

ED 347 893

HE 025 656

TITLE Federal Support for University Education and Research. A Report of a Review by the Standing Advisory Committee of the Association of Universities and Colleges of Canada.

INSTITUTION Association of Universities and Colleges of Canada, Ottawa (Ontario).

PUB DATE Jun 92

NOTE 37p.

AVAILABLE FROM Association of Universities and Colleges of Canada, 151 Slater, Ottawa, Ontario K1P 5N1, Canada.

PUB TYPE Reports - General (140)

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.

DESCRIPTORS Budgeting; Colleges; *Educational Finance; Educational History; Equalization Aid; *Federal Aid; Federal Programs; Federal State Relationship; *Financial Support; *Fiscal Capacity; Foreign Countries; Government Role; Higher Education; Research; Resource Allocation; Universities

IDENTIFIERS *Canada

ABSTRACT

This report briefly reviews the history of federal support of higher education in Canada and then turns, in Part II, to an overview of several factors which contribute to uncertainty over the future of federal support. It concentrates on mechanisms for federal support, and though it does not advocate a single funding option, it proposes several options. In addition, the report provides the Association of Universities and Colleges of Canada's position regarding federal support. This position statement calls for the federal government to continue playing a role, jointly with the provinces, in the support of higher education and university research, subject to the understanding that in the case of higher education, the federal and Quebec governments need to negotiate arrangements appropriate to Quebec's distinctiveness. In addition, the report addresses issues concerning established program financing (EPF) including restoring the original EPF formula, reforming the EPF; and replacing the EPF with a new arrangement. Appendices provide charts outlining the decreasing availability of EPF cash, and a review of the selected options for federal funding of university education and research. (GLR)

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**FEDERAL SUPPORT
FOR UNIVERSITY EDUCATION
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**FEDERAL SUPPORT
FOR UNIVERSITY EDUCATION
AND RESEARCH**

**A Report of a Review
by the
Standing Advisory Committee on Funding
of the
Association of Universities and Colleges of Canada**

June 1992



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and Colleges of Canada

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June 22, 1992

DEAR READER,

For more than forty years, the federal government has demonstrated an active interest in university education and university-based research in this country. It has backed up that interest with major financial contributions.

In recent years, the future of that interest and of those contributions, at least in the case of university education, has been increasingly in doubt. Canada's post-Meech Lake constitutional predicament has contributed to the uncertainty. So too have recent federal budgets, as a result of which some provinces will, within the next few years, cease to receive Established Programs Financing (EPF) cash transfers to support postsecondary education. This development will, for all intents and purposes, mark the end of federal support for core postsecondary educational activities unless an alternative arrangement is devised in the meantime.

The AUCC Board of Directors decided in mid-1990 to establish a Standing Advisory Committee on Funding with a mandate to review federal support for university education and research, to identify trends and to propose options for the future.

I agreed to chair the Committee and Howard Clark (President, Dalhousie University), Murray Fraser (President, University of Calgary) and Claude Hamel (Président, Université du Québec) agreed to serve as members. Robert Best (AUCC's Director of Government Relations and Public Affairs) is Secretary to the Committee.

In fulfillment of our mandate, we undertook background work on the history of federal involvement in university education and research, on the changing political and economic climate and on various options for federal funding. We also issued a discussion document on options (parts of which are summarized in Appendix B to our Report) and consulted widely with governmental officials, AUCC member institutions and other interested organizations.

However, as our work progressed, it became clear that we would be unable to complete our review until AUCC had come to grips with the difficult issue of how much of a role, if any, the federal government should play in future in relation to university education and research. Thus, following much discussion, the AUCC Board ratified a short position statement on the federal role in December 1991. It is described in Part III of our Report. The position statement calls for the federal government to continue playing a role, jointly with the provinces, in the support of higher education and university research, subject to the understanding that in the case of higher education, the federal and Quebec governments need to negotiate arrangements appropriate to Quebec's distinctiveness.

The Committee was then able to complete its review and to submit the attached Report, entitled *Federal Support for University Education and Research*, to the AUCC Board. The Board has now approved the document and authorized its distribution.

The Report briefly reviews the history of federal support and then turns, in Part II, to an overview of several factors which contribute to uncertainty over the future of federal support. The discussion of these factors and of the three broad processes of consultation that address them leaves off at March 1992. By way of update since that time:

1. The Constitution and the Division of Powers

The Beaudoin-Dobbie Special Joint Committee on a Renewed Canada has submitted its report to Parliament, including the following passage:

We recognize that *health, education and social services* are under provincial jurisdiction. The federal government has instituted a number of Canada-wide programs in some of these areas. We believe that the federal government should continue to deliver these. (p. 74)

It also proposes the inclusion in the Constitution of a section entitled "The Social Covenant and the Economic Union" which would, among other things, commit federal, provincial and territorial governments and legislatures to "providing high quality public primary and secondary education to all persons resident in Canada and ensuring reasonable access to post-secondary education." (p. 122)

As this letter is written, federal, provincial and territorial ministers for constitutional affairs (except Quebec, which has chosen not to attend) and representatives of first nations are negotiating a possible constitutional renewal package.

2. The Federal Prosperity and Learning Initiatives

There have been more than one hundred and eighty community-level consultations, five regional consultations and a round-table on learning. The Steering Group on Prosperity, which is overseeing the consultations, is charged with preparing an action plan including what the Learning Agenda document⁺ calls "shared national priorities and targets that should guide the federal and other partners as we build a system of lifelong learning." The Steering Group is scheduled to submit its action plan to the federal government in September 1992.

3. The Review of Federal-Provincial Transfers, including EPF and Equalization

The long-promised public consultations have not yet begun. However, Finance Minister Don Mazankowski continues to repeat -- for example, in an April 1992 letter to AUCC -- that the government is committed to consulting interested individuals and organizations, as well as provincial governments, on the future of the transfers.

The attached Report is intended as one of four AUCC contributions to these three

interrelated streams of consultation. These four documents are also intended, more generally, to provoke debate and action on the part of both governments and universities. The first two -- a January 1992 submission to the Beaudoin-Dobbie Committee (including the Association's short position statement on the federal role) and a May 1992 brief to the Steering Group on Prosperity -- have already been made public. The fourth document is the report of the AUCC Task Force on the Report of the Commission of Inquiry on Canadian University Education (the Smith Commission). The task force, chaired by Dr. Brian Segal, President of the University of Guelph, is to submit its report to the AUCC Board in June 1992.

The four documents are complementary. Thus, for example, while the attached Report touches only briefly on the reasons why the federal government should continue to play a role in support of university-based research and university education (with special arrangements for Quebec), the brief to the Prosperity Steering Group devotes rather more attention to this question.

Our Report concentrates on mechanisms for federal support. We have not chosen to advocate a single funding option. Instead, we propose several options that merit further consideration. In so doing, we seek to emphasize that between the two extremes of maintaining unconditional EPF transfer arrangements (a decreasingly viable option) and a total withdrawal of federal support (perhaps combined with a transfer of tax room to the provinces), there are several potentially viable options for a continued federal role in support of university education and research.

University education and research have contributed greatly to the economic, social and cultural development of Canada and the provinces. Provincial governments have jurisdiction over education and have played a central role in shaping their educational systems. However, it must also be recognized that university education and research have been developed and maintained with federal assistance and participation, and the central government in the Canadian federation has a responsibility to ensure a minimum level of equality of opportunity across Canada. We are convinced that federal support must continue.

Consequently, we are very concerned that neither the constitutional renewal process, nor the Prosperity and Learning Initiatives, nor the pending review of federal-provincial transfers should limit the federal government's ability to play a role in support of university research and higher education through any or all of the options suggested in this Report.

David C. Smith

Principal, Queen's University at Kingston and
Chair, AUCC Standing Advisory Committee on Funding

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ASSOCIATION OF UNIVERSITIES AND COLLEGES OF CANADA STANDING ADVISORY COMMITTEE ON FUNDING

FEDERAL SUPPORT FOR UNIVERSITY EDUCATION AND RESEARCH

I. THE HISTORY OF FEDERAL SUPPORT¹

Despite the Canadian Constitution's exclusive grant of powers to the provincial legislatures to "make Laws in relation to Education" -- "In and for each Province" -- the federal government has been interested in university education since the early years of Confederation. Its interest in university-based research dates at least to the First World War.

In the 1870s, for example, it created the Royal Military College, and in the 1880s, gave a land endowment to the University of Manitoba "for capital expenditures and . . . a permanent source of revenue for the university."² In 1916, it established the National Research Council which was initially intended to coordinate research during the First World War, but soon thereafter created scholarships for scientific study and began providing grants to universities to facilitate purchase of research equipment and otherwise to support graduate study and research.³ In 1918, it set up an education division within the new Dominion Bureau of Statistics, and in 1939, established, in conjunction with the provinces, a student aid program providing both grants and loans.⁴

These initiatives were important precedents for the post-World War II era when federal activities in relation to university education and research (as well as primary, secondary and other forms of postsecondary education) became even more diverse and involved much greater sums of money.

By 1984-85, there were, according to the terms of reference for the Nielsen Task Force's Study Team on Education and Research:

¹This section and the three that follow draw extensively on two background documents prepared for the Standing Advisory Committee on Funding by the AUCC Secretariat: *A Review of Arguments in Favour of a Federal Role in Support of Post-Secondary Education and Research*, September 20, 1990; and *A Review of the Political and Economic Climate and Options for Funding University Education and Research*, February 1991.

