

Review Article

Fiscal Adjustment in Nova Scotia

The problem of federal-provincial finances is as old as Confederation. The municipalities, because they are the creatures of the province, have always been a factor in these relations, but their importance has grown significantly in the past few years. "Matters of a local or private nature", which were made the responsibility of the provinces under the constitution and largely delegated to the municipalities, have come to represent a substantial share of total public expenditures in Canada.

The rate of economic growth and the nature of development in the post-war years have accelerated the trend to urbanization in Canada. This trend, with the accompanying growth in population, has increased the demand for public services, particularly those that are the responsibilities of the provinces and municipalities. Growing personal incomes have led to higher living standards and "rising expectations" in respect of such services. The result is a critical need for more attention to the field of provincial-municipal finances.

Much of the literature on this aspect of public finance is on federal-provincial or federal-state relations. With the growing importance of functions that were once considered private or local, and a commensurate rise in the proportion of public expenditures incurred for such services, it is timely for the social scientist to concern himself with the problems of fiscal adjustment between the province and the municipality. These problems are more than the concern of the local councillor or the Department of Municipal Affairs, or even of the government of the day in a particular province, for it is not simply a question of devising a formula that will serve as a basis for distributing a given amount of money at a particular time. Involved also are philosophical considerations concerning the role of local government in a democracy and policies affecting the rate and nature of economic growth, as well as the individual's proper concern for his local tax bill.

It may be suggested, as an aside, that the existence of financial crisis,

like the prospect of hanging, will, in Samuel Johnson's words, serve to concentrate the academic mind wonderfully. The rising birth rates of the 1940s led to a crisis in school finance in Nova Scotia, as elsewhere, in the 1950s. There are clear indications that the effects of the population "bulge" have now reached the universities; the signs of crisis among these institutions are growing.

Problems in the provision and financing of local services are not confined to North America, nor indeed to federal countries. In Britain last year the impact of rates (property taxes) on households was investigated; and while the terms of reference were limited, the resulting report has given rise to considerable discussion on the advantages and disadvantages of rates as a method of financing local services. Questions have also been raised as to what services should be financed wholly by the local authority, and where the administrative responsibility should lie. Similar matters are examined in detail in the smaller context of Nova Scotia's political and economic framework by John F. Graham in *Fiscal Adjustment and Economic Development—A Case Study of Nova Scotia*.*

The central theme of the book—provincial-municipal fiscal adjustment—was timely then and is perhaps even more so now. It is the first publication in the series of Atlantic Provinces Studies, established by the Social Science Research Council of Canada to encourage and support research on the economic and social problems of the region. The series is intended not only to shed light on these problems but also to help in the formulation of policies for their solution. In keeping with this objective, Dr. Graham has set himself the practical and exacting task of arriving "at a prescription for fiscal adjustment which will be conducive to optimum allocation of resources" (p. 6).

There are in a very real sense two major and distinct areas of study in the book: economic development and the pattern of provincial-municipal relations. Attention to the economic problems of Nova Scotia and of the Atlantic Provinces is not new, nor are problems of fiscal adjustment, federal-provincial-municipal. There is, however, a new sense of urgency about municipal matters. Evidence of this concern is the study recently completed for the Province of Nova Scotia (by Touche, Ross, Bailey, and Smart) on provincial and municipal taxation. And in the neighbouring Province of New Brunswick, a Royal Commission on Finance and Municipal Taxation completed an exhaustive report which was published early in 1964.

*Toronto: University of Toronto Press, 1963. Pp. ix, 278. \$6.50.

Also new, and timely, is the integrated treatment of fiscal adjustment and economic development in a low-income province. The importance of the relationship has been too little understood, and it is heartening to see an approach to public finance in Nova Scotia that sets out to establish an economic rationale. Consideration of fiscal relations involving the province and the municipalities on the one hand, or the federal government on the other, seems to have been guided by the lawyer or the administrator. At official conferences, at any rate, the economist has been conspicuous by his absence even though economic factors have been of paramount importance.

On the ground that the property tax is an inadequate basis for the support of all the services in which municipalities are involved, Dr. Graham advocates a programme of grants from the province. Just as there are differences in tax capacity among the provinces, there are variations among municipalities. He therefore contends that the pattern of fiscal adjustment should be based on the principle of fiscal equity, which he defines as equal fiscal treatment of similarly situated individuals in different localities. The criterion would be met if, regardless of where he lived, an individual were to receive the same public services and incur the same tax burdens with respect to his given income, wealth, expenditure, property, or whatever tax basis is used. With differences such as rural versus urban, the objective can of course only be approximated.

In determining the transfer of funds to poorer localities, in the author's view, the two main points to consider are (1) equity, equal treatment of similarly situated individuals and (2) the effect of transfers on the allocation of resources. It is argued effectively that the two objectives, equity for the individual and sound economic growth, can be reconciled. Further, in a province with a relatively low income, it is deemed even more important to have a pattern of provincial-municipal relations that is conducive to the best use of resources, both human and natural.

