

Provinces get by with a lot of help from the Feds

By Warren Lovely

You might have missed it, but at the height of the holiday season Canada's federal government (as per tradition) confirmed the amount of major transfer support the provinces will receive in fiscal 2021-22 (that is, the fiscal year set to commence April 1st).

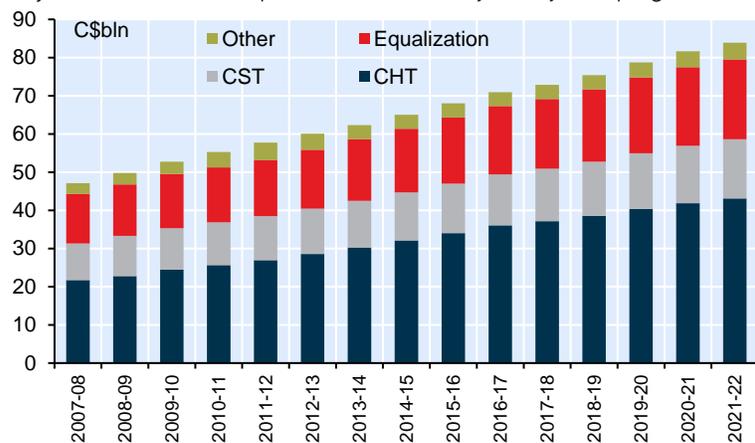
Simply put, federal transfers are a big deal for provincial governments and by extension provincial bondholders. Ask a credit analyst and they'll tell you that federal-provincial transfer mechanisms are bedrock elements of Canada's institutional framework, providing a strong foundation of support for overall provincial creditworthiness. So if your remit happens to include provincial debt, it's always worth exploring what the federal transfer envelop looks like.

Perspective on 2021-22 major federal transfers

For 2021-22, Ottawa will funnel just under C\$84 billion to the provinces and territories via major transfer payments (Chart 1). That works out to C\$2,181 for every Canadian (on average). Note: We're talking about the amount coming via the main/regular transfer programs, not counting additional special or one-off transfers (which we'll touch on in due course). Over half the C\$83.9 billion will arrive via the Canada Health Transfer (CHT), which is allocated on an equal per capita cash basis, offsetting a fraction of provincial health care outlays (more on that later). The provinces also get equal per capita cash treatment through the Canada Social Transfer (CST), which supports post-secondary education, social assistance/social services, childcare, etc.

Chart 1: Evolution of major federal transfers

Major federal transfers to provinces/territories by fiscal year & program

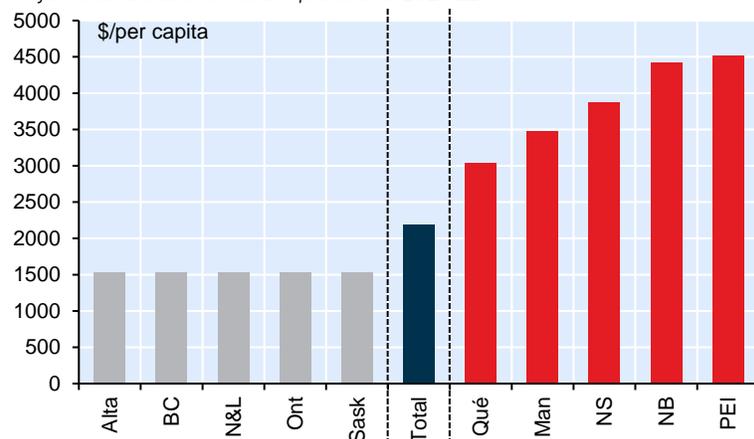


Source: NBF, Finance Canada | Note: Figures for 2020-21 & 2021-22 are preliminary

Then there's equalization, which in 2021-22 will see C\$20.9 billion distributed to five provinces where fiscal capacity (aka revenue-raising ability) is deemed to be below the 10-province standard. Equalization accounts for the sizeable variances in per capita transfer allotments that can exist from one province to another. Consider that next fiscal year, the five provinces that do not qualify for equalization—Alberta, British Columbia, Newfoundland and Labrador, Ontario, Saskatchewan—will each receive \$1,523 per capita in major transfers. The per capita tally will be two- to three-times as rich for the five equalization-receiving jurisdictions (Chart 2). Note: The single largest per capita amount will go to Prince Edward Island, followed by New Brunswick.

