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FISCAL FAIRNESS

Executive Summary

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provinciaux par habitant décalés de deux ans. Par conséquent, en Alberta, pour l'exercice 2018-2019, les revenus calculés aux fins de la péréquation étaient beaucoup plus élevés que les revenus effectivement gagnés qui, eux, subissaient le contrecoup de l'effondrement soutenu des prix de l'énergie.

Ensuite, la formule de péréquation impute à l'Alberta une capacité fiscale à la taxe de vente même si cette province n'utilise pas ce champ de taxation. Enfin, l'enveloppe de péréquation n'est plus liée à la formule; la péréquation totale est plutôt indexée chaque année en fonction de la croissance du PIB nominal avec, comme conséquence, d'inciter les provinces à décupler leurs efforts (et à rivaliser l'une avec l'autre) pour en tirer le maximum de manière à en faire leur principale source de revenus.

L'Alberta est cependant admissible aux paiements accordés dans le cadre du Programme fédéral de stabilisation fiscale. Malheureusement, ce programme est gravement sous-financé. Ainsi, au cours de la période de cinq ans à compter de l'exercice 2014-2015, le manque à gagner cumulatif de l'Alberta découlant de ses propres revenus s'est élevé à près de 25 milliards de dollars. Or, le paiement compensatoire au titre du Programme fédéral de stabilisation fiscale n'a totalisé que 503 millions de dollars.

En vue d'aplanir les difficultés liées à la formule de péréquation actuelle, le présent document propose au gouvernement fédéral les recommandations que voici :

- Éliminer les décalages excessivement longs du système afin de mieux tenir compte de la situation fiscale actuelle des provinces;
- Revoir le nouveau modèle de financement qui arrime la croissance des paiements de péréquation à celle du PIB et crée un jeu où il y a nécessairement des gagnants et des perdants;
- Réformer le Programme de stabilisation fiscale qui, par rapport à la taille du programme élargi de péréquation, ne contribue guère – étant gravement sous-financé – à compenser les baisses dramatiques des recettes provinciales.

Pourtant, cela ne veut pas dire que l'Alberta n'a aucun rôle à jouer pour régler ses propres difficultés fiscales car, dans les faits, les revenus que cette province tire de ses ressources sont intrinsèquement irréguliers. Dans le passé, l'[illegible] mis sur pied par l'ancien premier ministre Peter Lougheed pouvait être appelé en renfort en cas d'effondrement des revenus tirés des ressources. Cette avenue n'est plus offerte. Une solution pour l'Alberta serait d'introduire une taxe de vente, conformément aux suggestions faites récemment par Jack Mintz et Philip Bazel, deux économistes de l'Alberta : les recettes de cette taxe seraient contrebalancées par des réductions de l'impôt sur le revenu des sociétés et des particuliers, ce qui permettrait à la fois d'atténuer une grande partie des problèmes fiscaux de la province et d'accroître son attrait en matière d'immigration et d'investissements en immobilisations de la part des entreprises du reste du Canada.

Cependant, comme le démontre cette étude, les résidents de l'Alberta disposent d'arguments solides pour justifier que, dans leur situation économique actuelle, le système de péréquation du Canada a échoué et que des réformes urgentes sont nécessaires.

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	-		-
British Columbia	9554	–	9554
Alberta	9597	–	9597
Saskatchew,[illegible]			

[illegible]

1 2016-1 *

[illegible] 2019 [illegible]

*Displays actual revenue from tax bases included from tax bases in equalization, relative to potential revenue if national average tax rates applied. Excluding natural resources.

Why did Alberta not qualify as a have-not province for fiscal years 2019-20?

