

**ROUNDTABLE ON EQUALIZATION AND
TERRITORIAL FORMULA FINANCING**

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Summary report prepared by

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The Calgary Roundtable on Equalization and Territorial Formula Financing brought together approximately 40 participants for a wide-ranging and indeed freewheeling discussion of the equalization program (there was no significant discussion of Territorial formula financing). Although an attempt was made to follow a detailed agenda, the conversation for the most part moved freely across the various issues under discussion.

The focus of the Calgary roundtable was on participant feedback rather than on participant education. As a consequence, there were no expert presentations other than the opening comments by Al O'Brien, Chair of the Expert Panel. It should be noted, however, that roundtable participants were very well served by the quality and clarity of the March 31 background report.

The roundtable did not drive for consensus, and thus some caution must be exercised in applying the conclusions that follow to the entire group of participants; no votes were called and opposing points of view may not always have been expressed. It should also be noted that the opinions that were expressed were, in many cases, just that – opinions. Nonetheless, the following points strike me as particularly germane for the Expert Panel as it pursues its work:

- Discussions of equalization often fail to take into account the unique constitutional status of the equalization program. The country's constitutional commitment to equalization must be kept constantly in mind.
- At the same time, however, it is impossible to tell if our constitutional objectives and/or obligations are being met. In this respect, there has been a growing effort to measure the effectiveness of public programs, to determine if their objectives are being met. However, in the case of equalization, it is very difficult to determine if objectives have been met.

Indeed, the Government of Canada is committed to a progressive increase in program spending regardless of program success, whatever that might entail. Equalization is therefore best seen as an entitlement program that exists independently of any measurable objectives, goals or benchmarks.

- The equalization program helps sustain a relatively decentralized federal system. Were it not for equalization, “have not” provinces would be much more inclined to push for greater program spending by the federal government as the only tool to ensure some measure of equality across the country, and some means by which financial disparities might be addressed. As a consequence, “have” provinces have a stake in the equalization program as it provides a check on greater centralization. Equalization helps protect provincial autonomy.
- There is a strong tendency to roll the growing national debate on the *vertical fiscal imbalance* into discussions of equalization. Given that equalization addresses horizontal fiscal imbalances in the Canadian federal state, this tendency to collapse the two discussions into one should be resisted. However, some conflation in the public debate may be unavoidable.
- Equalization derives much of its legitimacy from being a rules-based transfer program. Although most Canadians are not aware of the rules per se (and are certainly not aware of their technical manifestations), there is a perception of a rules-based approach. However, what was described as “Ottawa’s ad hocery” has shaken this perception; equalization is increasingly seen as the result of bilateral bargains struck in the heat of election campaigns and minority governments. The principled foundations of equalization have been seriously eroded. Indeed, some participants went as far as arguing that equalization may not survive if it becomes too ad hoc, too much the result of lobbying rather than the rules-based application of basic principles.
- Some concern was expressed that the federal government’s decision to increase the amount of equalization funding regardless of what the equalization formula would predict will further erode the credibility of the system. In effect, funding levels have been divorced from any empirical measures of fiscal disparity. It was suggested, therefore, that the formula should be used to set the amount of money that is needed for equalization, and then the federal government should pay whatever portion it can afford at the time.
- Much of the opaque nature of the equalization formula stems from the complexities in trying to address natural resource revenues. If there is a pressing need for the Expert Panel, it is the need to come to grips with resource revenues, and to simplify how they are addressed within the

formula. Here, however, the recent bilateral deals with Newfoundland, Nova Scotia and Saskatchewan in effect tie the hands of the Panel. As a consequence, the very heart of the equalization problem – how to handle significant regional variations in natural resource wealth – will be very difficult to address.

