



Department of Finance
Canada

Ministère des Finances
Canada

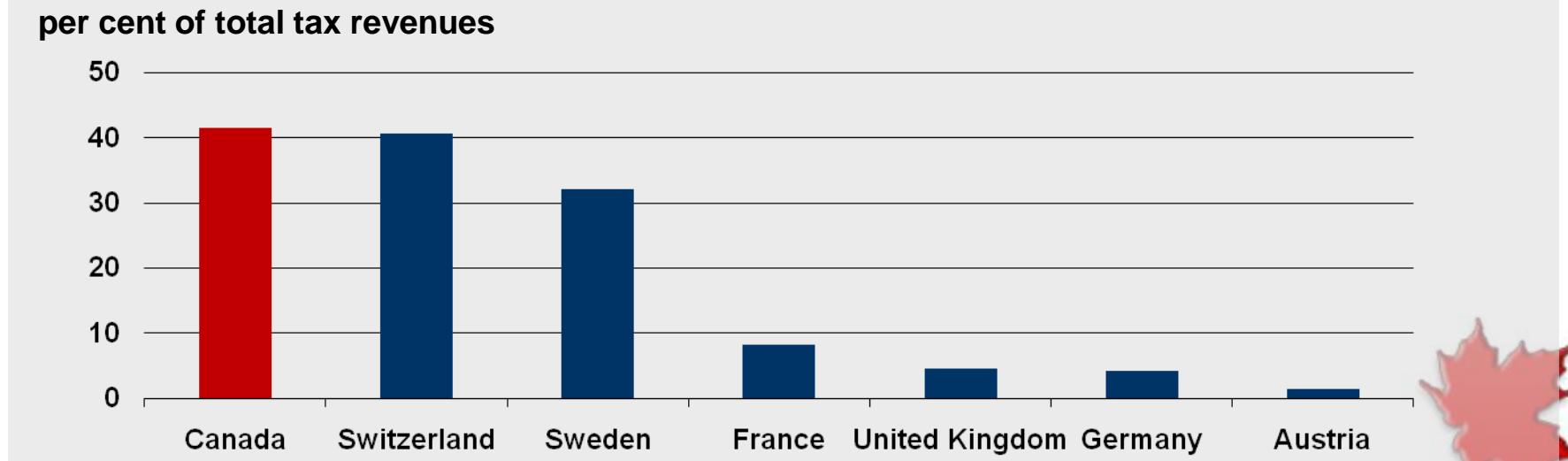
Federal Support to the Provinces and Territories

Prepared by Finance Canada for the Brazilian Officials' Delegation
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Canada is one of the most decentralized federations in the world

- Constitution creates two orders of government – federal and provincial – each with its own tax and spending responsibilities
- Provinces have complete autonomy in setting their tax rates and responsibility for making their own expenditure decisions in areas within their jurisdiction

