

reduced through de-insurance, and augmented by an advisory panel including "members of the public" as well as medical and governmental representatives and tied to tighter deadlines.

There are at least three points worth noting about these developments in Ontario for what they suggest about the evolution of the profession-state accommodation. First, they suggest that governments may be more willing to flex their legislative muscle to establish a "shadow" within which their negotiations with the profession proceed. Second, however, they suggest the resiliency of the profession-state accommodation even under conditions of growing fiscal constraint. And third, they suggest that the government's approach to accommodation may be shifting the balance of power within the medical profession over time. In the past, academically-based physicians were at the core of the profession-state accommodation; and the OMA played a varying role depending upon the vagaries of its internal politics (Tuohy 1992, pp. 126-127). The NDP government of Ontario has preferred, however, to deal primarily with the OMA as the legitimate "bargaining agent" for the profession. For its part, the OMA has worked its way through a wrenching internal process which has left it more open to accommodation with the state. Now for the first time a body central to the profession-state relationship, the JMC, has no academically-based medical members.

This new accommodation between the OMA and the provincial government in Ontario has not been without controversy within the profession. There is still a minority body of opinion within the profession which holds that the OMA has been too concerned with the preservation and enhancement of the power of organized medicine at the expense of the autonomy of the individual physician. The 1991 agreement, which not only established the JMC but also provided for an automatic check-off of membership dues to the OMA from each individual physician's payments under Medicare, was strongly contested by this minority.

Clinical Guidelines. The tension between the collective autonomy of the profession and the individual autonomy of the practitioner is raised even more squarely by the development of clinical guidelines. The issue of using clinical guidelines developed by professional bodies to shape the behaviour of individual practitioners has been on the agenda of Canadian health policy, to very little effect, for well over a decade. In the early 1990s, however, this mechanism has achieved greater prominence. A number of provinces have developed joint profession-government bodies to develop clinical guidelines, although the fiscal sanctions associated with the guidelines vary considerably. Ontario's Institute for Clinical Evaluative Sciences, under the aegis of the Joint Management Committee, is one such mechanism, and the status of the guidelines it is

to develop is as yet unclear. An earlier initiative in Ontario in which guidelines on the use of caesarean sections were widely distributed to obstetricians was unsuccessful in modifying behaviour. In Saskatchewan, however, guidelines on thyroid tests issued by the Health Services Utilization and Research Commission resulted in a marked drop (65 to 79 percent) in the ordering of certain tests in circumstances in which the guidelines suggested they were not indicated (Mickleburgh 1993). In British Columbia, an undertaking to develop clinical guidelines backed by legislation and fiscal sanctions formed the centrepiece of an agreement negotiated between the British Columbia Medical Association and the B.C. government in August 1993. As governments and professional bodies thus move slowly in the direction of "managed care," relations between the profession and the state, and between individual practitioners and professional bodies, will be under increasing pressure.

Organizational Change. These relationships will also be strained as the system increasingly confronts issues of organizational change in health-care delivery. Such issues have been on the agenda of Canadian health policy since the 1970s, but outside Quebec there has been little action. Now these issues are gaining prominence in a number of provinces. It is worthwhile to distinguish two dimensions of policy making in this regard: one relating to changes in health-care delivery arrangements per se, and one relating to changes in the policy-making structures through which decisions about the organization of health-care delivery will be made. Provincial governments have varied considerably in the emphasis that they have given to each of these dimensions, depending on a mix of factors including the partisan complexion of the government and the degree of populism or statism in the political culture. Under NDP governments, for example, both British Columbia and Saskatchewan have recently announced plans to decentralize policy-making structures by establishing systems of local (and, in B.C., regional) health authorities with greater budgetary and managerial powers than have been granted to similar bodies in the past. In less populist Ontario, the NDP government has made a number of decisions centrally, such as the decision to regularize the practice of midwifery, that have important implications for the reorganization of health-care delivery, and has not expanded the powers of district health councils beyond their traditional advisory functions. Quebec and New Brunswick, under Liberal governments, have established or reorganized regional boards with somewhat more limited scope and more constrained powers than those proposed in B.C. and Saskatchewan. Organizational reforms in Nova Scotia, begun under a Conservative government and continued under a Liberal government, established a system of regional planning agencies with advisory powers only. In Manitoba, under a

Conservative government, proposals for a restructuring of the delivery system have emanated from the provincial government without the creation of local or regional councils (Hurley *et al.* 1993).

