



Québec's new government and the question of fiscal imbalance

The election of a pro-federalist government in the province of Québec changes – but does not end – Canada's federal-provincial tensions.

BY LOUISE GAGNON

The newly elected Premier of Québec has served notice that conflict between his province and Canada's federal government is not about to disappear, despite his background as a federal politician. Jean Charest's Liberal Party won 76 of the Québec National Assembly's 125 seats in April, ending nine years of Parti Québécois government. The Québec results allowed the federal government and English Canada to let out a sigh of relief. That sigh was an expression that tensions with the previous nationalist/separatist government in Québec might dissipate.



Yves Séguin tables Québec provincial budget.

However, one of the main issues that the new Québec Liberal government has put on its agenda will place it in direct opposition to the federal government in Ottawa. Premier Charest and his new finance minister Yves Séguin are both campaigning to correct what they call the "fiscal imbalance" between the province and the federal government. The recently defeated Québec Premier Bernard Landry, leader of the separatist Parti Québécois in the province, simply described the dilemma this way: that the money is in Ottawa but the needs are in the provinces.

"The debate originates from a centralist vs. decentralist view of the nation," says David Perry, senior research associate and an economist at the Canadian Tax Foundation, a non-profit organization dedicated to exploring an optimal tax system for Canada. "The question becomes which level of government sets the pace for the nation as a whole. Clearly, the Canadian public will only pay so much for public services."

Charest is a former federal cabinet minister who went on to become leader of an opposition party in Ottawa before moving to provincial politics. With that background, he is well-positioned to build a broad national campaign to address what economists refer to as a "vertical fiscal imbalance". As a convincing federalist, Charest should have greater success than his predecessors in attracting political support in English Canada.

"Charest has the ability to gather other provinces behind him," says Perry. "The federal government will not easily discredit the Québec government on this question, as it has in the past. The federal government sees eye-to-eye with Charest on the need to keep the country intact. The disagreement will come over how much money should be flowing from Québec. The provinces will likely back his position."

Louise Gagnon is a journalist based in Ottawa who writes frequently on medical issues.

Federal surpluses; provincial debts

Vertical fiscal imbalance refers to the unequal capacity of each level of government to raise revenues and fund its expenditures. In recent years, the federal government has been declaring surpluses while many of the provinces have posted deficits.

At the premiers' annual conference in August of 2002, the provincial leaders claimed the fiscal imbalance was impeding their ability to meet health-care needs in their respective provinces. Health care consistently ranks as the top political priority in public opinion surveys and as the largest area of program expenditure by the provinces. The provincial share of all program spending in Canada is 62 per cent.

Last year the Conference Board of Canada, an independent economic research organization, was commissioned by the provincial and territorial premiers to examine the vertical fiscal imbalance. The study concluded that federal government surpluses were projected to rise steadily over the next two decades, reaching nearly \$86 billion. At the same time, the provinces and territories will need further fiscal restraints to avoid recurrent deficits, which could climb as high as \$12.3 billion by the 2019-2020 budget year.

The Conference Board concluded that while the federal government would virtually eliminate its debt by that year with successive annual surpluses, the total provincial/territorial debt would increase by 54 per cent to \$386.9 billion.

For its part, the federal government maintains that no fiscal imbalance exists, since both federal and provincial/territorial governments have access to the same major tax bases, including personal and corporate income taxes, sales taxes, and payroll taxes.

Canada's Minister of Intergovernmental Affairs refutes the Conference Board report because it assumes government spending will remain constant relative to GDP over time. The federal department of finance is also unconvinced, saying long-term forecasts for spending cannot be considered accurate beyond two or three years.

The simmering dispute over a fiscal balance or imbalance, depending on the perspective of the order of government, has perhaps arisen from a lack of transparency in governance: it is not readily apparent to the citizen/taxpayer which order of government finances which programs.

"The lines of accountability become frayed when multiple levels of government intervene in the taxing and spending decisions," says Finn Poschman, a senior policy analyst at the C.D. Howe Institute in Toronto, an independent and non-profit think tank that provides information on economic and social policy. "This is the context in which it makes sense to speak of

a fiscal imbalance. Ottawa could collect less in taxes, and leave the provinces room to step in as they see fit to finance the goods and services that their voters tell them they want.”

