Seeking a New Fiscal Transfer Arrangement for Nunavut

DEPARTMENT OF FINANCE
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Nunavut

Introduction

Finding a solution to the socio-economic shortfalls that plague the territory's progress has proven an arduous challenge. Meeting the high costs of programs and services in a territory consisting of small, remote, widely-dispersed communities with the lowest real income and employment levels in Canada imposes a real challenge for the territorial government.

Nunavut is struggling with the early stages of development – something other Canadian jurisdictions dealt with long ago. Despite working very hard to meet its basic objectives, even after six years of operation, the GN still faces enormous challenges in terms of being able to provide the full range of mandated public services to all Nunavummiut.

For example, of Nunavut's current population of nearly 30,000, approximately 55 percent are under age 25 and 37 percent are under age 15. Assuming a modest employment growth of 3.5 percent over the next 15 years to accommodate Canada's fastest growing population by 2020 Nunavut's economy will have to generate employment for approximately 10,300 more people. However, Nunavut's employment growth rate is more likely to be in the range of 6 percent based on the growth rate over the past five years (5.9 percent). In this case, the economy would have to create about 19,700 new jobs.

Annual reports on comparable health status indicators continue to provide an unsettling picture for Nunavut. For example, consider the following statistics. Measured per 100,000 of population:

- Nunavut's life expectancy for both men and women is significantly lower than the Canadian average;
- Infant mortality rates are three times higher in the territory compared to those born south of the 60th parallel;
- 35 percent more infants are born underweight in Nunavut;
- Smoking rates for youth are three times higher than those in Canada as a whole;
- Adult smoking rates are double the Canadian national average;
- Tuberculosis rates are 17 times higher than those in Canada; and
- Sexual transmitted disease (STD) infections are up to 17 times higher than those experienced in southern Canada.

In addition to these troubling indicators, Nunavut's per capita health care expenditures are more than three times higher than the national average. Even so, the number of physicians the territory has available to service its residents pales in comparison to the Canadian average.

Table 1 **- Number of Physicians by Province/Territory, Canada, 2000 -2004**

	Total Physicians					
	2000	**2001**	**2002**	**2003**	**2004**	**% change (2000-04)**
Newfoundland and Labrador	927	945	929	975	992	7
Nova Scotia	1,898	1,885	1,943	1,958	2,000	5.4
Yukon	41	54	52	55	61	48.8
Northwest Territories	47	37	46	43	51	8.5
Nunavut	**7**	**7**	**10**	**10**	**7**	**0**
Canada	**57,803**	**58,546**	**59,412**	**59,454**	**60,612**	**4.9**
Source: Southam medical Database (SMDB), Canadian Institute for Health Information (CIHI)						

While considerable progress has been made, the territory continues to face a number of significant challenges. Constrained finances and limited revenue raising capacity contribute to gaps and inconsistencies in government programs. Furthermore, the situation is likely to get worse as the GN moves to providing full public services, facing potentially significant deficits in its fight to fill the widest gaps between social challenges and outcomes in Canada.

Nunavut's ability to meet these challenges depends very much on Territorial Formula Financing (TFF). It currently makes up over 80 percent of GN's total revenues. Under the current fiscal regime – a fixed 3.5 percent annual growth to TFF grants – Nunavut is going to fall behind the national average indicators even further.

Nunavut needs a new adequate fiscal arrangement and it needs it now. We seek a "new deal" that provides:

- Separate agreements for each territory;
- No "fixed envelope" for Nunavut;
- Consideration for greater population growth rate;
- Adequate Gross Expenditure Base (GEB); and
- No negative impact on the TFF grant due to increases in our own source revenues.

In the past year, we have worked with the advisory panel established by the Council of the Federation and the Expert Panel established by the federal government to make our position clear. We are optimistic that our views have been heard by both panels and we look forward to seeing their reports early in 2006.