Most of the structural changes involving local and regional bodies are in their earliest stages; and their likely impact on the health-care delivery system remains to be seen: precursor bodies have had relatively little impact on the system. But if the scope of the authority of these or other predominantly non-medical authorities should extend to issues of the organization of medical practice, such as a re-definition of the roles of physicians and other health-care personnel, they could threaten the professional clinical autonomy on which delicate profession-state accommodations are based.

There is, then, at least in theory, considerable scope for variation across provincial plans: the definition of "medical necessity" and the structure of the health-care delivery system have been determined in the context of an accommodation between the medical profession and the state in each province. And it is true that costs, supply, and utilization vary considerably across provinces (Tuohy 1992, p. 137). What is remarkable is that the variation is not greater than it is, given the loose constraints of the federal legislation. This variation is limited because the interests of the medical profession are fundamentally similar across provinces; and, if clinical discretion is to be maintained while entrepreneurial discretion is limited, these interests militate in favour of a comprehensive and generously funded scheme.

THE FUTURE

I can now return to the question I posed at the beginning. Will the 1990s be an epoch of fundamental structural change in health care, or will we see a continuation of distributional politics within the parameters of the ongoing accommodation between the medical profession and the state?

What are the factors that might lead us to expect an epoch of structural change? Here a comparative perspective will be helpful. In the early 1990s, both Britain and the U.S. have embarked upon varying degrees of structural change in their health systems. In each case, the impetus for opening the window of opportunity arose from partisan politics. In Britain, as in Canada, ongoing distributional politics in health care have been governed by what Day and Klein have called an "implicit concordat" between the medical profession and the state. Day and Klein state the trade-off between clinical autonomy and economic discretion that underlies this concordat starkly: "[T]he state accepted the right of the medical profession to use the available resources without question, while the medical profession in exchange accepted the right of the

state to set the budgetary constraints within which it worked" (1992, p. 471; see also Schwartz and Aaron 1984, pp. 52-56; and Heidenheimer *et al.* 1983, p. 61). Governmental fiscal restraint put this understanding under increasing pressure in the 1980s. Nonetheless, the impetus for considering fundamental structural change clearly derived from the broader agenda of the governing Conservative party — specifically from Prime Minister Margaret Thatcher's distrust of the power of intermediate para-public institutions such as professional bodies and from Health Secretary Kenneth Clark's adherence to market-oriented policy instruments. In this context, a set of policy ideas then current among U.S. health-care economists (notably Alain Enthoven), regarding "managed competition" in health care was particularly influential (Ham 1992, p. 147).

The result was an attempt to define much more sharply the roles of "purchasers" and "providers" within the system. Specifically, general practitioners were to be given the option of functioning as "fund-holders," with global budgets from which all services for patients on their rosters were to be published. Hospitals were allowed to opt out of the NHS to function as "self-governing trusts" to offer services on a competitive basis to general practitioners and local health authorities. In practice, these changes have, in their early stages, made for less radical change than the debate surrounding their introduction might have implied. They have in some cases shifted some clinical decision-making authority to general practitioners from consultants (specialists) in the hospitals. And they have raised the potential for a greater privatization of the system if the newly-formed hospital trusts choose to compete to an increasing extent in private markets. But at least in the early days of the new regime, observers saw the fairly rapid re-establishment of an equilibrium not far removed from what had been the case before the changes (Coulter and Bradlow 1993; Gennerster and Matsaganis 1993). Without a massive change in information technology, the multitude of fine levers of decision making about health services in Britain continue to rest in the hands of the medical profession.

In the United States, the structural changes in health care proposed by the Clinton administration are much more sweeping than were the recent British reforms; and the policy arena into which they are being introduced is much more complex than is the case in either Britain or Canada. In the absence of national health insurance, American public policy has elaborated both categorical programs and regulatory constraints. The resulting complexity has given a competitive advantage to providers with the resources to invest in understanding the system and responding strategically. Public policy has thus fostered organizational change not only directly (as in the case of HMOs, PPOs, etc.) but also indirectly (as in the case of a large multi-institutional chains, many

of them for-profit, which have sprung up in response to the increasing complexity of the system).

The Clinton proposals recognize this complexity. They leave all of the existing actors in place, while introducing a significant new component upon which the functioning of the system depends: the regional health alliance. Modelled after European social insurance funds, the regional alliances are to act as purchasers on behalf of their enrollees, choosing among competing plans offered by private insurers and health-care providers. Various regulatory constraints will govern both the plans that can be offered and the premiums that can be charged — hence the label that summarizes the structure of the proposed regime: “managed competition.”

