

Submission to the Expert Panel on Equalization

Ronald H. Neumann

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Synopsis

The Expert Panel on Equalization has been created at a difficult time for Canada. Growing disparities in the fiscal capacities of provinces due to soaring energy prices are creating a major challenge for intergovernmental fiscal relations. Left uncorrected, the growing disparities are likely to dampen the economic and social prospects of Central Canada and the nation as a whole.

Alberta and other resource rich provinces will have the capacity to maintain programs while cutting taxes. Health, education and other social programs are in greater part financed through the unequal provincial tax bases. Provinces without revenues from natural resources will not be able to increase taxes to maintain programs should their economies slow, while maintaining a competitive environment with the provinces that enjoy energy revenues. Quality of social programs, to be maintained on a national scale, will require a stronger equalization effort. Businesses and individuals may make decisions to move based not on economic fundamentals, but rather on the basis of the availability of better services and lower tax rates. The differing prospects of individual provinces also may place our fragile federation in further jeopardy.

The limited mandate of the Expert Panel, focussing on allocation of a fixed sum, rather than on the adequacy of the Equalization Program, cannot be expected to address this problem adequately. Nevertheless, its recommendations can have an impact. In this paper there is discussion and nineteen points are drawn as conclusions on some of the key issues identified by the Panel.

The paper concludes that benchmarking of the fiscal capacities of provinces against the top province, the national average and each other, is necessary to gauge the adequacy of the Equalization Program. This basic degree of transparency and accountability is necessary for the nation to have an appropriate debate on the status of the equalization effort.

The paper gives reasons why the representative tax system should be used to calculate fiscal capacities, rather than using a macro approach. A macro approach appears to offer simplicity but adds complications and concerns about accuracy.

A further conclusion of great importance in the current circumstances is that all provincial revenues, and all natural resource revenues in particular, must be included in the calculation of Equalization. The inclusion of user fees should also be broadened to include income-tested user fees that provide a growing portion of the financing for health and education services.

With respect to the issue of a permanent commission, this paper concludes that, unless it operates with a broad mandate and has the confidence of both federal and provincial governments, it would be more likely to detract from transparency and accountability than to aid in management of the Program.

Introduction: The Intergovernmental Fiscal Environment

The Expert Panel on Equalization has been created in the midst of a storm in intergovernmental fiscal relations. This is driven primarily by two factors:

- changes in the economic and fiscal circumstances facing the nation and individual provinces, the most important of which result from rising oil and natural gas prices, and
- over a decade of inadequate and ad hoc adjustments to federal transfer payments and arrangements.

It is important to place the current work of the Panel in the context of historical developments.

Canada's fiscal policies and intergovernmental fiscal relations since the Second World War have served the nation reasonably well. The economy developed and incomes of Canadians grew strongly. Importantly, the per capita gaps between economic productivity and incomes in the various regions were converging over much of the second half of the previous century. An objective view is that the economy was supported by opportunities created by the greater equality of regions in receipt of equalization, not constrained as argued by some espousing an unsupported theory about "welfare traps"¹. We were able to institute a national social safety net with reasonable comparability of support for all Canadians. And we have held together despite strong forces for separation.

Specifically with respect to the Equalization Program, over a forty-year period, the arrangements acquired an unusual level of acceptance, both by governments and the public². While issues arose with respect to the Representative Tax System, they were mostly of a technical nature and involved a relatively modest degree of concern. All reviews supported the Equalization Program and the manner in which it was being implemented. In the past decade there was a growing concern over the inadequacy of the five-province equalization standard.

A crisis point in intergovernmental fiscal relations arose as the federal government withdrew or constrained its fiscal support to provinces and territories³ at a time when the demands for health and other social services were growing ever greater. This created a growing imbalance between the demands placed on provinces from their citizens and their constrained revenue, caused in part by relative declines in federal support and in part by an environment in which raising taxes would have been extremely difficult. The federal government was cutting taxes, while certain provinces had the fiscal flexibility to do likewise. Other provinces were under heavy pressure to at least move in a similar direction in revenue collections. Most could in no way match the personal and corporate income tax cuts of the federal government and those provincial governments that had other growing sources of revenue, in particular from natural resources. The reality is that the abilities of most provincial governments are highly constrained by these factors. The argument of the current federal government that there is no fiscal imbalance, because the provinces have access to a broad range of taxation, is fallacious because it ignores the economic and political constraints on use of many tax bases.

The fiscal imbalances that developed affected all provinces to some degree. The provinces presented the case that the federal government had growing surpluses and the ability to cut taxes, while the growth in program costs of the provinces exceeded their ability to finance these programs adequately in the constrained revenue environment⁴. This was labelled a vertical fiscal imbalance.

With the rise of oil and gas prices over the past five years, there also were growing gaps with respect to the relative abilities of individual provinces to fund programs – horizontal fiscal imbalances. Natural resource revenues, which are the most unevenly distributed part of the fiscal capacity of the provinces, were and are providing a growing proportion of the revenues of several provinces. Rather than being enhanced and amended in consideration of this new reality, the Equalization Program was being constrained by the continued use of a five-province standard and by discrete actions of the federal government to limit its contributions to the Program, through ceilings and the exclusion of one-half of user fees in the calculations. Provinces were united in a call to strengthen the Equalization Program to deal with these growing imbalances, through removal of the ceiling, consideration of a ten-province standard and the full inclusion of all revenues⁵. The fact that both recipient and non-recipient provinces were united in proposing changes should not be discounted. While it is easy to create divisions, it is difficult to achieve consensus. Federal actions over the past few years have engendered more division than harmony with respect to the direction for the Equalization Program.

After the deep cuts associated with the introduction of the CHST in 1995 and the constraints on the Equalization Program arising from the 1999 and earlier renewals, the federal government began to take steps to address parts of the resulting problems. However, the steps have been ad hoc, inadequate and in part have aggravated problems. The ad hoc nature of the federal response is particularly troubling. The actions taken to date include:

- “permanent” removal of the equalization ceiling in 2000 (since effectively re-imposed by the 2004 arrangements which fix total equalization entitlements at a substantially lower level as a proportion of GDP than was imposed by previous ceilings),
- some increases in per capita funding under the CHST/CHT/CST,
- placing a fixed limit on payments under the Equalization Program at a level near its historic low, as a proportion of GDP, and with an escalator (based on the historically limited growth of equalization under the five-province standard) which will further reduce the relative size of the Program over the next five years, and
- further ad hoc measures with respect to the Atlantic Offshore Accords and override adjustments to Equalization payments for Saskatchewan and British Columbia.

Growing disparities between the provinces, not addressed and sometimes aggravated by ad hoc measures taken so far, will add to strains in the Canadian federation. Funding provided on a per capita basis does little by itself to address the horizontal imbalances. However, it may take away from the ability of the federal government to maintain an adequate Equalization Program. It is important to note that, under the transfer arrangements, most of the increased financing necessary for health and other social services will continue to be drawn from provincial own-source revenues, which are inequitably divided prior to Equalization. While some provinces may find the existing arrangements to be adequate, others will continue to be constrained through inadequate Equalization transfers and an inability to raise own-source revenues while keeping a competitive cost environment against jurisdictions which are able to lower taxes due to an abundance of natural resource revenues and growing per capita transfers from the federal government. Furthermore, the Accords and other side deals not only create intergovernmental tensions, they add to the fiscal imbalances in the nation.