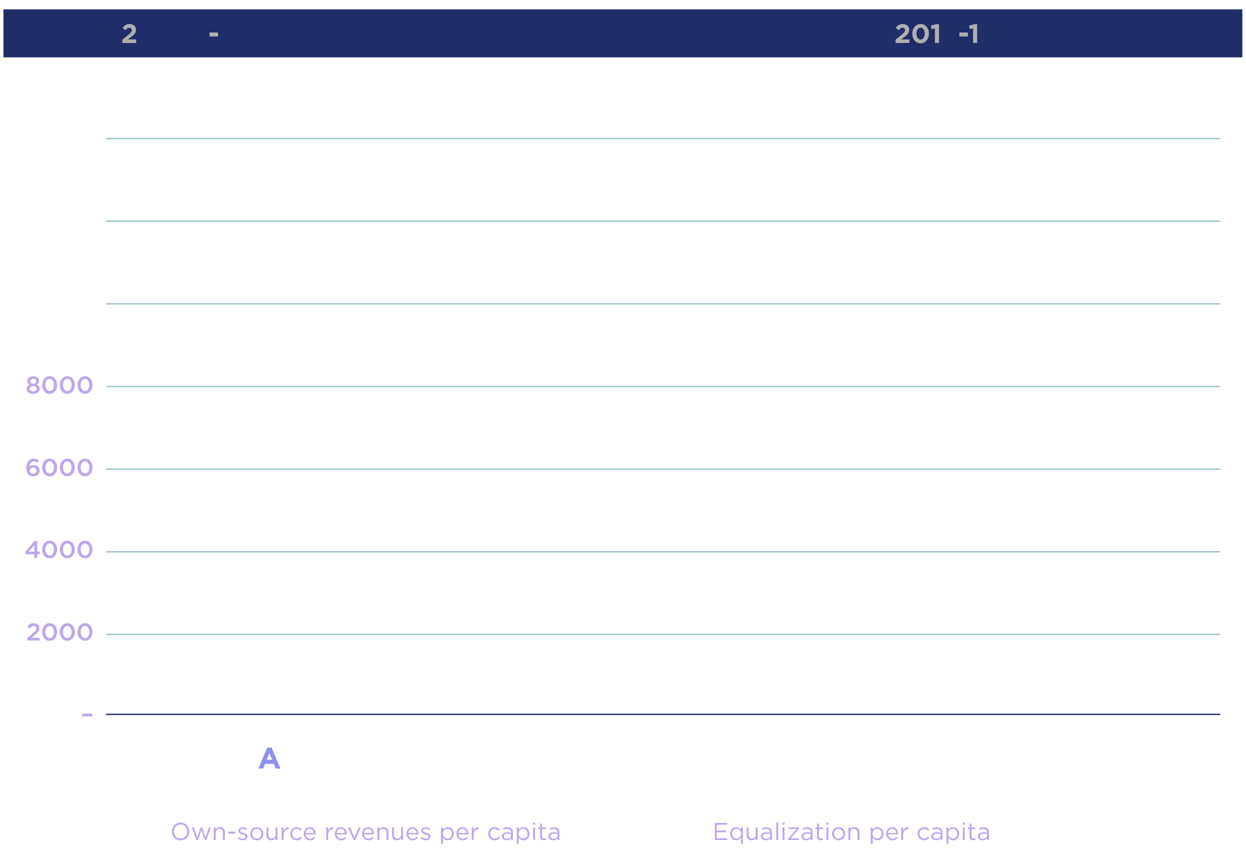
1. Lags in the formula

Prominent among the reasons why Alberta did not qualify as an equalization-receiving (i.e., a ”have-not”) province is that the data entering the equalization formula are three-year moving averages of provincial per-capita revenues calculated with a two-year lag. Of the three years utilized, the most recent year has a 50 percent weight, and the two earlier years each have a 25 percent weight (i.e. 50-25-25 lagged two years). This means that provincial revenues in the two most recent years are omitted from the equalization calculation, while the provincial revenues five years ago have a 25 percent weight in the formula.

This lagged, smoothing approach may be fine for provinces with diversified revenues of low volatility, but it exacerbates the difficulties for provinces whose revenues are highly volatile, a characteristic of those provinces that depend heavily on resource revenues. Phrased differently,
1 this means that Alberta’s revenues T0 8 scn/GS0 gs/T10 1 bates19BT/GS0 122 1

Some further implications of this new financing model are in order. With total equalization for fiscal 2020-2021 year set at $20,573 million and slated to grow each year in line with GDP growth, equalization will progressively be viewed as a major revenue source. If provincial tax rates are not as yet distributed across their tax bases in order to maximize equalization, the beacon of an ever-increasing equalization pot will ensure that they soon will be. This is apart from the likely reality that the federal budgetary process will progressively be constrained by ever growing equalization, especially in contrast with the former system where equalization payments could move up or down in any given year and were a dramatically smaller drain on the federal purse.

