Looking for Mr. Good-Transfer: A Guide to the CHST Negotiations

by

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**Introduction**

Sometime this autumn, federal and provincial delegations will gather to begin discussing the final form of the Canada Health and Social Transfer (CHST). The CHST replaces the Canada Assistance Plan (CAP) and Established Programs Financing (EPF) – the fiscal arrangements under which the federal government and the provinces had shared the costs of welfare, personal social services, health care and post-secondary education.

That the previous fiscal arrangements will be replaced has already been decided. But much else remains undecided. How will federal payments be distributed among the provinces? What conditions will there be on the federal payments and how will those conditions be enforced? Will the federal government abandon altogether the last 50 years of using leveraged federal dollars to shape Canada’s social security system – what is called its ‘spending power?’

These and other issues will be critical for Canada’s social, health and post-secondary education systems over the next decades. Not just social programs are at stake. The outcome of the discussions will help determine the relative tax burdens of Canadians in each province and how we respond to continuing instability in our economy. In the broadest sense, the new fiscal arrangements will reveal the extent to which Canadians remain committed to acting as a nation, sharing both adversity and good fortune among provinces, rather than a collection of semi-independent principalities loosely connected by trade links and a shared debt burden.

The coming negotiations will be the most important federal-provincial discussions since the late 1960s. Unfortunately, the prospects are not good for Canada’s social security system. The National Council of Welfare has called the CHST “the worst social policy initiative undertaken by the federal government in more than a generation,” an assessment shared by the Caledon Institute [National Council of Welfare 1995: 26].

In a series of commentaries and reports, Caledon has attempted to spell out the dangers of the CHST. However, it is certain that we are going to end up with some form of the CHST, so Caledon has also suggested ways to make the most of a bad thing [Battle 1995; Battle and Torjman 1995; Torjman 1995a,b; Torjman and Battle 1995]. This paper continues the Caledon commentaries on the CHST by setting out some of the key signposts we should look for in the coming negotiations and recommending ways to make, if not a silk purse, at least a serviceable handbag out of this sow’s ear.

**The negotiations process**

Oddly enough, the first signpost to look for is whether there will be any ‘signs’ at all. Will it be possible for anyone in the media, the public or even members of the federal Parliament and provincial assemblies to find out enough about the negotiations to follow and assess them? Traditionally, federal-provincial fiscal negotiations have taken place behind closed doors with no access to the media and no Parliamentary or public input. In these secret negotiations, not even the opening positions of the respective jurisdictions are known. The public is kept completely in the dark until the last moment – unless there is an acrimonious breakdown.

Although Caledon recognizes that detailed negotiations between governments cannot occur in public, we also believe that these negotiations are far too important to take place completely behind a screen of secrecy. Canadians should be
able to hold their governments accountable for the positions they take. We cannot do so without information.

There are a number of ways in which information can be made available to the public during the negotiations without compromising the ability of governments to negotiate. Although tedious, the tradition of opening statements to begin major federal-provincial meetings could be resurrected. At the very least, opening positions could be tabled with the media, if not read aloud in front of TV cameras. If undertaken periodically during the negotiations, this would provide some knowledge of what is going on. In addition, a schedule for negotiations could be released to permit monitoring of significant milestones. Periodic summaries could be issued, including differences of viewpoint where they exist. These are minor changes, not difficult to implement, but at least would go a small way to providing some openness in the negotiations.

Of course, when we speak of negotiations, this might be using the word very loosely. The money that is being discussed is federal money and its disposition is entirely under Ottawa’s control. No province’s agreement is required at all. The federal government can include whatever it wants in the new arrangements for federal-provincial financing and adopt these arrangements unilaterally against the will of all the provinces, if it so chooses. The only constraint is the Constitution and this imposes few, if any, limits on federal grants to the provinces. While the CHST implementing legislation speaks of mutual consent, this is placed in a strictly limited context, as discussed below.

The Caledon Institute would urge the federal government to seek mutual consent regarding the entire negotiations, including fiscal matters. Rather than rely on its unilateral powers, Ottawa should approach these negotiations in a spirit of true cooperation and search for a reasonable level of consensus. This does not mean that unanimity needs to be achieved. Although not necessarily alone among possible dissenting provinces, it is simply realistic to recognize that the current Quebec government will not readily endorse any federal-provincial agreement. Unanimity may be impossible. In any case, as we have seen in the Constitutional negotiations, unanimity can be a straight jacket, with one province able to hold all the others to ransom. Instead, the federal government should voluntarily state in advance of the negotiations its intention to achieve a consensus among the provinces.

