide support for important programs and services in Manitoba.

Federal decisions related to these other transfers have a significant impact on provincial and territorial budgets. Some current examples where there are funding-related issues include infrastructure, labour market and skills development, and immigration.

Infrastructure

Sustainable and predictable infrastructure funding enables strategic investments, maximizes economic benefits, creates new and lasting jobs in communities, increases competitiveness and improves critical services. Ongoing and new strategic investment in, and development of, key infrastructure is needed to ensure the necessary support for ongoing economic development.

Deficit spending on infrastructure by federal and provincial governments has provided much needed economic stimulus since the global economic downturn began in 2008. This funding helped maintain employment and economic growth, while at the same time improving Canada's economic competitiveness.

Federal Budget 2013 included a renewed 10-year infrastructure fund called the Building Canada Plan (BCP). BCP will require matching funds from provinces and municipalities.

The renewed Building Canada Plan commits a total of $53.5 billion in funding for provincial, territorial and municipal infrastructure from 2014/15 to 2023/24. The three primary funds are:

1. The Community Improvement Fund – $32.2 billion
2. The New Building Canada Fund – $14 billion
   a. National Infrastructure Component – $4 billion
   b. Provincial and Territorial Component – $10 billion
3. The P3 Canada Fund – $1.25 billion

Source: Federal Budget 2013

Labour Market and Skills Development

In 2013/14, it is expected the federal government will transfer over $2.7 billion directly to the provinces and territories for labour market and skills training programs. This funding, which supplements existing provincial program funding, is provided through the following bilateral labour market agreements: the Labour Market Development Agreements (LMDAs); the Labour Market Agreements (LMAs); the Labour Market Agreements for Persons with Disabilities (LMAPDs); and the Targeted Initiatives for Older Workers. In addition to transferring money to the provinces and territories, the federal government also continues to have its own labour market programs for youth, persons with disabilities and Aboriginal people.

Labour market programming is an example of an area where there is shared responsibility between the federal and provincial/territorial governments. However, successive federal governments have acknowledged that provinces and territories are best placed to design and deliver these programs. The process of devolving additional responsibility for labour market programming to the provinces and territories began in the 1990s with the establishment of LMDAs. In federal Budget 2007, the current federal government confirmed that it supported this approach by committing to completing the transfer of LMDAs, establishing new agreements (the LMAs), and exploring the feasibility of transferring the remaining existing federal labour market programs to the provinces.

At their November 2012 Council of the Federation Meeting, Premiers agreed on critical factors to ensure continued job growth and future economic prosperity. They agreed to "focus on enhancing skills to ensure all Canadians, including Aboriginal peoples, have the skills they need to compete in tomorrow's economy and that incorporates long term, predictable and flexible training and retraining funding. Provincial and territorial governments, which have the jurisdiction in training and workforce development, are best placed to design and deliver the active employment services and programs required to meet the needs of their citizens."

Source: Council of the Federation (2012) communiqué "Premiers Collaborate to Secure Canada's Economic Success"

Federal Budget 2013 suggests that the federal government has changed its views with respect to who is best placed to design and deliver labour market programming in Canada. The federal government intends to renegotiate existing federal-provincial/territorial LMAs, which are up for renewal in 2014. The federal government also announced a number of federally delivered labour market initiatives in Budget 2013.

Under the new federal approach, the government will dictate how the provinces and territories must use the funding under the new LMAs, and has signaled its intention to renew the LMDAs and LMAPDs along similar lines. Sixty per cent of LMA funding will be used for the federally designed cost shared Canada Job Grant and the remaining forty per cent will be used for "critical employment services, such as counselling and job search assistance, and administration." (Federal Budget 2013, pages 66-67).

While Manitoba appreciates the renewed priority the federal government is placing on skills training, these changes will reduce flexibility and result in additional pressures on provincial budgets due to the new cost-sharing requirements.

