Budget Paper D

FISCAL ARRANGEMENTS

FISCAL ARRANGEMENTS

CONTENTS

INTRODUCTION

Each year the federal government makes transfer payments to help fund important public services like health care, post-secondary education, social assistance, social services, and programs for seniors and children.

The design and operation of federal transfers has a significant impact on the lives of citizens in all provinces and territories, as well as on regional labour markets and economies. Provincial and territorial input into the workings of these programs is essential.

MAJOR FEDERAL TRANSFERS TO PROVINCIAL AND TERRITORIAL GOVERNMENTS

The vast majority of federal funding provided to the provinces and territories is through four major transfers including the Canada Health Transfer (CHT), Canada Social Transfer (CST) and Equalization/Territorial Formula Financing. Initial estimates suggest Manitoba will receive $3.7 billion in combined major transfers in 2017/18, up from $3.5 billion in 2016/17.

Major federal transfers are an important source of revenue for all provinces and territories. For Manitoba, the major transfers are budgeted to account for 22.8% of total provincial summary revenue in 2017/18, down from 26.9% in 2009/10.

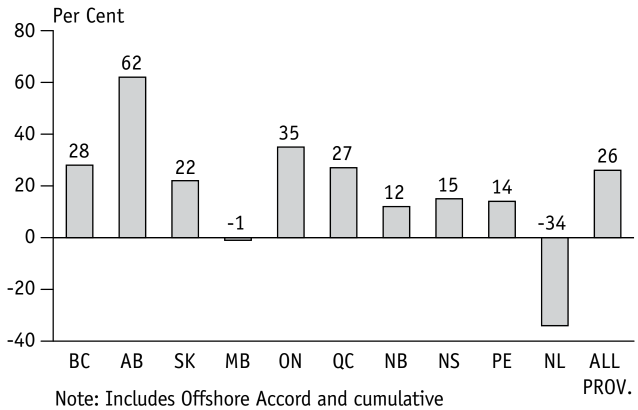
Major federal transfers to Manitoba have been increasing at a more modest rate than in most other provinces and territories. While Manitoba's combined major transfers were flat from 2009/10 to 2014/15, other provinces and territories received increases as high as 65%. Even with the recent growth, Manitoba's total major transfers since 2009/10 have grown by less than 10% – well below the 38% average increase for all provinces and territories.

This lack of major transfer growth has added to the financial challenges facing the province, particularly in light of the increased demand for public services resulting from Manitoba's rapidly growing population.

Manitoba's population growth in 2016 was again among the strongest in the nation, growing by an estimated 1.7%, the second highest among provinces, and well above the 1.2% growth rate for Canada as a whole.

In fact, once population growth is taken into account, the province's combined major federal transfers have actually declined by -1.2% on a per capita basis, or $34 per person, since 2009/10, and by almost -14% when both population growth and inflation are taken into account.

Per Capita Growth in Major Transfers, by Province, 2009/10 to 2017/18



Note: Includes Offshore Accord and cumulative "Best-of-Guarantee" payments

Source: Finance Canada and Statistics Canada

While Manitoba's per capita major transfers have declined since 2009/10, total per capita major transfers to all provinces and territories have grown by 26.5% over the same period. Manitoba, and Newfoundland and Labrador are the only two provinces where combined per capita major federal transfers are lower in 2017/18 than they were in 2009/10.

Equalization

Canada has had a formal Equalization program since 1957. The program is financed entirely by the federal government. As equalization payments are unconditional, provinces can allocate the funding to best meet the needs of their residents.