From a strict bargaining perspective, it may appear strange to recommend that the federal government give up its power to act unilaterally. This, after all, is its strongest card, and we are suggesting foregoing it before the negotiations even begin. However, this is to view the negotiations as a contest between adversaries. This view of federalism has done nothing but harm to Canada over the last decade. The federal government is responsible for the well-being of Canada, not just of the programs and services labelled ‘federal.’ Until the mid-1980s, a reasonable level of agreement among the provinces and the federal government was always implicitly assumed as a goal of federal-provincial relations. Only in the last decade or so has unilateral imposition against the will of all or almost all of the provinces become the common coin of everyday federal-provincial relations. Adopting an explicit goal of consensus now will make a clean break with this negative trend and go a long way to restoring a healthy climate of cooperative federalism.

It will also be useful to the federal government to discipline itself in this fashion. Ottawa will have to work much harder at achieving
agreement and dealing fairly with all the provinces. Without a constraint on federal powers, there will be an irresistible temptation to impose an arbitrary resolution at the first sign of a roadblock, leaving a residue of bitterness and weakening Canadian federalism. By contrast, requiring consensus will turn the forthcoming discussions into true negotiations and not just one-way consultations.

**Accountability to Parliament and provincial assemblies**

Right now, there is no role for our elected representatives, except those who happen to be a Cabinet Minister. As the outcome of the negotiations will be among the most important events shaping the future of Canada, it is ironic that agreements can be signed without even a symbolic debate in our legislative assemblies, let alone a ratification vote.

Real negotiations with agreements at the conclusion provide an opportunity to increase democratic accountability by enhancing the role of the federal Parliament and provincial assemblies in the new fiscal arrangements. At a minimum, Caledon would urge that all governments commit themselves to submitting the results of the negotiations and their final positions to their assemblies for open debate. Better still, proposed agreements should be submitted to the assemblies for a vote of ratification. This would ensure media attention and a public debate representing differing perspectives.

If the prospect of an open debate in the federal and provincial assemblies were known from the start, this would give the whole negotiation process much greater public accountability throughout and go hand in hand with openness in the negotiations.

**Who does the bargaining?**

Section 13(3) of the federal Act to implement the 1995 Budget directs that: “The Minister of Human Resources Development shall invite representatives of all the provinces to consult and work together to develop, through mutual consent, a set of shared principles and objectives for the other social programs... ” By ‘other social programs’ is meant anything other than programs covered by the Canada Health Act. The Minister of Finance, by contrast, is enjoined by the Budget summary document, not by any Act, to “consult [no ‘mutual consent’ needed here] with the provinces and territories in developing a permanent method of allocating payments among the provinces” [Canada 1995a]. So the plan seems to be this: Human Resources Development supposedly negotiates content, while Finance definitively decides on the money.

We have discussed above the need for more than just consultation with the provinces, and less than unanimity. However, regardless of what rule is adopted for decision-making, the process set up by the 1995 Budget seems to split the negotiations — with the money going to one table and any discussion of objectives, principles, conditions or standards going to another. Having had a major public review of social policy effectively cancelled by the 1995 Budget, the Minister of Human Resources Development is now asked to play poker when someone else is holding all the cards.

What this means is that any real discussions will be held by the Ministers of Finance with Human Resources Ministers left, at best, to come up with some meaningless, unenforceable platitudes to placate the public. Unfortunately, the federal Department of Finance has not in the last several years demonstrated a great regard for social programs. Trusting the Department of
Finance to negotiate social programs is the proverbial fox guarding the hen house.

If there is to be any social policy content in these negotiations, the discussion of dollars and programs must be undertaken simultaneously and at the same table. The Minister of Human Resources Development can follow the requirements of the Act by co-chairing with the Minister of Finance a joint Ministers’ conference. While this would be unwieldy, it would need to be maintained only as the plenary forum, with smaller working groups being assigned specific tasks. It is not beyond the realm of imagination to set up a workable negotiations process which is not dominated solely by a Finance perspective. Both Ministers should be co-participants in a comprehensive negotiation with the provinces and territories.