²Parliamentary Task Force on Federal-Provincial Relations (Breau Report), *Fiscal Federalism in Canada*, August 1981, p. 55.

³Roya. Commission on National Development in the Arts, Letters and Sciences (Massey Commission), *Report*, 1951, p. 174.

⁴Breau Report, pp. 55-56, 59.

... about 109 [federal] programs, costing an estimated \$6 billion, aimed at directly or indirectly supporting elementary and secondary school education and education and research in universities and colleges. Post-secondary education accounts for the largest portion of this.⁵

The May 1991 Speech from the Throne said that the federal government currently spends about \$11 billion on education and training, a figure later reiterated in the federal "learning agenda" consultation paper, *Learning Well...Living Well*.⁶ The majority of this amount, which includes the value of tax transfers under the Established Programs Financing (EPF) arrangements, is for the support of postsecondary education and university-based research. The Department of the Secretary of State has recently estimated total federal support to postsecondary education and university-based research at \$7.2 billion for 1989-90. This includes \$5.6 billion in EPF transfers to the provinces (\$3.4 billion of which was the estimated value of the tax transfer), \$710 million in research support, and \$615 million in student assistance. It does not include the value of federal tax expenditures in support of postsecondary education.⁷

As the above figures suggest, the primary federal activities in support of postsecondary education and university-based research in the post-World War II period -- and certainly those involving the greatest expenditure of funds -- have involved (a) transfers in support of core operations of postsecondary institutions; (b) direct support to university-based research, especially through the research granting councils;⁸ and, (c) student assistance, especially after the creation of the Canada Student Loans Program in 1964.

The first of these three activities has engendered the largest expenditures and arguably, the greatest controversy. Federal transfers specifically for university education began in 1945 with direct grants to the universities for education of returning veterans. As funding for veterans declined, the St-Laurent government, following recommendations from AUCC's predecessor, the National Council of Canadian Universities (NCCU), and from the Massey Commission, instituted a program of direct grants to universities based on provincial population (initially 50 cents per capita) beginning in 1951-52. In 1967, these direct grants were replaced with a federal-provincial shared-cost program combining cash and tax point transfers.

⁵The Task Force on Program Review (Nielsen Task Force), Study Team on Education and Research, *Report*, November 1985, p. 1.

⁶Government of Canada, Prosperity Secretariat, *Learning Well...Living Well*, Consultation Paper, 1991, p. 25.

⁷Department of the Secretary of State, *Federal and Provincial Support to Post-Secondary Education in Canada: A Report to Parliament, 1989-90*, 1991, p. 64. By 1990-91, EPF transfers for postsecondary education had reached \$5.8 billion, of which \$3.8 billion was in tax transfers. See AUCC, *Trends: The Canadian University in Profile, 1991 Edition*, p. 80.

⁸First through the National Research Council and the Canada Council, and later through the Natural Sciences and Engineering Research Council (NSERC), the Social Sciences and Humanities Research Council (SSHRC) and the Medical Research Council (MRC).

Throughout the period of both direct grants and shared-cost arrangements, there were persistent provincial complaints that the federal government was exploiting provincial fiscal weakness to interfere in their jurisdiction. Quebec was most outspoken in these protests -- indeed, the Duplessis government insisted for several years that Quebec universities not accept direct federal grants -- but it was not alone in expressing resentment.

Finally, faced with provincial opposition to the existing arrangements and concerned about the open-ended nature of its own contributions to postsecondary education, medical insurance and hospital insurance, the federal government negotiated the EPF arrangements. When it went into effect in 1977, EPF appeared, from the provincial perspective, to be a near ideal arrangement. While the federal government insisted that the EPF cash transfers guaranteed a continued federal presence in both postsecondary education and health care, the provinces could spend the unconditional block grant transfers as they pleased, or at least, as they could justify politically. In the federal government's books, just over 70 per cent of the EPF transfers are designated for support of health care, with the remainder for postsecondary education, but no province has felt bound by these designations.

Furthermore, in recognition of the link between economic growth and an educated and healthy population, the per capita EPF transfers were to grow at the same rate as per capita Gross National Product, providing the provinces and the federal government with a level of stability and predictability.

In a 1980 report for AUCC, Peter Leslie pointed to a fundamental irony in federal support for postsecondary education to that point in the post-War era:

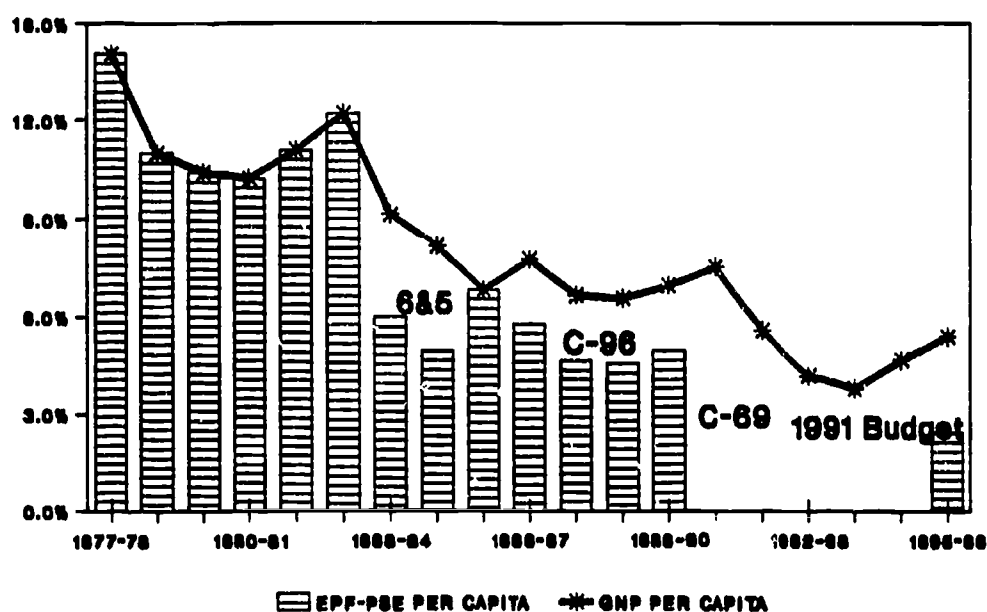
The history of the federal role in higher education since World War II is one of rising expenditures coupled with diminishing visibility and diminishing impact. This seeming paradox is easily explained. Since 1967 the federal money -- other than that earmarked for specific purposes such as research -- has been transferred to the provincial governments on the supposition that they will in turn pass it on to the universities and other postsecondary institutions. This has placed the provinces firmly in control. The 1977 amendments to the intergovernmental fiscal transfer arrangements accentuated the trend begun ten years earlier.⁹

Given this irony -- and in particular, the lack of federal visibility and the lack of clear accountability that characterize EPF -- it is not surprising that the federal government, citing the need to reduce inflation and control the deficit, has repeatedly "tinkered" with the EPF formula, thereby undermining the stability and predictability of EPF (Figure 1). In 1982, a series of changes, including the elimination of transitional payments included in the 1977 arrangements, resulted in a net decrease in the transfers. In 1983-84 and 1984-85, the Liberal government applied its 6 & 5 anti-inflation program to the postsecondary education portion of the EPF transfers.

⁹Peter M. Leslie, *Canadian Universities 1980 and Beyond: Enrolment, Structural Change and Finance*, AUCC Policy Study No. 3, September 1980, p. 146.

Figure 1

PER CAPITA GROWTH RATE¹ OF GNP & OF TOTAL EPF-PSE ENTITLEMENTS



Source: AUCC Research & Policy Analysis
¹Average per capita growth over 3 years

In 1986, the Progressive Conservative government's Bill C-96 partially de-indexed the EPF escalator to 2 percentage points below the rate of growth in per capita GNP. In 1989, the federal budget announced a further 1 percentage point de-indexation of the escalator, effective 1990-91, and Bill C-33 was tabled to give parliamentary sanction to this measure. However, before it could be passed, Bill C-33 was overtaken by the 1990 budget and Bill C-69 which froze the per capita EPF transfers for 1990-91 and 1991-92, after which time the further 1 percentage point de-indexation (to 3 percentage points below the rate of growth in per capita GNP) would go into effect. Then, the 1991 budget extended the freeze on per capita transfers for another 3 years to the end of fiscal 1994-95 after which the per capita transfers would grow at 3 percentage points below the rate of growth in per capita GNP.

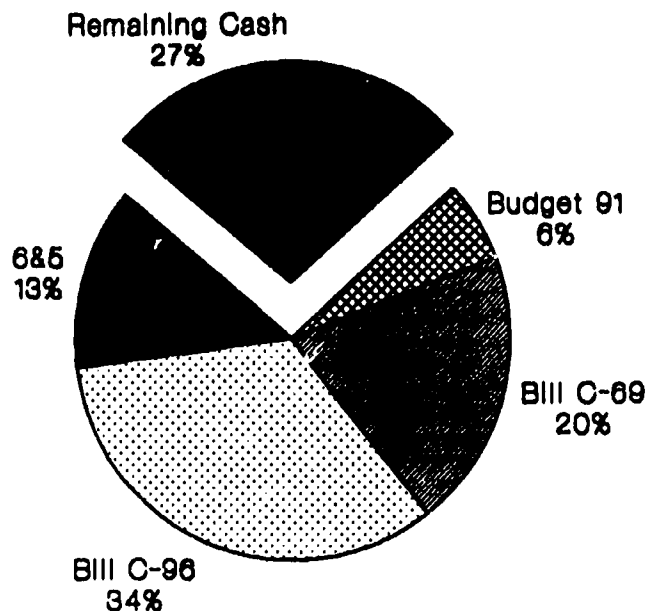
II. THE UNCERTAIN FUTURE OF FEDERAL SUPPORT

A. The Future of EPF Transfers

The burden of unilateral federal interference with the EPF escalator falls entirely on the cash portion of the transfers, as opposed to the tax point transfers (the tax room transferred to the provinces under the 1977 EPF agreement). The cumulative effect of these measures,

Figure 2

**PROJECTED EPF-PSE CASH 1994-95
AS A % OF CASH ENTITLEMENTS
WITHOUT 6&5, C-96, C-69 AND 1991 BUDGET**



Source: AUCC Research & Policy Analysis

beginning with 6 & 5, is an enormous shortfall in cash transfers for support of postsecondary education compared to what would otherwise have been the case (Figure 2).