Although the study is primarily concerned with public finance, Dr. Graham has concerned himself with why Nova Scotia is a low-income province and has attempted to determine desirable directions of economic development. Among the factors explaining why productivity is lower in Nova Scotia, he cites inferior natural resources (and their location), less application of capital, small scale of organization, and prevalence of part-time activity in the primary industries—and, it is ventured, perhaps in some areas intrinsically inferior labour resources: "In a region which has experienced almost con-

tinual migration over a long period there has been a severe drain on some of the province's most vigorous and productive stock" (p. 107).

In this latter statement, if it is true—and there is some evidence to support it—lies the most disturbing feature of the situation. One may be prepared to accept a slower rate of growth, and in some areas a decline, but it is disquieting to contemplate actual deterioration in the quality of the people. Do his prescriptions for industry as well as government envisage re-enforcing or reversing this trend, and are they practical? What is his assessment of their prospects for acceptance, and what is the timetable?

The recommendations for adjustments in the primary industries—agriculture, forestry, and fisheries—involving higher ratios of capital per man are generally accepted as sound, as is the forecast of reduced employment. At the same time, one positive result should be higher income for those remaining in these industries and working under more competitive conditions. This in turn should generate higher demand for other services and thus strengthen the base of the provincial economy. Since the book was published, interest in the province's mineral resources has heightened, and this has led to increased expenditures on exploration and to some new mining developments. In particular, the search for off-shore petroleum deposits may lead to a more optimistic assessment of the resource base.

Even so, there is little basis for gainsaying the author's statement that there are only two avenues for preventing a large and persistent surplus of labour: (1) even larger movements of population from the province than have been taking place in recent years or (2) a considerable expansion of secondary manufacturing industry. In fact, there is likely to be a combination of both.

The prospects for growth in secondary manufacturing are judged to be modest. If, as Dr. Graham thinks likely, a considerable labour surplus in the form of unemployment and underemployment persists, he contends that there is a strong argument *on economic grounds* for the use of federal subsidies for a limited duration in such forms as low-interest loans, grants, tax concessions of various sorts, and transportation adjustments, provided that the value of the contribution to production of the otherwise unemployed and therefore completely wasted labour exceeds the cost of subsidies (including, of course, the subsidies with respect to the cost of capital).

Since this conclusion was expressed, new policies, both federal and provincial, have been embarked upon and new agencies set up—the Area Development Agency of the Department of Industry, the Economic Council of Canada, and Voluntary Economic Planning in Nova Scotia. It will be some time

before the new agencies and new policies make an impact and before their effectiveness can be measured. The author speaks in terms of a decade or even a generation before the substantial economic improvements that he has outlined will take place. He contends that the success of new provincial programmes will depend to a large extent upon federal policies, the degree of direction the federal government is prepared to give, and the inducements it is prepared to offer.

The foregoing suggests that the scope for policy and programmes for the expansion of secondary industry is limited by the nature of Nova Scotia's economic base and the political framework. Moreover, the scope for fiscal adjustment as between the province and municipalities is limited by the province's fiscal resources with a consequent heavy dependence on federal grants. This, however, underlines the need for provincial-municipal financial arrangements that will take account of their effect on economic development. It is also apparent that dominion-provincial and provincial-municipal financial relations are simply different aspects of a single problem.

Commenting on the history of local government in Nova Scotia, the author refers to recent developments in these terms: "There has been no integrated reorganization in provincial-municipal fiscal relations in Nova Scotia in the postwar period; but there have been four major departures from long-established policies significant enough taken together to constitute a revolution" (p. 11). Briefly, these developments can be summed up by reference to the general services of education, health, and social welfare, in which the province has committed itself much more fully in both financing and control. A significant step by the province towards assistance on *local* services is the recently adopted practice of contributing, on a mileage basis, to the cost of maintaining urban streets. The scope for fiscal adjustment has thus been broadened.

The question whether grants stimulate the appropriate economic changes or tend to distort the allocation of resources from the optimum then becomes extremely important. Dr. Graham concludes that both federal and provincial transfers to other governments have positive effects on the whole. He does not, however, dismiss the contention that transfer payments to individuals, such as unemployment insurance and old age pensions, tend to inhibit the movement of people to better opportunities elsewhere. He recognizes its validity where such payments constitute a relatively large proportion of personal income, but the distorting effects are attributed to the redistributive fiscal system that our society has adopted as it affects individuals, rather than to the transfers

from the federal to provincial governments or from the province to its municipalities.

One could say that to the extent that the province's funds are devoted to welfare this distortion may be compounded, assuming that the above-mentioned relationship to personal income holds. But a large part of the activities of a provincial government—for example, education, and highways—is devoted less directly to social welfare than to development.