Manitoba will receive $1.8 billion in Equalization in 2017/18. Equalization is expected to account for about

Total Major Federal Transfer Entitlements to Manitoba, 2009/10 to 2017/18

	9/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18
					(Millions of Dollars)				
CHT	903	943	993	1,057	1,124	1,156	1,229	1,310	1,355
CST	392	404	418	426	440	453	468	485	502
Equalization	2,063	1,826	1,666	1,671	1,792	1,750	1,738	1,736	1,820
TTP		175	276	201	7				
Total	**3,359**	**3,348**	**3,352**	**3,355**	**3,363**	**3,359**	**3,436**	**3,530**	**3,677**
Per Capita	2,783	2,746	2,721	2,688	2,660	2,626	2,655	2,683	2,749

Note: Federal TTP was provided between 2010/11 and 2013/14 to ensure that a province's total major transfers in one of those years was no lower than in the previous year.

Source: Finance Canada

11.3% of total Manitoba summary revenue in 2017/18, down from 16.5% of total summary revenue in 2009/10.

Equalization is the federal government's main transfer program for reducing fiscal or revenue-raising disparities between provinces. Before any adjustments, the program calculates the revenues a province could raise on its own at typical rates of taxation and any shortfall relative to an all-province standard is paid out in Equalization.

Now that both the CHT and CST are allocated on a per capita basis, Equalization is the only major federal transfer that takes into account differences in the provinces' revenue-raising capacities. The Equalization program is currently under review with the provinces and will be renewed in 2019/20.

In 2009/10, the federal government unilaterally announced it was limiting growth in the Equalization program to growth in the national economy, as measured by a three-year moving average of national, nominal Gross Domestic Product (GDP).

The impact of this decision has been significant, reducing funding for Equalization by $26.5 billion since 2009/10, including $2.5 billion in 2017/18. Federal Total Transfer Protection (TTP) payments were in place between 2010/11 and 2013/14, and acted to reduce the impact on provinces. TTP reduced the total loss by $2.2 billion to $24.3 billion. After taking the value of TTP payments into account, Manitoba's cumulative loss has now reached $200 million.

While the constraints on Equalization have reduced expenditures for the federal government, they have undermined the purpose of the program, which is to bring the revenue-raising capacity of receiving-provinces up to the all-province standard. The result is increased revenue disparities among the provinces.

It is noteworthy that the legislated growth path for Equalization can also act as a payment floor. Should this situation occur, it would offset some of the $24 billion in funding reductions that have occurred to date under the caps.

Canada Social Transfer

The CST is a federal block transfer in support of post-secondary education, social assistance and social services, early childhood development, and early learning and child care. It accounts for only a minor portion of Manitoba's total spending on these important social programs.

The CST has been allocated on an equal per capita basis since 2007/08 and is legislated to grow by 3% per year.

Manitoba will receive an estimated $502 million in CST funding in 2017/18, up from $485 million in 2016/17. The CST is expected to account for about 3.1% of total Manitoba summary revenue in 2017/18, the same share as in 2009/10.

The federal government's decision to maintain the CST growth track at 3% rather than increase it at the rate of nominal GDP, along with the other major transfers, will tend to reduce over time the federal share of provincial and territorial spending on post-secondary education and social services.

Canada Health Transfer

Like all provinces and territories, Manitoba faces significant challenges in maintaining health care services. Cost pressures continue to increase while the federal funding partnership continues to decline.

Health care is the single largest budget item for provinces and territories, typically accounting for about 40% of total government expenditures. Provinces have the primary responsibility for the delivery of health care under Canada's *Constitution Act*.

The CHT is the federal government's primary transfer in support of provincial and territorial government expenditures on health care. Funding is conditional on provinces and territories meeting the five conditions of the *Canada Health Act* (public administration, comprehensiveness, universality, portability and accessibility), as well as provisions relating to extra billing and user charges.

Manitoba will receive an estimated $1.36 billion in CHT funding in 2017/18, up from $1.31 billion in 2016/17. The CHT is expected to account for about 8.4% of total Manitoba summary revenue in 2017/18, up from 7.2% of total summary revenue in 2009/10.

The CHT has been allocated on an equal per capita basis since 2014/15 (i.e. its allocation is determined by each province and territory's share of the national population – Manitoba's population share is 3.65%).