Chart 2: Equalization impact easy enough to spot

Major federal transfers to the provinces: 2021-22



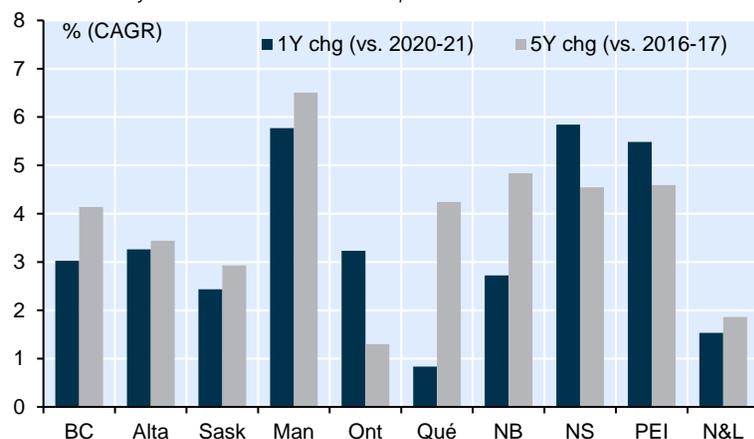
Source: NBF, Finance Canada | Note: Red bars denote equalization-receiving province

As can be seen in Chart 1, total transfers continue to grow in absolute terms. What might be less apparent is that growth in total major transfers has slowed, owing to the pro-cyclical nature of certain programs (i.e., both CHT and equalization are linked to average GDP growth, subject to limits/floors).

For 2021-22, total major transfer growth is slated to slow to 2.7% (on average). The total per capita allocation will be edging just 1.5% higher in the coming fiscal year. That's the slowest advance in over a decade and a half and could well be negative in real terms (assuming CPI all-items inflation gradually moves closer to the Bank of Canada's 2% target). Again, major transfer growth rates can and do vary considerably from province to province and over time. Québec will see the slowest growth in major transfer payments next fiscal year, and it's the only region where the per capita allocation is set to decline. Saying that, Québec will still boast above-average growth rates if your frame of reference is longer, say three, five or even ten years. Next door in Ontario—where an equalization entitlement ran out a couple years back—transfers will grow a bit above the national average next fiscal year (given relatively stronger population growth).

Chart 3: Growth in major transfers varies considerably

Growth in major federal transfers to the provinces: 2021-22



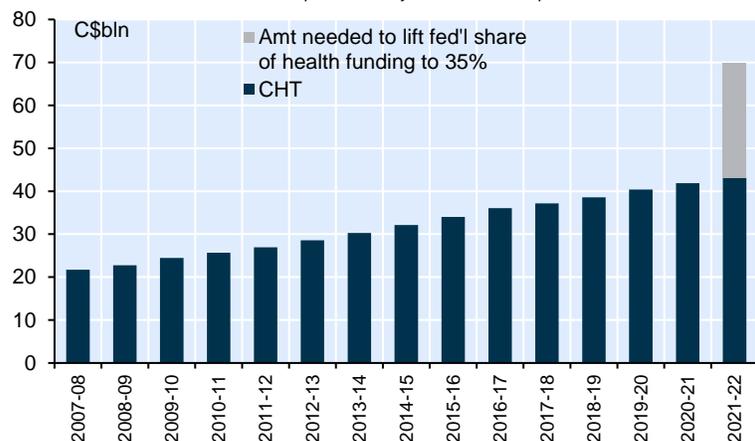
Source: NBF, Finance Canada

Provincial dissatisfaction seemingly a natural condition

As meaningful as these major transfer programs appear, there was disappointment when a recent first ministers meeting on the CHT ended without an immediate and hefty boost to health transfers—priority number one for Canada’s premiers. As it stands, CHT cash will grow by 3% in 2021-22, scraping along the legislated floor. At C\$43.1 billion, CHT dollars would be nowhere near the ~C\$70 billion annually the premiers have pleaded for (Chart 4). That’s the level deemed necessarily to immediately increase the federal share of health funding from 22% to 35%. Saying all that, the CHT debate is hardly dead, with federal leaders (including the Prime Minister) sounding sympathetic. Stay tuned; some movement could come in 2021.