The level of the CHST

The 1995 Budget announced that combined CAP and EPF entitlements would be reduced by $2.5 billion and $4.5 billion in 1996-97 and 1997-98, respectively. In 1997-98, the combined CAP and EPF entitlement would have been $29.6 billion; instead it will be $25.1 billion. But all is not as it seems. To explain the 1995 Budget’s fiscal impact on the provinces requires a brief excursion into the arcane world of tax points, because the entitlement of $25.2 billion is not really a payment of that amount of money to the provinces.

Entitlements are made up of tax points plus cash. A ‘tax point’ is a percentage point of the basic federal tax (e.g., if a province’s income tax is 50 percent of the basic federal income tax, this is 50 tax points). As part of fiscal negotiations in 1977, the federal government transferred 13.5 personal income tax points and one corporate tax point to the provinces. From the point of view of the taxpayer, there was no change except that more tax now showed up as payable to the province and less to the federal government. But from the point of view of the provinces, there was a big change: The federal government no longer had any control at all over the revenue from these tax points. Now, with almost 20 years having passed, the tax transfer has become just another indistinguishable part of the provinces’ general revenue base.

However, every year Ottawa still calculates the up-to-date value of the tax points that were transferred in 1977 and subtracts this updated value from the entitlements. The result is the amount of real cash paid. When the value of the tax points goes up more quickly than the value of the entitlements, the result is a reduction in cash paid to the provinces. By freezing and placing ceilings on the entitlements, the federal government has cut cash transfers over the last several years and more. Ottawa could claim it was only freezing the EPF at its existing level; but for the provinces, the freeze amounted to cash reductions.

What all this means about the 1995 Budget is that while entitlements are decreasing $4.5 billion from what they otherwise would have been, the cold hard cash paid to the provinces will decrease even more. Cash will be $6.6 billion less in 1997-98 than in 1994-95. In 1994-95, combined CAP and EPF cash payments were $16.9 billion; in 1997-98, cash payments under the CHST will be $10.3 billion.

These are large, abrupt cuts. But if the remaining CHST entitlements are not indexed or only partially indexed so that they do not grow with inflation and the economy, the cuts after 1997-98 will be even larger – if a little more gradual. As we pointed out in Constitutional Reform by Stealth [Battle 1995], partial indexing of the CHST would mean that the remaining...
$10.3 billion cash would run out in 10 to 15 years. With partial indexing, CHST entitlements would decrease in real terms every year and, as the value of the tax points continued to grow proportionately to the economy, the cash payment would decline until it disappeared altogether. Even before the money ran out, the federal government would soon be unable to enforce any conditions associated with the transfers. We discuss the issue of conditionality and national standards below, but the threat of a continuous decline in federal cash transfers has important consequences in itself, regardless of the issue of national standards. This point has been little understood to date.

Because most provinces are now reporting surpluses, while Ottawa still has a big deficit, it is often thought that the provinces are in relatively good fiscal shape compared to the federal government. This is one of the reasons why it appears reasonable for Ottawa to be shifting part of its deficit to the provinces, which seem better able to cope. Unfortunately, this is a misleading picture of the underlying reality — arising mainly from the great variation in the size of Canadian provinces and their economies.

All of the smaller provinces, six out of ten, are highly dependent upon federal transfer payments — made up mainly of CAP, EPF and equalization — accounting for about 35 to 40 percent of revenues in Newfoundland and the Maritimes, and 25 to 30 percent for Saskatchewan and Manitoba. But since they make up only 13 percent of Canadian gross national product (GNP), very small changes in payments in Ottawa’s terms can loom very large for those six provinces. This is just what happened a few years ago. In a positive move for Canadian federalism, the Chretien government restored full equalization payments by moving to a 1992 base and removing the ceilings which had accumulated since 1987. This gave large bonuses to provinces receiving equalization and made a big fiscal difference for the six small provinces. Ottawa has stated its continuing support for the equalization program. Caledon applauds this commitment, which was reaffirmed in the 1995 Budget.

As for the larger provinces, Alberta and BC do not receive equalization payments, but are both awash in resource revenues. This leaves Ontario and Quebec. Ontario does not receive equalization and the federal share of its revenue is less than 15 percent. Although Quebec does get equalization payments, these are relatively small. Quebec usually gets less than 20 percent of its revenue from federal transfers, partly because it opted for more tax point transfers than the other provinces. Neither province has any special sources of revenue.