There is a further issue associated with the new equalization model, namely that in any year the total amount of equalization is fixed, i.e., [illegible]. Under the old model if province A receives an additional $1000 in equalization this does not affect the allotment to the other provinces. This is no longer the case under a fixed-quantum model where, at the limit, an extra $1000 of equalization to one province will need to be offset by an equivalent reduction in some other province. A related implication of this zero-sum model will be that any perceived over-equalization accruing to a province will now be more likely to be challenged by other provinces. High on the list would be the equalization formula's treatment of hydro-electric revenues in Quebec and Manitoba (Holle 2012).



[illegible]

Fiscal stabilization to the rescue?

The federal Department of Finance also has a Fiscal Stabilization Program that enables the federal government to provide financial assistance to any province faced with a year-over-year decline in its non-resource revenues (such as income and sales tax revenues) that is greater than 5 percent. Provinces must apply for payments under the program. Each claim is subject to analysis and verification by the federal government. While a province may submit a claim to the Minister of Finance as late as 18 months after the end of the fiscal year in question, it may instead submit a claim for an advance payment based on as few as five months of data for the fiscal year in question. The maximum payment is $60 per capita.

In 2016 Alberta applied for a fiscal stabilization payment. Finance Minister Bill Morneau provided Alberta with a fiscal stabilization payment of $251 million as part of Ottawa's ongoing support to provincial and territorial governments to assist them in the provision of programs and services. This was the maximum amount available under the provisions of the program, i.e., $60 per person. Alberta also applied for and received a fiscal stabilization payment of $251 million for 2017.

Some perspective is warranted here. From Alberta's 2020 budget, the following are Alberta's total own-source revenues in millions of dollars:

- 2014-15 ($43,449)
- 2015-16 ($35,477)
- 2016-17 ($34,314)
- 2017-18 ($39,688)
- 2018-19 ($41,594)
- 2019-20 ($41,894)

Alberta's cumulative shortfall in own-source revenues from 2014-15 levels in the subsequent five years amounted to almost $25 billion, whereas Alberta's cumulative fiscal offset from Ottawa under the Fiscal Stabilization Program was only $503 million. Surely there is a convincing case to be made that Canada is dramatically underfunding provincial revenue collapses relative to the rapidly escalating monies devoted to equalization. Indeed Premier Kenney's latest position is that Canada owes $2.4 billion in fiscal stabilization money going back five years.

As the recent election results made clear, the fossil-energy-rich provinces are veering in the direction of desiring more independence from Ottawa. The ongoing equalization allocations and the meagre Fiscal Stabilization payments are surely playing into this scenario.

Attention now focuses on what might be Alberta's role in all of this.

Policy options for Alberta

1. Create a "rainy day" fund to serve as an offset to the inherent volatility of Alberta's revenue base

Given the inherent volatility of Alberta's resource revenues, it would make eminent sense for the province to re-energize Premier Peter Lougheed's Alberta Heritage Savings Trust Fund (AHSTF). Established in 1976, the fund had three objectives: "to save for the future, to strengthen and diversify Alberta's economy, and to improve the quality of life in Alberta." While the role of the fund was to ensure that energy revenues would benefit current as well as future Albertans, it would arguably make fiscal sense for the province to borrow from the fund when fiscal times are tough and repay the loan to the fund when revenues recover. However, the politics of accumulating these funds are difficult, evidently requiring more fiscal discipline than, demonstrably, the relevant Alberta governments possessed. After making the initial contributions to the fund from non-renewable resource revenues between 1976 and 1987, Alberta contributed to the fund in only three subsequent years: 2006-2008. With current Heritage Fund assets of $18 billion, there is limited scope to rely on the existing fund to stabilize provincial own-source revenues.

While provincial wealth funds would make eminent sense as a counter to volatile revenue sources, perhaps they are more suitable for nation-states than they are for competitive provinces in a federal system.