There is a distinct possibility that Alberta will have the ability to become a debt free tax haven in the midst of the federation. In years past when oil and gas revenues were particularly strong, including fiscal year 2000/01, Alberta would have been able to fund all its programs without any personal or corporate income taxes and without resorting to the deficit financing

required by many other provinces. The Canadian federation is one of the most decentralized in the world, with heavy reliance on sub-national government revenues. Given this situation, differences in provincial tax rates in various parts of Canada can become so significant as to seriously distort business and personal decisions. This combination creates a situation unlike any other in mature federations around the world. It has the potential to negatively impact on large sections of the nation's productivity, in particular in central Canada, encompassing New Brunswick, Quebec, Ontario and Manitoba. Within the past two weeks, as the author has worked on this paper, there have been national news stories of the move of the head office of a major aerospace company from Ontario to Alberta (Spar), the decision of a renowned child surgeon to move to Alberta which was motivated by the availability of expensive new research facilities which could not be matched by the Government of Ontario, proposals to spend additional billions over the next few years on infrastructure in Alberta and suggestions that there will be further measures for alternate funding for health care in Quebec.

Tax competition seriously diminishes the revenue capacity of most provinces – revenue that is necessary to provide health and other social programs delivered by the provinces. The structure of funding for social programs has been pushed towards the provincial governments over the past several decades. Provincial revenue in most provinces, constrained by the need to maintain competitive tax rates with Alberta, may well prove insufficient to maintain the social programs, which are a part of our national identity. **Canada's expenditure on public programs has already dropped by 7.6% of GDP to 27% (a decline of 22% between 1992/93 and 2004/05) and is likely to become the lowest amongst the industrialized nations**⁶. The position taken by this analyst is that this dramatic drop in the financial support for public programs is the unintended result of over-reliance on the unequal and uncorrected fiscal capacities of provinces. Tax competition amongst unequals negates the seemingly strong revenue potential of most provinces. The drop in expenditure on public programs is in conflict with the priorities of Canadians who continue to support investment in our social safety net.

Finally, the ad hoc and inadequate decisions with respect to intergovernmental fiscal arrangements may well increase the strains on the federation. When the Equalization Program was implemented in the 1950s and as it matured in the 1960s, it was described as the "glue" of the federation. The glue now being applied is less than half that applied in the past and it is not being evenly spread.

Like from an approaching hurricane, whose path and pace is uncertain and measured in years rather than days, we can already feel the winds which signal the potential damage of the storm arising from the unequal fiscal circumstances of provinces. The damage may be limited to creating the conditions which result in under-performing economies in major parts of the nation. Or it may be more destructive, leaving the nation without the ability to maintain the universal national social programs which have been an important part of our identity as Canadians. The greatest danger would arise if the weak points and divisions in the Canadian federation suffer direct hits. However, unlike with hurricanes, we have the ability to calm (or to intensify) the storms within intergovernmental fiscal relations. The work of the Expert Panel must pay very close attention to the successes of the past and to the challenges in the evolving fiscal environment. Its recommendations should be such as to provide protection and insurance against potential events, and not leave the nation vulnerable.

Addressing the Mandate of the Panel

The Panel has been asked to address:

- The allocation among provinces of the annual Equalization allotment
- The allocation among territories of the annual Territorial Financing Formula (TFF) allotment
- Mechanisms which would ensure that payments to provinces and territories are stable and predictable, to assist in sound planning
- Evidence-based aggregate measures of the evolution of fiscal disparities among provinces and Northern program costs to assist in future evaluations of the overall level of federal support for Equalization and TFF
- Whether to have a permanent independent body to provide advice on these matters.

The Panel has summarized its mandate in the form of fourteen “key questions”. This paper will address only a limited number of these questions. It will not deal directly with issues around TFF arrangements, though there will be lessons from addressing provincial equalization issues which have applicability to TFF arrangements. The paper will also not examine the issue of expenditure need, other than to make the statement here that expenditure needs should be examined, that sufficient work has not been done in the past, and that expenditure needs likely should be factored into calculations some time in the future. This paper addresses the remaining questions raised by the Panel in the following sections:

- Fiscal capacities, and equalization standards, with comprehensive inclusion of revenues
- Measurement of fiscal capacity disparities, using the Representative Tax System (RTS) versus macro approaches
- Addressing predictability, stability and responsiveness
- A permanent advisory commission

Fiscal Capacities and Standards

It is instructive to begin by examining the Constitutional provision for the Equalization Program. While commentators most often recite the clause in Section 36(2), they often move on to ignore the clause or reduce its significance in favour of other objectives.

Under the Constitution, which no one is seriously suggesting will be amended in the near future:

“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”.

What issues are raised?

- **The objective:** The stated objective places the main emphasis on the abilities of provinces to provide public services and not, as some would want, on equalizing incomes of Canadians or on economic or other objectives (except to the extent that these objectives are already

imbedded in the rationale for providing comparable public programs with comparable taxation).

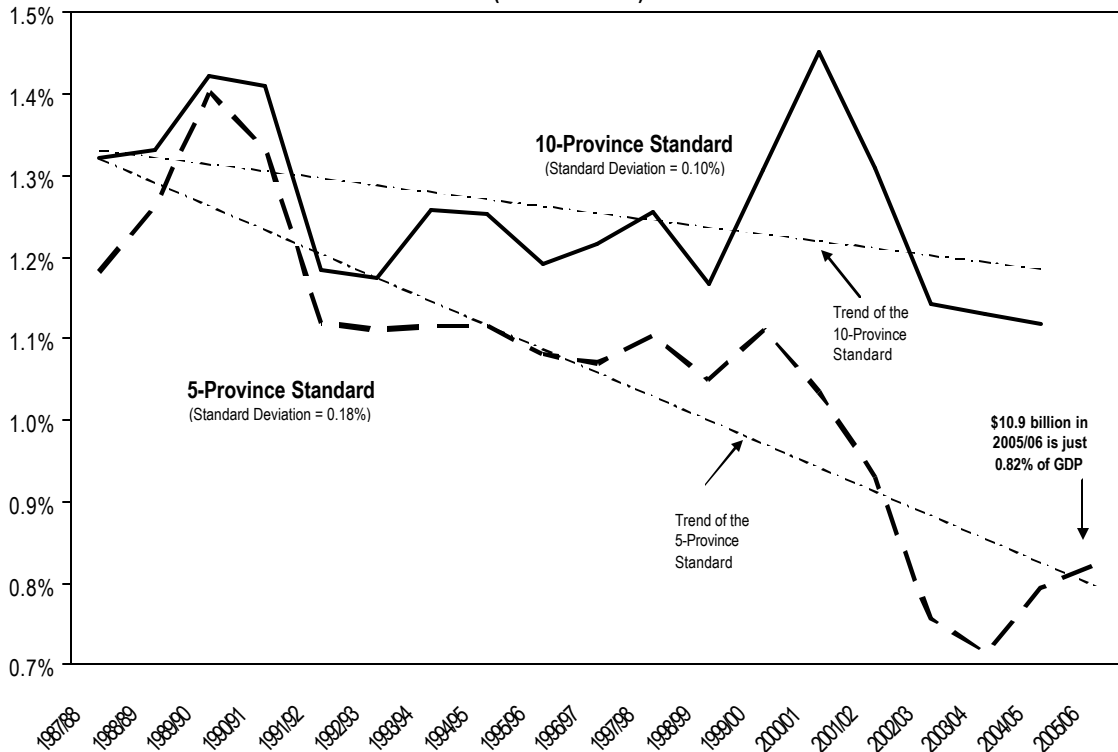
- **Sufficiency and comparability:** These two principles are intertwined in the constitutional construct. Sufficiency of a province's revenue to provide public programs, after equalization, is not absolute nor based on some conception of public program responsibilities, but is based on a comparison with what is needed to provide programs reasonably comparable to those available in other provincial jurisdictions. However, sufficiency and comparability, while not precise terms, are too often discounted in proposals for reform of the Equalization Program.
- **Comparable levels of taxation:** While this phrase refers specifically to taxation, as the earlier part of the Section refers to "sufficient revenue", all revenue must be considered, including that provided by "comparable levels of taxation", in order to measure the need for Equalization payments required by the Constitution.
- **Affordability:** It is the government of Canada that must make equalization payments to the provinces. This leads directly to the issue of affordability. The argument that the federal government does not have the fiscal capacity to provide adequate equalization demands the complete examination of the reasons why this would be the case, given the federal government's access to both direct and indirect taxation and the fact that it provides payments to all provinces. It has had the fiscal flexibility to cut taxes and to provide greater equal per capita transfers, but continues to constrain equalization to a level, as a percentage of GDP, which is near an historic low. Some analysts suggest this is linked to the fact that some provinces have access to revenue from natural resources, availability of which is not matched for the federal government.