The issues related to TFF are unique and tremendously critical for Nunavut. There is no need to delay decisions on these critical negotiations. The negotiations on the new TFF agreement should move ahead on a schedule entirely separate from Equalization negotiations.

Major Federal Transfers

The Constitution [subsection 36(2)] commits the Government of Canada 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."

Funding is transferred by the federal government to the provinces and territories to support important social investments, such as health care and education. These are called transfers. Finance Canada administers these transfers. The key transfer programs are:

- The *Canada Health Transfer* (CHT) and *Canada Social Transfer* (CST) go to all provinces and territories and are used to fund health care, post-secondary education, social assistance and social services. The CHT and CST were put in place in 2004-05 when the *Canada Health and Social Transfer* (CHST) was restructured to enhance the transparency and accountability of federal support for health;

- *Equalization* ensures that less prosperous provinces can provide reasonably comparable public services without their taxes being out of line with those of more affluent provinces. The program has been in effect since 1957; and

- *Territorial Formula Financing* (TFF) provides territorial governments with funding to support public services, in recognition of the higher cost of living in the North. The program has been in effect since 1985.

TFF was designed to ensure that a territory could adequately meet its expenditure needs. This approach deals with some of the special requirements of the North where costs are so much higher than those in the provinces and the economics are generally less developed. All three territorial governments have had TFF agreements with the federal government that, except for small variations, were identical.

In the 2005-06, major federal transfers will account for about 91 percent of the territory's revenue. This translates into a total of $844 million (about $28,061 per capita).

To put the major federal transfers into context, Nunavut's entitlement to basic TFF in the current fiscal year is estimated to be about $805 million. Using the Statistics Canada Intercensal Population Estimate (as of July 1, 2005 the population of Nunavut was 29,992), the TFF transfer provides $26,574 per capita.

The Canada-wide equal per capita CHT/CST transfer provides another $32 million to the territory. It makes up only 11 percent of the estimated total expenditures of the department of Health and Social Services.

Another example of per capita approach to funding is Wait Time Reduction Trust. Created as a measure under the 10-Year Plan to Strengthen Health Care in Canada, the Wait Times Reduction Trust provides $4.25 billion in payments to all jurisdictions together over five years. Based on the population proportion, Nunavut's share of the total trust fund is 0.0941 percent. That translates into

$3.9 million over five years. To put that into perspective, that's enough money to fund a total of extra 133 medevac trips for the territory over five years (about 26 trips per year).

It is clear that a per capita approach to funding the expenditure needs of the Government of Nunavut is not adequate and by far insufficient.

Current TFF Arrangement

The New Fiscal Framework was introduced at the September 2004 First Ministers' Meeting.

- It was introduced without the extensive discussion and analysis that accompanied the introduction of TFF in 1985.
- There was no warning, consultation or participation by the territories in what has been the most significant change in the fiscal structure of the North.

The federal government maintained that these changes brought stability, predictability, and growth to the overall level of funding. Some of the highlights of the New Framework include:

- Aggregate funding of $2 billion in 2005-06. Nunavut's share was estimated to be about $800 million.
- Complete protection for Nunavut against any declines in payments.
- An escalator of 3.5 percent for the fiscal years after 2005-06.

Although total territorial funding was increased in the short term, the new arrangements have meant considerable fiscal uncertainty for the territories. As well, these arrangements have been built upon an inadequate base that will, in the very near future, exhibit losses when compared to the historic growth rate of the previous TFF agreement.

Problems with the Current TFF Arrangement

Adequacy

Despite the federal government's claim that the New Framework brings a measure of stability and predictability, the notion of adequacy is by far the most paramount component of any new TFF arrangement.

The adequacy of the territorial formula financing agreements is an ongoing concern for Nunavut. The current level of TFF funding is just enough to provide the basic public services expected of any government in Canada, but inadequate to improve or add significantly to Nunavut's essential infrastructure, or to deal with external cost pressures. A very recent example is the dramatic spike in world oil prices. These increases have put the Nunavut government under tremendous fiscal strain. Our current territorial formula funding arrangements are predicated on stability. However, there is no provision in our current TFF arrangement to address the impact of such a dramatic change on our territory. If the price of oil continues to remain high, government energy expenditures will absorb almost the entire 3.5 percent increase of the TFF grant.