Furthermore, because the value of the tax points has been growing faster than the value of the overall EPF transfer, and because the cash transfers are a residual amount after calculation of the value of the tax points, federal interference with the escalator is hastening the disappearance of the cash transfers. Thus, while the federal government's books continue to show that its contribution to PSE is increasing, its actual cash contribution is now decreasing. Indeed, as a result of the 1991 budget, EPF cash transfers to Quebec and Ontario for postsecondary education (EPF-PSE) will disappear likely in the mid-1990s and those to all other provinces will probably end by the year 2000 or shortly thereafter. Total EPF-PSE cash transfers, which totalled approximately \$2 billion in 1990-91, will drop to about \$1 billion by 1994-95 (see Appendix A) and to zero by the end of the decade.

It should be stressed that if current trends continue, Quebec and Ontario will not only cease to receive EPF-PSE cash in the near future but the value of their tax transfers will exceed the total amount to which they are entitled under the EPF legislation. As a result, the federal government cannot long delay reforming or replacing EPF, a fact acknowledged, if only implicitly, in the February 1991 Budget:

The federal government will consider reforms to the major transfer programs within the fiscal framework set out in this budget. We want to ensure that, in the future, the system of transfers:

- provides for the sharing of the opportunities and benefits of Confederation;
- makes a more efficient and competitive Canada; and
- embodies the principles and standards that are the basis of Canadian citizenship while respecting provincial flexibility.

All Canadians have a stake in these reforms, and we will be considering how best to seek their views.

Discussions on the updating and renewal of the Equalization program are already well under way, and will be carried forward as an integral part of this broader process.¹⁰

To date, the Finance Department has not said how it will seek the views of the public and, in fact, there have been indications that the department may not conduct a public consultation process on the future of transfers after all. The prosperity/learning consultations might offer an opportunity to explore the issue of transfers (see Subsection C below) -- but only if the most important decisions have not already been taken. As AUCC pointed out in a letter to the co-chairs of the Special Joint Committee on a Renewed Canada (Dobbie-Beaudoin):

Reform of transfer payments is a necessary corollary both to constitutional change and to reforms to enhance Canadian competitiveness and learning. It would be ironic and unfortunate if the federal government held extensive public consultations on constitutional reform and on prosperity and learning, and then left the reform of fiscal federalism to closed-door negotiations among federal and provincial finance officials.¹¹

Theoretically, at least, the options for consideration in a review of transfer payments range from minor reform of the existing arrangements to more radical changes such as ceding the current EPF tax transfers to the provinces and then shifting the remaining cash into alternative PSE-funding mechanisms; or at the opposite extreme, replacing remaining cash transfers with further transfers of equalized tax points. The latter option could conceivably be part of a broader reform that would roll the major existing transfers (EPF for both health care and PSE, the Canada Assistance Plan, and the Equalization Program) into a sort of "super-transfer program" that would likely be unconditional and would have no express purpose other than providing provinces, on some kind of equalized basis, with the revenue necessary to meet their constitutional obligations.

Some of these options will be discussed in more detail later in this report. However, it is important to stress at this point that regardless of which option is chosen, the federal

¹⁰Canada, Department of Finance, *The Budget*, Tabled by Hon. Michael Wilson, February 6, 1991, p. 19.

¹¹Letter of January 14, 1992 from AUCC President Claude Lajeunesse to Dorothy Dobbie and Senator Gérald Beaudoin, p. 2.

government will have to address the issue of equalization which, as the above quote from the 1991 Budget indicates, is closely linked to the future of EPF. Because the existing Equalization program was due to expire in 1992, federal and provincial governments have been discussing the matter for some time. At the end of January 1992, Finance Minister Don Mazankowski informed his provincial counterparts that the existing Equalization will be extended for another two years (to the end of fiscal 1993-94) with some changes to the formula to provide an extra \$600 million to the recipient provinces.¹²

B. Equalization

The principle of equalization has become a fundamental characteristic of the Canadian brand of federalism (distinguishing it, for example, from its American counterpart), so much so that it was entrenched in Section 36 of the Canadian Constitution in 1982.¹³ In practice, the equalization principle has been embodied in the Equalization program itself and in EPF. Indeed, the principle of equalization was one of the underlying rationales for the design of EPF.

The preceding shared-cost arrangements had not taken into account the varying fiscal capacities of provinces to support their PSE and health care institutions -- the federal government paid half of operating costs no matter how much they might vary per capita from province to province. EPF, on the other hand, specifically provided for equal per capita transfers to the provinces and took into account the provinces' varying fiscal capacity by applying the equalization formula employed in the Equalization program to the tax point portion of the EPF transfers. The EPF tax transfer thus has two components: (1) the transfer of the tax points

¹²*The Globe and Mail*, January 31, 1992.

¹³36. (1) Without altering the legislative authority of Parliament or of the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, Parliament and the legislatures, together with the government of Canada and provincial governments, are committed to

- (a) promoting equal opportunities for the well-being of Canadians;
- (b) furthering economic development to reduce disparity in opportunities; and
- (c) providing essential public services of reasonable quality to all Canadians.

(2) Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

themselves; and, (b) the equalization associated with those tax points. The actual payment of the latter is made through the Equalization program and not through EPF *per se*.¹⁴

Any attempt to dismantle EPF by permanently ceding the current tax transfers to the provinces and then shifting the remaining cash into alternative PSE-funding mechanisms could have significant redistributive consequences for provincial revenues -- and thus, for the provinces' relative capacities to fund PSE institutions. While the total transfer is equal per capita for all provinces, the cash and tax components of the transfer are not equal per capita because, as noted earlier, the cash transfer to each province is a residual amount after calculation of the value of the tax transfer -- and the latter varies significantly by province. Some provinces receive larger per capita cash transfers than others because the per capita value of their tax transfer is smaller than in those other provinces (even despite the fact that the tax transfers are partially equalized through the Equalization program.)¹⁵ The provinces currently receiving larger per capita cash transfers could lose out if the tax transfers are permanently ceded to the provinces and the cash is shifted into other arrangements.

This problem could be addressed by increasing equalization payments to guarantee all provinces the same per capita revenue from the tax transfers. Assuming that this increase in payments under the Equalization program would have to come from the EPF cash component, the amount of cash available for a new PSE funding mechanism in 1990-91, for example, would have been reduced from \$2 billion to \$1.6 billion (or \$1.9 billion if Quebec was willing to participate in the new arrangement and to relinquish the additional tax points which it has received in lieu of cash under EPF).

If, on the other hand, the federal government was to opt for replacing remaining cash transfers with transfers of further equalized tax points, perhaps as a new "super-transfer program", it would still face the equalization issue. For example, if the existing equalization formula was

¹⁴It is important to note the interaction between EPF and the Equalization program. To quote economist Thomas Courchene, *Equalization Payments: Past, Present and Future*, Ontario Economic Council, 1984: "the value of the (EPF) tax points enters the equalization program along with the balance of the personal and corporate tax points. Hence the value of equalization for 1981-82 incorporated the equalization associated with these tax points for the financing of established programs. In calculating how much the various provinces are owed for the established programs, the federal government takes equalization associated with established program financing into account before making any further payments to reach the guaranteed equal-per-capita level. One could, if one wished, separate out these tax points from equalization and include them in the financing figure for the established programs." In other words, counting both the full amount of equalization paid under that program and equalization portion of the EPF tax transfer is double-counting.

¹⁵The transfer of "equalized" tax points does not mean that all provinces receive the same per capita transfer. A province whose yield from these tax points is below the average tax yield in the five provinces making up the standard for the Equalization program receives the difference between its tax yield and the five province average. Since the difference is only up to this average tax yield, at least one province will, by definition, be above that average. For example, the per capita tax transfer for EPF-PSE for Ontario in 1990-91 was \$144.69. In the provinces who received equalization payments, the value of the equalized tax transfer was \$119.93 per capita.

employed, the result could be greater disparities in the provinces' fiscal capacity to fund their constitutional obligations, including PSE.¹⁶

C. The Constitution and the Division of Powers

In the months following the collapse of the Meech Lake Accord in June 1990, the federal government appointed the Spicer Citizens' Forum on Canada's Future and the Beaudoin-Edwards joint Commons-Senate committee on constitutional amendment procedures to sound out public opinion and devise options. Importantly, it also had committees of deputy ministers carry out an internal, wide-ranging review of federal activities and programs. All of these reports became grist for the Cabinet Committee on Canadian Unity and Constitutional Negotiations (chaired by Constitutional Affairs Minister Joe Clark), which was charged with drafting the federal constitutional proposals. A number of provincial governments also created committees to seek out public views on constitutional change.