Chart 4: Provinces pleading for major CHT boost

Federal CHT transfers: Actual/preliminary amounts vs. provincial ‘ask’



Source: NBF, Finance Canada, Council of the Federation | Note: C\$70bln ‘ask’ as per Sep-2020 recommendation from Canada’s premiers

Ottawa’s efforts to address deficiencies in the Fiscal Stabilization Program (FSP) likewise left the provinces wanting. As the name suggests, stabilization payments are made to provinces suffering a significant year-over-year revenue hit (5%+ decline for non-resource revenues; 50%+ decline for resource revenues). Historically, payments were capped at C\$60 per capita. Federal FinMin Freeland announced plans to lift the cap to C\$170 per capita, alongside other tweaks designed to improve fairness and speed up processing. The feds crowed that these changes could “provide billions of additional support beyond the current parameters”. But the program’s notional ‘deductibles’ remained. Nor were changes retroactive to 2015-16, leaving Alberta Premier Kenney non-plussed. We’re sympathetic to provincial arguments here and feel Ottawa could have gone further.

Chart 5: Announced FSP changes leave provinces wanting

Announced changes to FSP vs. provincial ‘ask’

- ✓|✗ Ask: Eliminate \$60 per capita limit
FES: Per capita limit increased to \$170 & allowed to grow
- ✗ Ask: Reduce non-resource revenue threshold (5% to 3%)
FES: No change announced
- ✗ Ask: Reduce resource revenue threshold (50% to 40%)
FES: No change announced
- ✗ Ask: Make changes retroactive to 2015-16 downturn
FES: Higher limit applies to 2019-20 and onward

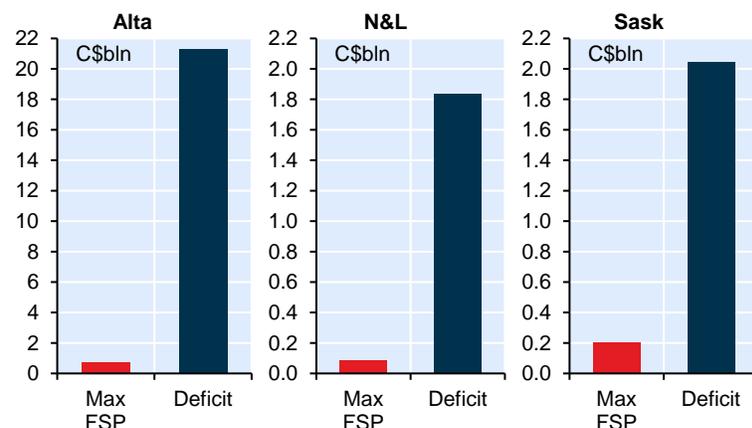
Other technical changes announced in FES to speed up claim process, address issues related to indexation of tax systems, etc.

Source: NBF, Finance Canada, Council of the Federation | Note: FES=Fall Economic Statement, presented by federal government 30-Nov

The one-two punch from the pandemic and lower oil prices means Alberta remains a clear candidate for fiscal stabilization in 2020-21. By way of illustration, even if you assumed Alberta and the other major oil-producing provinces qualified at the new, higher per capita limit, prospective FSP payments would offset only a small portion of today’s deficits (Chart 6). But that’s not the end of the story...