The simplest and most transparent approach to restoring the adequacy of territorial fiscal arrangements is to restore the adequacy of the expenditure base.

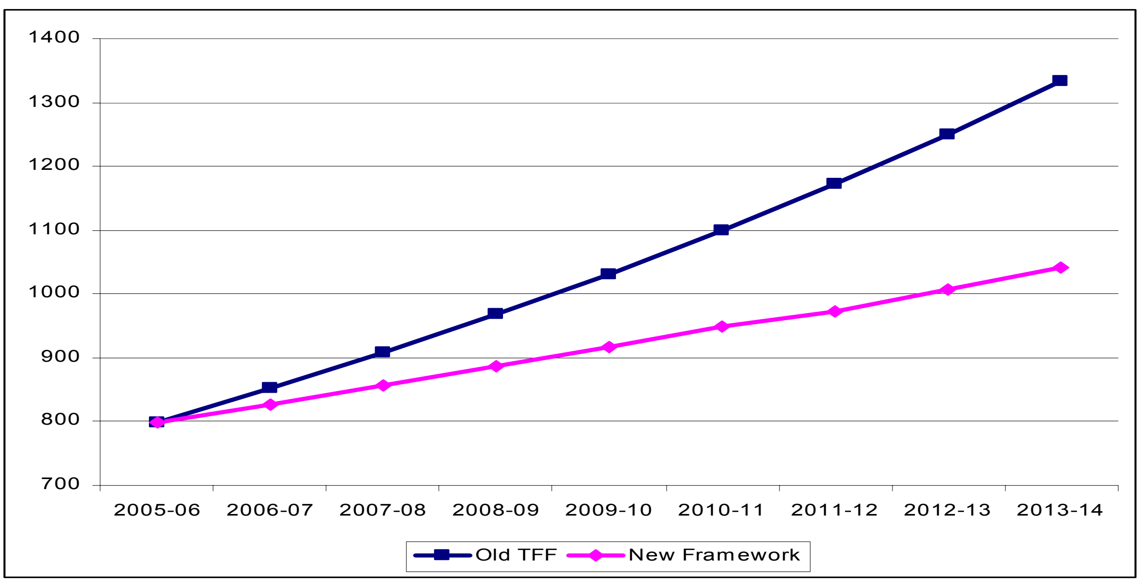
Fixed Escalator

The fixed 3.5 percent escalator after 2005-06 is inadequate compared to the population adjusted GEB growth rates defined under the previous TFF arrangement. This is because provincial/local government spending adjusted for Nunavut's population growth has outpaced eligible revenues.

Historically, Nunavut's entitlements under the old arrangement consistently grew at a much higher rate than the 3.5 percent that had been lauded by the federal government as stabile and predictable. Nunavut would have suffered a drastic revenue shortfall if, from a hypothetical standpoint, the New Framework had been implemented in 1999. In fact, had a fixed escalator, set at 3.5 percent been put in place in 1999, Nunavut would have received approximately $230 million less in TFF revenue than under the old arrangement.

Table 2 below provides a comparison of forecasted TFF revenue growth under the previous arrangement (including GEB adjustments committed to in the 2004-05 federal budget) and the current fixed 3.5 percent escalator. It should be kept in mind that under the old TFF formula, the historical growth rate was 6.6 percent per annum.

Table 2 **-TFF Forecast: Historical TFF Growth vs. New Framework ($ millions)**



Source: Table adapted from joint territorial submission to the Panel of Experts

While Nunavut benefits from a short-term gain in TFF entitlements under the current legislation, the territory loses in the long-term.