Together, Ontario and Quebec account for 63 percent of Canadian GNP. In hard-nosed economic terms, Canada’s tax base is Ontario and Quebec, with some relatively modest influences from other areas. It is, therefore, no coincidence that the three jurisdictions in fiscal trouble are Quebec, Ontario and the federal government; all three have experienced the same problem of a stagnant or declining revenue base, increasing social costs due to high unemployment and high debt servicing costs due partly to high interest rates. Ottawa can rescue a small province by dipping into Ontario’s tax base, in this way.

If the new Ontario government proceeds with its promised income tax cuts, unless it raises other taxes to compensate (e.g., through GST and provincial sales tax integration), its fiscal situation will probably deteriorate further. This is simple arithmetic. Federal CHST cash transfers to Ontario decrease by more than $2 billion and the promised Ontario income tax cuts will
cost at least $5 billion. Add them together and Ontario’s lost revenue is at the very minimum $7 billion, and this is likely a significant underestimate. The Ontario spending cuts of $1.9 billion announced in July 1995 pale in comparison to this daunting figure. In any case, the $1.9 billion savings have been used mainly to compensate for revenue estimate shortfalls and cannot offset much, if any, of the $7 billion or more still needed.

At the same time, if Ontario proceeds with its tax reduction, this will automatically reduce federal payments to the equalization-receiving provinces. Equalization is calculated based on the National Average Tax Rate for each separate provincial tax source (e.g., personal income tax, corporate income tax and provincial sales tax). Of all provincial tax sources, the personal income tax is the largest. Table 1 estimates the losses to equalization-receiving provinces resulting from Ontario’s planned tax reduction.

As a result, in the next few years, even the small provinces now in good fiscal shape will have their hands full coping with the federal transfer reductions announced in the 1995 Budget and reduced equalization payments. After the Referendum, Quebec will also have to deal with the combined effects of the CHST and equalization reductions, as well as spillover pressure to reduce taxes if Ontario proceeds with its tax cuts. Only BC and Alberta would remain relatively unscathed and able to absorb further federal reductions with their current revenue base. And this scenario assumes continued modest economic growth. If there is another economic downturn, everything becomes much harder.

All of this has one simple implication: If the CHST continues to decline in real terms, after the two large cuts now planned for 1996-97 and 1997-98, the steady loss of federal transfers will require continued long-term reductions in the public sector in almost all provinces — meaning everything from universities and hospitals to highways and parks. A decision to partially index the CHST entitlement is not just a decision about a federal transfer payment. It is a decision about the role of the public sector in Canada over the next decades.

Table 1

<table>
<thead>
<tr>
<th>total tax cut</th>
<th>Nfld.</th>
<th>PEI</th>
<th>NS</th>
<th>NB</th>
<th>Quebec</th>
<th>Man.</th>
<th>Sask.</th>
<th>Canada</th>
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<tr>
<td>$5.0 billion</td>
<td>42,421</td>
<td>8,657</td>
<td>38,543</td>
<td>41,117</td>
<td>191,303</td>
<td>43,532</td>
<td>55,131</td>
<td>(420,704)</td>
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<tr>
<td>$5.5 billion</td>
<td>46,663</td>
<td>9,522</td>
<td>42,398</td>
<td>45,228</td>
<td>210,434</td>
<td>47,885</td>
<td>60,644</td>
<td>(462,774)</td>
</tr>
<tr>
<td>$6.0 billion</td>
<td>50,905</td>
<td>10,388</td>
<td>46,252</td>
<td>49,340</td>
<td>229,564</td>
<td>52,238</td>
<td>66,158</td>
<td>(504,844)</td>
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Note: These are estimates of the effect of the tax cut based on current (1995-96) data. By 1997-98 or 1998-99 when the tax cuts are fully implemented, income would have grown and tax disparities may have shifted among the provinces. The nominal amount of the equalization losses likely will be somewhat larger at that time.
While the 1995 federal Budget did not include a fiscal projection beyond 1996-97, it is clear that the transfer payment and other reductions already built in for 1997-98 will result in continuing significant improvement in the federal fiscal position [Canada 1995a:79-80]. By then, the federal deficit should be well below $20 billion. Perhaps more importantly, net financial requirements (the actual cash the federal government will need to borrow will likely be below $10 billion or only a little more than one percent of GNP—among the lowest ratios of any industrialized nation. More importantly, the operating balance—revenue minus program spending—should be at a surplus of around $35 billion or more.