CHT payments to all provinces and territories grew by 6% per year from 2006/07 to 2013/14 as part of the 10-Year Plan to Strengthen Health Care, the Health Accord signed by all First Ministers in 2004. The 6% escalator was subsequently extended for three years to 2016/17.

For 2017/18 and beyond, the federal government has legislated that growth in the total CHT will slow to 3% per year or at a rate equal to a three-year moving average of national, nominal GDP growth, whichever is higher.

The reduction in the growth rate of the CHT comes at the expense of provinces and territories that are left to address the rising cost of health care.

Cutting the rate of growth in the CHT significantly reduces federal support for health care in Manitoba, and the other provinces and territories.

A November 2016 report prepared for Canada's Premiers through The Council of The Federation (COF), determined the change in the annual growth rate of the CHT from 6%, will reduce federal health transfers to provinces and territories by $1.1 billion in 2017/18 and $61.7 billion over 10 years.

Manitoba estimates the reduction in the CHT's annual growth rate from 6% will reduce transfers to the province by $39 million in 2017/18 and about $2.2 billion over the next 10 years.

The COF report noted that the reduction in the CHT is occurring at a time when demands on the health care system are increasing. Population ageing alone is expected to cost provincial and territorial governments billions of dollars per year in added health care costs.

As part of its election commitment in 2015, the current federal government had indicated that it would pursue a new multi-year Health Accord and a long-term funding agreement with the provinces and territories to help strengthen the public health system, particularly with respect to home care and mental health services.

In December 2016, in the absence of promised negotiations with provinces and territories, the federal government presented a unilateral, time-limited offer at the Finance Ministers' Meeting (3.5% fixed growth in the CHT for five years plus an additional $11 billion over ten years in money targeted for home care and mental health services). The provinces and territories unanimously rejected that offer, arguing the annual increase should be about 5.2% to better reflect the estimated annual average cost of providing health care services.

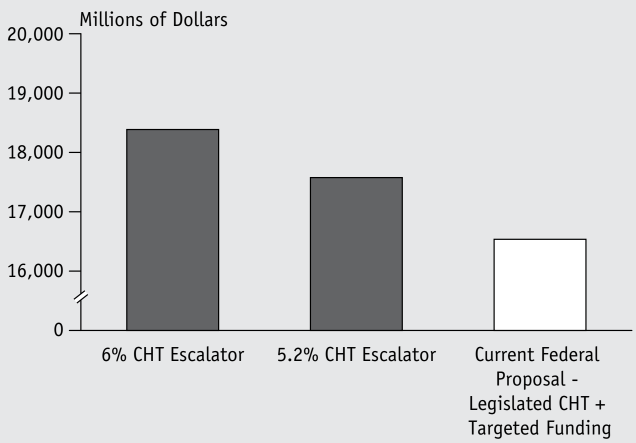
THE CURRENT FEDERAL HEALTH CARE FUNDING OFFER

The federal government's health care offer is inadequate and does not achieve the sustainable funding partnership required to keep up with growing health care needs.

Where once there was 50/50 cost sharing of health care costs between Manitoba and the federal government, today the province pays about 80% of total health care costs. The proposal currently on the table from the federal government will further erode the federal share of health spending and put additional fiscal strain on provinces and territories, including Manitoba.

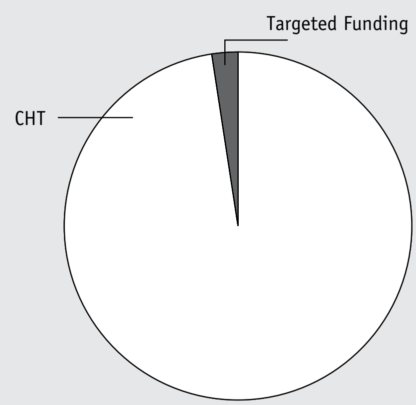
The current federal offer includes an equal per capita share of the legislated CHT which will increase by three per cent per year or by a three-year moving average of national, nominal GDP growth, whichever is higher. It also includes $11 billion over 10 years in targeted funding for home care and mental health services. Manitoba's per capita share of the $11 billion in targeted federal funding is about $400 million over 10 years (and about $11 million in 2017/18).