Lack of Population Adjustment Factor in New Framework

With the imposition of a 3.5 percent escalator, the growth in TFF on a per capita basis is less for Nunavut than for provinces receiving Equalization. This is because Nunavut's population growth rates have increased exponentially compared to overall population growth rates in equalization-receiving provinces and in Canada overall. Nunavut's higher population growth relative to that of Canada as a whole was appropriately reflected in the old formula's annual escalator and was a contributing factor on the overall growth in Nunavut's grant. However, the 3.5 percent escalator included in the New Framework does not incorporate a population adjustment factor that reflects Nunavut's greater population growth. This impedes Nunavut's revenue growth and underscores the inadequacy of the New Framework.

A Zero-Sum Game

An aggregate cap on total TFF entitlements creates a zero-sum game for Nunavut. If a change in economic conditions in one territory results in a higher entitlement, the others must experience a reduction in entitlements even if conditions in that territory remain constant. In other words, gains (or losses) for Nunavut must necessarily come from another territory (or territories). This means that Nunavut will, in effect, share the revenue growth or losses of the other two territories. In a three-player game where the stakes are 70 to 90 percent of total revenues and in the absence of the flexibility of own-source revenues, marginal gains are significant and competitive behavior becomes necessary. This approach is not in the best interests of Nunavut, creates an unnecessary and adversarial environment between the territories and is contradictory to the original intentions of TFF.

Concurrent Panels on TFF and Fiscal Imbalance

In March 2005, the federal Minister of Finance established the Expert Panel on Equalization and Territorial Formula Financing. Shortly thereafter the Council of the Federation established the Advisory Panel on Fiscal Imbalance.

On April 26, 2005 the three territorial Deputy Ministers of Finance made a presentation to the Expert Panel that focused on identifying issues and establishing a dialogue. In addition, a joint territorial paper was submitted to the Panel. The paper was based on the premise that certain features of the New Framework, as set out in legislation, are unacceptable to each territory.

In August 2005, a roundtable discussion on territorial fiscal arrangements was held in Yellowknife, NWT. The invitations to the roundtable discussion were sent to various stakeholders – public governments and institutions, private businesses, Inuit and First Nations organizations, educators, analysts and experts.

In September 2005, representatives of Expert Panel met in Iqaluit with GN officials. The same month, the territorial governments made a presentation to the Advisory Panel on Fiscal Imbalance.

The intention of both presentations was to focus on the major issues constraining long term development of the North. The discussions concentrated on Nunavut's uniqueness among three territories, specifically its current socio-economic conditions, expenditure needs and cost pressures, economic potential and opportunities.

Currently, the Expert Panel is finalizing its report and recommendations. The Panel has indicated that it will produce two separate reports – one addressing Equalizations issues and the other describing the realities of the North and making recommendations on improving TFF.

The Advisory Panel on Fiscal Imbalance will provide an independent review by March 2006, and make recommendations to address any fiscal imbalance in the federation over the long term.

Conclusion

Nunavut needs a new fiscal arrangement with Canada in order to progress socially and economically. The Government of Nunavut is making its case to the federal government for a fiscal framework that recognizes the needs of Nunavummiut and the unique environment we live in.

Nunavut requires a territorial financing arrangement that ensures our annual grant will grow at a rate that not only allows the territorial government to deliver programs and services comparable to other jurisdictions in Canada, but ensures that the territory can take advantage of future economic development opportunities. Nunavummiut are eager to become more self-reliant and make a greater contribution to the rest of Canada.

The new Conservative Government has said on several occasions that it is committed to responding to the important issues of Canada's northerners, and we will proceed with developing a partnership on that basis.

In his letter to the three territorial premiers during the election, the new Prime Minister said his party agrees that the territorial formula financing arrangements need to be reviewed. He also indicated that he is prepared to discuss future funding arrangements so that they take into account the difference between expenditure needs and the revenue means of the territorial governments.

Principles such as these are a promising starting point for developing a relationship between Nunavut and the new federal government and resolving outstanding financial issues to the benefit of all Nunavummiut.