In short, there is no fiscal need for Ottawa to continue reducing the CHST beyond 1997-98. The only rationale the federal government would have for partial indexation rather than full indexation of the CHST would be a philosophical commitment to a continuing reduction in public services. There is no argument of fiscal necessity. Quite the reverse; given that many of the provinces likely will be in a more fragile fiscal position than the federal government by that time, good fiscal management may require the federal government at least to maintain the real value of its cash payments at 1997-98 levels into the future. This would mean, at minimum, continuing the cash transfers of about $10.3 billion in real terms.

The federal Minister of Health was recently reported in the media as announcing that Cabinet had, indeed, decided to maintain the cash portion of the CHST and not to allow it to decline to zero [Globe and Mail, 5 July 1995:4]. If this report is correct and the Cabinet decision is not reversed at a later date, then it would seem Ottawa has come to a similar conclusion. Whether this means payments would be maintained at 1997-98 levels, increased to accommodate special circumstances, as discussed below, or just kept somewhere above zero would be an appropriate subject for the federal-provincial negotiations. This gives the federal government the leverage it needs to work successfully within a cooperative decision-making process.

**Distribution among the provinces**

The 1995 Budget announced the distribution of CHST entitlements for 1996-97, but left the distribution for 1997-98 and beyond to be negotiated. For 1996-97, CHST entitlements will be “allocated among the provinces in the same proportion as provincial entitlements under combined CAP and EPF transfers in 1995-96” [Canada 1995c: 54]. This leads to some curious consequences, as can be seen in row A of Table 2. New Brunswick gets $901 per capita, while Quebec gets $1,001, Saskatchewan gets $865 per capita; BC gets $877. Such a distribution lacks all rhyme or reason other than that it is based on the sum of the previous CAP and EPF transfers. However, CAP was not a block fund; it cost-shared 50 percent of eligible expenses except in Ontario, Alberta and BC where a ceiling was imposed in 1990. There was little enough rationale for this distribution of the cost-shared CAP. There is certainly no rationale for reproducing this allocation in a block fund. Of course, this is only for 1996-97; 1997-98 and subsequent years are to be negotiated. That is where the fun comes in.

In the multi-year fiscal projections for their Budgets, all provinces had to make assumptions about what they would get from the CHST in 1997-98. The previous Ontario government’s Budget plan assumed Ontario’s worst case scenario—that the federal government would continue the distribution of the CHST on the
1996-97 basis. As seen on row D of Table 2, this assumption results in approximately $385 million less for Ontario than an equal per capita distribution. However, Quebec assumed exactly the opposite. Quebec estimated its worst case scenario, that the current distribution of the CHST would be replaced by an equal per capita allocation after 1996-97. This assumption results in a loss of $652 million for Quebec compared to continuing the existing distribution (row D, Table 2). Clearly, Quebec and Ontario cannot both be correct!

Table 2

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<tr>
<td><strong>Distributing the CHST Among the Provinces</strong></td>
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<td><strong>($000,000 unless otherwise indicated)</strong></td>
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<tr>
<td>942</td>
<td>906</td>
<td>924</td>
<td>901</td>
<td>1,001</td>
<td>869</td>
<td>906</td>
<td>865</td>
<td>840</td>
<td>877</td>
<td>906</td>
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</tr>
<tr>
<td>B. 1997-98 CHST distributed same shares as 1996-97</td>
<td>514</td>
<td>116</td>
<td>816</td>
<td>646</td>
<td>6,882</td>
<td>9,007</td>
<td>967</td>
<td>892</td>
<td>2,158</td>
<td>3,071</td>
<td>25,100</td>
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<tr>
<td>C. 1997-98 CHST distributed equal per capita</td>
<td>495</td>
<td>116</td>
<td>801</td>
<td>649</td>
<td>6,230</td>
<td>9,392</td>
<td>967</td>
<td>868</td>
<td>2,327</td>
<td>3,174</td>
<td>25,100</td>
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<tr>
<td>D. 1997-98, same shares minus equal per capita (cash)</td>
<td>20</td>
<td>0</td>
<td>16</td>
<td>(3)</td>
<td>652</td>
<td>(385)</td>
<td>0</td>
<td>(40)</td>
<td>(169)</td>
<td>(104)</td>
<td>0</td>
</tr>
<tr>
<td>E. Federal cost of equalizing to Quebec per capita (cash)</td>
<td>32</td>
<td>12</td>
<td>68</td>
<td>71</td>
<td>0</td>
<td>1,368</td>
<td>101</td>
<td>130</td>
<td>413</td>
<td>436</td>
<td>2,628</td>
</tr>
<tr>
<td>F. 1% of 1997-98 CHST: province’s below Quebec per capita (cash)</td>
<td>5</td>
<td>1</td>
<td>8</td>
<td>6</td>
<td>0</td>
<td>90</td>
<td>10</td>
<td>8</td>
<td>22</td>
<td>31</td>
<td>181</td>
</tr>
<tr>
<td>G. Years to reach Quebec level at 1% ‘extra’ per year</td>
<td>6</td>
<td>10</td>
<td>8</td>
<td>11</td>
<td>0</td>
<td>15</td>
<td>10</td>
<td>15</td>
<td>19</td>
<td>14</td>
<td>NA</td>
</tr>
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</table>