Comparison of Federal Health Funding Scenarios, Manitoba Amounts, 10 Years



Sources: Finance Canada, Conference Board of Canada and Manitoba Finance

Federal Health Care Funding Offer to Manitoba, 10-Year Amount (2017/18 to 2026/27)



Source: Finance Canada

While Manitoba recognizes the need for additional federal funding for home care and mental health services, the $400 million over 10 years would account for less than 5% of what Manitoba projects it will invest in these two areas over the same time period.

Under the federal offer made to other provinces, Manitoba would receive $18 million less from the federal government in 2017/18 than the research indicates will be needed to address the cost pressures facing the province's health care system. A loss of $18 million over just one year is significant and would be enough to pay for 2,084 home care clients, 25,788 MRIs, 1,505 unilateral hip replacements or 180 people on hemodialysis.

The federal government's current offer will not be sufficient to meet the ever increasing fiscal pressures impacting Manitoba's budget and health care system, particularly as the Manitoba population continues to grow and age.

Aspects of Manitoba's health care needs are unique. For example, Manitoba has the highest rate of chronic kidney disease in the country. By 2024, more than 3,000 Manitobans will need treatment for kidney failure either by dialysis or transplant. Chronic kidney disease is disproportionately evident among Manitoba's northern and remote communities, occurring at a rate of two to three times higher than that faced by other population segments in our province. These unique realities necessitate a strong federal partnership.

Manitoba is pleased with the federal government's recent commitment to funding aimed at improving health outcomes for First Nations and Inuit peoples. This investment is the action Manitoba was calling for and we look forward to working with our federal partners to meaningfully address disparities in Indigenous and non-Indigenous health services and health outcomes, including appropriate federal support of medical transportation.

Canadian Health Care Cost Drivers, 2015 to 2035

Demographics	
Population Growth	0.9%
Ageing	1.0%
Inflation	
Consumer Price Index	2.0%
Health Care Inflation	0.5%
Sub-Total	**4.4%**
Ongoing Enrichment	
Access, Adaptation and Innovation	0.8%
Total Average Annual Increase	**5.2%**

Source: The Conference Board of Canada

Manitoba's concern with the inadequacy of the federal offer is supported by a number of independent experts that looked at the sufficiency of the CHT's new lower growth rate, including the Conference Board of Canada.

A report prepared by the Conference Board of Canada on behalf of Canada's Premiers suggests that health care costs are expected to grow by an annual average of 5.2% per year from 2015 to 2035.

The Conference Board forecast of health costs was based on their assessment of key cost drivers in the health care system, including demographic changes (i.e. ageing and population growth), cost inflation and ongoing enrichment and adaptation to address changes in public expectations, professional standards, accessibility, innovation and technology.

A February 2017 study from the Institute of Fiscal Studies and Democracy concluded that "beyond fiscal 2018-19, health care costs are expected to continue increasing at a pace well above the growth in the CHT proposed by the federal government. Consequently, the CHT is likely to fall over time as a share of total health expenditures."

It noted regardless of the forecasts used, the health care cost drivers are very real and growth in the CHT will be insufficient to meet the increasing pressures on provincial and territorial health care systems.

In 2014, the Office of the Parliamentary Budget Officer aptly pointed out that "By indexing the Canada Health Transfer to GDP, the federal government has insulated itself from the impact of demographics on health spending. Federal spending on health transfers will grow inversely with health care costs; as the population ages, GDP growth will decline."

Manitoba has indicated a desire to return to the negotiating table to secure a partnership on health care.

Since the December 2016 meeting, nine provinces and the territories have been forced to accept the federal government's unilateral approach on the dramatic reduction of the legislated CHT growth rate. Out of fear that their respective shares of the targeted federal funding supports for home care and mental health would otherwise be lost, bilateral agreements have resulted.

