

Fiscal Federalism and the Dependency of Atlantic Canada

by Fred McMahon

Fiscal federalism, the massive and unbalanced flow of federal money to and from the provinces, will create a huge fiscal challenge going forward for at least three reasons: economic difficulties emerging after the COVID-19 pandemic, the overhang of provincial and federal deficits prior to COVID-19, and, most importantly, the decline of the energy industry, which arguably funded fiscal federalism in past years. For more than a decade, Alberta's taxpayers have funded the lion's share of federal fiscal transfers flowing predominantly to Atlantic Canada and Quebec. The decline of the energy industry will dramatically reduce this source of funding. To return to a federal balance, Ottawa will have to cut spending significantly, or reform fiscal federalism, or increase tax revenues.

Federal fiscal flows are larger and more unbalanced than many Canadians would imagine. Equalization forms only a small part of these transfers. Consider Atlantic Canada: over the period from 2007 to 2019, Ottawa spent \$423.2 billion and raised revenues of \$226.5 billion for a net transfer of \$196.7 billion to the region (all amounts inflation-adjusted to 2018 constant dollars, unless otherwise noted). Total federal spending on average equalled over a quarter of the Atlantic economy at 27.5% of GDP. Net federal transfers—the difference between federal revenues and spending in the region—alone averaged 12.8% of GDP.

In Alberta, on the other hand, despite its weakening economy in the last three years of the 2007–2019 period, Ottawa spent \$337.1 billion but raised revenues of \$617.5 billion or \$280.4 billion more than it spent. In Alberta, federal spending equalled 7.7% of the provincial GDP while federal revenues from the province equalled 14.1% of its economy, for a net outflow equivalent to 6.4% of the Alberta economy. In the last financial crisis and recovery

(2007/08), Alberta taxpayers carried most of the weight of fiscal federalism, with a federal surplus of \$52.9 over the two years compared to \$32.3 billion from Ontario and \$13.1 billion from British Columbia. By comparison, Atlantic Canada's federal deficit was \$29.2 billion.

For the foreseeable future, the burden will shift to Ontario taxpayers, as Alberta struggles after a period of weak growth, declines in energy prices, and challenges in building energy infrastructure. Calls for reform of fiscal federalism have already come from Alberta and Ontario, the largest contributors to fiscal federalism. The shift of burden and the magnitude of Canada's fiscal and economic problems are likely to intensify calls for reform of fiscal federalism.

Atlantic Canada is deeply dependent on federal spending. That leaves the region vulnerable to economic dislocation if significant changes are made to fiscal federalism, though in the long run a reduction of transfers would likely be economically positive for the region.

A full accounting has never been made of the costs of fiscal federalism or what the overall structure is intended to accomplish. Looking regionally and provincially, however, we can note the following data (2018 dollars) for the period from 2007 to 2019: ► net transfers to Atlantic Canada equalled \$82,953 per person or \$331,812 per family of four; ► equalization formed about a quarter of the net transfer to Atlantic Canada; ► Quebec received net transfers of \$200.3 billion or \$24,796 per person, almost \$100,00 for a family of four, equalling an average of 3.9% of GDP; ► the net transfer out of Alberta was \$71,563 per person or over \$286,000 per family of four; ► Ontario, despite receiving equalization from 2009 to 2019, was a net contributor to fiscal federalism of \$126.1 billion from

2007 to 2019, or \$9,102 per person; ► net transfers out of Ontario equalled 1.2% of GDP, but rose in recent years to 2.4% in 2019; it had been as high as 6.1% in 2000.

The tables in the study provide details on federal fiscal flows for all the provinces and territories.



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