

**Brief to the Expert Panel on Equalization and Territorial Financing**  
**Donald G. Dennison, Advisor to Next NB/Avenir N-B**  
**Fredericton, NB**  
**July 28, 2005**

## **Executive Summary**

Equalization is a fundamental tenet of Canadian federalism, and strengthening equalization strengthens the capacity of both individual citizens and the economy. It also strengthens the role and capacity of provincial government, which underpins provinces, the constituent units of the federation. A society which strongly favours universal medical coverage must surely also be committed to universal quality education. Investment in essential public services is an investment in economic well-being and Canada cannot afford to stint in developing a productive society and workforce. Equalization is the underpinning to this objective.

## **Introduction**

This brief is being submitted on behalf of Next NB/Avenir N-B, a broadly consultative process being carried out with New Brunswickers to take stock of their present circumstances and future prospects. On June 21-23, 2005 a conference—Seachange 2005—was held in Saint John, and one of the workshops of that conference examined New Brunswick's relationship with Ottawa and the rest of Canada. The workshop considered fiscal relationships and the equalization program in particular, and it is with this perspective that I participated in the July 20 Roundtable in Moncton. However, the specific recommendations contained in this brief are my own, and do not necessarily represent Next NB.

The workshop at Seachange 2005 focused on the position of New Brunswick as a province within the Canadian political community. This brief focuses on the importance of equalization as a support to the role of provincial government. Provinces are constitutionally mandated with specific responsibilities, and their governments act under the obligation to serve their populations. Since Confederation, governments have implemented various measures intended to help ensure that provinces have the means and capacity to provide services.

These measures became more formalized and institutionalized in the post-war period, and saw the introduction of an equalization program in 1957. The understanding of the value of assuring common basic services developed to the point where, in 1982, provisions were added to the Constitution that committed the federal and provincial governments to

promote equal opportunities for well-being, to reduce disparity in opportunities, and to provide essential public services of reasonable quality to all Canadians. (Section 36 (1))

A further commitment was assigned to the Parliament and the government of Canada to make equalization payments to ensure that provincial governments have sufficient revenues to be able to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. (Section 36 (2))

The values that underlie these commitments are widely understood and shared, but the mechanisms to achieve them are less well understood and come under threat as a result of complicating factors and competing priorities. The Expert Panel has an opportunity to make recommendations that will better ensure that the equalization value continues to receive full service and that Canadians can better understand the extent to which the objectives of equalization are being realized.

## **Equalization – What it is and what it is not**

A good deal of misunderstanding about equalization has developed and there is a tendency toward confusion between equalization, regional development aims, and the goals of redistributing income and opportunities between individuals. Canadians support all of these general objectives.

Equalization does not act directly to put individuals or provinces on an equal financial or economic footing, but merely to put their provincial governments on a more equal footing. This is accomplished not by well-endowed provinces sharing a portion of their revenues with less favoured provinces, as some spokespersons would lead us to believe, but by a portion of the contributions of all Canadian taxpayers going into an equalization payment program. The Government of Canada is the agency by which this takes place through the collection of federal taxes and the payments directly to provincial governments.

There are redistributive effects between provinces as a result, but they do not come at the expense of provincial governments in wealthier provinces. If the federal government were to direct the money elsewhere, it does not follow that it would flow back to the coffers of the wealthier provincial governments, or even displace some of their expenditures. And if the federal government were to not collect the portion of tax that goes toward equalization, it does not follow that the provinces would occupy the tax room. Making up for revenue shortfalls for some governments does not come at the cost of other provincial governments. These are points that the Panel, and following it a commission, should make to refute arguments that are starting to cause negative views about equalization.

## **Equalizing the Capacity of Provincial Governments**

Canadians know that they live in a federation and that the constituent units, the federation's fundamental building blocks, are the provinces. Equalization is a concept

that strengthens the federation by reinforcing these building blocks by ensuring that each province has the capacity to provide comparable services to its residents. It aims to do this by ensuring that the provincial *governments* are provided with the means to provide the essential public services to support the well being of individuals, communities and the nation as a whole.

The essential point is that these public services are public goods, in that their availability and consumption advances the interests of all. Some have argued that the equity in this arrangement is offset by inefficiency, that equalizing the quality of basic services removes incentives to move to wealthier jurisdictions. This notion is refuted by the realization that inducement to migrate should be for better economic opportunities and not to receive better services. The role of provinces as basic social service providers is fundamental to our federalism. To the extent that disparities in the levels of these services are allowed to occur or grow, the role of provincial government is challenged and federalism is weakened.

## **Specific Questions Facing the Panel**

The panel has been charged with addressing some key questions with regard to equalization. I have reviewed the Report of the APEC Atlantic Policy Forum on Equalization, held prior to the Moncton Roundtable, and support the recommendations of the APEC Forum as being consistent with the approach of Next NB/Avenir N-B in its call for a strengthening of the national institutions that reflect and support the provincial role in the federation.

### *Driven by Principle*

The concepts behind equalization are so fundamental that they are expressed as constitutional commitments. The reasons for entrenchment lay in the recognition that conditions could change and principles can be compromised or sacrificed to circumstances. The equalization program has been compromised in many instances, particularly in recent years, and it is critical that the objective—ensuring that all provincial governments have the revenues to provide a comparable level of services—not continue to be qualified by putting limits on the resources allocated to the program.

Shifting away from a ten-province base, capping the amount available to distribute, and putting artificial considerations in place to disqualify jurisdictions, are measures adopted for temporary expediency at the cost of the objectives and success of the program. The recent move to replace a formula-driven process by establishing an arbitrary, though escalating, ‘pot’ is an understandable but unworthy decision.

### *No Capping*

The amount of money to be distributed should be the result of the process, not the starting point. If the principles, properly applied through a formula, produce results that cannot be accommodated in the federal fiscal framework, the discrepancy should be noted and

fiscal planning adjusted to be able to reach the goal. Here again, there is a useful role for a future commission.

### *Ten Province Base*

Comparability of treatment is the guiding principle of equalization. Therefore all provinces should be taken into account in determining what is comparable or average in terms of public services.

### *All Revenues Included*

A continuation of the representative tax system would seem to be better than some other proxy for fiscal capacity. Non-renewable resource revenues have presented the greatest challenge to the program. By the same guiding principal they should be included initially, even if they have to be factored down or 'reported out'.

### *Calculation of Expenditure Need*

Disparities in conditions across the country make a case for equalizing for expenditure need. The case is being made that wealthier provinces, largely because of their prosperity, have a higher cost base and therefore greater revenue need. Poorer provinces tend to have older and less concentrated populations, and hence greater revenue need. The factors around these types of considerations would be many, lending even greater complexity to already complicated formulas. Caution should be exercised before making the workings of equalization more disputable.

### *Permanent Commission*

As long as equalization is a federal spending program, accountability must remain with the federal government. There is, however, a strong argument for de-mystifying the program through having an appointed body outside the government monitoring performance of the program in meeting its stated and constitutionally entrenched objectives. There is a need for increased public understanding of the program and its effects, and a commission could play a key role in reporting annually to the public through Parliament. Because the program may fall short of its objectives due to limited fiscal capacity, the discrepancies should be reported and explained in order to build support for improvements.

## **Summary**

Equalization is a fundamental tenet of Canadian federalism, and strengthening equalization strengthens the capacity of both individual citizens and the economy. It also strengthens the role and capacity of provincial government, which underpins provinces, the constituent units of the federation. Investment in essential public services is an investment in economic well-being and Canada cannot afford to stint in developing a productive society and workforce. Equalization is the underpinning to this objective.