Canada – An Overview of Fiscal Arrangements

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Canada is an independent federal democracy, with two primary levels of government: federal and provincial. The legislative powers of the two levels are generally mutually exclusive, although federal powers prevail in the event of a conflict. The country consists of ten provinces and three territories. Each province has its own government, while the territories are still governed federally. The local level of government includes municipalities and school boards, as well as special agencies, boards and commissions. Local governments have no innate powers and only enjoy those powers delegated to them by the provinces. Only federal and provincial governments are recognised in the constitution.

The federal government is responsible for matters that cross inter-provincial and/or international borders, including defence, transportation, communications, immigration, foreign affairs, trade regulation, taxation (both direct and indirect), banking, monetary policy, citizenship, criminal law, unemployment and healthcare. The provincial governments are responsible for direct taxation for provincial purposes, regulation of provincial trade and commerce, natural resources, labour and property law, health and social services, civil rights, provincial and municipal courts, municipal affairs, and primary and secondary education. Municipalities are formed to handle the affairs of cities, counties, towns, villages, districts and metropolitan regions. They provide citizens with services such as water and sewer systems, garbage disposal, roads, building codes, parks and libraries, and have authority over property tax.

Some areas of responsibility are shared by both levels of government. For example, in the area of transportation, the federal government has jurisdiction in matters involving movement across provincial or international borders (aviation, marine transport and rail), whereas the provinces look after provincial highways, vehicle registration and driver licensing. Control over agriculture, immigration and certain aspects of natural resource management are also shared.

Spending

Under the constitution, the provinces are given exclusive powers and responsibilities concerning the three major functions of education, health and social services. These three areas alone accounted for 76% of total program spending by the provincial governments in 2000-01. Health alone constituted almost 40% of provincial expenditure. By comparison, seniors' benefits, employment insurance, national defence and Indian affairs were the four most funding-intensive programs assumed directly by the federal government in 2000-01, representing 43% of total expenditure.

Provincial reliance on federal funds gives the federal government significant influence in most major policy areas and has acted as a source of uniformity in most basic social welfare functions. Its discretionary power in allocation of funds is, however, a source of ongoing conflict with the provinces.

Taxation

The federal government is the most autonomous of the three levels of government and has the broadest powers in terms of taxation. It administers the personal and corporate income taxes, as well as the goods and services tax and is the only level of government that can levy excise taxes and duties. It also receives some mineral and resource revenue. The provinces derive revenue from the personal and corporate income taxes and property and related taxes. All provincial governments, except Alberta and the territories, levy retail sales taxes.

To finance the areas over which they have jurisdiction, the two levels of government rely first and foremost on their own-source revenue. Despite the different scale and nature of their spending, the federal government and the provinces split the total accessible revenue fairly evenly between them. However, given the current occupation of taxation fields and the relative growth in their various portfolio responsibilities, the provinces do not have enough revenue to finance their responsibilities, whereas the federal government has more revenue than it needs to finance its own areas of jurisdiction.

In 2000-01, the federal government received 52% of the own-source revenue collected by the two levels of government, while the provinces received 48%. The proceeds of personal income tax are shared by the federal government (63%) and the provinces (37%).

Equalization/Federal transfers

The federal government makes a number of transfer payments to the provinces, notably to contribute to the funding of social programs. The Canadian Health and Social Transfer is the most significant program dealing with vertical fiscal imbalances, and is intended to contribute to the funding of health care, post-secondary education and social assistance programs. Usually considered an unconditional grant program, it imposes few conditions on provinces, although it is notionally targeted by the federal government. A large number of smaller and conditional cost-share programs dealing with agriculture, housing, transportation and other issues are also administered by the federal government. All of these programs require the participation of the provinces. They may or may not result in fiscal transfers by the federal government, as opposed to direct spending.

Since the mid-1980s, there has been an almost steady decline in the relative percentage of provincial funding needs covered by federal transfer payments. For Canada as a whole, the portion of health, education and social services spending financed by the Canadian Health and Social Transfer dropped from 23% in 1985 to 11% in 1998-1999.

Federal transfers also include amounts accorded as equalization payments. Even when this other category of transfer payments is taken into account, the relative weight of federal financing is nonetheless in decline. In just under 20 years, between 1983-1984 and 2000-2001, the share of total federal transfers in provincial revenue fell from 24.6% to 15.0%.

Sources

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