Sub-central government tax revenue as a share of total government tax revenue

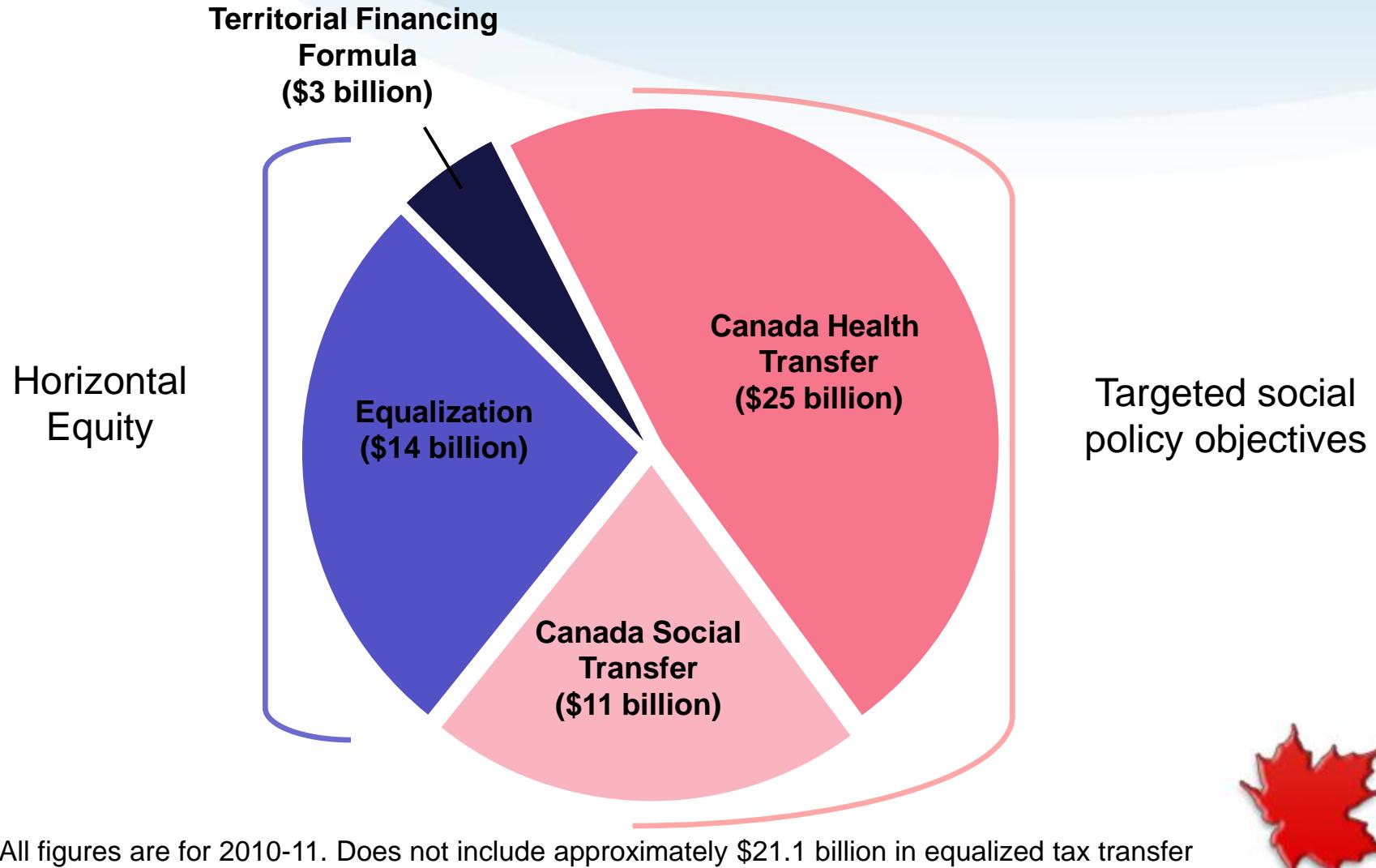


Constitution assigns a range of legislative powers to governments – some responsibilities are shared

Responsibility	Federal	Provincial
Money and banking	✓	
International and interprovincial trade	✓	
Airlines and railways	✓	
Foreign affairs/international assistance	✓	
Defence and border security	✓	
Employment Insurance	✓	
Criminal law	✓	
Fiscal equalization	✓	
Indirect taxation	✓	
Direct taxation	✓	✓
Pensions and income support	✓	✓
Aboriginal peoples	✓	✓
Immigration	✓	✓
Environment/Agriculture	✓	✓
Policing	✓	✓
Transportation infrastructure	✓	✓
Industry	✓	✓
Health care and social programs	✓	✓
Primary and secondary education		✓
Municipal institutions		✓
Natural resources		✓



Canada's transfers address horizontal equity and targeted social policy objectives



Transfers to support targeted social policy objectives

Canada Health Transfer

- Provides provinces and territories with long-term predictable funding for health care on an equal per capita basis.
- Supports the principles of the Canadian Health Act (CHA): universality; comprehensiveness; portability; accessibility; and, public administration.
- The CHA establishes criteria and conditions that the provinces and territories must fulfill to receive the full federal cash contribution under the CHT.