These points are pertinent to decisions on measuring fiscal capacity and establishing a standard. Specifically:

- The measurement of fiscal capacity must consider all sources of revenue available to provinces (and their municipal governments) which are used to provide public programs (full inclusion of revenue)
- The standard must be set in a manner and at a level so as to be adequate to allow for "reasonable comparability" in fiscal capacity (in relation to expenditure needs to provide those public programs)
- The affordability issue needs to be addressed, but should not be a rationale for introducing distortions and inequities in the Program.

Equalization in theory and as practiced, has been and is to a large extent self-limiting in cost. When equalization is based on the actual expenditure decisions of provinces, not all of which are recipient provinces, a measure of affordability is imbedded in the program. The cost varies with two factors. The first are the decisions of the provinces on the extent to which their fiscal capacity is constrained within acceptable taxation limits and the second are the movements of relative fiscal capacity differentials. Using fiscal decisions of all provinces in the calculations, should and does provide a benchmark of collective affordability of programs provided by the provinces. An examination of Equalization which would have been paid under both the five-province and the ten-province standards over the past fifteen years, shows that a ten-province standard would have been relatively constant as a proportion of GDP (trending slightly lower) and more stable than the five-province standard. This should be expected, as any change in energy pricing usually has opposite effects on the economic and fiscal fortunes of Alberta and Ontario.

Equalization Entitlements, 1987/88 to 2005/06 (as a % of GDP)



The use of a national average tax rate in calculating fiscal capacity has the virtue of being able to adjust to taxpayer preferences. National average tax rates of provinces should reflect a roughly similar pattern of public preferences for programs over the cost of taxation as would be at play nationally. If there is greater demand for public programs and less constraint on taxation levels, this should be felt relatively the same by the federal government and cumulatively across all provinces. Therefore, a greater or lesser demand for services, resulting in higher or lower provincial taxation levels (and the resulting need for higher or lower equalization payments), should be matched by a corresponding tolerance for higher or lower ability of the national government to provide equalization. However, the preference may not be the same in each province, as they face differing circumstances. For example, they could be at different points in their business cycles and individual provinces could have restrained programs or increased taxation more at any given time.

While the federal government does not have access to the same natural resource revenues as provinces, the relative importance of this consideration on the affordability issue is often overplayed. Federal revenues do respond to economic growth in the oil and gas plays, most particularly through corporate profits and the increased revenue from the GST and excise duties as the activity and prices of products increase.

More importantly for this discussion is the effect of natural resources on the relative differences in fiscal capacity. The differences in fiscal capacity related to natural resources are the most unevenly distributed of all sources of provincial fiscal capacity. Furthermore, they are becoming

an increasingly important source of revenue to the three western provinces and to Newfoundland and Labrador. Recent data for 2004/05 show that non-renewable natural resource revenues provided 31% of the total Alberta revenue, approximately 12.5 % of the revenue of Saskatchewan and British Columbia and over 9% of the revenue of Newfoundland and Labrador. It could be expected that these figures will rise once again in 2005/06. Revenue from these sources in all other provinces average less than 1% and do not exceed 2% of revenue.

The greatest disparities in relative fiscal capacity are created by revenue from the exploitation of natural gas. Data from the October 14, 2004 calculations of equalization for fiscal year 2004/05 show that natural gas is estimated to provide \$7.2 billion in provincial revenue, of which Alberta receives 80.6%. Given that Alberta has 10.1 % of the Canadian population, the disparity in revenue capacity from this single source is nearly eight times its population share and provides Alberta with \$1,790 per capita more than the average received in the five standard provinces in the equalization formula. While it might be argued that natural gas reserves in Alberta are depleting (as has been argued since this author worked in the energy industry in 1967), new reserves still remain to be found and, should the reserves decline, prices are likely to continue to rise, creating a situation in which the three western provinces are most likely to enjoy exceptional revenues for at least the next two decades.

Oil bases and the sale of crown leases related to oil and gas exploitation provide less revenue than provided by natural gas alone and they are slightly more evenly distributed. However, they are still by far the next largest contributors to fiscal capacity disparities. Alberta tends to dominate these sources as well. However, as Saskatchewan has a significant portion of the oil play and a lower population share, its fiscal capacity disparity arising from all oil bases is relatively large, even slightly larger than that of Alberta (\$423 to \$402) when calculated on a per capita basis. Newfoundland and Labrador also receives a significant fiscal capacity boost from the Offshore Oil Arrangement, amounting to \$448 per capita more than the standard. British Columbia and Saskatchewan, despite having a lesser share of other oil and gas tax bases than Alberta, still enjoy high fiscal capacity differentials resulting from the gas, oil or crown lease bases. In total, Alberta has an advantage in oil and gas over the equalization standard of \$2,569 per capita. Saskatchewan has an advantage of \$756 per capita. Newfoundland and Labrador per capita fiscal capacity, including both the positive effects of the Offshore and the lack of other oil and gas, is \$363 above the standard. British Columbia has an advantage of \$254 per capita.

These fiscal disparities from oil and gas far exceed other sources of disparity. The closest competitor is with respect to the Ontario personal income tax base, which provides a fiscal capacity for Ontario of \$273 per capita above the standard.

Other natural resource bases provide significantly above average fiscal capacity for certain provinces. Mineral resources provide Saskatchewan with \$178 per capita more than the standard. This is true despite the fact that the minerals base doesn't provide as much revenue to provinces as oil or gas, and the base is more evenly distributed, with Saskatchewan having only 37% of the base. However, the differential between its share and its population share is great, with its fiscal capacity share almost eleven times larger than its population share, which results in the large per capita differential. British Columbia receives \$175 per capita more than the standard from forestry resources.

