

Rethinking Fiscal Arrangements in Canada

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Building Back Better:

Forging a Post-Pandemic Social Policy That Works for All

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Overview

- Issues with existing fiscal arrangements
- Fallout from the pandemic shock
- Policy options

Issues with Federal-Provincial Fiscal Arrangements Pre-Pandemic

Growing Vertical Fiscal Imbalance

- Provincial debt-GDP ratios relatively high
- Provincial social spending growing vis-à-vis federal transfers
- Demographic pressures on both expenditure and revenue sides
- Municipalities increasingly constrained
- Advantage of sizeable federal-provincial transfers:
 - Federal leadership in revenue-raising versus
 - Advantages of social program decentralization
 - But, danger of soft budget constraint

Continuing Horizontal Imbalance

- Sizeable fiscal capacity differences
 - Differences in provincial debt-GDP ratios, growth rates and demographic pressures
 - Pressures on natural resource provinces
- Shortcomings of equalization
 - Structural issues: GDP cap; resource revenues; carbon taxes; needs
 - Inadequate as insurer of risk to provincial revenues
 - CHT/CST more effective at equalizing “have” provinces down
- Fiscal competition pressures leading to protective measures

Inadequate Fiscal Stabilization

Provinces prone to idiosyncratic fiscal shocks

- Have limited self-insurance ability, with the arguable exception of resource revenues; resource provinces have not self-insured
- Federal government can pool risks across provinces and time, but
- Equalization program not very stabilizing: standard varies with shocks
- Fiscal Stabilization Program has inadequacies:
 - \$60 per capita limit has not changed and is declining in real terms
 - Deductible on resource revenue is 50%; based on actual revenues

Coordination of Responsibility Issues

Federal-provincial harmonization done on a case-by-case basis

- Tax harmonization a success story, but incomplete
- Environment: diverse carbon pricing and regulation approaches
- Progress on internal common market: CFTA and bilateral agreements
- Capital market regulation a work-in-progress
- Social safety net/protection: lack of coordination between social insurance (EI), income security, tax transfers and social assistance
- Limited coordination among provinces in areas of provincial jurisdiction

Fallout from the Pandemic Shock

Fiscal and Economic Fallout

- Once-over increase in federal and provincial debt
- Increase in private indebtedness and bankruptcies
- Vulnerabilities of social protection exposed
 - Inadequacy of EI, income support for working poor and precariat
 - Long-term care, childcare
 - Public health preparedness
- Temporary job loss concentrated among low-wage, service sector workers and those unable to work from home
- High-income earners sheltered

Intergenerational Impact

Cost of pandemic uneven across generations

- Immediate costs to the young:
 - Loss of education opportunities
 - Disadvantages of delayed job market entry
- Capital income better protected than labour, favouring the well-off elderly
- Potential for current younger generations to suffer as pandemic debt paid down in future
- Older generations spared costs of financing debt

Policy Options for Fiscal Arrangements

Policy Options: Fiscal Reforms

- Spread cost of pandemic debt across generations
 - Pay debt off gradually to spread burden to future
 - Tax reform to spread costs to older generations: broaden income tax base, once-over Pigou wealth tax
- Reallocate debt from provinces to feds: once-over transfer
- Reform fiscal transfers
 - End cap on equalization
 - Tie growth of CHT/CST to provincial program expenditures
 - Enhance fiscal stabilization
- (Potential new spending power initiatives)?
 - Long-term care, childcare, pharmacare

Policy Options: Structural

- Reallocate expenditure responsibilities
 - Make social assistance federal
 - Create federal-provincial basic income guarantee
- Change vertical balance: increase in federal tax room & CHT/CST
 - Make provinces less vulnerable and preserve tax harmonization
- Tax reform to improve fairness & incentives to innovate and invest
 - Basic income guarantee, broaden capital income base
 - Reinstate inheritance tax
 - Reform CIT to encourage investment & reduce incentive for debt finance

Policy Options: Institutional

- Federal and provincial responsibilities are interdependent, but often conducted in silos
- Worth exploring institutional mechanisms for fostering coordination and harmonization
 - Expand Council of the Federation to include federal government?
 - Fiscal Council to monitor federal and provincial fiscal situations?
 - Grants Council to advise on federal-provincial transfers?