Through late 1990 and into early 1991, many informed observers, including some highly placed federal officials, saw as a real possibility a wholesale devolution of federal powers to the provinces in response to pro-sovereignty sentiment in Quebec and decentralist pressures emanating from Western Canada.

Pro-sovereignty sentiment in Quebec found expression in the rise of the Bloc Québécois, in the many submissions to and public hearings of the Bélanger-Campeau Commission on the Political and Constitutional Future of Quebec, in the March 1991 report of that Commission and in the report of the Quebec Liberal Party's constitutional committee (the Allaire report). Views on what form sovereignty should take ranged from outright independence to a substantial devolution of jurisdiction to Quebec which some, but not all, supporters are prepared to call "renewed federalism." Importantly, the Allaire report, which was subsequently ratified by the Quebec Liberal Party's March 1990 policy convention, called for a major reduction (though not a complete elimination) of the number of areas of shared jurisdiction. It listed 22 areas, including education and research and development, in which Quebec should have exclusive jurisdiction.¹⁷

Decentralist pressures in the West have been expressed in the rise of the Reform Party and in a report from the four Western Finance Ministers which was endorsed by the Western Premiers' Conference in July 1990. The report argued that public spending is essentially out of control and accused the federal government of "offloading" its deficit onto the provinces through unilateral and arbitrary cuts in transfer payments while, at the same time, centralizing taxing

¹⁶Of course, as noted in the *AUCC Position on the Role of the Federal and Provincial Governments in relation to Higher Education and Research*, December 12, 1991, this option would also constitute a *de facto* withdrawal of federal support for higher education.

¹⁷Report of the Constitutional Committee of the Québec Liberal Party, *A Québec Free to Choose*, January 28, 1991.

powers through the creation of the GST. In response, it called for "disentanglement," which it defined as:

... a fundamental re-examination of federal and provincial spending responsibilities and revenue capacity. This would be aimed at reducing federal spending in areas of provincial responsibility with accompanying transfer of adequate fully equalized tax room.¹⁸

Despite these pressures, senior federal officials, including the Prime Minister, began giving out the message in February 1991 -- both publicly and privately -- that there would be no "fire sale" of federal powers. In part, this seeming shift in the government's approach likely reflected opinion polls indicating that outside Quebec, there is substantial public opposition to a wholesale devolution. As it prepared its constitutional proposals through the summer of 1991, the federal government had to balance these sentiments against the pressures from Quebec for a devolution of powers and a recognition of the province's uniqueness and the pressures from Western Canada for disentanglement and recognition of provincial equality (a concept which also enjoys considerable support in Atlantic Canada).

The preliminary proposals were made public in late September 1991.¹⁹ They were remarkable for several reasons:

- (a) *their sheer number*: the twenty-eight proposals tackle a much more ambitious list of subjects than did the Meech Lake Accord;
- (b) *the fact that none require unanimous provincial approval*: most would need the approval of seven provinces with fifty percent of the population, while some would not require a change to the written constitution at all. Consequently, some major issues such as the issue of provincial vetoes are absent from the proposals;
- (c) *their lack of precise legal language and their complexity*: this combination has generated many questions about the implications of many of the proposals and much debate about whether the proposals are relatively centralist or decentralist and, especially in Quebec, about whether they represent more or less than Meech.

Of the particular relevance to university education and research:

1. *economic union proposals* -- a revised Section 121 would prohibit federal or provincial laws, programs or practices that restrict mobility of persons, capital, goods and services within Canada; and a new section would empower Parliament, with the agreement of at least seven provinces representing fifty percent of the population, to make laws for the

¹⁸Report of the Western Finance Ministers to the Western Premiers' Conference, *Economic and Fiscal Developments and Federal-Provincial Fiscal Relations in Canada*, Lloydminster, Saskatchewan, July 26-27, 1990, p. 25.

¹⁹Government of Canada, *Shaping Canada's Future Together: Proposals*, 1991.

efficient functioning of the economic union, including the establishment of Canadian objectives, norms and standards (dissenting provinces could opt out for up to three years);

2. *labour market training* -- a constitutional amendment would explicitly designate labour market training a matter of exclusive provincial jurisdiction;
3. *recognizing and withdrawing from areas of provincial jurisdiction* -- the federal government proposes to recognize exclusive provincial jurisdiction in a number of areas and to withdraw from them. These are described as sectors which are more properly provincial but in which the federal government has become involved because of its responsibilities relative to, for example, international affairs, native people and research and development. Significantly, postsecondary education is not included in this list and this section indicates that the federal government remains "committed to ensuring the preservation of Canada's existing research and development capacity."
4. *the federal spending power* -- the federal government proposes to commit itself not to introduce new Canada-wide shared-cost and conditional transfer programs in areas of provincial jurisdiction without the agreement of at least seven provinces with fifty percent of the population. Dissenting provinces could opt out with reasonable compensation if they set up their own programs meeting the objectives of the new Canada-wide program.

The same conflicting pressures that confronted the Cabinet Committee as it drafted the preliminary federal proposals now face the Special Joint Committee of the House of Commons and Senate on a Renewed Canada to which the proposals were referred for public study. Based on submissions received, its public hearings and the results of five constitutional conferences in January-February 1992, the Committee is expected to submit its report in time for the federal government to release revised constitutional proposals in April 1992.

Beyond April, events are impossible to predict with any certainty. Quebec's Bill 150 requires a referendum in that province no later than October 1992, but the law could be amended to provide a delay. A Quebec referendum could be preceded by a general election in that province, referenda in some other provinces, a national referendum or even a federal general election. It also remains unclear when, or even if, the federal government will attempt to bring provincial and/or territorial governments to the negotiating table -- and how many of them would respond favourably to such an attempt, especially Quebec.

D. The Federal Government's Prosperity and Learning Initiatives

The May 1991 Speech from the Throne included a commitment to "invite Canadians to participate in fashioning a new agenda for prosperity" including an attempt to rejuvenate the government's 1989 education initiative which had been de-railed by the Meech Lake failure. The Throne Speech described the new "learning agenda" in these terms:

The time has come to reach a national consensus on performance, goals, partnerships and priorities for learning. As part of my government's new agenda for prosperity, a discussion paper on learning will be published to stimulate and focus discussion on education and training.

My government recognizes that education is a provincial responsibility under the constitution and respects that fact. My government also recognizes that Canadians are concerned about education, and would like to see Canada-wide goals established, with provincial endorsement and cooperation, for the year 2000. . . .

Students and parents, employers and employees, educators and governments will be asked to work together to develop a "learning culture," just as we have developed an environmental culture. . . .²⁰

Outside Quebec, provincial reaction to the Speech was generally low-key except to point out the contradiction in the federal government's placing such emphasis on the importance of education to Canada's future at the same as it reduces its own cash contributions in support of postsecondary education. This theme was articulated by the provincial and territorial Premiers and Government Leaders (Quebec did not attend) who met at Whistler, B.C. in late August:

Premiers welcomed the new-found federal interest in improving education and supporting efforts to develop evaluation and accountability mechanisms. Any federal involvement must be accompanied by adequate federal financial commitments and respect for provincial and territorial responsibility for education. In this regard, Premiers noted that federal cutbacks in education including Established Programs Financing, English as a Second Language (ESL), and reductions in support for native education, are inconsistent with the recent federal education initiative.²¹

The Quebec government's response to the Throne Speech placed much more emphasis on what it saw as the constitutional problem posed by the education initiative in the Speech. Immediately following the Speech, several Quebec Cabinet Ministers strongly denounced as unacceptable any federal intrusion into this area of exclusive provincial jurisdiction. And the Quebec Liberal caucus, including a number of Ministers, voted in favour of a Parti Québécois motion condemning what it characterized as the federal intention to interfere in education and training.²²

In August 1991, Lucienne Robillard, Quebec's minister responsible for higher education and science, wrote to the heads of the province's universities and colleges to spell out the government's position on the initiatives in the Throne Speech. The letter, which was made public, said that the government of Quebec is prepared to discuss with the federal government the competitiveness of business and also, more generally, to discuss ways of "restarting" the

²⁰*Speech from the Throne to Open The Third Session, Thirty-Fourth Parliament of Canada, May 13, 1991.*

²¹*Final Communiqué, 32nd Annual Premiers' Conference, Whistler, B.C., August 26-27, 1991, p. 8.*

²²*Le devoir (Montréal), May 30, 1991.*

economy within the framework of a prosperity strategy -- but on the understanding that educational objectives remain a matter of exclusive provincial jurisdiction. Given the exclusivity of provincial jurisdiction over all education, including postsecondary, the letter states that it is up to the provinces "to define common (or national) objectives in education"²³ and to decide whether to respond to educational needs identified by the federal government in the exercise of its jurisdiction.

In taking this position, the Quebec government was following a path well-worn by its predecessors, as explained by the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements in 1981:

Among French-speaking Canadians, higher education is seen as critical in nurturing and developing the French language and culture. This is true for all French language institutions but has found, and continues to find, its strongest expression in Quebec where a succession of provincial governments has maintained a constant vigil against the possibility of outside interference.²⁴

Consequently, Quebec's distinctiveness has been reflected in a number of ways in the design and operation of federal-provincial arrangements related to higher education. For example, under the EPF arrangements, Quebec received a special abatement of eight tax points. Thus, a larger portion of Quebec's EPF transfer is in the form of tax room than in the other provinces, and as a result, Quebec will be the first province to cease receiving EPF cash transfers. Finally, in another example of Quebec's distinctiveness, only that province has chosen to opt out of the Canada Student Loan Program.