Immigration

The majority of funding provided to Manitoba for immigrant settlement services by the federal government was terminated on April 1, 2013. In 2012/13, Manitoba received over $36 million in settlement funding which it allocated through more than 200 contribution agreements to not-for-profit and institutional service providers. The unilateral decision to centralize settlement services in Ottawa has created uncertainty for Manitoba's immigration strategy because of the connection of the Manitoba Provincial Nominee Program selection process to pre- and early arrival settlement and labour market supports. Manitoba will receive non-recurring funding of over $9 million from the federal government through a federal Order in Council for the delivery and management of a portion of immigrant settlement services in Manitoba during fiscal year 2013/14 only.

Transfers to Persons

The federal government also provides transfer payments directly to Manitobans. Major transfers to persons include the Old Age Security (OAS) Program, Employment Insurance (EI) and children's benefits through the Child Tax Benefit and the Universal Child Care Benefit. Individual Manitobans will receive an estimated $2.5 billion in federal income support and children's benefits in 2013/14, about 3.4% of the national total. Payments to Manitobans include about $1.5 billion in elderly benefits, $515 million in EI benefits and $470 million in children's benefits.

Federal changes to transfers to persons can have a significant impact on the standards of living of Manitoba's most vulnerable citizens, including seniors, unemployed individuals and low-income families. Because of these impacts, and the effects the changes can have on provincial programs, Manitoba believes that the federal government should work closely with the provinces and territories to ensure reforms to federal programs are fully considered.

Old Age Security

The largest of the federal transfers to persons is the OAS Program. In 2013/14, the federal government will transfer $42 billion to persons though this program. OAS includes the OAS pension, the Guaranteed Income Supplement (GIS), the Allowance and the Allowance for the Survivor. Virtually all Canadians aged 65 and over receive the basic OAS pension. The GIS and the Allowance are for lower-income seniors.

In Budget 2012, the federal government announced a major reform of the OAS Program. The changes include an increase in the eligibility age for the OAS pension (including the GIS) from 65 to 67 over six years, starting in April 2023. OAS benefits make up a large proportion of many seniors' retirement income, so changes to the program can have a real impact on the standards of living of Canadian seniors. This change will make other sources of retirement income more important for many Canadians. There are also costs for the provinces and territories associated with these changes. Manitoba expects the federal government will follow through on its Budget 2012 commitment to compensate provinces and territories for additional costs they will face because of the increase in the age of eligibility for OAS.

Employment Insurance

In 2013/14, the overall cost of EI benefits nationally is estimated to be $18.3 billion. Manitobans are net contributors to EI, meaning that workers and employers contribute more each year than Manitobans receive in benefits overall. The main reason is that Manitoba has a relatively low unemployment rate.

Reforms to the program beginning in the 1990s have reduced overall eligibility for EI. This has contributed to a significant decline in the percentage of unemployed Canadians receiving benefits. Recent changes introduced by the federal government are expected to further affect access to the program. While some EI funded services, such as career counselling and job search assistance, are available to all; skills training programs are only available to eligible individuals. Manitobans not able to access EI must look to other sources for support during their job search, including provincial employment and income assistance programs.

CONCLUSION

Over time, federal spending power relative to the provinces has played an important and often positive role in the development of Canada's system of intergovernmental fiscal transfer arrangements. However, federal spending in areas of provincial and shared jurisdiction has at times led to conflict between the levels of government. Concerns raised by provinces have included adequacy, lack of consultation, distorted spending priorities, increased costs when matching funds are required, and a lack of long-term, stable funding.

The federal government has typically had greater fiscal (revenue-raising) capacity than it needs for spending in its own areas of jurisdiction, giving it the capacity to introduce transfers that support the provinces in meeting responsibilities in their areas of jurisdiction. This has allowed the federal government to "drive" spending priorities in certain areas of joint responsibility while withdrawing support in other key areas.

Co-operation and collaboration between and among orders of government must be part of our federation's principles for action. Given the varying and ongoing responsibilities of governments in Canada, the effectiveness and make-up of fiscal arrangements will continue to be a critical factor in our success as a nation.