Chart 6: Stabilization payments won't erase deficits

Maximum FSP payment @ \$170/person limit vs. 2020-21 budget deficit



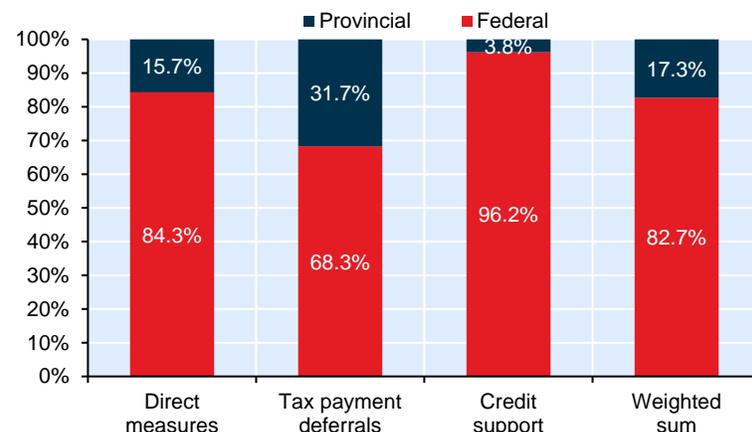
Source: NBF, Finance Canada, provincial gov'ts, StatCan | Note: Illustration, assuming all three provinces qualified for new max payment of \$170 per capita (after deductibles)

Feds covering most of Canada's outsized response to virus

In terms of sheer dollars and cents, the FSP turned into a sideshow in 2020-21, at least compared to the laundry list of programs Ottawa rushed out to combat COVID-19. When it comes to regional economies, household finances, business revenue or provincial finances, the biggest stabilizing influence has been the nearly C\$500 billion in federal support thus far committed. That takes the form of income supports, tax deferrals, credit support programs and, yes, extraordinary transfers to the provinces. Not included here is C\$70-100 billion in extra stimulus Ottawa aims to deploy *after* the virus has been beaten back, designed to speed closure of output gaps.

Chart 7: Feds covering >80% of Canada's total stimulus tab

Financing of COVID-19 economic response measures by level of gov't



Source: NBF, Finance Canada | Note: Finance Canada calculations as of Nov-2020; combined impact of all fed-prov measures estimated at C\$594bln

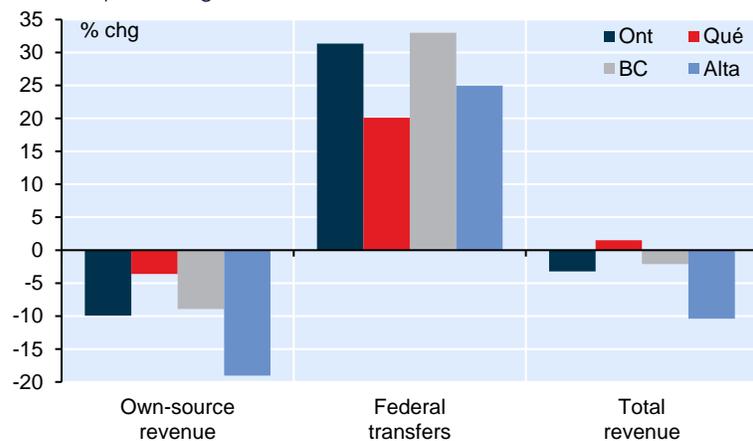
We don't wish to trivialize provincial efforts to fight/contain the virus. How could you? Provincial health systems are providing urgent care to those afflicted with COVID-19. Provincial education systems have

been radically altered to ensure kids can continue to learn in safe and innovative ways. Provinces provide vital social assistance to vulnerable segments of the population. Provincial governments have developed all kinds of additional programs, geared to their own unique circumstances and priorities. All true. But at the end of the day, the feds have put up the lion's share—around 80%—of the public sector money committed to fight COVID-19 (Chart 7, prior page).

Federal stabilization efforts have come in all shapes and sizes, including additional direct support to the provinces. Take the [Safe Restart Agreement](#), a rough C\$20 billion transfer supplement to help ensure provincial and local economies could safely re-open following the stringent yet necessary lockdowns that were imposed as the virus initially took root. You can't miss the stabilizing impact of these special federal transfers on provincial revenues. In general, Canada's provinces have seen federal transfers jump by 20–35% this fiscal year, offsetting a significant portion (in some cases all) of the weakness observed in own-source revenue (Chart 8).