By comparison, water power rentals provide much less revenue than oil and gas (about \$1 billion nationally). Furthermore, no province dominates the base, relative to its population share. Thus, while Quebec has 60% of the base and this is 36% more than its population share, the excess of share over population is less than 1.5 times its population share. The net result is that Quebec is

estimated to have a fiscal capacity of only \$41 per capita above the standard. This is less than 2.5% or one-fortieth of the per capita differential enjoyed by Alberta with respect to natural gas alone and 1.6% or one-sixtieth of the advantage of Alberta in total oil and gas. Thus, even dramatic increases in water power rentals will not move this source into the league of oil and gas revenues. Other provinces with a greater share of water power potential than their population (Newfoundland and Labrador, Manitoba and British Columbia, enjoy less of an advantage than Quebec. Thus, the attempt by some commentators to suggest equivalency of fiscal capacity potential from water power to that from oil and gas is without credible foundation.

To put some of these numbers into better perspective, it should be noted that the \$2,569 per capita received by Alberta from its energy resources exceeds the per capita revenue derived from the combination of provincial personal and corporate income taxes in several provinces. Thus the earlier statement that, should resource revenues continue to provide these levels of revenue or to grow further, and should other provinces not be assisted appropriately through equalization to fund programs or lower their tax rates, **Alberta has the potential to become a tax haven in the midst of Canada. Assuming yet higher prices in coming years as fields of hydrocarbons become more depleted and demand in China, India and elsewhere continues to grow, Alberta could have the ability to provide comparable public programs with no provincial personal income tax, no provincial corporate income tax and no provincial sales tax.**

Given the importance of differences in natural resource revenues to differentials in total fiscal capacity, it is essential that these sources be factored into equalization calculations in full.

These differentials do impact on the affordability of the Equalization Program. “Reasonable comparability” in fiscal capacity would suggest that the Equalization Program should provide equalization in relation to that of the highest, Alberta. The cost would be prohibitive, though it might be noted that such a program would allow other provinces to lower their tax rates and thus provide room for the federal government to raise taxes to pay for the enlarged equalization payments. While a “highest province” standard is impractical and would likely lead to excess provincial expenditure, there is no need to distort the program by excluding portions of natural resource revenues in order to achieve affordability. The simpler and fairer way is to:

- calculate equalization with all resource revenues considered,
- use national average tax rates in calculating relative fiscal capacity
- make a decision on the degree to which it is fairer to allow one or more provinces to be excluded from the standard which will result in a lower standard, or whether a higher standard should be chosen, entitlements from which could then be scaled back to the level that is “affordable”.

The current five-province standard is likely to leave four provinces as non-recipients in the foreseeable future. A ten-province standard is likely to leave two provinces as non-recipients at the present time. However, the Panel should be acutely sensitive to the possibility that Ontario may become a recipient province and that the measured fiscal capacity of Saskatchewan and British Columbia, in addition to Alberta, may rise above that of Ontario.

There is a need to judge the adequacy of the equalization payments in meeting the goal of “relative comparability” and the extent to which they can serve to provide a more solid foundation for the delivery of public programs and, in particular, the social programs of the federation which Canadians continue to strongly support. In this regard, it would be appropriate to continue to measure the fiscal capacity of provinces under actual taxing practices and using

national average tax rates. This would provide a measure of the fiscal disparities being addressed by the Equalization Program. Whichever standard is chosen, in order to judge the adequacy of the program, the chosen standard should be benchmarked against the highest province and the national average fiscal capacity of provinces after Equalization. The fiscal capacity of each province before and after equalization should be measured. This basic set of data has not been readably available, and the Canadian public has not been sufficiently aware of the challenges, success and shortcomings of the Program in reducing fiscal capacity disparities. The success of the program could be related to the rate of progressive realization of the objective of equalization to provide sufficient revenues to provinces such that they can provide reasonably comparable services at reasonably comparable levels of taxation.

Fairness and equity should be the guiding principle for the Equalization program, not some manipulation which includes or excludes provinces based on past performance or current politics. Theory and experience around the world stand in favour of the use of a clear and fair formula for establishing intergovernmental transfer arrangements. In such an approach, there is little room for ad hoc measures or for elements which may be perceived to be unfair, such as multiple standards.

At some stage, whether on the issue of comparability or adequacy, the Program is likely to come under challenge in the Courts. As the Supreme Court has already ruled on the “waiting list” issue, it is less likely to avoid consideration of the financial underpinnings of the programs which it is generally believed should be equally available to all Canadians. Ad hoc arrangements are likely to be most vulnerable to challenge in the courts.

Conclusions on Fiscal Capacity and Standards

While the Panel is constrained by its mandate and the current arrangements imposed last year, it has chosen to include in its list of key questions, those on appropriate indicators of fiscal capacity, the issue of multiple standards and the possible exclusion of natural resource revenues. The conclusions reached here are that:

1. The fiscal capacities of provinces should be measured using actual taxing practices, with full inclusion of all revenues used to provide public services, and national average tax rates to derive fiscal capacity disparities.
2. The equalization standard chosen and the resultant effects of equalization of fiscal capacity should be benchmarked relative to the measured fiscal capacity from the province with the highest fiscal capacity and from a national average standard.
3. Multiple equalization standards are not reasonable or sustainable and should be eliminated as quickly as possible after they arise.
4. Natural resource revenues are large, are the most unevenly distributed of provincial tax capacities and create differentials which are too important to be excluded in whole or in part from the Equalization Program. Overcoming the negative consequences of fiscal capacity disparities arising from natural resource revenues is now and is likely to remain as the central challenge which must be addressed by the Program through the foreseeable future.

Measurement of Fiscal Capacity Disparities

Since the inception of the Equalization Program, a representative tax system (RTS) approach has been used to measure fiscal capacity disparities. The approach is also used in Australia and our two nations are often studied as envied models for the manner in which fiscal capacity disparities may be measured. Nevertheless, there have been proposals for change based on the following considerations:

- **Theoretical:** Some believe that the RTS does not capture the underlying tax capacity of the provinces. This is the principal argument used with respect to measurement of property tax capacity
- **Complexity:** The degree of detail required to maintain an RTS system is quite large, though it doesn't require a large effort to develop data, as it is most often already available
- **Accuracy:** Technical issues arise when tax bases are not standard across provinces. In some cases, such as with gaming bases and Saskatchewan's Crown Lease revenues, it is difficult to separate tax capacity from tax effort
- **Disincentives:** It is argued by some that disincentives to promote development and/or disincentives to tax result from the "tax back" aspects of the RTS system
- **Other:** A variety of arguments are brought forward by both the federal government or provinces to mask hidden agendas related to the costs and benefits, be they direct financial or political benefits, of the program to their jurisdictions. Frequently, contradictory arguments are put forward.

There has also been an issue as to what constitutes "public programs" and therefore if the revenue from certain fees should be equalized.

Addressing the theoretical arguments: It is counter-intuitive to suggest that a system based on actual taxing practice (the RTS) is less able to capture underlying tax capacity than a proxy measure such as GDP or income.

The differences between the entitlements based on an RTS system and those based on macro approaches are significant⁷. Proposed proxy measures have obvious major flaws leading to inaccuracies in measuring fiscal capacities under those approaches.

