

JAN 18 2023

Hon. Chrystia Freeland
Deputy Prime Minister and Minister of Finance
Government of Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Re: **Equalization Program**

Dear Deputy Prime Minister Freeland:

Canada's Equalization Program seeks to ensure provincial governments have adequate revenues to provide comparable levels of public services at comparable levels of taxation. Changes are needed to ensure this is achieved. As provinces are currently being consulted as a part of the 2024 renewal of Equalization, I would like to identify two of the weaknesses in the formula used to determine who receives equalization in our country. Newfoundland and Labrador is seeking further consideration of the following improvements to the program:

1. Removal of the Fiscal Capacity Cap (FCC)

The FCC introduced by the Harper administration in 2007 contributes to the inequitable treatment of natural resource revenue. The current methodology is in contradiction to a 2006 report by an *Expert Panel on Equalization and Territorial Formula Financing*, established by the federal Minister of Finance, which articulated reasons to exclude natural resource revenue in the Equalization formula. The reasons cited include:

- Provinces constitutionally own their natural resources and those resources should provide a net fiscal benefit to the province who owns them.
- Provinces benefitting from natural resources face considerable revenue uncertainty.
- Provinces with resource revenues receive revenue but must also pay the costs for development, regulation and management of their natural resource sectors.
- Equalization is meant to be policy neutral – as actual resource revenue is included, any policies affecting resource revenue will have a direct impact on EQ entitlements. Resource revenue inclusion could act as a disincentive to provinces to develop its natural resources.

Prior to applying the FCC, the calculation of Equalization entitlements is based on either 50 per cent of natural resource revenues or fully excluding those revenues - whichever is to a province's advantage. However, the FCC is applied based on the inclusion of 100 per cent natural resource revenues. This approach results in the effective natural resource revenue inclusion rate to vary between provinces.

As we transition to a net-zero economy with less reliance on non-renewable resources, the net benefit of provincial resource revenues should not be reduced as a result of the

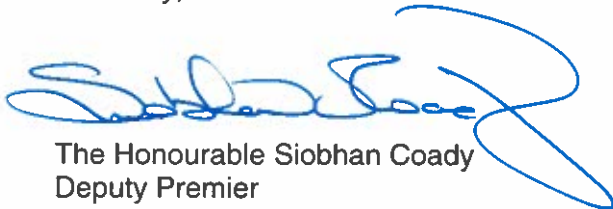
Equalization Program. Removal of the FCC is central to ensuring natural resource revenue is treated equitably across provinces.

2. Fully incorporating "reasonably comparable levels of public services at reasonably comparable levels of taxation"

A key weakness of the current Equalization Program is that it does not consider the cost to deliver comparable public services across provinces. Service delivery costs can vary significantly between jurisdictions based on differences such as geography and demographics. In fact, Newfoundland and Labrador constitutes three times the land mass of the Maritime Provinces, yet only has roughly one quarter of the population. Inclusion of expenditure requirements would address the fact that provinces have varying costs when delivering public services, regardless of their revenue-raising capacity. Integrating the variable cost of delivering public services is feasible; other countries have already included it in their 'equalization' programs. Any steps toward including expenditure requirement will bring the program closer to its intended purpose of providing equivalent public services in all provinces at comparable tax rates.

As the Government of Canada works to finalize the renewal parameters for the Equalization Program, I am hopeful that improvements will be made to the program to ensure its purpose is fully achieved. I would appreciate a meeting to discuss further at your earliest convenience.

Sincerely,



The Honourable Siobhan Coady
Deputy Premier
Minister of Finance
President of Treasury Board
Minister Responsible for the Public Service Commission
Minister Responsible for the Newfoundland and Labrador Liquor Corporation
MHA for St. John's West