Chart 8: Special transfers shore up provincial revenue

Growth in provincial government revenue: 2020–21 vs. 2019–20



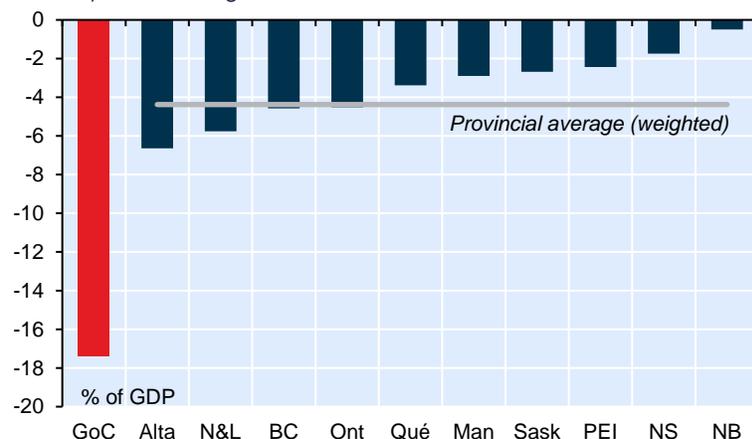
Source: NBF, provincial gov'ts | Note: Four largest provinces, based on latest updates; transfers include major programs plus special support related to pandemic

We get it, extraordinary federal transfers aren't saved, but rushed out the door to support growth and/or address spending pressures (health or otherwise). So special, time-limited federal transfers haven't prevented provinces from falling into deficit (or moving deeper into the red where deficits were already evident). As it stands, all ten expect a budgetary shortfall for 2020–21. But consistent with the notion that the feds are doing the heaviest lifting, Ottawa's projected deficit is now more than 4X larger than the weighted provincial average (Chart 9). From an international perspective, the federally led stimulus push means Canada's general government deficit has shot up faster than any other G20 nation in 2020 ([link](#)). The Government of Canada has hardly scrimped, even if some provinces have criticized the non-recurring nature of all this help.

It's not just the size, but also the speed of the federal response that has been noteworthy. In order to finance its massive action plan, net federal borrowing was nearly 8% of GDP during the first two quarters after the pandemic struck (i.e., 2020:Q2 to 2020:Q3), more than 20X larger than the net borrowing undertaken by all provincial governments during that same six-month period. This stands in stark contrast, both in terms of size and composition, to the borrowing patterns observed in the immediate wake of the Global Financial Crisis of 2008–09 (Chart 10).

Chart 9: Little wonder federal deficit so much larger

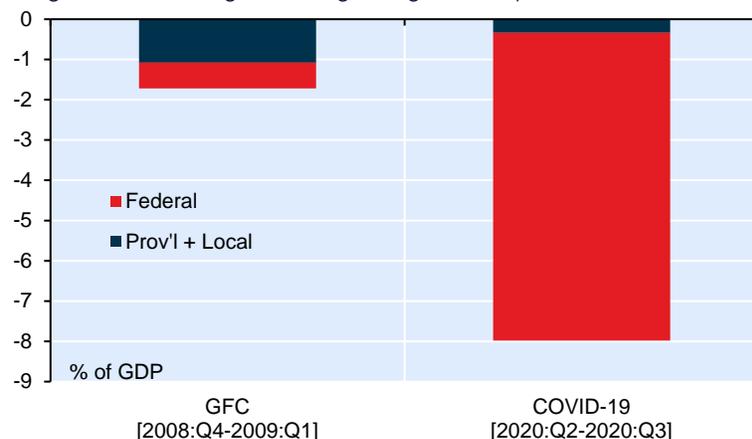
Federal-provincial budget balances: 2020–21



Source: NBF, Finance Canada, provincial gov'ts | Note: Applies official budgetary projections to NBF estimates for 2020 nominal GDP

Chart 10: Initial response massively different than 2008–09

Net government lending/(borrowing) during first two quarters of shock

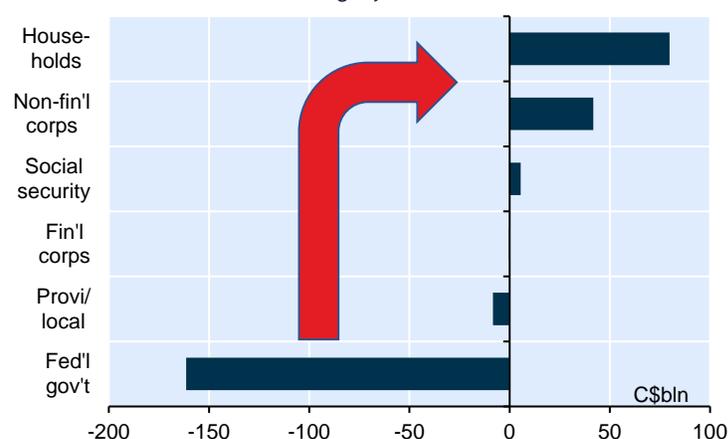


Source: NBF, StatCan | Note: Based on Government Finance Statistics

Yes, Ottawa's outsized stimulus has eased the burden on other levels of government, but federal programs have also funnelled tremendous sums to households and non-financial corporations—a wave of federal cash that in many cases was saved/invested (Chart 11).