In the case of the current federal government's learning initiative, Premier Robert Bourassa stressed to the National Assembly that he had a commitment from Prime Minister Brian Mulroney that provincial jurisdiction would be respected.

That being said, I do not see why Quebec, since we are all in this Chamber in favour of a shared economic space in Canada, I do not see why we would refuse even to discuss shared objectives.²⁵

The federal government released its prosperity and learning discussion documents and formally launched the formal consultation process in late October 1991. A national steering committee was named in December by which time the first of about 175 community-level

²³AUCC translation. Original quotation: "...il appartient aux provinces de définir des objectifs communs (ou nationaux) en éducation..." Ministère de l'Enseignement supérieur et de la Science, *Communiqué : La ministre Lucienne Robillard compte sur la solidarité québécoise en matière d'éducation*, 21 août 1991.

²⁴Breau Report, p. 77.

²⁵AUCC translation. The original quote: "Ceci étant dit, je ne vois pas en quoi le Québec, alors que nous sommes tous d'accord en cette Chambre pour un espace économique commun au Canada, je vois pas pourquoi on refuserait même de discuter des objectifs communs." *Le devoir* (Montréal), May 16, 1991.

consultations were already underway. The organization of formal consultations with national organizations took somewhat longer, with the first learning roundtable taking place in February 1992. Nevertheless, the steering committee is to submit its final report to the federal government in mid-1992.

The ultimate success of the prosperity and learning initiatives remains in question. In its learning agenda document, the federal government says it "wants to act as a catalyst in initiating a dialogue among all stakeholders on the challenges facing our learning system."²⁶ This role is similar to that proposed by AUCC in its submission prior to the 1991 federal budget: to work with stakeholders to "develop and articulate a shared vision of how to meet global challenges -- a shared vision toward which they can all work."²⁷ However, as AUCC pointed out in that pre-budget submission, it will be very difficult for the federal government to play an effective catalyst role as long as it is seen to be "pulling its money off the table."

The learning agenda document does little to change this perception. It does briefly review some of the options that have been proposed for changing the form of federal support for postsecondary education, including some of the options discussed later in this report. It notes the 1991 budget commitment to a review of federal-provincial transfers and also implies that dealing with funding issues might be unavoidable in the learning consultations. However, it stresses that "[f]rom a federal perspective, the most important task over the next year will be to engage in dialogue on priorities and goals, not specific program changes to federal support."²⁸ The problem with this perspective is that it appears to ignore the rapid rate at which EPF cash transfers are decreasing and the effect that this decline is having in a number of provinces.

III. AUCC'S POSITION ON FEDERAL SUPPORT

AUCC has long advocated federal participation in the support of university education and university-based research. This view was recently reiterated by the AUCC Board of Directors, with an essential caveat concerning Quebec's distinctiveness.

As noted above, AUCC's predecessor, the NCCU, played an important, and some would say decisive, role in convincing the St-Laurent government to initiate direct grants to universities and later acted as dispersing agency for the grants.

The NCCU's main arguments in favour of federal funding have been employed by AUCC ever since to support a continued federal role:

²⁶ *Learning Well...Living Well*, p. 26.

²⁷ AUCC, *Canada's Universities and the New Global Reality: AUCC Pre-budget Submission to the Minister of Finance*, December 1990, p. 15.

²⁸ *Learning Well...Living Well*, p. 25.

- (a) that the university education and research are of social and economic importance, not only to their provinces and local communities, but also to Canada as a whole;
- (b) that given the mobility of students and graduates, the costs and benefits of university education are not evenly shared among the provinces; and,
- (c) that there is a need to strive for equality of educational opportunity across Canada.²⁹

AUCC has also argued that university education and research have a vital international dimension which justifies and even necessitates a federal role.

These same arguments led AUCC to express major reservations about the EPF arrangements at the time of their creation and ever since. For example, in a January 1981 brief to Prime Minister Trudeau, the Association observed that:

. . . the current EPF arrangements do not necessarily ensure that country-wide interests in higher education are served because the provinces are free to reduce their share of university support regardless of the potential impact on the overall needs of the country.³⁰

While AUCC viewed as positive the equalization aspect of EPF and the indexing of growth in the transfers to growth in the economy and in population, it criticized the lack of any guarantee that provincial governments would increase operating funding to the universities accordingly. Furthermore, because there was no assurance that provinces would use the transfers for purposes intended by the federal government and because EPF-PSE transfers involved very large expenditures with little federal visibility and no real federal policy role, AUCC recognized that it was only a matter of time until the federal government began trying to reduce its contribution.

Such a reduction could in turn have a negative impact on universities because, while growth in EPF transfers did not necessarily guarantee corresponding growth in provincial operating grants, cutbacks in the transfers could provide provinces with both a ~~fiscal~~ incentive and a political excuse to tighten university operating grants. At the very least, it could have the effect of thrusting universities more directly into competition with other PSE institutions, school boards, health care providers and municipalities for a slice of provincial budgets.

²⁹NCCU, *The Financial Problems of Canadian Universities*, A Statement Presented to Prime Minister Louis St-Laurent, March 4, 1949; and NCCU, *Statement Submitted to the Royal Commission on National Development in Arts, Letters and Sciences*, July 11, 1949.

³⁰AUCC Brief to the Prime Minister, January 1981, reproduced in Alan Earp, "The Association of Universities and Colleges of Canada and Established Programmes Financing", in David M. Nowlan and Richard Bellaire, eds., *Financing Canadian Universities: For Whom and by Whom?* Toronto: Institute for Policy Analysis, University of Toronto and Canadian Association of University Teachers, 1981, p. 181.

When the federal government did in fact begin reducing its commitment to EPF, AUCC and its member institutions were put in the awkward situation of defending against further cuts a program about which the Association had significant reservations. In 1988, the AUCC Board ratified a Statement on Funding which stressed that:

[B]oth levels of government have shared responsibilities in ensuring that universities have adequate resources of an unrestricted nature to fund their main activities in teaching and research. This core unrestricted support by the federal and provincial governments for universities must be harmonized.

Federal transfers to the provinces provide an important underpinning to the support of universities. It is essential that, under the present Established Programs Financing Arrangements, funds transferred to the provinces for postsecondary education in fact be spent in that sector and that, in addition to the monies received from the federal government under the EPF Arrangements and any successor agreements, the provinces should make increased use of their own resources to ensure an overall level of university funding compatible with the development of a dynamic and competitive university system in Canada.³¹

In light of Canada's constitutional crisis and the impending demise of EPF cash transfers, the AUCC Board again addressed the issue of the federal and provincial roles in relation to higher education and research in December 1991. It adopted a position with two elements:

that the federal government continue to play, jointly with the provinces, a role vis-à-vis the support of university research;

that the federal government continue to play, jointly with the provinces, a role vis-à-vis the support of higher education (and more specifically, a role that goes beyond a simple transfer of tax room), subject to the understanding that this does not bind Quebec universities and that the federal and Quebec governments need to negotiate appropriate arrangements in this regard.³²

This position is based on two principles. The first -- that "[h]igher education and research are intrinsically linked to the economy and the prosperity of a country and to the social and economic well-being of its citizens" -- has, in combination with the constitutional jurisdiction of the provinces in education, led to both orders of government contributing substantially to the support and development of higher education and research.³³ The second -- that "Quebec constitutes a distinct society within Canada" -- has, as noted earlier in this report, been reflected in a variety of ways in federal-provincial arrangements relating to postsecondary education.

³¹AUCC, *Statement on Funding*, March 3, 1988.

³²AUCC *Position on the Role of the Federal and Provincial Governments in relation to Higher Education and Research*, December 12, 1991.

³³This same principle has led central governments in virtually all developed federations to develop and maintain an interest in postsecondary education and/or university-based research. This was a recurring theme of presentations and discussions during the International Colloquium on Higher Education in Federal Systems, held at Queen's University in Kingston, Ontario, May 8-10, 1991.

Given this position statement and the political and economic environment -- especially the rapid decline in EPF cash transfers -- described in Section II above, it is very important that AUCC come to grips with the increasingly urgent question, "from the point of view of the universities, what would constitute a satisfactory reform of or replacement for EPF?"

IV. THE RANGE OF OPTIONS FOR FEDERAL SUPPORT

Any of the following would amount to a *de facto* withdrawal of the federal government from its long standing commitment to funding core university (and other PSE) activities:

- (a) simply allowing the cash transfers to disappear as a result of the freezes and partial de-indexation imposed by recent federal budgets;
- (b) lumping the remaining EPF cash with other federal transfers in a consolidated transfer scheme with no specified purposes other than support and equalization of provincial revenues; or,
- (c) replacing the remaining cash transfers with an increased transfer of equalized tax points.

While either (b) or (c) might improve the revenue situation in some provinces (or at least leave it unchanged) and so might lead to improved core funding to universities (or at least have little effect on it), such results are far from guaranteed.

If, on the other hand, the federal government is to continue its large-scale investment in Canada's universities, there are theoretically several options open to it. In considering this range of options, the Standing Advisory Committee on Funding assumes:

- (a) that, pursuant to the *AUCC Position on the Role of the Federal and Provincial Governments in relation to Higher Education and Research*, the federal and Quebec governments need to negotiate arrangements appropriate to Quebec's distinctiveness within Canada;
- (b) that for any proposed arrangements to be considered seriously by the federal government, they would have:
 - to contribute in a meaningful way to the quality of university education and research and to Canadians' economic well-being and competitiveness;
 - to provide greater visibility for federal contributions and increased accountability (at least in the sense that federal funds are demonstrably expended on PSE and/or research) than has been the case under EPF; and,

- to avoid locking the federal government into open-ended and uncontrolled financing;³⁴
- (c) that education will remain a matter of provincial jurisdiction and, therefore, that if new arrangements are to result in any net improvement in the universities' financial situation, they would require provincial cooperation and agreement not to offset federal support with corresponding reductions in core funding; and,
- (d) that, as discussed in Section II.B. above, dismantling EPF or replacing it with new arrangements would have serious interprovincial redistributive consequences that would need to be addressed.