Manitoba is now the last remaining jurisdiction without a bilateral agreement. While the federal government cannot be dissuaded from its reduced CHT growth rate agenda, Manitoba continues to advocate for additional considerations that reflect the province's unique health care needs and circumstances. This advocacy has already played a role in securing the large scale national investments being made by the federal government towards improving First Nations and Inuit Health Care Outcomes, which will significantly benefit Manitoba. And Manitoba's share of the targeted home care and mental health funding has been secured – through the recent federal budget – pending the finalization of related negotiations.

Manitoba's determination to manage the significant funding challenges created by the imposed federal government approach will continue, as it makes the best of a difficult situation now and over the longer term.

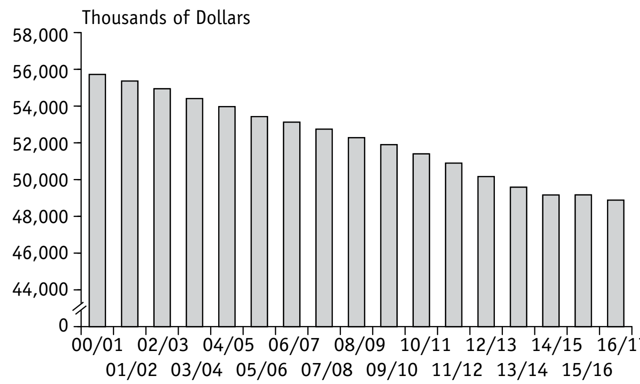
OTHER FEDERAL TRANSFERS TO PROVINCES AND TERRITORIES

In addition to the major transfer programs, the federal government also transfers funds to the provinces and territories to support investments in specific program areas. One prominent example is targeted funding provided through federal-provincial/territorial Labour Market Transfer Agreements (LMTAs). The federal government will transfer close to $3 billion through the LMTAs in 2017/18. This funding helps to support labour market development programs delivered by the provinces and territories.

The federal government has committed to collaborate with the provinces and territories to undertake a significant reform of the LMTAs. Adequate, fairly distributed and flexible federal funding going forward will be necessary if provinces are to innovate and effectively address their unique and ever evolving labour market challenges.

Manitoba continues to be concerned with the manner in which funding provided through the Labour Market Development Agreements (LMDAs) is allocated to the provinces and territories. The national amount of core program funding transferred under the LMDAs has been fixed at $1.95 billion since 2000, by far the largest of the LMTAs. However, since the LMDA was fully implemented, Manitoba's allocation has declined every year but one. This has resulted in a cumulative loss of over $60 million in LMDA funding for Manitoba since 2000/01.

LMDA Funding



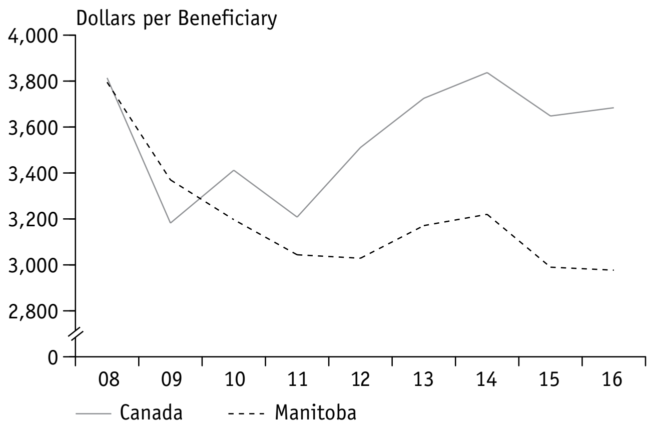
Note: This includes the funds transferred to Manitoba to help cover administrative costs related to the LMDA's, but does not include the additional $23.1 million in one time "stimulus" funding provided over two years (2009/10 and 2010/11), or the additional $3.4 million provided in 2016/17.