Chart 11: Federal government helping out all over

Net financial investment/(borrowing) by sector: 2020:Q2 & 2020:Q3



Source: NBF, StatCan | Note: Based on Financial Flow Accounts | Note: Two quarter sum

Look no further than Canada's savings rate, which averaged 21% during the middle two quarters of 2020 vs. the ~3% trend registered in the ten years prior. It's hoped that this outsized pool of savings can/will be drawn upon to help keep consumers engaged in 2021, at least or until critical immunization thresholds are reached (still some time off). Whether it's via resurgent wages and salaries growth ([link](#)), surprisingly healthy wealth effects ([link](#)) or the eventual funnelling of above-noted household savings into spending, provincial own-source revenue streams stand to benefit from a massive federal stimulus effort. Think of this as indirect federal support for the provinces, above and beyond the transfer dollars we've focused on here.

Conclusion

To be clear, this note is *not* meant to be a treatise on how Canada's fiscal federation could or should be remade. There are no radical policy recommendations here. Rather, the goal has been to provide some context and perspective around federal support to the provinces via major transfers (and through other means).

As should be apparent, major federal transfers—as meaningful as they may be—are only part of the story when it comes to federal efforts to directly and indirectly shore up regional economies (and by extension provincial finances). Regardless of your political leanings, it would be fair to say that the Trudeau government has provided truly extraordinary and reasonably timely support as the pandemic took

hold, lessening the financial burden on the provinces. There appears to be a very real willingness to do more should the situation warrant.

In a way, Ottawa has opted to sacrifice its own balance sheet (and at least one of its AAA credit ratings) to shore up the economy and aid other sectors, be it households, businesses or other levels of government. Consider for a moment where provincial unemployment rates, budget deficits, borrowing requirements and/or credit ratings might be in the absence of such outsized federal help. Better yet, let's not.

Now, the provinces make a compelling argument for greater permanent support for health funding—the proverbial budget buster for some provinces as populations age. Believe it not, Ottawa likely still has some excess fiscal capacity that could be shifted to the provinces, in the form of extra health transfers or some other approach. That may be a sensible (more like required) course of action to help place Canada's broader provincial sector on a more sustainable long-term footing. We've long argued as much. Transfer reform, particularly via the CHT, could well be a story for 2021. The upcoming federal budget seems a natural enough time and place to take action. But at a bare minimum, the provinces have a non-trivial C\$84 billion of major transfer payments coming their way in 2021-22. Notwithstanding some grumbings in the background, it's a level of support that should continue to comfort provincial bondholders, all else equal.

Table 1: A closer look at major federal transfers to the provinces... roughly C\$84 billion to be doled out in 2021-22