2. What if Alberta did the unthinkable and levied a sales tax?

Albertans take pride in living in the only province that does not have an explicit provincial sales tax, although, in common with the residents of the other provinces and territories, they do pay a variety of consumption-related levies. Might this now change under the pressure of the ongoing fiscal collapse? This would certainly make eminent fiscal sense since sales taxes are ideally suited to be a counterweight to volatile energy revenues because they can provide stable and growing revenues. However, it would take a creative proposal to convince Albertans to forego the so-called "Alberta advantage" and embrace a provincial sales tax.

Nonetheless, Jack Mintz, one of Canada's foremost fiscal economists, and his co-author Philip Bazel (both from the University of Calgary's School of Public Policy) provided one version of a creative proposal in their 2013 paper titled

- Reducing the Alberta personal income tax rate from 10% to 9%;
- Reducing the Alberta corporate income tax rate from 10% to 8.43%; and
- The HST would also bring in an estimated $800 million annually from tourists and visitors.

If and when the energy revenues return to, or near, their former levels and if Alberta does implement a version of this approach to sales taxation, then the rest of Canada may well find Alberta to be most attractive for inward personal as well as corporate head-office and production relocations.

Conclusion

With Alberta in the throes of a revenue collapse, the announcement of the equalization payments across provinces for fiscal year 2018-19 – $11.7 billion for Quebec and nothing for Alberta and repeated on a grander scale in 2019-20 – left many Canadians dumbfounded. The role of the foregoing analysis was to elaborate on several factors that led to these allocations and to suggest the ways forward so that this does not recur.

In summary, the following aspects of the current equalization formula require attention by the federal government:

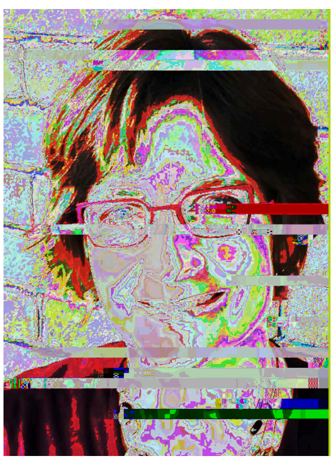
- Eliminate inordinately long lags in the system so that it better captures current provincial fiscal realities;
- Review the new financing model which sees equalization grow at the rate of GDP growth and creates a zero-sum game among the provinces;
- Reform the dramatically underfunded Fiscal Stabilization Program, which does relatively little to address provincial revenue collapses compared to the size of the broader equalization program.

However there is another message that is implicit in the above analysis, namely that Alberta may in part be the author of its own fiscal woes. Alberta's fiscal reality is that resource revenues are inherently volatile. In an earlier era Premier Lougheed's Alberta Heritage Fund could be deployed in the case of a resource revenue collapse. This avenue is not available to present-day Alberta. One obvious alternative way to rein in revenue volatility would be for Alberta to introduce a sales tax, perhaps along the lines of the Mintz-Bazel model highlighted above. This would serve to not only reduce Alberta's overall revenue volatility but as well would enhance Alberta's attractiveness for inward personal and corporate migration.

About the Authors

Thomas J. Courchene, OC, SOM, FRSC, was born in Wakaw, Saskatchewan and educated at the University of Saskatchewan, Princeton University and the University of Chicago. He holds honorary doctorates from the University of Regina, Western University, and the University of Saskatchewan. Tom has authored / edited several hundred publications across a wide range of Canadian public policy areas and is the recipient of numerous awards, including the inaugural Donner Prize in 1998 and the Canada Council Molson Prize for lifetime achievement in the social sciences in 2000. Tom was awarded his second Donner Prize for his 2018 book, [illegible] *150* [illegible].

Currently, Tom is Professor Emeritus at Queen's University. He was the founding director of Queen's School of Policy Studies.



Teresa M. Courchene was born in Princeton, New Jersey and educated at Western University, Queen's University and the University of Toronto. Teri spent 13 years in the economics department of the TD Bank, becoming Associate Vice President and Director of Research.

Over the past 15 years, Teri has focused on teaching and research in the areas of early years' learning, mathematics and financial literacy. Teri currently teaches investing at the University of Toronto School of Continuing Studies.

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