In a recently published paper⁸ and elsewhere, the author has explored some of the reasons why the RTS is a more accurate measure of fiscal capacity disparities than macro-measures such as income or provincial GDP. Some of these matters will have been raised in other presentations to the Panel. There are at least five primary reasons:

- the RTS is able to factor in the real (as opposed to theoretical) abilities and constraints on provincial access to tax bases and the returns from accessing these bases, by using actual tax practice and returns
- the RTS data base is more sound, grounded in reality and less subject to artificial statistical assumptions and manipulation
- the RTS is able to factor in progressivity of the income tax system and other tax preferences
- the RTS automatically factors in the effects of tax exportation. Provinces with large natural resource and financial industries are able to export more of the taxes they raise

- The RTS automatically adjusts for some tax exemptions of the aboriginal populations resulting from federal legislation and the treaties, which become more significant over time.

Turning to some of the issues raised in application of the RTS, it may be noted that, in certain instances, a case might be made that the tax rate which can be applied to the tax base is constrained by a factor which is not directly a part of the tax base. However, this is not the same as arguing that this other factor is what actually constitutes the tax base. With respect to all but the rarest of instances, the constraint on a tax base would be adequately recognised within an RTS system using national average tax rates (NATR). The NATR would capture the constraint on use of the base.

The one instance in which it appears that the constraint argument might have some validity, is with respect to the property tax base. Since the early 1990s, it has become standard practice of provinces and their municipalities to base property taxes on market values. This is clearly the actual tax base and should be used within an RTS system. However, it can be observed that tax rates are lower in jurisdictions with higher average per capita property assessments. Of course, this phenomenon is most readily explained by the fact that expenditure needs are similar in jurisdictions with different relative assessments and therefore, in order to raise sufficient revenue, only a lower tax rate is required in jurisdictions with a higher average tax base. This is the same explanation as to why Alberta does not have a provincial sales tax and why it is able to tax other bases at lower tax rates. However, an alternative argument could be that wealth may not be well correlated with income and the ability of taxpayers to have cash in hand to pay the tax. This situation may influence jurisdictions with higher per capita property values to limit their rates on residential properties. This then raises the question as to whether this perceived constraint should be factored into an RTS calculation. It is not at all clear that it should be for reasons noted below and, even if there is a constraint on using property taxes based on income, there are a number of further considerations:

- There is no way of establishing whether the first factor of lower rates based on need and a higher fiscal capacity does not fully explain the observed phenomenon
- This phenomenon (higher tax bases correlated with lower tax rates) is similar to the situation with respect to the sum of all other tax bases.
- It is arguable that the constraint is adequately factored in by virtue of using the national average tax rate.
- How could the “constraint” effect be measured relative to the first factor?
- What income measure should be used to modify the market value assessment base, should the constraint be recognised? Higher property valuations are most often accompanied by appreciation of residential properties, creating capital gains, which are not included in some measures of income and, to the degree they pertain to principal residences, are not taxed under the personal income tax system. Furthermore, a significant proportion of the wealth which pertains to property is imported into the province by immigrants. Neither provincial income measures nor taxable income measures would capture these factors in developing a factor to reflect the appropriate measure of constraint on the use of the market value assessment base.
- If the higher property values are not to be fully factored into the equalization calculations in the property tax base, should not the capital gains noted above be considered in equalization calculations by modifying the income tax base?

There is no clear-cut case for modifying the market value assessment approach, but the “constraint on use of the tax base argument” may have greater validity with respect to the property tax base than with respect to any other. Therefore, some further consideration may be given to this argument. It should be noted that the use of a stratified market assessment approach could gain some justification by virtue of this line of reasoning.

Addressing complexity: It is often noted that Canada’s Equalization Program is conceptually simple, but complicated in its application, with a seemingly complex formula established in pages of legislation, numerous data points and pages of calculations for each estimate. This detail is necessary because the provincial taxing practices are not simple; nor are they uniform. While the provinces’ tax legislation on which an RTS system is based could fill a room, the legislation for the Equalization Program is relative simple and compact.

Perhaps one of the most important positive features of the RTS system is that the data is for the most part of a very high calibre of relevance, accuracy, timeliness and accessibility. Most of the data is free from the need for assumptions and extrapolations which have a major impact on final entitlements. This is not the case with respect to economic data upon which macro models and other approaches to equalization rely. Those who would advocate for the “simplicity” of a macro approach are sure to be thoroughly disappointed should a macro approach be implemented. The debates around the RTS would simply shift to more complex debates on the efficacy and accuracy of the macro measure(s) chosen. The panel will have heard arguments that the measures of GDP or income are fraught with technical debates, assumptions and extrapolations based on estimates. Resolution of these issues can have major implications for the calculation of entitlements of an equalization program based on a macro measure. To illustrate, a seemingly innocuous change in the deflator for residential capital stock, from a national to a provincial deflator, changed the entitlements of British Columbia by approximately \$500 million annually and moved it to recipient from non-recipient status. The Panel must recognise that the economic accounts have not been established for the purpose of calculating Equalization. They may be perfectly adequate for the purposes for which they were designed, but they would be subject to severe scrutiny and debate should \$11 billion of transfer payments rest on their accuracy.

Addressing Accuracy: Setting broad theoretical issues aside, debates concerning accuracy in calculations in an RTS system most often revolve around establishing tax bases and tax rates. There are instances when it is difficult to separate tax base from tax effort.

The most vexing example of this concern has been the calculations with respect to Crown Leases. Saskatchewan, supported by a study by Thomas Courchene, has argued that the perceived 100%+ tax back rate for Saskatchewan’s Crown lease revenue “*indicates a flawed measurement base and is indefensible on its own*”⁹. **Of course this is not an accurate statement.** Should a recipient province choose to have a lower tax rate than the national average, revenue from an increase in that tax base may have more than a 100% offset in related equalization entitlements. However, it is true that it is difficult to separate out tax rate from tax effort with respect to Crown Lease revenue and therefore it is difficult to establish the degree to which Saskatchewan has chosen to lower its Crown Lease structure in order to create greater activity today with higher offsetting returns from royalties in the future. Furthermore, the exclusion of Alberta from the five-province standard while continuing the use of national average tax rates, has negatively impacted on the calculations of Saskatchewan’s entitlements, as it does with a myriad of other calculations in the Equalization formula. Prior to the 1999 Renewal, the Technical Committee on Equalization reviewed the negative impacts of combining ten-province tax rates applied to the five-province tax base. As ten-province tax rates are lower, a similar phenomenon of lower Equalization entitlements is observed across the board.

All of this is not to say that Saskatchewan has no valid arguments. In particular, it legitimately argues for use of a ten-province standard. As well, the disincentive arguments of high tax back rates, to be discussed in the next sub-section of this paper, are also relevant. However, all recipient provinces would like the luxury of lowering their tax rates to be more competitive with a wealthier province with lower tax rates. However, the Equalization Program should not be subsidizing those efforts, with resulting escalating impacts on the competitiveness of the next province.

The gaming base has been another example of concern about accuracy, because of a limited ability to separate tax base from tax effort.

Other concerns with respect to accuracy have arisen and been dealt with over the decades. They will not be rehashed here. However, it is very important to note that these waves have not been tsunamis, destroying the credibility of the Equalization Program. In fact, **the controversies raised over the previous forty-five years of experience with the RTS system pale in significance to those which have arisen recently through the use of limits and ad hoc adjustments to transfer payments and offshore arrangements**. The Panel must guard against introducing issues with respect to accuracy and fairness that have the potential for raising far greater concerns and creating more damage to federal-provincial and inter-provincial cohesion than those which have arisen through the use of the RTS.