- Some concern was expressed about equalization-maximizing provincial strategies, and their potential adverse (perverse?) impact on regional economic development and prosperity. Although there was far from universal agreement that such strategies are in fact pursued, participants did argue that a simplified formula, perhaps one that used macro-indicators, might reduce the use of such strategies.
- The treatment of non-renewable natural resource revenues has been a constant source of strain and difficulty for equalization. Perhaps, then, such revenues could be taken out of the formula altogether, and instead the formula could measure second-order effects (e.g., personal and corporate income). The argument was made, although not universally endorsed, that royalties simply convert physical assets owned by the provinces into financial assets, and thus the sale of assets should be handled differently than other revenue sources.
- The treatment of resource revenues within the formula has already been greatly complicated by the side deals with Newfoundland, Nova Scotia and Saskatchewan, and by Alberta's exclusion from the calculation of the national average. Given these exceptions and therefore constraints on the Expert Panel, maybe the time has come to exorcise natural resource revenues from the formula, although the political/public perception problems of so doing should not be underestimated. The roundtable agreed that this will be an exceptionally difficult nut for the Expert Panel to crack, but nonetheless an essential nut to tackle.
- Alberta is the elephant in the room when it comes to national discussions of equalization. However, it is by no means clear that Alberta's fiscal challenge to the federation can or should be addressed within or through the equalization program. This may be asking more than the program can deliver. At the same time, the public may expect that Alberta's relative good fortune will be addressed by the Expert Panel.
- Although there was no clear consensus and not a lot of discussion, the roundtable participants felt that differences in expenditure needs across the provinces could best be met through other instruments (other transfer programs) rather than by building needs into the equalization program per se. This underscores another point that roundtable participants felt needed to be high-lighted in the public debate, and that is the equalization

program is just one tool among many that the Government of Canada uses to address inequalities among Canadians and Canadian communities.

- Perfection will be an elusive goal for the Expert Panel, but this does not preclude meaningful improvements to equalization.
- Equalization, in large part because of its constitutional entrenchment, is increasingly seen as an entitlement, as a right of citizenship. It is important to note, however, that equalization flows to provincial governments and not to citizens, and provinces per se do not hold citizenship rights.
- The national discussion on equalization will inevitably serve as a magnet for other issues – vertical fiscal imbalance, the fiscal challenge that Alberta poses, etc. If the Expert Panel is the hammer, then a multitude of issues may become nails. In short, there is a real danger of agenda creep, at the very least in terms of public and media expectations.
- The case for a national advisory body has not yet been well developed. Although it would be a mistake to conclude that roundtable participants were hostile to the idea, concerns were expressed about the mandate of such a body, and its membership and accountability. Some optimism was expressed that such a body might strengthen public education and might prevent ad hoc fiddling with the formula, although optimism in the latter case was limited. The point was made that equalization will always have a political component, and that attempts to depoliticize equalization would at the very best have limited success. There was a strong argument that any advisory body should stay well clear of policy recommendations (CIHI was suggested as a possible model).
- There was some discussion about whether an advisory body would increase or decrease transparency. There was also some discussion about whether it could play a useful role in ad hoc challenges to equalization, such as those manifested in the Atlantic Accords.
- The creation of a fixed pot of equalization funding challenges the entire logic of the equalization program and formula. It will also lead to increased zero-sum competition among provinces, and thus to increased inter-provincial stress within the federation (some suggested that this may be an intended rather than unintended consequence of the fixed pot strategy).
- There was little discussion about how user fees should be handled within the equalization formula. Nor was there any discussion about how property taxes should be handled within the equalization formula. Although this may be an important issue for the Panel, there is little

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evidence that Canadians, expert or not, are sufficiently primed for a meaningful debate.

A final point – it will be important for the Expert Panel to retell the tale of equalization, to locate equalization against the backdrop of Canadian values. While Canadians undoubtedly have perceptions of equalization in terms of how it works and why, there is considerable doubt that such perceptions are well rooted in an empirical understanding of equalization. It is essential, therefore, to tell the story, to explain to Canadians why this program is embedded in the Constitution, and why it is linked to Canadian values in ways that are quite different from the case of most federal programs.