I would like to describe three broader, longer term opportunities to keep the federal budget balanced while promoting better public policy that would benefit all Canadians.

1) Fixing the mismatch between taxing power and federal government jurisdiction under the Canadian constitution.
   - The Federal government collect about 43% of total taxes in Canada, the largest proportion by a government level. It means federal involvement in areas of provincial responsibility – health, education, municipal transit/roads/infrastructure.
   - The current tax and transfer system reduces accountability and efficiency in those areas, particularly from health and social transfer programs, the equalization program and tri-level cost-shared programs.
   - The broader effect is to unnecessarily promote higher levels of spending, staffing and taxation which undermine the goal of having fiscally sustainable, pro-growth balanced budgets.
   - The way to fix this institutional bias toward higher spending, etc., and therefore support a more fiscally sustainable and pro-growth federal budget, is to return to Canada’s original constitutional division of powers.
   - The federal government should transfer taxing powers to the provinces, particularly GST and federal gas tax, concurrent with phasing out federal transfer payments for those areas of services.

2) Equalization Reform
   - Canada’s equalization program is well-intended but increasingly undermines and damages both recipient and source provinces.
   - It damages recipient provinces by burdening them with larger, more politicized public sector services, while rewarding them for having higher taxes; and subsidizing lower domestic electricity prices such as in Quebec.
   - It undermines source provinces which have less funds for local services while sustaining higher taxes to carry the broader program. Those higher taxes slow source provinces’ economic growth.
   - Much research has documented Equalization’s “flypaper effect”, where transfers are simply transformed into higher levels of provincial bureaucracy and public sector staff counts. The provinces with the largest numbers of civil servants per capita are all equalization recipients.
   - A smarter and more fiscally sustainable path would also involve shifting taxing power, particularly the GST, to the provinces (in exchange for phasing out equalization).

3) Core Public Sector Reform in the Federal Civil Service.
   - There are ample opportunities and ‘room’ to make the federal civil service system smarter, smaller and more effective.
   - We can learn from other countries, those which have embedded performance measurement, more useful accounting systems and more decentralized management to improve asset stewardship and bring an output and outcome focus to their service operations.
   - I have included a paper on New Zealand’s public sector reforms in my supporting materials today which describes these innovations in more detail.
   - A smaller federal government apparatus is possible if the feds vacate provincial jurisdiction in exchange for a shift of tax sources to the provinces. This, plus a move to a gold-standard performance framework for the federal civil service would promote a fiscally sustainable and pro-growth balanced federal budget.
Supporting Materials provided:

Decentralization:

Strengthening Fiscal Responsibility through Decentralization: Empower local voters to increase government accountability and efficiency by Steve Lafleur


Equalization Reform:

Fiscal Imbalance in Canada: A Look at the Opportunity Costs of Equalization by Eric Merkley


Federal Civil Service Reform:

Reforming Financial Management in the Public Sector by Ian Ball, Tony Dale, William D. Eggers, and John Sacco