1. Restoration of the original EPF formula

Restoring the original EPF formula would have the merit of re-establishing the link between growth in the transfers and growth in the economy and maintaining the equalization function of EPF.

The recent report of the Commission of Inquiry on Canadian University Education recommended that "the Federal government continue (and restore) its contributions in the field of established program financing (EPF)." However, the text of the chapter on funding attaches one major caveat to this recommendation: "restoration" of EPF contributions should take place "if and when" new federal funds are available.³⁵ The sums involved would be large. Restoring the 1982 formula could, for example, result in \$4 billion in EPF-PSE cash transfers in 1994-95 rather than the \$1 billion currently projected.

Furthermore, simply restoring the original EPF formula would not deal with the visibility or accountability problems which have contributed to the successive federal cutbacks to EPF. Nor would it address the present federal government's concern regarding the open-ended nature of the financing. There is much reluctance within the federal government at this time to defend the original EPF arrangement -- or indeed, the altered arrangement after 1982 -- as an option for the 1990s.

Consequently, simple restoration of the original EPF formula does not appear likely at this time.

³⁴Even in the absence of formula-driven financing, greater visibility can in some circumstances provide a certain stability to funding levels because arbitrary cuts become politically more difficult. Thus, for example, in the United States, federal student aid largely escaped the general budget-cutting of the early Reagan years because it was perceived as too risky politically.

³⁵Commission of Inquiry on Canadian University Education (Stuart Smith, Commissioner), *Report*, Ottawa: AUCC, 1991, pp. 26-27.

2. Reform of EPF

As noted earlier, AUCC has long called for reform of EPF, and in the view of the Committee, a reformed EPF or similar program remains worthy of serious consideration. Ideally, this arrangement would:

- (a) recognize the need to support the provincial governments in the exercise of their responsibility for core funding of postsecondary institutions;
- (b) recognize the equalization role of the federal government;
- (c) employ a formula explicitly recognizing the link between economic growth and an educated population and dealing with the "disappearing cash" problem;
- (d) provide for greater visibility for the federal contribution in order to provide an incentive for continued federal involvement; and,
- (e) clearly differentiate federal funds intended for support of postsecondary education from those intended for support of health care, and provide some real assurance that funds transferred for support of postsecondary education are in fact spent in that sector.

Again, we stress that, consistent with the *AUCC Position on the Role of the Federal and Provincial Governments in relation to Higher Education and Research*, the federal and Quebec governments need to negotiate arrangements appropriate to the distinctiveness of Quebec society within Canada.

Designing a program that would meet the above criteria and still be acceptable to both federal and provincial governments would admittedly be a tall order. The attachment of rigid conditions or cost-sharing requirements to the federal transfers would undoubtedly provoke a major federal-provincial confrontation and so does not appear to be a realistic alternative.

In principle at least, it should be possible to design a program perhaps involving some form of cost-sharing which employs incentives, rather than conditions, and still respects provincial jurisdiction. For example, the Johnson Report, prepared for the Department of the Secretary of State in 1985, proposed one such scheme. It recommended that the federal government "stand ready to increase the federal fiscal transfers for PSE at the same rate as the GNP and population rise," while creating for the provinces "an incentive -- but no obligation --

to increase their grants to universities and colleges at the GNP rate of increase provided for in the EPF-PSE Act."³⁶

However, with regard to the political feasibility of such an option at this time, it is instructive that the Johnson Report was, for all intents and purposes, ignored by the federal government, and the government has shown no interest in such proposals since that time.

3. Replacement of EPF with a new arrangement

The Committee first considered the option of replacing EPF with direct federal operating grants to the universities, and concluded that it is not feasible at this time. It would involve turning the clock back 25 years. Such a policy would represent a major departure from existing practice and would likely require either a transfer to the federal government of primary or exclusive jurisdiction for postsecondary education or a greatly extended use of the federal spending power, neither of which is likely in the current constitutional climate.

The Committee then considered two areas where the federal government already plays an important role -- support for university-based research and aid to students. While the latter does rest primarily on the spending power, this use of the power has provoked little opposition (though, as noted earlier, Quebec has opted out of the Canada Student Loans Program).

The Committee concluded that, given:

- the federal government's responsibilities in relation both to economic development and competitiveness and to equalization of opportunity and services; and,
- its long standing and relatively uncontroversial involvement in research support and student aid,

the most promising avenues for continued federal investment, should reform of EPF not prove feasible, would involve direct-to-student funding (including the possibility of requiring income

³⁶Johnson described the "incentive" in these terms:

"An indication [should be given] to the provinces that provision would be made in the PSE legislation for the eventuality that some provinces, in some years, may not wish to adopt this GNP escalator. This provision would require the Government of Canada to adopt, and to follow, for the purposes of its PSE fiscal transfers to individual provinces, such *lower* rates of increase as any province may employ for increasing its grant to universities and colleges. Briefly put, the federal government would respect and would follow the priority which each province established for post-secondary education, up to the maximum now provided for in the PSE legislation (the rate of increase in GNP and population)." A. W. Johnson, *Giving Greater Point and Purpose to the Federal Financing of Post-Secondary Education and Research in Canada*, February 15, 1985, pp. 25-26.

contingent repayment of some portion thereof),³⁷ increased research support (including support for research overheads as well as direct costs), or a blend of these two broad options.

Appendix B provides a summary overview of several options for direct-to-student funding (vouchers, contingent repayment loans, scholarships and bursaries, and a combination plan) and for increased research funding as alternatives to EPF. These options were reviewed in more detail in the Committee's preliminary report to the Board in June 1991, which was subsequently distributed as a discussion document to AUCC members and other interested groups.

Based on the arguments in that document and on comments received in response to it, the Committee concludes that the following options (individually or in combination) merit further consideration and development by AUCC and other interested stakeholders:

- (a) a direct-to-student funding plan providing all university students with a tuition bursary which would be at least partly re-payable on a post-graduation income contingent basis (the "combination plan" on page 4 of Appendix B), and,
- (b) increased research support, with two variants worthy of further study: payment of the indirect costs of council funded research at the same time as doubling the research support budgets of the granting councils; or payment of research overheads on federally funded, peer adjudicated research and the payment of an equal per faculty grant to all institutions to cover the cost of non-sponsored research.

In the case of the direct-to-student option, it would be necessary for the federal and Quebec governments to negotiate arrangements appropriate to Quebec's distinctiveness.

It should be stressed as well that both of these possible replacements for EPF could lead to increased targeting or earmarking of funds. This could threaten university autonomy if that funding came at the expense of unrestricted core funding or if it imposed new demands on the universities' core budgets. In this regard, it is worth noting that, in general, the world's most successful universities (those most renowned for their contributions to new concepts in science and technology and to the advancement of understanding and debate about ideas in most fields of human endeavour) are those operating with a high degree of freedom and autonomy.

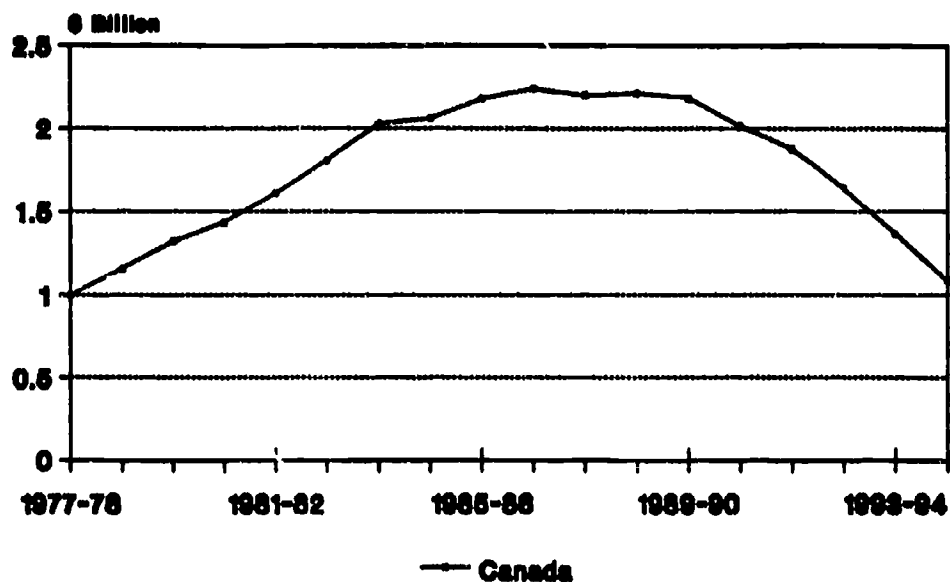
³⁷ A report on the Canada Student Loans Program, prepared for the Department of the Secretary of State, recommends that student loans and loan interest be made repayable on an income contingent basis, subject to remission after 10 to 20 years for those unable to repay the full amount. *Bonnecon Limited, Assessing Need in the Canada Student Loans Program*, March 1991. p. 132. In addition, the *Report of the Commission of Inquiry on Canadian University Education* recommends that tuition be allowed to increase on condition that "the Federal government institute an Income-Contingent Repayment Student Assistance Plan, whereby student loans would be widely available and would be paid back as a surtax on the federal income tax once the recipient's income rose above a certain level" -- pp. 27, 96.

