

# **Joint Submission to the Expert Panel on Equalization and Territorial Formula Financing**

submitted by



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## **The Importance of Adhering to Agreements**

As associations representing small medium and large businesses throughout the NWT and (in the case of the Construction Association) Nunavut, we fully endorse the eight principles that were supposed to underlie the original Territorial Formula Financing (TFF) agreement. As our members are significant potential investors in both territorial economies, we are (and governments should be) particularly concerned with the principles of predictability and certainty, and that of stability, because businesses are loath to invest without those crucial ingredients.

Neutrality is key to predictability, certainty and stability inasmuch as the neutrality principle stipulates that funding should not be subject to arbitrary actions on the part of either federal or territorial governments.

When dealing with its deficit situation the federal government unilaterally imposed a ceiling on the NWT's Gross Expenditure Base (GEB) between 1990 and 1993 and imposed further cuts to the GEB in 1996-97, thereby clearly violating all the above principles. The resulting funding reductions for the Government of the Northwest Territories (GNWT) led to needless staff reductions of 25% and an inability to make urgently needed investments in health and social facilities and services precipitated by the arrival of diamond mines.

These reductions were exacerbated by the fact that the formula relies heavily on population growth and Statistics Canada underestimated growth in the NWT in the 1990s. Thus for about seven years – five between the 1996 and 2001 censuses and a couple of years to compile the results and adjust for errors – the GNWT had to provide services to about 1000 people without being compensated under the formula, which at the time would have equated to \$16,000 per person per year.

The GNWT was eventually compensated for the shortfall, but predictability, certainty and stability were nonetheless all compromised. There was a growing feeling that the TFF was continually failing to deliver the kind of funding the federal government had promised, and that the GNWT was in a permanent cycle of under-funding with the occasional make-up windfall to rescue it from complete financial disaster. The end result was a government that was significantly under-funded for the task of supplying comparable public services to its small and widely scattered population.

The GNWT's fiscal situation was further compromised by the federal imposition of the Tax Effort Adjustment Factor (TEAF) in 1990-91. This poorly conceived attempt to establish incentives for the GNWT to raise more of its own revenues resulted in the federal government clawing back more than a dollar for every additional dollar of own-source revenue raised by the GNWT.

## **Impact on the Private Sector**

Not surprisingly, given government's prominence in the territorial economy, all of the above had a considerable negative effect on the business community in the NWT. Government programs were cut or scaled back, and purchases of goods and services reduced or eliminated. This led to lay-offs and even some bankruptcies in the private sector.

It also fed a sense within the business community and the GNWT that the solution to the instability of funding was for the GNWT to negotiate a new Formula Financing Agreement that would actually adhere to the original principles and not be subject to arbitrary reductions due to the federal government's fiscal situation.

## **Fixed Funding Inappropriate**

The proposed new formula indicates the federal government once again has no intention of adhering to the principles it originally agreed to. A fixed level of funding obviously cannot accommodate changes in economic circumstances and population growth rates, and therefore will not necessarily provide the territorial governments with "adequate funds to provide services which are reasonably comparable to those in other jurisdictions" as provided for by the principle of adequacy and comparability.

In fact, in the case of the NWT, not only does the proposed approach fail to address existing shortfalls generated by the previous formula, the 3.5% escalator is clearly inadequate to address both our annual economic growth (the fastest in Canada) and our projected population growth.

Further, although the fixed-funding and fixed escalator approach to the new formula would provide some stability in funding, it will inevitably be divisive. A fixed-dollar amount is likely to lead eventually to confrontation among the three territories, as each economy is driven by completely different factors.

In short, Ottawa is once again imposing a solution on the North that has the single virtue of maintaining predictability for the federal government alone, and is bound to foster exactly the same deficiencies experienced under the previous agreement, i.e. a failure to adequately equate funding levels with actual need.

## **Royalties**

We believe petroleum and diamond royalties, currently being collected and spent by the federal government, should be transferred to the GNWT and to aboriginal self-governments to help finance these governments and provide the GNWT with the additional funding required to address existing and projected physical and social infrastructure needs generated by our rapidly expanding economy.

Such a transfer would also go a long way to accord the GNWT, the business community and NWT residents much more independence from the federal fiscal situation in the future.

It seems reasonable to us that royalty revenues should be outside of any Formula Financing Agreement and not subject to any sort of claw-back. Our rationale here is that royalties are generated from the extraction of non-renewable resources and will therefore eventually cease. In the interim, the GNWT could use these funds not only to address current economic needs but also to explore ways of ending the endless boom-bust cycle implicit in non-renewable resource development by growing a sustainable economy based on such renewable resources as tourism, and run-of-the river hydroelectric generation, etc.

We differ with the territories' proposal that \$68-million be exempt from offsets with 60% of any balance of royalties eligible for offset. Pursuant to Ottawa's recent agreements with Newfoundland and Nova Scotia, we believe none of the royalties should be offset. These funds represent a one-time opportunity to develop our economy to the point where we could very probably evolve into a full-fledged province and net contributor to equalization payments to less fortunate provinces. We agree with the GNWT, however, in the establishment of a Revenue Stabilization Fund.

## **Conclusion**

The territorial governments' submission adequately describes two possible options for the panel to consider. We think the choice between the options is a matter best left for negotiations between the federal and territorial governments.

However, we think it paramount that whatever formula results cannot contain the flaws of previous ones. It must adhere to the original principles, it must not be subject to unilateral and capricious reductions by the federal government and it must, above all else, provide the GNWT with adequate funding to address issues arising from current economic activity and to develop a sustainable future economy that is not predominantly dependent on non-renewable resources.

In conducting its deliberations, we urge the Panel to bear in mind that cutbacks in the NWT TFF yielded negligible savings to the federal treasury while the fiscal trauma suffered by the GNWT has been severe. The \$58-million the federal government "saved" by arbitrarily cutting the GEB in the mid-90s, for example, represented only 0.2% of the 1996 federal deficit alone, as opposed to about 5% of the entire GNWT budget in the same year. Not incidentally, this amount

compares, perversely we think, with almost \$2-billion for the gun registry and \$250-million for the sponsorship scandal.

We also urge the panel to remember that it is already extremely difficult to attract the qualified personnel needed in the North to sustain the industrial development that generates significant revenues for the federal government. This problem is exacerbated by the fact that we must we must compete for labour with Alberta, which has the lowest tax rate in the country. We therefore caution against any formula financing measures that would leave the NWT even less competitive in this regard than it already is.

Finally, we strongly suggest that an impartial body be struck to ensure both sides of any future agreement adhere to their commitments. Ironically, had the federal government abided this principle during the previous agreements, there well have not been a need for a new TFF.