Major federal transfers to provinces & territories by fiscal year & program

	Total	Y/Y: \$mln	Y/Y: %	Canada Health Transfer	Canada Social Transfer	Equalization	Offshore Offset Payments	Territorial Formula Financing	Total Transfer Protection	Additional Payment	Per Capita Allocation
Federal support to provinces & territories via Major Transfers (C\$millions)											C\$
2007-08	47,102			21,729	9,607	12,925	563	2,279	-	-	1,434
2008-09	49,758	2,656	5.6	22,768	10,552	13,462	663	2,313	-	-	1,499
2009-10	52,736	2,978	6.0	24,476	10,857	14,185	645	2,498	-	74	1,570
2010-11	55,281	2,545	4.8	25,672	11,179	14,372	869	2,664	525	-	1,628
2011-12	57,739	2,458	4.4	26,952	11,514	14,659	787	2,876	952	-	1,683
2012-13	60,085	2,346	4.1	28,569	11,859	15,423	443	3,111	680	-	1,731
2013-14	62,297	2,212	3.7	30,283	12,215	16,105	350	3,288	56	-	1,774
2014-15	65,029	2,732	4.4	32,113	12,582	16,669	196	3,469	-	-	1,832
2015-16	68,013	2,984	4.6	34,026	12,959	17,341	125	3,561	-	-	1,899
2016-17	70,943	2,930	4.3	36,068	13,348	17,880	44	3,603	-	-	1,959
2017-18	72,870	1,927	2.7	37,150	13,748	18,254	36	3,682	-	-	1,997
2018-19	75,416	2,546	3.5	38,584	14,161	18,958	-72	3,785	-	-	2,038
2019-20	78,746	3,330	4.4	40,373	14,586	19,837	2	3,948	-	-	2,098
2020-21	81,646	2,900	3.7	41,870	15,023	20,573	-	4,180	-	-	2,149
2021-22	83,890	2,244	2.7	43,126	15,474	20,911	-	4,380	-	-	2,181
1Y %	2.7			3.0	3.0	1.6	NA	4.8	NA	NA	1.5
3Y % (CAGR)	3.6			3.8	3.0	3.3	NA	5.0	NA	NA	2.3
5Y % (CAGR)	3.4			3.6	3.0	3.2	NA	4.0	NA	NA	2.2
10Y % (CAGR)	3.8			4.8	3.0	3.6	NA	4.3	NA	NA	2.6

Notes: Table prepared by NBF based on Department of Finance Canada information on federal support to provinces and territories;

1Y/3Y/5Y/10Y growth rates are in reference to 2021-22 allocation announced in December 2020; 3Y/5Y/10Y figures represent compound annual growth rates;

Refer to Government of Canada for complete details and additional notes: <https://www.canada.ca/en/departement-finance/programmes/federal-transfers.html>

Tables 2-3: Province-by-province major transfer allocation... total dollars & per capita basis