Dr. Graham devotes a good deal of attention to education, which he considers the most important service involving the province and the municipalities. He takes the position that payments on the basis of fiscal need are strongly corrective, mainly because of the greater mobility that education and training give the labour force. This is an interesting point in view of the current emphasis on growth-points in the discussions of regional development. On the face of it, payments on the basis of fiscal equity, to achieve equal treatment along with commensurate services for similarly situated individuals, might appear to restrain rather than encourage growth in areas where development is most feasible. But the author makes a good case that the net effect is for improved allocation of resources.

It is to be hoped in the interests of the province as such, as distinct from its residents as individuals, that grants for education and other local services will improve the productivity of the people who continue in the Nova Scotia labour force. Inferior public services or a relatively high tax burden can put pressure on individuals who are otherwise well situated in terms of relative productivity, and to the extent that such pressure is a factor in migration out of the province, it constitutes an unnecessary drain on the economy.

As it is now, the most conspicuous element in the stream of migration from the province is the exodus of graduates of our universities. Certain information on the Nova Scotia labour force suggests that "selective" migration runs throughout the population spectrum, leaving behind those with lower general education and less technical skill. To the extent that the nature of the labour supply is a function of the industrial and occupational composition of the economy, the situation can be altered only by structural changes in the economy. It is arguable, however, that a better equipped labour force would be, in itself, a dynamic factor in economic growth.

Little has been said so far of the actual application of the principle of fiscal equity. There are three elements in the system of grants prescribed. For the purposes of this review, these need be outlined only in a general way. First, conditional grants are recommended for the general services, of which

education, health, and welfare are the most important; this represents an extension to the other general services of a modification of the education formula based on the concept of a foundation programme and aiming for a uniform burden for the municipal share of costs in all municipalities.

Dr. Graham believes that the existing education formula, without the provision of a minimum provincial contribution and with a change in the way the uniform burden is determined, can be used for the general services where minimum standards are required. For local services such as fire and police protection, construction and maintenance of streets, sanitation, and the like, unconditional grants are recommended. Such grants would take into account ability to pay for a given level of services but would not fix minimum standards.

A third category consists of grants in lieu of motor-vehicle revenues to towns and cities toward the cost of their streets. For administrative reasons, such grants are favoured over municipal taxes on motor vehicles or gasoline.

Experience with the programme of educational finance supports the view that the recommended system of grants is practical. Possible alternative patterns of fiscal adjustment are considered but rejected. A redistribution of functions or revenues would not alter the situation under which the burden of raising a given amount of revenue is heavier in some localities than in others. The author also rejects the approach toward fiscal equity that could be achieved by having the province take over complete responsibility for the general services. He does this on the ground of administrative efficiency rather than of the importance usually attached to participation in local government as the cornerstone of democracy. This is interesting in view of the recommendations of the Royal Commission in New Brunswick which, if implemented, would bring a high degree of centralization and a commensurate reduction in the functions of local government. It should be added that the author believes that provincial politics in Nova Scotia are close enough to the citizens to give ample opportunity for nurturing the democratic process.

The system of grants recommended is part of a programme of fiscal adjustment which includes the assumption by the province of responsibility for mental hospitals, child care, and certain aspects of the administration of justice. It is intended to give financial relief to the municipalities and to transfer much of the tax burden from the highly regressive property tax; in that connection, reference is made to the need to improve the economic conditions under which business firms operate in the province by reducing fixed costs. The spate of special tax arrangements for industry approved at the 1965 session

of the Legislature and under other authority in the face of mounting pressure for more revenue is indicative of the problem. Unfortunately, such arrangements, where they represent concessions, merely transfer the burden to other taxpayers rather than resolve the conflicting demands for more money and a less onerous property tax.

Assuming that the proposed programme is administratively sound and can be reconciled readily with the existing institutional framework, what about the cost to the province? On the basis of 1956 data, it was roughly estimated that the full implementation of the programme would cost the province an additional \$10 million. This represents a substantial proportion of net general revenue at that time. The cost of the services involved has risen rapidly since then, but at the same time there has been a very marked growth in provincial revenue (from \$56 million in 1956 to an estimated \$140 million in the current fiscal year). In any case, one of the great virtues of the programme is that it can be implemented by degrees in accordance with the "art" of politics as distinct from the "science" of economics.

Dr. Graham's book makes a solid contribution not only in the field of public finance but even more to the growing body of literature on regional development. As the first of the series of Atlantic Provinces Studies, it deals with a subject that is singularly appropriate. The pattern of provincial-municipal relations is an important factor affecting resource allocation, and hence economic development, and it is within the control of government.

Quite apart from the merits of the specific recommendations, Dr. Graham's book should open new areas of investigation and raise the level of discussion on matters which touch us all but are considered all too often without an objective frame of reference. Perhaps the most appealing part of the argument for the principle of fiscal equity, the central idea, is its focus on the individual. To present a programme in this field that is ethically satisfying, and has economic and political validity, is no mean achievement.

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