Source: Government of Canada

In 2009/10 and 2010/11, in response to the recession, the federal government transferred an additional $1 billion nationally over 2 years through the LMDAs. The federal government also provided an additional $125 million nationally in 2016/17. Whereas this additional funding has helped to partially offset the ongoing reductions in Manitoba's annual LMDA amount, it has not been enough to keep up with the increased need for skills training in the province.

Manitoba's capacity to meet ongoing demand for skills training through the LMDA remains well below pre-recession levels. For example, once adjusted for the number of regular Employment Insurance (EI) beneficiaries, Manitoba now has $800 less in LMDA funding per person than it did in 2008, and 20% less funding per person than the national average. Manitoba would like the federal government to consider a more equitable approach to allocating labour market funding as part of its commitment to improve the LMTAs.

LMDA Allocation Per Regular EI Beneficiary, 2008 to 2016



Note: Includes the additional federal funding provided in 2009/10, 2010/11 and 2016/17.
Excludes funds to help cover administrative costs.

Source: Government of Canada

Currently, federal labour market transfers are administered through several separate agreements, each with their own specific monitoring and reporting requirements. In addition to the LMDA, which is for persons who are eligible for EI, there are separate agreements for non-EI eligible unemployed and low-skilled workers, older workers and persons with disabilities. These agreement-specific eligibility and accountability requirements add to the complexities and costs of delivering labour market programs in the provinces and territories.

In its most recent budget, the federal government has proposed reducing the number of labour market agreements from four to two, one for those who are eligible for EI (by maintaining the LMDAs), and a new, consolidated agreement for unemployed and underemployed Canadians who are not eligible for EI. Manitoba feels this is a step in the right direction and looks forward to working with the federal government on the details of these agreements. A more streamlined approach should help to support more efficient and coherent labour market and skills development systems across Canada.

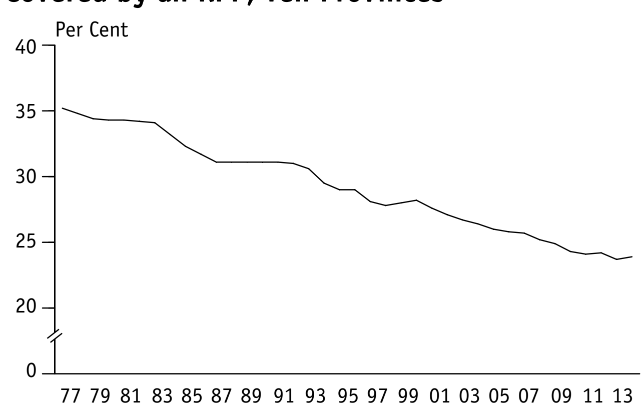
TRANSFERS TO PERSONS

In addition to funding transferred directly to provincial and territorial governments, the federal government will also transfer around $96 billion in 2017/18 directly to individuals through elderly benefits, EI benefits and children's benefits. This represents almost one-third of total federal program spending.

Federal elderly benefits are provided through the Old Age Security (OAS) Program, which includes the Guaranteed Income Supplement (GIS). The OAS/GIS is an important component of Canada's retirement income system, along with the Canada Pension Plan (CPP) and voluntary private savings.

Concerns with the adequacy of Canada's retirement income system have received much attention over the past several years. Research commissioned by finance ministers suggests that some Canadians, particularly middle-income earners and younger workers, are at risk of not maintaining their standard of living in retirement. One of the main reasons for this is

Share of Private Sector Employees Covered by an RPP, Ten Provinces



Source: Statistics Canada

the steady decline in registered pension plan (RPP) coverage. The share of private sector employees covered by an RPP has fallen from over 35% in the 1970's, to under 25% today.