Even as far back as 1867, it was recognized that the balance between spending and revenue-raising capacities under the Constitution was uneven and that provinces would need varying levels of assistance from the federal government to carry out their responsibilities.

Given current uneven fiscal capacity and program commitments, provinces are finding it increasingly difficult to deal with the consequence of slower economic growth and the economic costs associated with major unforeseen disruptions, such as floods and forest fires.

In these circumstances, without appropriate and adequate federal transfer payments, the majority of the provinces will face the prospect of either reducing access to, or quality of, public services below current standards, or resorting to increases in taxes or fees.

Appendix: DESCRIPTION OF MAJOR FEDERAL TRANSFERS TO PROVINCES AND TERRITORIES

Canada Health Transfer and Canada Social Transfer

The Canada Health Transfer (CHT) and Canada Social Transfer (CST) are the main federal transfers that support provinces and territories in the delivery of vital health and social programs to Canadians. In 2013/14, combined national CHT and CST cash payments will total about $42.5 billion.

The CHT is the primary federal transfer in support of health care. The CHT supports the federal government's commitment to maintaining a national program as well as the conditions of the *Canada Health Act* (comprehensiveness, universality, portability, accessibility and public administration, and specific provisions related to extra billing and user charges). Provinces and territories must comply with the conditions of the Act to qualify for the full cash transfer. In 2013/14, the national total CHT will be $30.3 billion.

Total annual CHT cash levels are set in legislation until 2013/14 and reflect the agreement on the *10-Year Plan to Strengthen Health Care*, signed by all First Ministers in September 2004. Under the *10-Year Plan*, the federal government committed $41 billion in new, long-term funding, including a 6% annual escalator, beginning in 2006/07. The CHT is allocated to provinces and territories on an equal per capita basis taking into account both cash and previously transferred tax point revenues. CHT cash is determined by subtracting each province/territory's equalized tax transfer from its total equal per capita entitlement. Under the formula, provinces with tax points that are worth more, like Alberta, receive less CHT cash than jurisdictions with lower-valued tax points.

The CST is a block transfer to provinces and territories in support of post-secondary education, social assistance and social services, early childhood development and early learning and child care. The CST has been allocated on an equal per capita basis since 2007/08. Prior to that, the CST allocation included cash and a notional equalized tax transfer component, similar to the current CHT allocation. In 2013/14, the national total CST will be $12.2 billion.

Equalization

Equalization is Canada's formula-driven transfer program for addressing differences in revenue-raising capacity between the provinces and reflects a long-standing Canadian commitment, enshrined in the Constitution (1982), to sharing and equal opportunity for all Canadians regardless of where they live. The Program facilitates growth, stability and the reduction of regional economic disparities.

The purpose of Equalization is to ensure all provinces have the financial capacity to offer their residents reasonably comparable public services at reasonably comparable rates of taxation. The Program calculates, on a per capita basis, what each province could raise on its own at typical rates of taxation, and any shortfall relative to a "10-province standard" is paid out in Equalization. In the absence of Equalization, Canadians in less wealthy provinces would face higher debt, lower levels of public services or higher levels of tax than Canadians in more wealthy provinces. The federal government capped total payments under the Program in 2009/10. In 2013/14, Equalization will total $16.1 billion.

Total Transfer Protection

Total Transfer Protection (TTP) was first introduced by the federal government in 2010/11 to help provinces address the challenges of emerging from the recession. TTP ensures no province receives less in combined major transfers (CHT, CST and Equalization) than it did in the prior year. It has since been extended into 2013/14.

Territorial Formula Financing

Territorial Formula Financing (TFF) is an annual unconditional federal transfer to the territorial governments that recognizes the high cost of providing public services in the North. Its purpose is to give territorial governments the capacity to provide their residents with a range of public services comparable to those offered by provincial governments, at comparable rates of taxation. For 2013/14, TFF will total $3.3 billion.