Note: CHST totals in rows A, Band C are ‘entitlements’ made up of tax points and cash, but figures in rows D, E and F are in cash because they are incremental adjustments to the entitlements. Estimates in row G would vary over time, depending upon tax versus GNP growth over the years. Numbers do not add due to a small adjustment for the Territories.
Note that these gains and losses are above and beyond the losses as a result of the cut in transfers generally and result only from the distribution of the already reduced transfers. Without additional federal money, there is no way to square this circle. Without more money, moving towards an equal per capita allocation means that the current beneficiaries of the skewed distribution—almost entirely Quebec—lose out. Failing to move towards an equal per capita allocation means that the provinces on the short end of the arbitrary 1996-97 distribution—mainly BC, Alberta, Saskatchewan and Ontario—are the losers.

There are two general strategies that could be followed to move towards an equal per capita distribution of CHST, assuming that entitlements in general are fully indexed to GNP. The federal government could adopt a ‘no loser’ strategy and increase those below the national average gradually towards the highest per capita province (Quebec). Alternatively, Ottawa could adopt a ‘no cost’ strategy and ‘super-index’ those now below the national average and pay for it by partially indexing those above the national average until they meet.

To illustrate a ‘no loser’ strategy: Say one percent additional escalation was added to the indexing formula for all the provinces receiving less per capita CHST than Quebec. The cost to the federal government would be an estimated $181 million (row F of Table 2) extra each year (i.e., $362 million in the second year) until all the provinces are caught up. This is not an overwhelming amount of money relative to the very large sums involved. It would achieve equity between provinces over time without penalizing any provinces, taking almost two decades for all provinces to catch up to Quebec (row G in Table 2).

Over the 20 years, this method of equalizing per capita distribution would restore in the order of $2.6 billion in today’s dollars (row E of Table 2) of the approximately $6.6 billion cut. From a fiscal perspective, this would mean that as the federal government regained fiscal health, it would gradually return about 40 percent of the financing it had removed from social transfers during today’s period of fiscal crisis. This makes sense in re-establishing fiscal balance to the federation, since it now appears that with the exception of BC and Alberta, the provinces will be in worse fiscal shape than the federal government within the next decade or so. Moreover, this would give the federal government additional leverage to develop and maintain national standards.

Caledon recognizes that it may appear wildly dissonant to talk at this time of additional funding for the CHST. But this is a system being designed for more than the current fiscal situation. We should not be blinded by today’s requirements when thinking about a gradual restoration of part of the funding cuts over the next two decades. In any case, whether through this method or some other—the point is that if the provinces currently over the national average are not to be cut further in real terms and per capita equality is to be achieved, there is no choice other than additional federal funding.

Let’s look at the alternative. To illustrate the ‘no cost’ approach, say that the CHST is indexed to increase by a formula tied to GNP and this results in a four percent indexation. This strategy would index those provinces below the national average by, say, four percent plus one percent (i.e., five percent), while indexing those above the national average by four percent less one percent (i.e., three percent). This would have no net cost for the federal government, but it
would result in a gradual loss in the value of the CHST in all provinces east of Ontario other than New Brunswick. The amounts would be small except for Quebec. In Quebec, however, this would result in a steady, long-term erosion in the level of public services (about $65 million a year) and undoubtedly would be very difficult for federal-provincial relations. Moreover, because Quebec has a larger tax point transfer than other provinces, its cash payments are relatively lower. As a result, partial indexation would substantially erode relative per capita cash payments to Quebec, making federal conditions uniquely difficult to enforce in that province.