The genesis of these proposed changes was in the desire in the Clinton campaign, and then the Clinton presidency, for a centrepiece for its domestic policy agenda. Twice before in the last 30 years, partisan politics in the U.S. have opened windows of opportunity for structural change in the health-care arena. In the mid-1960s, when Canada was adopting comprehensive national health insurance, the U.S. also entered into a major reform of health-care financing. Faced with implacable opposition from organized medicine, however, Democratic strategists chose to focus upon the provision of hospital and medical insurance for the elderly and the poor, and the establishment of the Medicare and Medicaid programs was the result. Then, almost a decade later in 1974, it appeared for a time that a bipartisan coalition might achieve a comprehensive national health insurance plan built upon a combination of private carriers and government programs. In the partisan manoeuvring leading up to the 1974 Congressional election under the cloud of Watergate, however, the moment was lost (Starr 1982, p. 405). In the current case, the prospects for real change are somewhat brighter. The issue is being addressed early in the first term of a president who can claim a mandate for health-care reform; and the opposition of organized medicine is much more muted and focused upon particular aspects of the plan. But the structure of the health-care arena, with its proliferation of financial interests, is much different than it was 20 and 30 years ago. The passage of the Clinton proposals through that landscape will shape the resulting plan in ways that cannot yet be anticipated.

The contemporary British and American experience, together with earlier Canadian experience, suggests that structural change in the health-care arena is likely to be triggered by partisan factors outside the arena, although its implementation is shaped by the configuration of interests in the arena. Is there reason, then, to expect that structural change in this arena will soon be triggered in Canada?

On one scenario, an era of structural change appears likely. After the period of the late 1980s in which the role of the federal government in social policy was unilaterally redefined, we can look towards an explicit renegotiation of the federal-provincial relationship. And in the next federal Parliament, it is possible that the Reform Party and the Bloc Québécois could play a role in decentralizing social policy analogous to the role played by the NDP in centralizing it in the 1960s. Even given the Liberals' firm majority, Reform and the Bloc represent strong regional challenges to the legitimacy of the Liberal mandate. Together with fiscal and political pressures within the nexus of relationships between federal and provincial governments, the complexion of Parliament could well lead the governing Liberals in a more decentralist direction.

As for the federal-provincial nexus, there is clearly growing enthusiasm in some quarters (as reflected in a number of contributions to this volume) for greater "disentanglement" between federal and provincial program responsibilities and revenue sources. There is also a growing recognition, within both federal and provincial circles, of the need to reduce provincial vulnerability to unilateral decisions by the federal government affecting transfer payments. On some of the models that have been developed for consideration, the federal government would relinquish all responsibility for Medicare, and the residual cash transfers for Medicare under EPF arrangements would be converted to tax points (Norrie in this volume).

If provinces are given greater discretion in health policy (an outcome that would occur in due course under current arrangements anyway, as discussed earlier) this will have the effect of providing ten possible windows of opportunity for structural change in health care, rather than one, that might be opened up under certain partisan conditions. And it also raises the possibility that provincial experimentation will have demonstration effects similar to the effect of Saskatchewan medicare in the 1960s.

If one or more of these provincial windows do open, it will open on a landscape of policy ideas in which "managed competition" holds great sway. Some Canadian health policy analysts have argued for some time in favour of an approach that would introduce market forces within the publicly-funded Canadian system (Stoddart and Seldon 1983). Any significant movement towards managed competition in the current Canadian context would lead to a much greater diversity in the types of coverage that Canadians enjoy than is the case today. It would also increase the transaction, and hence the administrative costs of the system. And it would reintroduce private insurers as significant political and economic actors in the medical and hospital insurance arena. In short, it would render the system, in the experience of both consumers and providers, significantly more "American," especially if the United States, by

providing universal coverage through a Clinton-style plan, moves somewhat closer to the Canadian model.

This scenario is a real possibility. On balance, however, I believe that it is unlikely that fiscal decentralization in health care will progress as far as the complete vacation of the medicare field by the federal government. Furthermore, I believe that the fiscal decentralization that does occur (even if it includes the vacation of the field by the federal government) will not likely lead to extensive structural change along "managed competition" lines. My reasons for this belief are twofold.