Major federal transfers to provinces & territories by fiscal year & jurisdiction

	Total	Y/Y: \$mln	Y/Y: %	BC	Alta	Sask	Man	Ont	Qué	NB	NS	PEI	N&L	Territories
Federal support to provinces & territories via Major Transfers (C\$millions)														
2007-08	47,102			4,376	2,795	1,317	2,982	12,087	14,622	2,204	2,442	429	1,465	2,384
2008-09	49,758	2,656	5.6	4,547	2,920	1,090	3,295	13,071	15,952	2,348	2,529	464	1,120	2,419
2009-10	52,736	2,978	6.0	4,789	3,143	1,178	3,359	14,274	16,673	2,488	2,648	490	1,079	2,614
2010-11	55,281	2,545	4.8	5,034	3,374	1,174	3,348	15,446	17,267	2,491	2,626	490	1,253	2,779
2011-12	57,739	2,458	4.4	5,269	3,495	1,204	3,352	17,335	17,292	2,493	2,652	493	1,157	2,997
2012-13	60,085	2,346	4.1	5,523	3,661	1,277	3,355	19,177	17,349	2,497	2,848	509	648	3,241
2013-14	62,297	2,212	3.7	5,790	3,878	1,354	3,363	19,915	17,911	2,497	2,975	519	670	3,426
2014-15	65,029	2,732	4.4	5,832	5,175	1,411	3,359	19,184	19,614	2,616	3,001	544	677	3,618
2015-16	68,013	2,984	4.6	6,152	5,475	1,484	3,436	20,445	20,348	2,658	3,052	553	694	3,716
2016-17	70,943	2,930	4.3	6,482	5,772	1,565	3,531	21,347	21,372	2,741	3,060	584	724	3,766
2017-18	72,870	1,927	2.7	6,857	5,912	1,602	3,680	21,022	22,640	2,829	3,140	600	737	3,852
2018-19	75,416	2,546	3.5	7,114	6,122	1,657	3,964	21,337	23,674	2,972	3,227	637	750	3,962
2019-20	78,746	3,330	4.4	7,442	6,377	1,714	4,257	21,260	25,554	3,160	3,435	649	767	4,131
2020-21	81,646	2,900	3.7	7,706	6,619	1,765	4,575	22,058	26,088	3,379	3,611	693	782	4,369
2021-22	83,890	2,244	2.7	7,939	6,835	1,808	4,839	22,771	26,306	3,471	3,822	731	794	4,575
1Y %	2.7			3.0	3.3	2.4	5.8	3.2	0.8	2.7	5.8	5.5	1.5	4.7
3Y % (CAGR)	3.6			3.7	3.7	2.9	6.9	2.2	3.6	5.3	5.8	4.7	1.9	4.9
5Y % (CAGR)	3.4			4.1	3.4	2.9	6.5	1.3	4.2	4.8	4.5	4.6	1.9	4.0
10Y % (CAGR)	3.8			4.2	6.9	4.1	3.7	2.8	4.3	3.4	3.7	4.0	(3.7)	4.3
Per capita allocation (C\$)														
2007-08	1,434			1,021	797	1,316	2,510	948	1,902	2,958	2,611	3,110	2,882	22,270
2008-09	1,499	65	4.5	1,047	814	1,073	2,754	1,016	2,057	3,144	2,703	3,349	2,191	22,344
2009-10	1,570	71	4.7	1,087	856	1,141	2,783	1,100	2,128	3,319	2,824	3,504	2,093	23,888
2010-11	1,628	58	3.7	1,128	905	1,118	2,746	1,178	2,180	3,308	2,788	3,459	2,404	25,056
2011-12	1,683	55	3.4	1,172	924	1,130	2,721	1,309	2,162	3,301	2,810	3,430	2,204	26,548
2012-13	1,731	48	2.9	1,216	946	1,178	2,688	1,431	2,148	3,301	3,014	3,514	1,233	28,379
2013-14	1,774	43	2.5	1,263	973	1,227	2,660	1,471	2,199	3,304	3,154	3,578	1,270	29,752
2014-15	1,832	58	3.3	1,259	1,259	1,259	2,627	1,404	2,390	3,465	3,185	3,722	1,281	30,969
2015-16	1,899	67	3.7	1,312	1,312	1,312	2,655	1,483	2,466	3,525	3,236	3,776	1,312	31,502
2016-17	1,959	60	3.2	1,364	1,364	1,364	2,684	1,530	2,571	3,621	3,228	3,912	1,364	31,448
2017-18	1,997	38	1.9	1,395	1,395	1,395	2,760	1,496	2,732	3,692	3,306	3,991	1,395	31,586
2018-19	2,038	41	2.1	1,425	1,425	1,425	2,932	1,493	2,826	3,858	3,370	4,163	1,425	32,036
2019-20	2,098	60	2.9	1,464	1,464	1,464	3,114	1,464	3,010	4,071	3,547	4,131	1,464	33,052
2020-21	2,149	51	2.4	1,497	1,497	1,497	3,317	1,497	3,043	4,328	3,690	4,344	1,497	34,565
2021-22	2,181	32	1.5	1,523	1,523	1,523	3,477	1,523	3,039	4,418	3,864	4,510	1,523	35,781
1Y %	1.5			1.7	1.7	1.7	4.8	1.7	(0.1)	2.1	4.7	3.8	1.7	3.5
3Y % (CAGR)	2.3			2.2	2.2	2.2	5.8	0.7	2.5	4.6	4.7	2.7	2.2	3.8
5Y % (CAGR)	2.2			2.2	2.2	2.2	5.3	(0.1)	3.4	4.1	3.7	2.9	2.2	2.6
10Y % (CAGR)	2.6			2.7	5.1	3.0	2.5	1.5	3.5	3.0	3.2	2.8	(3.6)	3.0

Notes: Tables prepared by NBF based on Department of Finance Canada information on federal support to provinces and territories;

'Major Transfers' include Canada Health Transfer, Canada Social Transfer, Equalization, Offshore Offset Payments, Territorial Formula Financing, Total Transfer Protection & Additional Payments; shading denotes receipt of Equalization in a given fiscal year;

1Y/3Y/5Y/10Y growth rates are in reference to 2021-22 allocation announced in December 2020; 3Y/5Y/10Y figures represent compound annual growth rates;

Refer to Government of Canada for complete details and additional notes: <https://www.canada.ca/en/department-finance/programs/federal-transfers.html>



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