There are variations other than an equal per capita allocation for distribution among the provinces. The most prominent alternative advocated doubtless will be to build a measure of economic or social need into the allocation formula among the provinces. As discussed below, Caledon believes that the federal government must share responsibility for welfare costs arising from extraordinary economic downturns in a province; but such downturns should have minimal effects on health care, post-secondary education and personal social services. These types of services require long-term predictable funding which should not be greatly sensitive to economic cycles. This argues for a split in federal funding: stable support for institutional and service expenditures on the one hand, and responsive support for volatile welfare costs on the other.

It is difficult to make a sound argument for any consistent interprovincial pattern of higher needs or costs for institutional and service programs. Attempting to develop a formula becomes a quagmire of comparative salary levels, percentage of elderly and disabled population, comparative use of facilities, policy differences and so on. In fact, if an accurate measure of needs for non-welfare public services were developed, BC probably would be the big winner, not Newfoundland.

The bottom line is simple. Once you move to block funding, equal per capita entitlement is a simple, fair criterion for funding health care, personal social services and post-secondary education. Of course, the federal government may attempt to ignore this issue or somehow finesse it. But this will just set up a ticking time bomb under Canadian federalism. The issue of a fair distribution will need to be addressed at some point. It should be dealt with now in a clear and forthright fashion, even if the process of achieving a fair distribution takes many years. From the point of view of social programs, Caledon would urge a ‘no loser’ strategy because this would restore some of the funding lost to social programs, minimize tensions in the federation and give the federal government additional bargaining leverage.

**Responding to extraordinary economic downturns**

In rationalizing the move to block funding, the 1995 Budget states that the provinces “have clear responsibility to design and deliver social assistance programs” [Canada 1995d: 17]. If this is taken to mean that provinces have sole responsibility for social assistance, this statement is neither historically nor legally accurate.

Since the introduction of the Old Age Pensions Act in 1927 and the Unemployment Relief Act in 1930, the federal government has been a partner with the provinces in both paying for and designing social assistance programs. Ottawa has been an active participant almost since the beginning of Canada’s developing social security system.

Legally, Ottawa has an almost unre-
stricted ability to offer conditional grants to provinces, which it has long upheld as a power of Parliament. For example, in papers prepared for the 1968-71 Constitutional discussions, the federal government argued that: “In addition to the Powers of the Parliament of Canada to legislate, the Constitution as it has been interpreted by the Courts gives to it the power to spend from the Consolidated Revenue Fund on any object, providing the legislation does not amount to a regulatory scheme falling within provincial powers” [Canada 1969: 12].

In fact, it was only under the Mulroney government that the federal government began to retreat from the assertion of its legal right to exercise its spending power as part of the unholy alliance between advocates of ‘provincial rights’ with those opposed to social programs. It is disappointing to see the Liberal government now automatically reflecting this philosophy as a ‘given,’ apparently without careful consideration. Nor, as argued above, does Ottawa have to use its spending power in an arbitrary and unilateral manner. Aiming for consensus while asserting a federal role is entirely consistent with pre-Mulroney federal-provincial fiscal relations.

Caledon believes the exercise of the federal spending power to influence and assist provinces in carrying out their responsibilities is legitimate and consistent with Canada’s historical experience. There is an especially obvious and necessary federal role when unemployment reaches mass proportions, putting enormous strains on local resources.

There are many different mechanisms through which this could be accomplished. Perhaps the simplest would be to supplement the CHST with a per capita payment to a province to kick in if unemployment rose above a certain level, with the transfers required to be spent on programs to assist the unemployed through training and relocation or income assistance. Alternatively, a more complex and finely-tuned mechanism could be developed – e.g., the reintroduction of cost-sharing for the portion of assistance costs attributable to extraordinary economic distress. Or, as suggested in Constitutional Reform by Stealth, a more general counter-cyclical formula could be incorporated right into the CHST – e.g., “by designating a certain portion of the CHST for welfare and building into the annual indexation formula an indicator of demand, such as the percentage of each province’s non-elderly population that is not employed” [Battle 1995: 6]. This latter mechanism would require the CHST to be divided into welfare and non-welfare components.