For the first reason, I must return to the neglected "symbolic" dimension of policy to which I alluded at the outset. Polls have consistently demonstrated that Medicare is by far the most popular public program in Canada. A 1988 cross-national poll showed that Canadians were more satisfied with their health-care system than were either American or British respondents, and that they overwhelmingly preferred the Canadian system to the British or the American. A large majority of American respondents, on the other hand, preferred a Canadian-style system to their own (Blendon 1989). Subsequent polls have reinforced these results (Gallup Canada 1991). This level of public support exists not only because of the tangible benefits that Medicare yields, though that is clearly an important factor. It exists also because Medicare is a central part of Canadian public mythology. It has become an important element by which Canadians distinguish themselves from other nations, and particularly from the U.S. During the heated and wrenching public debate over the Free Trade Agreement with the United States in 1988, politicians opposing the agreement (including the then leader of the federal Liberal party) repeatedly invoked Medicare as one of the things that distinguished Canada from the U.S., and alleged that it was threatened by the agreement. Public opinion polls showed that this allegation was the most effective way of galvanizing opposition to the FTA (Johnston and Blais 1988). Given the volatility of symbolic politics, it is difficult to judge how tightly the mythological status of Canadian Medicare constraints fundamental structural change. But it is fair to say that proposing structural change in Medicare, especially in the direction of the "American" model of managed competition now gaining increasing prominence on the policy landscape, carries great political risk.

In the second place, even if structural change in the health-care arena were to be attempted, it would be conditioned, as it has been elsewhere, by the existing configuration of interests. Any attempt to introduce other administrative actors into the system as required by a managed competition model would threaten the fundamental accommodation between the medical profession and the state that underlies the Canadian system. This can most readily be

appreciated through a quick comparison with the United States, where the effect of organized medicine's opposition to the introduction of national health insurance over the past few decades in the U.S. has been to preserve the economic discretion of physicians while increasingly constraining their clinical autonomy.⁵ In the absence of comprehensive national health insurance, as noted above, administrative structures have proliferated. In the effort to control costs and/or to generate revenue, both provider institutions and third-party payers have elaborated systems of parameters to govern clinical decision making — systems of so-called "managed care."

Medical groups in Canada are aware of the different trade-offs that underlie the Canadian and American systems. Even in briefs critical of government policy, they typically present the Canadian system as one of the best in the world, while expressing some concerns about its future (Tuohy 1992, pp. 144-145). The twin spectres of the U.S. system (intrusive regulation, corporate dominance, inadequate coverage) and the British system (inadequate resources, excessive rationing) are frequently evoked. Attitude surveys of physicians find large majorities on balance satisfied with their conditions of practice and positively oriented towards Medicare — although sizable pockets of discontent remain. A 1986 survey of Canadian physicians, for example, found less than one-quarter dissatisfied with medical practice and less than one-third dissatisfied with the functioning of Medicare. Sixty percent believed that Medicare had positively influenced health status, but 75 percent believed that it had reduced the individual's personal sense of responsibility for health (Stevenson *et al.* 1987). A comparative survey of physicians in Canada, the U.S. and western Germany in 1991 found that although a majority of physicians in each country believed that some fundamental changes in their health systems were necessary, satisfaction with the health system was higher among Canadian and German physicians than among American physicians. When respondents were asked to identify the most serious problems with their system, the sharpest differences arose between Canadian and American physicians, whose judgements of their respective systems appeared virtually as mirror images of each other. Canadian physicians were more likely to complain of limitations on the supply of well-equipped medical facilities. American physicians, on the other hand, were more likely to identify delays or disputes in processing insurance forms and in receiving payment, the inability of patients to afford some aspect of necessary medical care, external review of clinical decisions for the purpose of controlling health costs, and limitations on the length of hospital stays as serious problems with their system (Blendon *et al.* 1993, p. 1015).

It is true that a degree of structural change, in the direction of "managed competition," has occurred in Britain even in the context of an established

accommodation between the medical profession and the state based on the preservation of clinical autonomy. The effects of these structural changes seem so far to be internal to the medical profession, in enhancing the positions of "fund-holding" general practitioners. It may be the lack of the necessary information technology that has blunted the impact of change; and that the effect of the reforms will be seen only when information technology catches up with them. But by and large, the impact of the changes appears to have been blunted through their absorption into existing patterns of behaviour.