Canada Social Transfer

- Provides provinces and territories with support for post-secondary education, social assistance and social services, and programs for children on an equal per capita basis.
- Provinces and territories cannot impose minimum residency conditions for social assistance.



Transfers to address horizontal equity

Equalization

- Enables less prosperous provincial governments to provide public programs and services that are comparable to those in other provinces, at comparable levels of taxation.

The Territorial Financing Formula

- Enables territorial governments to provide public programs and services that are comparable to those offered by provincial governments, at comparable levels of taxation.



Equalization's role

- Purpose of program entrenched in the Constitution:
"Parliament and the Government of Canada are committed to the principle of making Equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."
[s.36(2) of the Constitution Act, 1982]
- Federal program funded from general federal revenues
- Unconditional transfer – provinces can spend the funds according to their own priorities. The federal government does not set targets or impose requirements.
- Eligibility is determined through a formula that measures each province's revenue-raising capacity against an Equalization standard

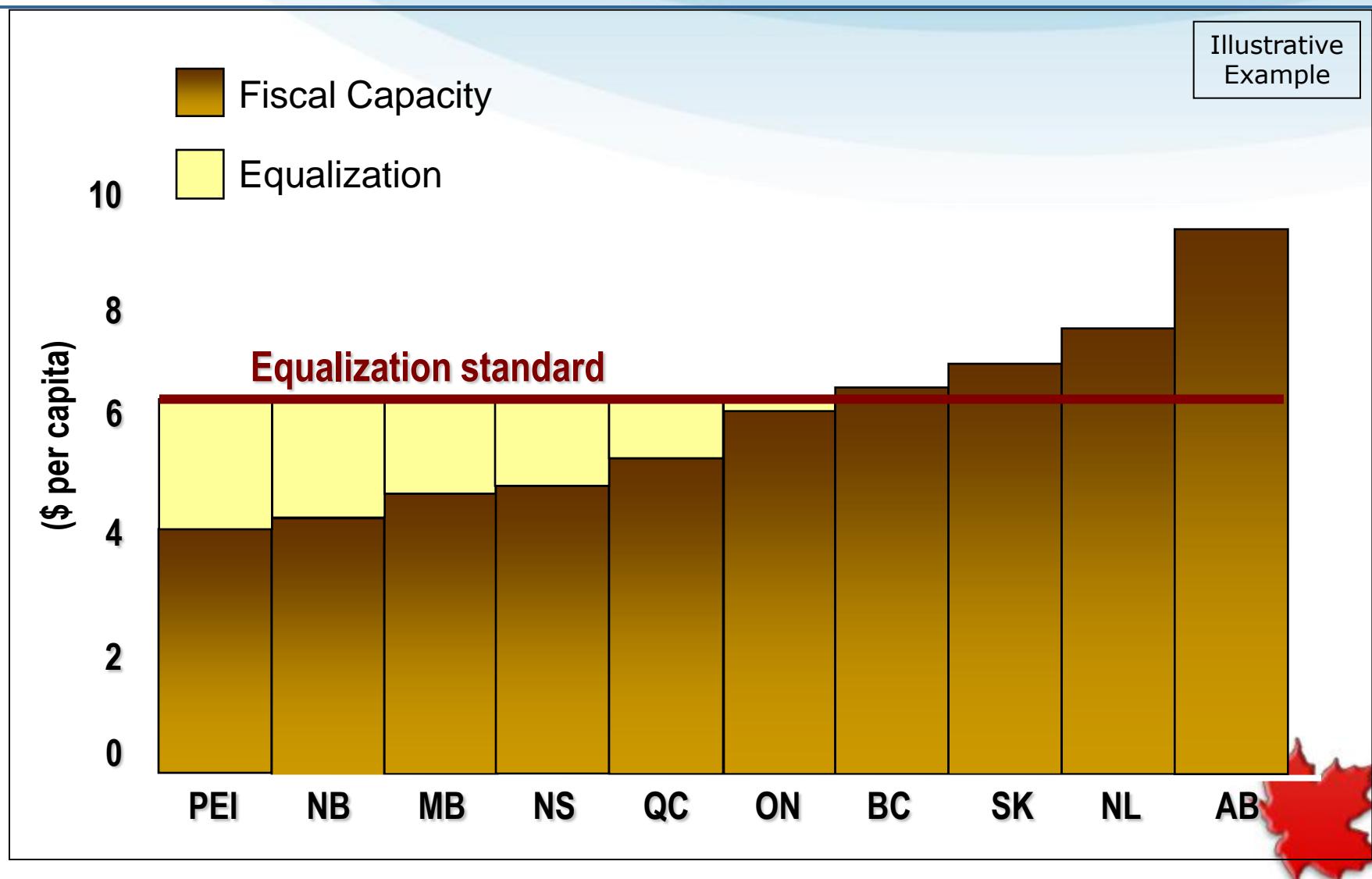


How Equalization is calculated

- Formula-based, data intensive
- Payments are determined by the provinces' relative fiscal capacity (ability to raise revenue).
- Fiscal capacity is determined using a representative tax system approach. This approach applies the national average tax rate to the corresponding tax base for each province.
- Provinces with fiscal capacity below the average fiscal capacity of the ten provinces receive Equalization payments equal to their shortfall.
- Budget 2009 implemented the sustainable growth track which requires total Equalization payouts to grow at the rate of the economy.