Addressing the issue of disincentives: It is argued by some commentators that disincentives to economic development or to tax result from the “tax back” aspects of the RTS system. These two aspects will be dealt with separately.

The Panel has been asked to examine the question of whether “equalization or TFF grants may create particular disincentives for governments to exploit natural resources.

A few years ago, the Hon. Stephane Dion, in an article entitled “*In Defence of Equalization*” elegantly summed up the exploration of this topic as follows:

“Equalization does not impede economic development.

“The fact that Equalization received by a province declines when its fiscal capacity increases does not prevent it from taking action to develop its natural resources or promote any other form of economic development.

“The impact of economic development on their revenues is far from being governments’ main consideration when they make their economic policy decisions. What guides them above all is a concern that they meet their citizens’ desire for increased prosperity. No government can long escape the critical scrutiny of its electorate if it does not do everything in its power to promote the job creation and greater well-being that flow from taking advantage of whatever economic development opportunities present themselves.

“Equalization has not stopped provinces from developing their natural resources. Saskatchewan’s oil and gas industry was developed even though that province’s equalization entitlements declined as a result. Similarly, other examples – potash in Saskatchewan, nickel in Manitoba, and hydro-electric development in Quebec, Manitoba and Newfoundland and Labrador – show that Equalization has not impeded

the development of natural resources in the past. There is no reason for it to be otherwise in the future”

His confidence would be confirmed through the actions of governments since then, such as the agreement to develop the Voisey’s Bay ore deposits. Premier Calvert of Saskatchewan gave further evidence recently before the House of Commons Sub-committee of Finance on Fiscal Imbalance. He cited the case of proceeding with a tertiary oil play, despite the fact that calculations showed that total provincial income after equalization might be lower as a result of the provincial decision.

There is a further and more important dimension to this discussion which is often forgotten. That is, the equalization implications of development usually go well beyond the calculations for a specific base related directly to the economic activity. The most important of these effects relate to population, as it is the most important piece of data in equalization calculations. The positive impacts on population of development result in large increases in the basic standard against which a province’s revenue is measured (per capita standard times population – provincial tax bases times national average tax rates equals equalization paid). There are also other subsidiary effects on other bases which impact on entitlements. The impacts on equalization from effects on population and other bases may more than cancel out the so-called effects of “tax-back” on individual bases.

However, rather than simplistically placing the issue of incentives in the negative, it should also be asked whether equalization has a positive impact on economic development and prosperity and whether uncorrected imbalances constrain economic growth and prosperity.

As would be expected, fiscal capacity disparities created by the unequal division of resources and other factors remain decade after decade. However, the disparities do change over time. In fact, there has been a convergence of incomes and productivity across provinces. In their paper titled *“Reconciling Diversity with Equality: The Role of Intergovernmental Fiscal Arrangements in Maintaining an Effective State in Canada”*¹⁰, Richard Bird and Francois Vaillancourt document this convergence.

After the Equalization Program had been introduced, from 1961 to 2001, personal per capita income of almost all provinces converged toward the national average. The minor exceptions were Manitoba, where incomes moved virtually in tandem with national growth, and Alberta, which moved from the national average to 110% of the national average (the highest amongst the provinces). The range narrowed almost by half - from a difference of 58 points (between that of Ontario and both NL and PEI) to 31 points (between Alberta and NL). GDP per capita showed similar convergence, except that Alberta rode the wave of higher energy prices and surged ahead to 140% of the national average, from 109% in 1961. This data suggests a powerful argument that equity enhances opportunity and thus increases incomes and wealth. Clearly it does not support the unfounded conjecture that equalization is a form of welfare trap for regions or provinces.

This argument is further supported by a recent study of the long term effects of the Equalization program by Professor Sam Wilson at the University of Alberta¹¹. The study concludes that the efficiency gains from the Equalization Program are high – much higher than when viewed over the short term.

The second aspect of disincentives is with respect to disincentive to tax. This argument has more validity. A province is unlikely to tax at higher rates, if the increase in revenue will be offset in

whole or in large part by a decrease in Equalization revenue. This has been explicitly recognised and dealt with in the RTS system over the past two decades. It must be noted that this is not a problem which applies when no province has a large share of a tax base. However, in cases in which a single province has more than 70% of a tax base, the “generic solution to tax back” applies. There is no evidence that the generic solution has not been sufficient to avoid the disincentive to tax.

Addressing the issue of fees: The issue of inclusion of fees in equalization calculations revolves around the issue of what is regarded as “public programs”. If the revenues are used to provide public programs, the constitutional construction suggests that the revenue from these fees should be included in the calculations as to whether provinces have sufficient revenues to provide reasonably comparable public programs at reasonably comparable levels of taxation. As noted earlier in this paper, the source of revenues, whether from taxation, fees or transfers, is irrelevant. What is relevant is whether or not they are used to provide public programs and whether or not there are different capacities to raise such revenues, which should be equalized.

It has been argued that certain fees pertain to quasi-private goods provided primarily on the basis of fee for service. Parking fees raised by municipal governments are a pertinent example, though they may have an element of public purpose which goes beyond that of private operation. However, such fees are a very minor element in the total of fee revenue. Water, sewer and garbage pick-up are viewed by most provinces as being public services, with objectives similar to those programs funded through taxes and with high levels of cross-subsidization between fee payers, similar to the cross-subsidization through taxation. In many instances, recent changes in revenue patterns have resulted in a switch from funding these public programs through taxation to greater funding through fees. Most often, providing incentives to conserve are the primary motivation for this switch. It is not primarily motivated by an ideological position that the user should pay the full cost for individual use. Even in instances in which the total service may be operated on a cost-recovery basis, there remain cross-subsidization and public welfare considerations. Therefore, these user fees should be equalized if there are different capacities amongst the provinces to raise revenue from these fees. And clearly there are. The capacity is most directly related to income and therefore the equalization base for fees should be calibrated to income. An examination of the patterns of payment of fees could provide clues as to whether there is a degree of progressivity in the payment of the fees, which then should be mirrored through adjustments to the calibrated income base.

The Panel should consider the inclusion in the formula of user fees not yet equalized under the formula. These include tuition fees, pharmacare deductibles, home care and personal care home fees and levies. This class of fees has become an important source of revenue in providing public health and education programs. In most instances these fees are means tested and therefore there is clearly differential per capita ability to raise revenues based on income differentials between the provinces. The varying pattern of progressivity could be accommodated within the equalization formula in much the same manner that differing provincial income tax progressivity is factored into the formula.