Finally, further consideration of these options should include attention to the design of transitional arrangements and to potentially negative impacts on those provinces in a relatively weak fiscal position. And it should address any potential impact on the quality of undergraduate and graduate education, on accessibility, on the quality of research, on interprovincial mobility, on university autonomy, and on the allocation of resources within and among universities.

APPENDIX A.

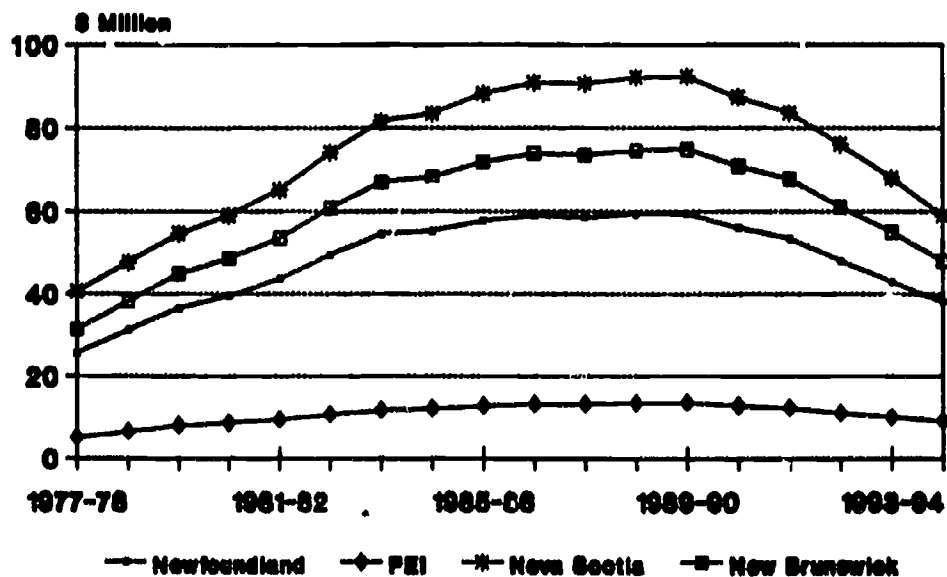
DISAPPEARING EPF CASH

Established Programs Financing PSE Cash Entitlements



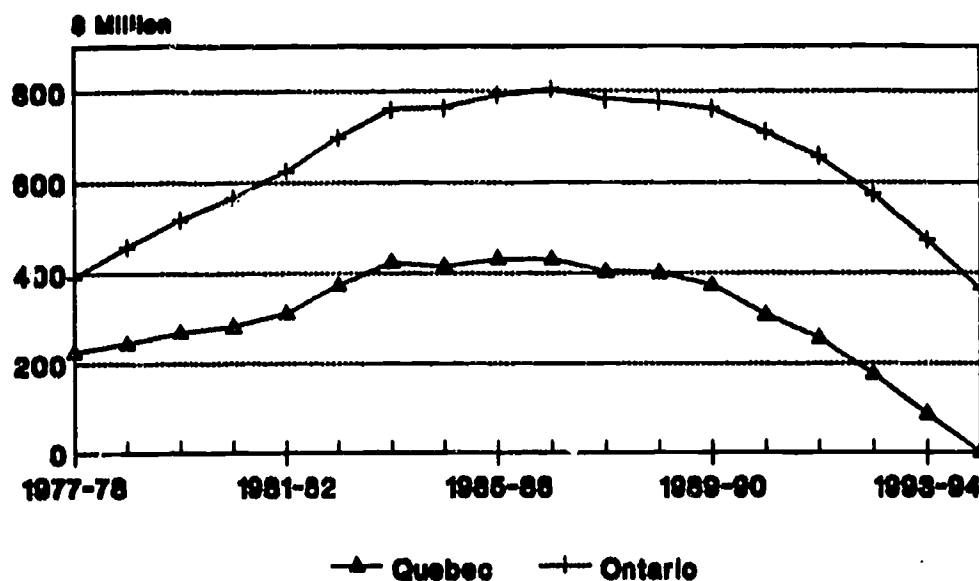
Source: EPF Calculations and Projections
Department of Finance, April 1991

Established Programs Financing PSE Cash Entitlements



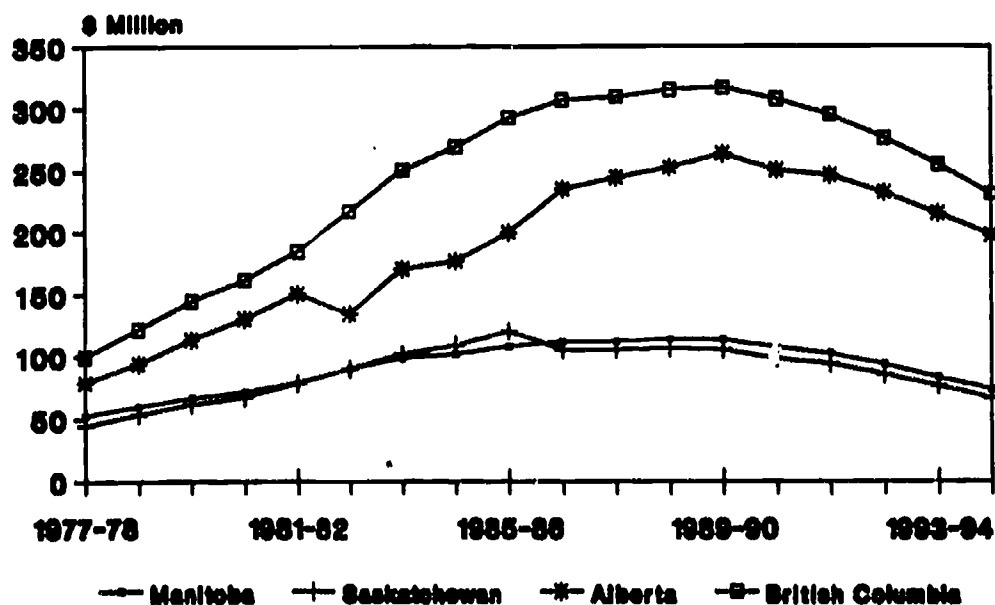
Source: EPF Calculations and Projections
Department of Finance, April 1991

Established Programs Financing PSE Cash Entitlements



1994-95 Quebec tax entitlement exceeds
the total transfer by \$12 million.
Source: Dept. of Finance, April 1991

Established Programs Financing PSE Cash Entitlements



Source: EPF Calculations and Projections
Department of Finance, April 1991

APPENDIX B. SELECTED OPTIONS FOR FEDERAL FUNDING OF UNIVERSITY EDUCATION AND RESEARCH

Appendix B consists of an overview of various options for federal support of university education and university-based research. It is a summary of Parts II and III of an earlier document¹ prepared by the Standing Advisory Committee on Funding for presentation to the AUCC Board as a preliminary report in June 1991 and for distribution to AUCC members and other interested organizations and individuals as a discussion document in July 1991.

A. DIRECT-TO-STUDENT FUNDING MECHANISMS

This section deals with vouchers, contingent repayment loans, scholarship/bursary programs, and a proposed combination plan involving aspects of all of these mechanisms. The Committee's discussion document also briefly examined three other direct-to-student funding mechanisms: (a) "entitlements" (a sum of money for educational purposes or a guaranteed period of postsecondary education upon which individuals could draw in early adulthood or at later points in life); (b) tax credits/deductions/exemptions; and, (c) registered educational savings plans.

Direct-to-student funding mechanisms are often advocated to enhance accessibility and, by injecting some market forces, to foster diversity, choice, efficiency and quality. If the intent is also to increase universities' revenues, tuition fees would have to increase and provinces would have to agree not to reduce core grants by a corresponding amount. If the 1990-91 EPF-PSE cash component (about \$2 billion) was replaced with direct-to-student funding, fees would have to increase, on average, by about 200% or \$3,100 per FTE over 1990-91 levels. Such a scheme would not involve net increases in student contributions, but without a prior effort to inform the public of this fact, tuition increases of this magnitude could meet substantial resistance.

Vouchers Educational vouchers are certificates issued by a government agency to parents or students, who pay part or all of the tuition fees with the vouchers. The educational institution then returns the vouchers to the public treasury in exchange for cash.

Vouchers have generated considerable interest and controversy in the United States and United Kingdom, but only one real experiment (Alum Rock, California). In these countries, vouchers have been proposed for elementary/secondary education primarily to introduce or restore market forces to the educational system and to increase choice, quality and efficiency.

In Canada, various commissions, task forces, and individual authors have commented on or proposed vouchers primarily as a method for the federal government to contribute to postsecondary education. In fact, vouchers do seem more applicable at the postsecondary level

¹ *An Overview of Selected Options for Funding University Education and Research: A Discussion Document Prepared by the Standing Advisory Committee on Funding of the Association of Universities and Colleges of Canada, July 1991. Part II of this document, on direct-to-student funding mechanisms, was prepared by Dr. David Stager of the Department of Economics at the University of Toronto. Part III, on options for increased funding of university-based research, was prepared by the AUCC Secretariat.*

where there is more institutional and program diversity and where, therefore, centralized decisions are more apt to result in inequity and/or inefficiency. However, restrictions might be placed on the vouchers that could have an even stronger steering effect than the existing direct government grants. As well, vouchers could have a bias or influence if, for example, the value of the voucher exceeded the increase in tuition fees such that student enrolment was increased or redistributed between programs.