In 2010, based on significant research, finance ministers agreed to a multi-pronged strategy to strengthen the retirement income system. The strategy included:

- Considering a modest, phased-in and fully funded enhancement of the CPP.
- Pension innovations that would allow financial institutions to offer broad-based defined contribution pension arrangements to multiple employers, all employees and to the self-employed.
- Promoting financial literacy so that people who are saving for retirement will make better-informed decisions.

In June 2016, federal and provincial finance ministers agreed on an approach for a modest enhancement of the CPP. On March 2, 2017, the federal legislation needed to fully implement the CPP enhancement came into force, following formal consent through Orders in Council from all provinces, with the exception of Quebec.

"I would like to thank Canada's Finance Ministers for their hard work in reaching an historic agreement to make the CPP even better. Their commitment to improving the lives of Canadians in retirement is an example of what we can accomplish together—and of federalism at its best." – The Honourable Bill Morneau, Minister of Finance Canada, News Release, March 2, 2017

Manitoba's support for the CPP enhancement was provided after securing a commitment from the federal government to consider several Manitoba proposals for additional enhancements to help modernize the plan. At the December 2016 Federal, Provincial and Territorial Finance Ministers' Meeting, all ministers agreed to prioritize the issues raised by Manitoba, including a comprehensive review of CPP supplementary benefits, as part of the 2016-2018 Triennial Review of the CPP. Manitoba believes the CPP must continue to be affordable for workers and employers. The cost of any proposed changes, or combination of changes, must be subject to careful consideration in order to avoid impacts on overall contribution rates.

"Manitoba's new provincial government successfully advocated with the federal, provincial and territorial governments for further research and analysis to be conducted on a number of modifications that would make the CPP not just bigger, but better as well" – Honourable Cameron Friesen, Minister of Finance, Government Resolution, Legislative Assembly of Manitoba, November 30, 2016

Canada Pension Plan Enhancement

The CPP is a universal and portable public pension plan that is an important source of retirement income for virtually all Canadians. The CPP is financed by contributions from workers and employers, and is administered by the federal government. The CPP also provides contributors and their families with partial replacement of earnings in the case of disability or death.

The upcoming CPP enhancement will increase the income replacement level from one-quarter to one-third, and the upper earnings limit by 14%. The CPP enhancement will also increase survivor and disability benefits subject to the amount of contributions made to the enhanced plan.

The Government of Canada and the provinces are the joint stewards of the CPP. Major changes to the federal legislation governing the CPP require the formal consent of the Parliament of Canada and at least 7 out of the 10 provinces representing two-thirds of the population of the 10 provinces.

Pooled Registered Pension Plans

In addition to supporting a modest enhancement of the CPP, Manitoba will be partnering with the federal government and several other provinces in bringing Pooled Registered Pension Plans (PRPPs) to the province. PRPPs will provide Manitobans with another option to save for retirement.

A PRPP is an innovative new voluntary pension arrangement that pools contributions together to achieve larger scale and lower costs in relation to investment management and plan administration, allowing workers to keep more of their savings. PRPPs are straightforward in design and implementation so that it will be easier for small and medium sized businesses to offer plans to their employees. PRPPs are portable so that employees are able to maintain or transfer their plan when changing employers and/or moving to another province or territory.

Although Manitoba has relatively high pension coverage compared to the other provinces, still over two-thirds of private sector workers in Manitoba are not covered by an RPP. The implementation of PRPPs in Manitoba will help to increase pension coverage in the province.

CONCLUSION

Federal transfer payments to other levels of government and directly to persons play an important role in helping fund Canadian priorities. They also play an important role in helping to ensure that all provinces and territories have the financial means to offer their residents comparable public services at reasonably comparable levels of taxation.

Manitoba continues to be concerned with the federal government's unilateral approach related to transfer programs and in particular its refusal to engage in meaningful discussions on a long-term and sustainable health care funding partnership.

The decision by the federal government to gradually reduce its share of Manitoba's health care expenditures will increase the fiscal challenges facing the province as it seeks to maintain a balanced budgetary position over the long term, while still meeting the health care needs of a growing and ageing population.