The point here is first to adopt a principle of ensuring that each province is not cast adrift; the means to reflect this principle within the CHST can then be developed through negotiation. Canada should not again repeat the mistakes of the 1930s when the federal government responded with endless ad hoc (and completely inadequate) measures to the bankruptcy or near bankruptcy of some municipalities and provinces, bowled under by the weight of unemployment and economic collapse. If we are to be a nation, these are not burdens to be carried by each province alone.

National standards and conditions

In Can We Have National Standards? [Torjman and Battle 1995a], we set out in detail a number of potential objectives, principles, conditions and standards which should be considered. We will not repeat these here. The most important of these is for the federal government to provide some protection for the most vulnerable, through making sure that a reasonable portion of federal funds goes to welfare, rather than all siphoned off for health care, and that the
gains achieved through the CAP are not all lost in the CHST. This might be accomplished by dividing the funds into two components and by attaching specific conditions to protect welfare.

But for those looking for national standards or conditions for welfare, a careful reading of the CHST implementing legislation will prove very disappointing. The legislation provides for enforcement of the conditions of the Canada Health Act through financial penalties. However, for the other social programs – welfare, social services and postsecondary education – the Act permits a financial penalty only for a single condition: the imposition of residency conditions under provincial welfare rules.

Section 13(1)(c) of the Act states that one of its purposes is “maintaining national standards where appropriate, in the operation of other social programs,” and 13(3) requires the Minister of Human Resources Development to develop shared principles and objectives for these other social programs through mutual consent. ‘Social programs’ are defined by Section 25 as “health, post-secondary education, social assistance and social services,” so ‘other social services’ refers to post-secondary education, social assistance and social services.

Section 13 gives the casual observer the impression that the Act was being set up to allow the enforcement of some conditions, to be developed by mutual consent, for programs other than health. We imagine this is why lawyers had to be invented – because the casual observer would be dead wrong.

The legal labyrinth in the Act works like this: Section 17(2)(a) is the part of the Act which permits financial penalties to be imposed for failure to meet conditions. This Section allows penalties only through a process set out in Sections 21 and 22. These sections, in turn, refer only to a failure to comply with conditions set out in Section 19 for other social programs. Then Section 19 imposes one and only one condition: “The laws of the province must not require or allow a period of residence in the province or Canada to be set as a condition of eligibility for social assistance ... .” There is no other basis under which this Act allows a financial penalty to be imposed.

This makes the quest assigned to the Minister of Human Resources Development even more quixotic, if that could be imaginable. For it to be anything else, Ottawa must be willing to amend the CHST implementing legislation. Otherwise, there cannot be any enforceable conditions, with the exception of residency, for programs other than health. If the recommendations in this paper are adopted, in particular the measures that would see federal dollars on the table, it may be possible to achieve agreement on a set of relevant conditions for welfare and personal social services as well as health (post-secondary education is different because there were no conditions under the pre-CHST system). In this case, an amendment to the legislation becomes the denouement to a successful negotiation and not an insurmountable barrier. On the other hand, if Ottawa is unwilling to amend the legislation, the negotiations under Section 13 will be nothing more than a farce.

**Conclusion**

The coming negotiations of the CHST will be among the most important federal-provincial discussions in this generation. Caledon has set out a number of signposts in this paper which can be used to measure the progress, or otherwise, of the negotiations. Unlike the various Constitutional rounds, these negotiations must...
have a conclusion, even if the final resolution of outstanding issues is, in the end, unilaterally imposed by the federal government.

The Government of Canada can turn these negotiations into an opportunity for the resurrection of cooperative federalism, reasserting the sharing of adversity which is the signature of nationhood, while stabilizing and protecting part of our social security system if it wishes to do so. That’s the big if.

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Endnotes

1. All figures derived from Canada 1995c:51, Table 4.4: Major transfer entitlements to provinces. If the equalization on the tax points transfer is also ‘counted’ as a cash payment under the CHST rather than the equalization program, the cash payment will be about $11.1 billion in 1997-98. However, there was also $786 million in equalization paid on the tax point transfer in 1994-95, so the amount of the cash reduction in 1997-98 is almost unchanged.

2. There are several ways to calculate the promised 30 percent tax cut and the exact cost will not be known until the Ontario government releases details of its plans. The minimum cost would appear to be 30 percent of total income tax revenue. Total income tax revenue was about $16 billion in 1995-96; it should be at least $18 billion by 1998-99, the first full year of the tax cut. This suggests a minimum cost of $5.4 billion.

References