A voucher scheme for university students would need to address a number of operational issues, including:

- how to determine the base value of the vouchers;
- how to determine eligibility requirements for students;
- whether to have standard or differentiated values for vouchers;
- whether to require means tests;
- whether provinces would retain any control over tuition fees;
- whether the federal government would use other regulations or incentives;
- what type of detailed administrative arrangements to establish;
- how to integrate the voucher scheme with existing student loan plans;
- how to include part-time students in the scheme, if at all;
- how to determine institutional and program eligibility; and,
- how to assure flexibility within the voucher scheme itself.

Proponents argue that vouchers would enhance efficiency (allocative efficiency in the economy as opposed to internal institutional efficiency), diversity of programs and institutions, choice and accessibility for students, quality, and both institutional adaptability and institutional stability. For these benefits to be realized, students would need high quality information on educational and career options and on labour market conditions; and there would have to be a mechanism to ensure that only satisfactory institutions could accept and redeem vouchers. Finally, it would be necessary to determine how to adjust the total allocation for vouchers in future -- whether by changes in prices, population, or enrolment, or whether it would be capped as in the case of EPF.

Contingent Repayment Loans

This option would involve a government-sponsored agency making loans to students for the direct costs of their education. On completion of the program, the graduate would pay some fraction of his/her annual earnings until the loan was repaid or the remaining balance was forgiven. Such programs have attracted considerable interest in Canada, the U.S., the U.K. and New Zealand, and variants have recently been introduced in Australia and Sweden.

The contingent repayment loan option should not be confused with a "graduate tax" -- a surtax on postsecondary graduates without any link to a specific loan or imputed fee -- which would be intended to increase the state's general revenue by increasing the contribution from persons who had earlier received subsidies through state support of educational institutions.

A contingent repayment loan program might include the following general features:

- any student could receive a loan equal to part or all of the educational costs;
- the loan would state repayment conditions, including the percentage of annual taxable income to be paid, the maximum number of years for which payments would be required, and the interest rate;
- an individual who, because of low or irregular income, had not repaid the principal plus interest by the end of the repayment period (say 25 or 30 years) would not be required to make further payments;
- persons who left the country would continue to make payments under provisions of international tax treaties;
- graduates would not be required to make payments until their incomes reached a certain level;
- the program would be administered by a public agency that would raise funds initially by issuing its own government-guaranteed bonds; later it would lend the repayments received from graduates;
- the above features could be varied to make the program self-financing, or to include any degree of subsidy.

It would be necessary to determine the ceiling on the amount borrowed (and eligibility conditions); the percentage of a graduate's annual income to be paid; the interest rate; the length of the repayment period; and conditions by which repayment could be accelerated.

Proponents point to a number of benefits, including possible elimination of financial barriers to university education and avoidance of the regressive redistributive effects of low tuition fees. Any risk in this method of borrowing would be borne by the graduates collectively, and ultimately by the general public, rather than by the individual -- but only to the extent that the individual graduate does benefit significantly (in a financial sense) from his/her education.

The program would not require means tests and would free the student from financial dependence on his or her family. A given generation would finance its own university education rather than relying on the political willingness or taxability of the preceding generation, and rather than having to be taxed to finance the following generation.

Some fear that students would hesitate to take on a repayment "burden" lasting for twenty or thirty years. But a contingent repayment plan is not a fixed-debt plan with required fixed payments at fixed intervals. Rather, it allows for low or irregular payments in response to low or irregular incomes, and provision can be made for individuals who earn high incomes to discharge their liability at an earlier date.

Scholarships and Bursaries A national program for university scholarships or bursaries has been proposed, and even promised, for over fifty years, especially from the late 1930s to the late 1960s. In 1989, the federal government introduced the Canada Scholarships for science and engineering students, with at least half awarded to women.

Merit-based scholarships may provide a strong political signal of moral support for university education, especially for designated fields or groups. However, they have limited

value either for steering purposes (because they reward the academic performance of students who would likely have enrolled anyway) or as a way of channeling federal funds through students to universities (because they are only awarded to a small fraction of the student population).

If scholarships were part of a universal direct-to-student funding mechanism, the vast majority of students would need to be awarded bursaries, requiring criteria and documents for determining merit, and officers for processing the documents. Political and administrative problems would arise at the eligibility "break-point" between scholarships and bursaries. The more appropriate mechanism would be a universal bursary program, distinct from special scholarship programs intended for academic and political purposes. But such a scheme would be identical in concept to voucher schemes and would raise the same set of issues.

Experiences with large-scale bursary-like programs in Europe and the U.S. provide two lessons: (1) the major problem in the European case has been that with low-or-zero tuition fees and limited state support, the universities have had to restrict enrolment, with the result that a grants scheme intended to increase accessibility has instead resulted in a lower participation rate; and, (2) the advantage of the American program, from the universities' perspective, is that it has been politically difficult to reduce federal funding for a program that is based on students and their families, rather than on institutions.

A Combination Plan

A program could be developed to overcome most of the disadvantages noted in previous sections by combining the universality of the voucher scheme with the financial assistance implied in the bursary scheme and the income contingent repayment of the contingent loan scheme. The federal government would issue a bursary certificate (without a means test) to each student offered admission to an accredited university program. Students would present the certificates at registration as partial payment for tuition fees, and universities would submit the certificates for federal reimbursement.

Students would be required to repay part or all of the bursary monies. Interest might be charged at the government's borrowing rate, or as in Australia, the debt could be adjusted for annual inflation in lieu of interest. Repayments, calculated as a percentage of the graduate's taxable income above a certain threshold, would be collected annually by Revenue Canada.

As to financing, if the equivalent of EPF cash transfers, say \$2 billion, was committed to the contingent repayment program for a period of ten years, this would create a revolving fund. Repayments, which would commence even in the second year of the program, would gradually replenish a major portion of the fund. Assuming the Canada Student Loans Program would be integrated with the new program, the money currently expended on the former could provide another source of funding.

B. INCREASED RESEARCH FUNDING AS AN ALTERNATIVE TO EPF

This section reviews the current research funding situation and examines the possibility of redirecting EPF cash transfers to university research support (direct and indirect costs) through the three federal granting councils. It should be stressed that nothing in this section should be read to imply that the Funding Committee is in any way proposing a shift away from peer adjudication in the approval process for research projects sponsored by the granting councils.

The Current Situation Although the federal government's share of total support for university research has been declining since the mid-1980s, it remains the principal source of sponsored research in the country's universities. About 70% of its support is channelled through the three granting councils. Some 40% of council support is concentrated in five institutions; and within each region, support is similarly concentrated in a handful of doctoral degree-granting institutions. A redirection of federal support toward university research could have redistributive effects in favour of research intensive institutions. Even within the group of research intensive institutions, those with a large human science component could "gain" less than strong natural sciences institutions.

Since the Lortie Report (1987), the academic community has continually advocated a doubling of granting council budgets and a recent Commons Committee report has concurred. Part III of the Committee's discussion document poses questions about the capacity of the research infrastructure to sustain such a dramatic increase in the short run, but substantial increases are clearly needed.

Part III also raises the issue of the distribution of resources among the three granting councils.

The Indirect Costs Issue: Options The granting councils cover only the direct costs of the research they support, while the indirect or overhead costs are paid by universities in the course of fulfilling their educational and research functions. A decade of financial restraint has resulted in erosion of the research infrastructure of universities, and various reports have deplored the lack of overhead on research grants received from the granting councils. Quebec is the only province to pay for overheads on research grants which have been obtained as a result of peer review. In addition, some provinces, such as Quebec and British Columbia, provide overhead funds to centres of excellence in their provinces.

The erosion of the research infrastructure has had detrimental effects on both sponsored and non-sponsored research in universities, and is an impediment to a significant increase in direct research support through the councils. As long as EPF was a viable program, it was possible to argue that overheads on council research awards were included in the EPF transfers. This argument loses much of its saliency as the EPF cash transfers rapidly erode.

Part III of the Committee's discussion document examines two options for dealing the indirect costs issue. One option would be to pay the indirect costs of council

research at the same time as doubling the research support budgets of the granting councils. Assuming that the budgets of the granting councils would have grown by 5% annually between 1992 and 1996, the additional cost of this option would have been in the order of \$1.5 billion per year on average. An increase of this magnitude could lead to a further concentration of research in a small number of institutions and could affect the balance between research and teaching within institutions.

The second option would involve both the payment of research overheads on federally funded, peer adjudicated research and the payment of an equal per faculty grant to all institutions to cover the cost of non-sponsored research. It would be designed both to offset the disincentive associated with the absence of overhead on research grants and to acknowledge that a significant amount of research and scholarship activity in universities is conducted without direct external financial support. Part III provides three simulations of this option, employing 1988-89 data, with each simulation assuming a different per faculty grant. In each scenario, federal research funding would have increased by about \$1.1 billion. This option would also have varying implications by type of institution, though the pattern would be different from that in the first option.

For both options, there is an important question as to whether payments for overhead costs would be added to the amount of each research grant or directed to the institutions as block grants. If the former, universities could lose considerable flexibility in the use of the funds.

Part III concludes that whatever mechanism is adopted, some form of partnership among stakeholders and improved policy coordination between the provinces and the federal granting councils is required. The objective of revitalizing research infrastructure would be undermined, for example, if provincial governments decided to reduce their core support by an amount equal to granting council support of the indirect costs of research.