Conclusions on Measurement of Fiscal Capacity Disparities

5. The RTS system has served the program well and should be retained. Arguments against the RTS are often made with little foundation and the arguments in favour of macro and other approaches have not fully explored or have discounted potential problems of sound theoretical justification, inaccuracy in measuring fiscal capacity, resulting complexity and controversy with respect to the data base.
6. The calculation of the relative property tax base capacities should be based on market value assessment. The issue of a potential exceptional constraint on the use of this base could be explored further. Such an exploration might support the use of the stratified market value assessment approach or some other mechanism to recognise this exceptional constraint, if it is found to exist.
7. The RTS system is conceptually more clear and simple than other approaches and certainly more transparent and clear than a hybrid approach. The large amount of detail is manageable because it is relatively accessible, uncontroversial and timely. Macro approaches require data which would be highly complex and controversial when broken down and examined in the context of use in an equalization formula.
8. Issues of accuracy in calculations under the RTS system are not overwhelming to the system. They have and can be dealt with. The use of a formula with a standard inclusive of data from all ten provinces would alleviate certain problems which have arisen in the measurement of Crown Leases and other natural resource revenue bases under the five-province standard.
9. Equalization does not provide a disincentive to economic development. By providing a more equitable playing field with more equal opportunity, it removes barriers to growth and improves both the balance and the overall rate of economic growth in Canada.
10. There is no evidence that the generic solution provides insufficient remedy against a possible disincentive to tax when a province has a major portion of a tax base. There is no need to change from an RTS formula in order to remove non-existent “disincentives”.
11. All fees used to provide public goods should be equalized. This includes the growing revenue from income-tested user fees in public health and education services.

Addressing Stability, Predictability and Responsiveness

The Panel has been asked to consider options to stabilize Equalization revenue to individual provinces. This stabilization consideration is in addition to the fixing of the total Equalization expenditure, rather than having it respond to the movement in fiscal capacity disparities among provinces (except as it could be adjusted under a quinquennial review of adequacy). Because provincial revenues can be more variable than national revenue, both the measure to fix the total sum and any proposed measure to stabilize individual shares appear to be moving the Equalization Program in the wrong direction.

The focus should not be on one part of provincial revenue (equalization), but on total revenue. Maintaining comparability between the capacities of individual provinces is not served through

the establishment of shares that are “stable and predictable” but unresponsive to the fiscal circumstances of individual provinces. A stable program may be poorly suited to achieving the objectives laid out for the program under our Constitution.

There have been studies that indicate the Equalization Program does not contribute to revenue stability of provinces and, in certain instances contributes to instability. On the surface, this is surprising, because in only a few instances would cumulative revenue of the provinces be more volatile than that of individual recipient provinces. Therefore, it could be expected that own-source revenue plus equalization, linked to a national standard, would be more stable than own-source revenue. Indeed, stabilizing total provincial revenue could and should be a side benefit of the conduct of an equalization program.

Therefore, in addressing the observed instability, it is necessary to look behind the theoretical to the operational aspects of the Equalization Program as it has been conducted over the past decades. In such an examination, one is immediately struck by the massive changes in estimated entitlements from one estimate to the next and the escalating problem of cascading adjustments. Cascading refers to adjustments for estimates for several fiscal years being made at the same time and each acting to increase or decrease a province’s revenue in the same direction. This phenomenon has brought the issue of stability to the forefront of issues in equalization.

During the first few decades of the program, the principal source of cascading adjustments was with respect to census adjustments, which occurred every five years. The federal government generously handled the problem of resulting instability by forgiving most of the negative adjustments. During this period, it could also be observed that the Equalization Program did act in a very positive way to stabilize revenue received from the important income tax bases. As a provincial share of personal and corporate income tax changed, creating positive or negative adjustments through the Tax Collection Agreements, equalization adjustments most often softened the impacts. This responsiveness has been very important in stabilizing the revenues of provinces such as Manitoba.

More recently, changes in entitlements related to natural resource revenues have become increasingly important and have been a source of great instability to recipient provinces receiving a greater proportion of total revenues from resources, Saskatchewan in particular. Cascading adjustments, often counter in timing to the cycles of the natural resource extraction industries, have magnified the problem.

What has gone wrong? The first problem is that the changes to the system for equalizing natural resource revenues have relied increasingly on data that only becomes available two or more years after the fiscal year. Therefore, unlike adjustments to personal and corporate income tax revenue under the Tax Collection Agreements and corresponding Equalization adjustments which are made virtually simultaneously, in the same fiscal period, the changes in a province’s natural resource revenues occur in one year and the Equalization adjustments are made several years later. This phenomenon has been illustrated in material provided by the Government of Saskatchewan and in a recently published article by the author¹². The second problem is that the negative census impacts are no longer forgiven. As well, current accounting standards require the cascaded impacts all to be recorded in the same fiscal year. Finally, it must be noted that the ad hoc measures put in place by the federal government over the past two years are more troubling to the integrity of the program than the census adjustment forgiveness and repayment schedules of the past.

It should be recognised that the issue of predictability is quite another matter from the issue of stability. Most experienced practitioners will have a pretty good estimate of the direction and magnitude of future movements of equalization entitlements generated from natural resources, once the officials have reasonable estimates of the revenue data for the year. They will also have a fair idea of the upcoming census adjustments a year in advance of when they impact Equalization entitlements. However, this ability to predict has not been translated into operational changes in formal estimates of equalization entitlements in the past.

Thus there are four matters that could be addressed to allow the Equalization Program to be responsive and to provide the benefit of stabilizing total provincial revenue, as it should:

- The revenue estimates used for equalization, from the federal government (with respect to the Tax Collection Agreements) and from the provinces (in particular from natural resource revenues) must be more accurate and adjustments factored into calculations in a timely manner. At the present time, there is considerable games playing and there are time lags. The federal government has, in some years, grossly underestimated its revenues from income taxes and the resource-producing provinces have provided estimates that even more blatantly depart from reality.
- Projected and actual revenue data is not now translated into estimated changes in provincial shares of the tax bases, which would provide the offsets on a real-time basis to the increases or declines in natural resource revenues. Constructs in the program calculations which rely on future economic data should not be allowed to delay reasonable adjustments to equalization estimates.
- There is a need to develop new equalization arrangements, with the concurrence of the auditing profession, constructed in a manner which will allow census adjustments (and perhaps other adjustments) to impact revenue in a phased-in manner, rather than having cascaded adjustments falling in a single year once every five years.
- For all of this to work, there needs to be collective responsibility for the estimates of equalization, and a move away from the “games and blame” mentality which has characterized the operation of the program over the past several years. It is proposed that the work of the Economic and Fiscal Data Committee and the Fiscal Arrangements Committee, including a Technical Sub-committee on Equalization, be charged by First Ministers with the responsibility to make the program responsive to actual fiscal circumstances of the provinces.

In summary, it is important to create real responsiveness of Equalization Program entitlements. Only in this manner can the objectives of the program, as prescribed in the Constitution, as well as its capacity for stabilizing total revenues of recipient provinces, be realised to the greatest extent with the resources available. The search for greater stability of Equalization payments alone is misplaced. Whether responsibility for the program’s operations is placed within a co-operative federal-provincial relations environment or with an arm’s length independent commission, the focus on responsiveness must not be lost.

Conclusions on Stability, Predictability and Responsiveness

12. The Equalization Program must retain responsiveness to the fiscal circumstances of the provinces, in order to achieve its constitutional objective and to provide the ancillary benefit of stabilization of total revenue of recipient provinces. Generating stability in equalization payments alone is misdirected action.
13. A substantial improvement in predictability of entitlements under a responsive program, with accompanying diminishment of cascading adjustments and instability, is not difficult to envisage. However, it requires a change in the manner of calculating estimated entitlements and more responsible input from both federal and provincial governments.
14. New arrangements, developed in concert with the accounting and auditing profession, should allow for more gradual adjustment to major census and other impacts on entitlements.