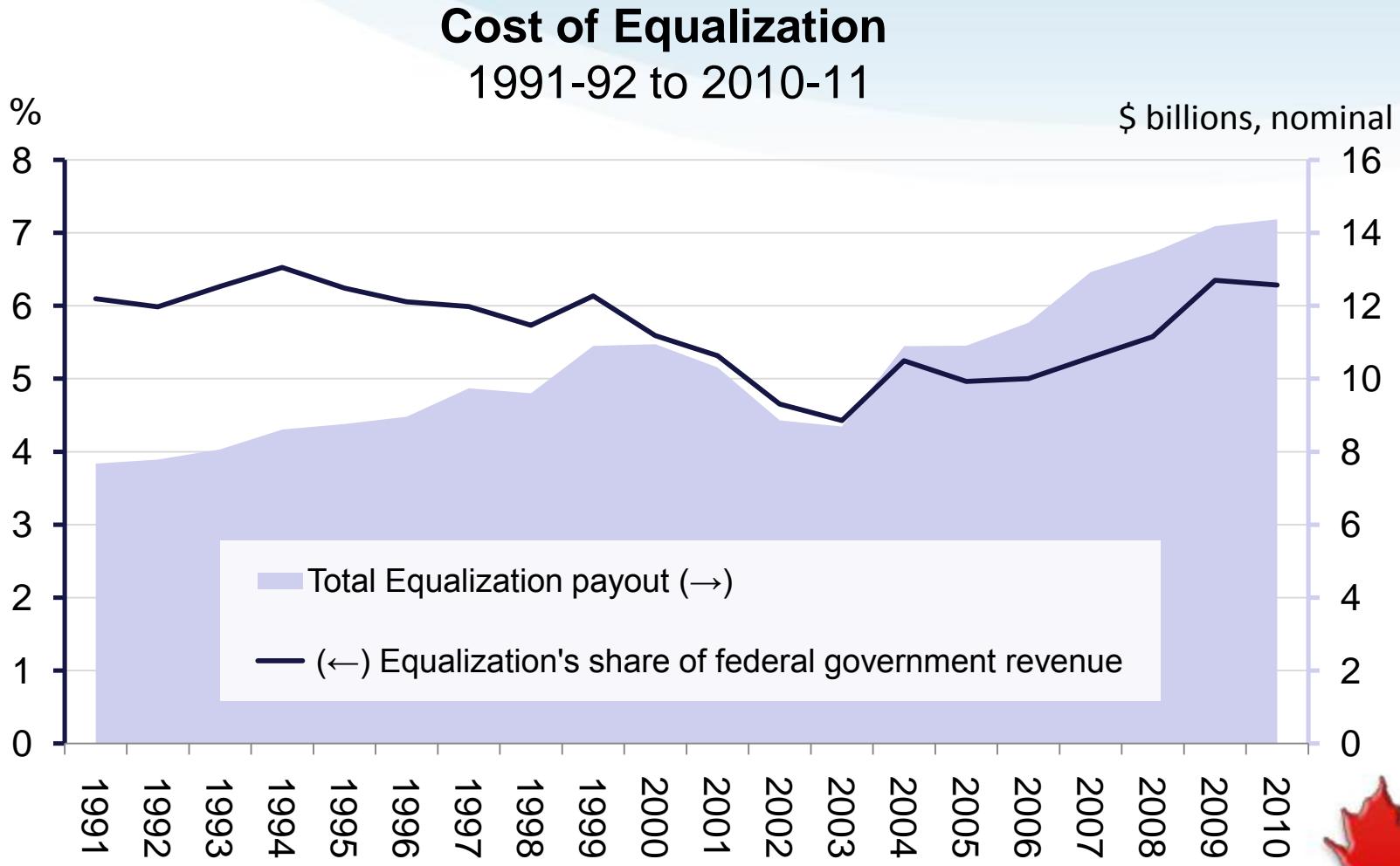


Equalization payments bring provinces to a per capita standard



Addressing specific questions:

Equalization and the federal budget



Addressing specific questions:

Calculating fiscal capacity

- **Fiscal capacity is the estimated amount of revenues a province would be able to raise if it taxed at the national average tax rate (representative tax system)**
- **Equalization uses five revenue categories.**
 - Personal Income Tax
 - Business Income Tax
 - Consumption Tax
 - Property Tax
 - Resource Revenues
- **For each revenue category, a province's fiscal capacity is equal to:**

Provincial tax base x

$$\frac{\text{National revenues}}{\text{National tax base}}$$



Addressing specific questions:

Calculating the bases

- The personal income tax base is primarily determined by a simulation model that estimates the average revenue raising capacity for each province. Data are provided by the Canadian Revenue Agency.
- The business income tax base is the sum of corporate taxable income with adjustments for Government Business Enterprises and small businesses for each province. Data are provided by the Canadian Revenue Agency.
- The consumption tax base is determined by the level of expenditure (such as consumer expenditure and business investment) within each province and net of tax. Each expenditure sub-category is weighted by the proportion subject to taxation. Data are provided by Statistics Canada.
- The property tax base is determined by the market value of residential property and the stocks of commercial and farm property for each province. Data are provided by Statistics Canada
- The natural resource tax base is determined by actual natural resource revenue in each province. Only 50 per cent of resource revenues are included for the purposes of calculating Equalization. Data are provided by Statistics Canada.



Addressing specific questions:

The Equalization standard and the sustainable growth track

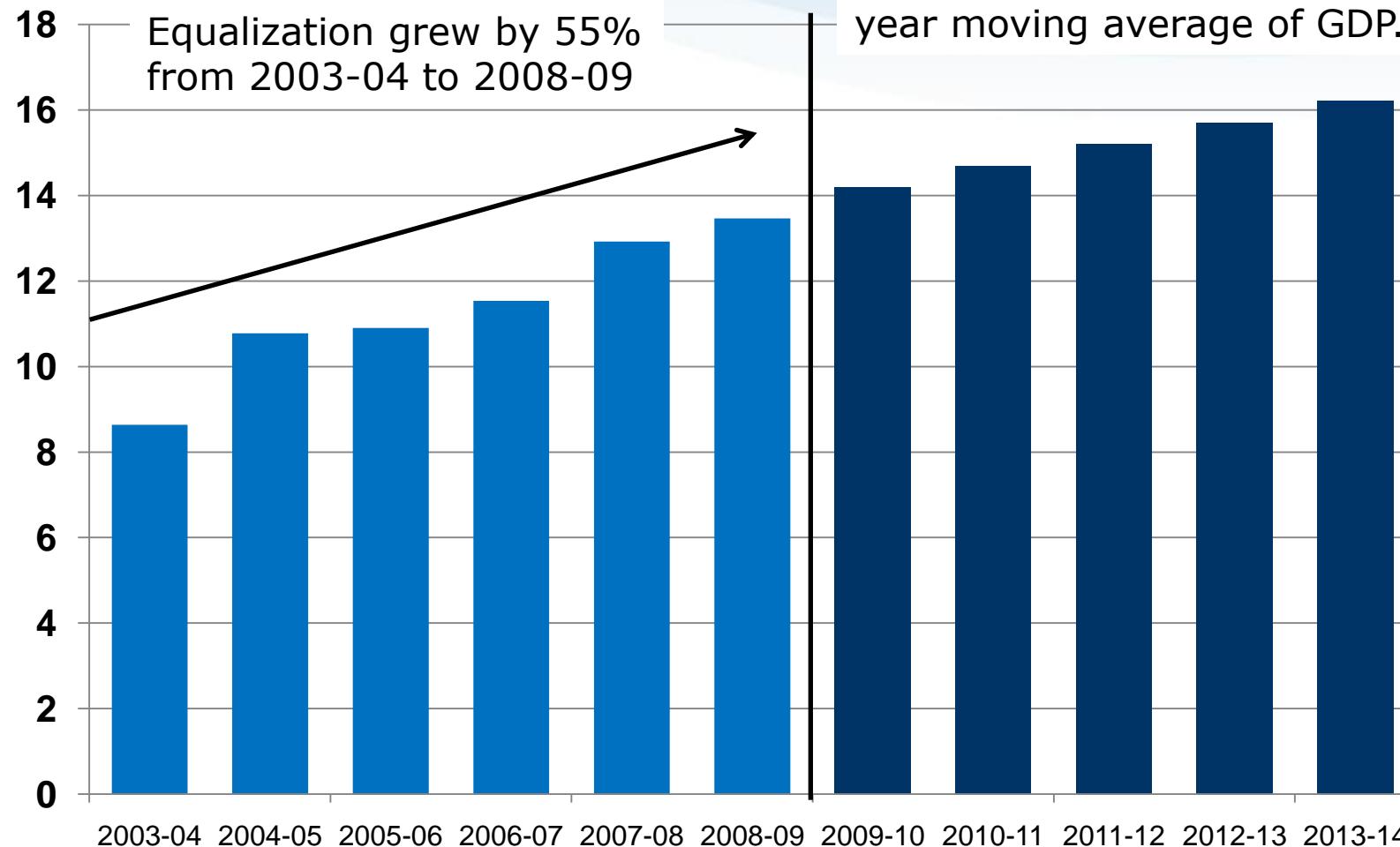
- To set the Equalization standard, the average fiscal capacity of all ten provinces is averaged. This mechanism is called the ten province standard.
- The sustainable growth track pre-defined total payments to \$14.2B in 2009-10 and mandates growth equal to the 3-year moving average of GDP growth.
- An equal per capita adjustment is applied to all provinces' Equalization entitlements to ensure that the total payout would grow in line with the economy.



Addressing specific questions:

Effect of the sustainable growth track

\$ billions, nominal



Addressing specific questions:

Estimates and payments

- Currently, the Equalization system is based on a single estimate that is announced by the end of the calendar year prior to the fiscal year being estimated.
- Payments are made by electronic transfer twice a month; on the 1st and 3rd working days after the 15th day of the month.