Poschman praises Charest’s suggestion that income tax points be transferred from the federal to the provincial governments, to ensure they have adequate revenues to meet the spending obligations. Charest’s finance minister, Yves Séguin, has gone further. Séguin was revenue minister in a previous Liberal government, then was commissioned by the sovereigntist Parti Québécois government to study the fiscal imbalance. The Séguin Commission recommended that Canada’s lucrative Goods and Services Tax (GST), which came into effect in 1991, be shifted from the federal government to the provinces.

“Yves Séguin is saying that Ottawa is not accountable,” says Poschman. “It’s Québec’s task now to garner some support for the report and its recommendations. Québec has to construct a political alliance and establish viewpoints on how the fiscal machinery will work. Their natural allies would be Alberta and Ontario. We do find ourselves now in a position where Ottawa is taxing way beyond its needs.

“If what the provincial premiers say starts to resonate with voters, the elected government in Ottawa will start listening,” says Poschman. “With a leadership change in Ottawa in the next year, the question of solving the alleged fiscal imbalance will have more traction.” Prime Minister Jean Chrétien has announced his intention to retire next winter, potentially paving the way for new policies in Ottawa regarding tax points and transfer payments.

Growing provincial expenditures

Harvey Lazar, director of the Institute of Intergovernmental Relations at Queen’s University in Kingston, Ontario, notes that Canada is already one of the most highly decentralized federations in the world. Lazar is concerned that the vertical fiscal imbalance is an impediment to optimal health-care delivery in Canada and says there are efficiencies that lie both in centralized revenue collection and decentralized expenditure. He says Charest has a chance to forge successful alliances, but that the provinces’ complaints are weakened by some of their own policies.

“The wisest course for Charest is to build an alliance with other provinces to substantiate their claim for additional federal resources,” says Lazar. “To the extent that they choose to do it, their claim might be better received in Ottawa if most provinces were not promising tax cuts to their own voters. It might be an easier sell for Québec and other provinces if they abandoned that particular part of their program. It might also be easier for the Québec Liberal party to try to strike a deal with the next federal prime minister than the current incumbent.”

The focus on the fiscal situation would broaden the nature of the dispute between Québec and Ottawa. While the issue of sovereignty sets Québec against English Canada, the fiscal imbalance sets all the provinces against the federal government.

However, Charest’s approach could backfire if it is not successful, predicts William Johnson, the former head of “Alliance Québec”, an English rights group in the province. Johnson is a columnist and long-time observer of Québec public affairs. He is concerned that while Charest is a staunch federalist, Québeckers could see the federal government as rigid and inflexible, giving comfort to those who advocate separation of Québec from Canada.

Johnson notes that the ongoing demands for greater taxing and spending powers date back to the Québec Liberal government of the early 1960’s, which implemented what it called the “Quiet Revolution”. The province saw a more active role for the state in education, health care, economic development and social welfare.

“The governments that have led Québec since the Quiet Revolution of the 1960’s have had an unrealistic approach to the workings of the federation,” says Johnson. “For its part, the federal government will inject funds as the need arises in areas such as health care or education. The federal government will be weak in its own capacity to guide national policy, the national economy, and national welfare.”

An international development

The push for greater decentralization is not a distinctive Canadian phenomenon. The trend is one that is taking shape globally. In many other federations such as Switzerland and Belgium, the theory that supports decentralization is that sub-national governments can make more informed choices about spending decisions.

Peter Graefe, a post doctoral researcher at McMaster University in Hamilton, Ontario, notes that Canada’s federal government sometimes takes on initiatives which encroach on provincial jurisdiction. For example in health care, where Ottawa has established a national health insurance scheme, Ottawa has set five guiding principles. Graefe believes one’s view on the question of fiscal imbalance determines one’s position on a centralized vs. decentralized view of the country, how it should be governed, and the responsibilities of the respective levels of government.

“A more centralized approach to governance permits the federal government to ensure that the five principles of medicare are being met,” says Graefe, who holds a PhD in political science from the Université de Montréal. “It’s been at the federal government’s discretion to play a role in national cultural institutions. That’s not something that’s stated in the constitution.”

As far as Charest’s determination to tackle this issue, Graefe suggests that it will supply nationalists in Québec with the opportunity to rebuild their platform and radicalize their demands, and if Charest is unsuccessful in attaining any concessions from Ottawa, Québec secessionists will claim the federation is untenable. ☺