A Permanent Advisory Commission?

The panel has posed the question as to whether a permanent advisory commission would significantly improve transparency and accountability to Canadians or whether it is needed (for other purposes?).

The question raises questions. Why an “advisory” role rather than a more authoritative one? Why the emphasis on transparency and accountability rather than on making the Program more effective in reaching its objectives? The lack of detail on how such a commission might be constituted, the resources available to it and its relation to provincial governments makes any definitive answer impossible. With regard to the last item mentioned, the difficulties around the establishment of the Expert Panel itself are illustrative of potential difficulties that may ultimately impact on the credibility of a commission.

There are a number of models around the world of commissions dealing with fiscal arrangements. The Commonwealth Grants Commission of Australia has evolved in a manner such that it has no control over the size of the total grants to be distributed, but virtually absolute control over the distribution of the grants from the Government of the Commonwealth. Its recommendations have been followed for decades. The Indian Fiscal Commission is reconstituted at five-year intervals. Its recommendations are generally followed, but not as absolutely as those of the Australian Grants Commission. The relatively new Financial and Fiscal Commission (FFC) established under the 1994 Constitution of the democratic Republic of South Africa has had significant influence in the development of intergovernmental fiscal arrangements in that nation, but often the arrangements implemented took forms which varied from the specific recommendations of the FFC. Interestingly, the Government is required under the Constitution to not only set certain issues before the FFC and receive its recommendations prior to passing legislation, but is also

required to respond to the recommendations of the FFC and give reasons should it not take the advice rendered.

The formation of the FFC came with other imperatives. As South Africa had been highly centralized in the past, there were few centres of research and learning with respect to the conduct of intergovernmental relations in the nation. As well, potential divisions in the country and government (which have not materialized to date) suggested the possible need for independent recommendations. In a very insightful response to those who suggested that the FFC may not be needed, given the relative harmony in national-provincial relations, the former Chair of the FFC likened it to buying an umbrella on a sunny day. Perhaps an “umbrella” may yet be needed in Canada.

It might be noted that, unlike the situation in South Africa, there is in Canada a plethora of organizations capable of providing expert analysis and opinion with respect to intergovernmental relations and considerable research being conducted within academic and other institutions.

The conduct of intergovernmental fiscal relations in Canada has involved First Ministers and Ministers of Finance, mobilizing committees of officials supporting their meetings. This process had the capacity to research and analyze existing and proposed arrangements on both technical and political levels. It is difficult to envisage any commission being able to replicate such work. While there was a decline in the operational vigour of this network, perhaps understandably in the wake of the massive unilateral reductions in federal transfer payments in the 1990s, there has been evidence of more robust activity in recent years. The newly created Council of the Federation, together with individual provincial governments, provides a counterpoint to federal positions with respect to intergovernmental fiscal relations. The primary criticism of this “executive federalism” has been that discussions were often behind closed doors and the Canadian public was not sufficiently involved or knowledgeable about the dimensions of the issues being addressed. This too has been changing.

A commission, when newly created, has the advantage of not carrying any baggage from past decisions. However, with time, it could get burdened with the defence of past decisions and become captured by a set pattern of research and analysis. A commission would need to renew itself and its way of looking at issues. In this regard, the model of the Indian Commission, which is reconstituted at five-year intervals, commends itself, though it too has many drawbacks.

The consideration of a permanent advisory commission for Canada comes immediately after the implementation of a scheme for fixing the size of the total equalization fund, which was a radical departure from the previous arrangement. There also has been a series of ad hoc adjustments to transfer payments. The greatest value of a commission could be to halt the destructive activity of ad hoc adjustments to equalization and restore it to an objective formula-based arrangement.

This proposal also comes at a time when the developments with respect to natural resource revenues are likely to create higher disparities and the need for increasing equalization. A focus solely on slicing an inadequate pie may detract from, rather than add to, transparency and accountability to Canadians for the results of the program. Of course, unlike the Expert Panel, a commission could also be mandated to make recommendations on the adequacy of the Program. This could change the value of a commission. On the other hand, restrictions on the mandate of a commission also could make it counter-productive. For example, if it were not able to comment on redress of the inequities raised by the new Offshore Accords, it might serve the purposes of the Government, but might side-track the scrutiny of these arrangements and their impact on equity in Canada as a whole.

Conclusions with Respect to a Permanent Advisory Commission

A permanent commission is not necessary but might perform a useful role under the following set of conditions:

15. A commission must have an appropriately strong relationship with both federal and provincial governments.
16. It must have sufficient resources.
17. It must have a broad mandate, which includes examination of the adequacy of the Program.
18. Its recommendations must not be simply advisory but, as in the South African case, should require a formal response from government.
19. A commission must have the ability to renew itself at regular intervals, with new membership and new analysis.

Conclusion

The Expert Panel is faced with a situation in which it is dealing with a limited mandate, at a time which requires more. The author wishes the Panel success and would support it being given a broader mandate and sufficient time to make recommendations on matters which may impact on the health of the nation for a significant time into the future.

ENDNOTES

1. This theory has been promulgated in recent years principally by the Atlantic Institute for Marketing Studies and the Frontier Institute. In papers and public commentary, they suggest that, because the gaps between the recipient and non-recipient provinces have not disappeared since the introduction of the Equalization Program that “Equalization locks have-not provinces into enormous welfare traps that encourage increased dependency on its funding” (Peter Holle, the Frontier Institute, as quoted in the national Post, 14 April, 2004). This argument ignores the fundamental cause of the horizontal fiscal imbalances in Canada and the fact that per capita productivity and incomes of Canadians in different regions converged after the introduction of equalization and stronger federal transfers made directly in support of provincial health, education, and welfare programs.
2. Polling in the 1990s put Canadian’s support for Equalization in the range of 90%, while through most of the 1990s and into the new millennium, provinces were united in calling for a stronger equalization effort, together with improved financing under the CHST/CHT/CST. These positions were explicitly made in communiqués and press releases from annual Western and Premiers’ conferences.
3. This paper will refer subsequently only to provinces, though many of the references could also pertain to the Territories.
4. See for example the studies conducted by the Conference Board of Canada, “Fiscal Prospects for the Federal and Provincial/Territorial Governments” released by the provinces in July 2002 and February 2004, as well as the work of the Seguin Commission for the province of Quebec.
5. Reports and communiqués from the Annual Premiers Conferences of 1999 and subsequent years.
6. 2004 Government of Canada Budget.
7. As documented in a variety of reports, including the Fourteenth Report of the Standing Senate Committee on National Finance, March 2002.
8. Neumann, Ronald; “*Equalization in Canada: Reform of the Representative Tax System or Move to a Macro Approach? Reflections in Consideration of Recent Developments*” In What Works and What Might Work Better; Institute for Intergovernmental Relations; June 2005.
9. Courchene, Thomas J; “*Confiscatory Equalization: The Intriguing Case of Saskatchewan’s Vanishing Energy Resources*”; Institute for Research on Public Policy; March 2004.
10. Richard Bird and Francois Vaillancourt: “*Reconciling Diversity with Equality: The Role of Intergovernmental Fiscal Arrangements in Maintaining an Effective State in Canada*”; Government and Policy, Volume 19; pages 163 – 187.
11. Wilson, Sam;
12. Neumann; *ibid*