A prediction that fundamental structural change in health care is unlikely in the next decade is not, it must be emphasized, a prediction of stasis. In the first place, current policy directions in health care will have incremental structural effects. As various services are fully or partially de-listed, the scope for private insurance, and hence the economic and political role of private insurers will increase. In the foreseeable future, however, this expansion of scope is likely to be marginal, and to be contained within the structure of existing provider-state accommodations. Second, as issues of technology assessment, clinical guidelines and organizational change are worked through existing policy-making structures, they are likely to yield significant if incremental change in the allocation of resources to health care and in distributional outcomes. These changes as well will vary across provinces, as they have done in the past, according to the nature of the evolving accommodations between health-care providers and provincial governments.

NOTES

1. Various scholars have wrestled with the appropriate terminology for this third dimension of policy — the terms "constitutional" (Day and Klein 1992), "constituent" (Lowi 1985) and "positional" (Aucoin 1971). In an earlier version of this chapter, presented at the conference from which this volume is drawn, I used the term "constitutional." That term, however, has specific connotations related to the fundamental law of the land. Particularly in the context of a volume devoted to issues of fiscal federalism, it is difficult to shed those connotations for analytic purposes, and I have chosen to refer instead to the "structural" dimension of policy.
2. In 1991, the federal Parliament passed legislation enabling the government to withhold *other* transfers to the provinces in the event that the "penalty" for non-compliance with the *Canada Health Act* exceeded the cash transfer thereunder. This legislation has yet to be invoked, or tested in the courts.
3. There is no doubt that the U.S. exceeds Canada in the availability of high-technology procedures. This is consistent with the general phenomenon that the diffusion of technology has been greater in systems with high proportions of specialists and less centralized cost control (Hollingsworth *et al.* 1988). As a matter of public policy, Canadian provincial governments control the diffusion of medical technology. Operating funds for certain types of equipment such as

imaging machines will not be provided unless acquisition of the equipment has been approved by the government. Furthermore, under the hospital global budgeting system, any significant change in the volume of service, including high-technology services, must be approved in order for the hospital to receive the necessary additional operating funds. A recent study based on interviews and available documentation found substantially greater numbers of MRI (magnetic resonance imaging) and radiation therapy units, lithotripsy centres, and cardiac catheterization and open-heart surgery units, and slightly more organ transplantation units per capita in the U.S. than in Canada. German ratios were intermediate between Canada and the U.S. in the case of cardiac catheterization, radiation therapy, lithotripsy, and MRI, and were below Canadian ratios for open-heart surgery and organ transplantation (Ruble 1989). Rates of coronary artery bypass surgery are much higher in the U.S., although other forms of treatment of ischemic heart disease such as other major reconstructive vascular surgery and pacemaker implantation, Canadian rates were higher (Anderson *et al.* 1989).

4. That is, payment for a given service could be reduced or denied if the number of services provided to a given patient, or by a given physician, or within a given facility exceeded a prescribed maximum during a particular time period. The legislation also granted the government broad regulatory powers to control expenditures, limit the number of practitioners, and affect the geographic distribution of practitioners and facilities.
5. The greater economic discretion of U.S. physicians does not necessarily translate into higher incomes, given the higher administrative expenses and greater incidence of bad debts associated with the U.S. system. In the decade following the introduction of Canadian Medicare, real physician fees rose much faster in the U.S. than in Canada — in Canada, indeed, (with the exception of British Columbia and Alberta) real fees declined over that period (Barer and Evans 1986, pp. 78-80). Between 1971 and 1985, real fees declined 18 percent in Canada and rose 22 percent in the U.S. (*idem.*). Differences in net income are less than might be expected, however, in part as a result of lower practice expenses. Because of the different specialty mixes in the two countries, income comparisons are best made by specialty. One such comparison, by Iglehart, related U.S. physicians to their counterparts in Ontario. (Ontario physicians represent about 40 percent of all Canadian physicians; and both net professional incomes and medical fees are close to the Canadian average (Barer and Evans 1986, pp. 78, 94)). In 1986, average net incomes in general practice and family practice were marginally higher for U.S. than for Ontario physicians. The differences were more pronounced in obstetrics and gynaecology, with U.S. physicians earning on average one-quarter to one-third higher than those of their Ontario counterparts. In pediatrics and internal medicine, however, the net earnings of Ontario physicians were on average marginally higher than those in the U.S. (Iglehart 1990).

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Comment: Calmness and Desperation

Greg Stoddart

I enjoyed Carolyn Tuohy's chapter a great deal, and her distinctions of distributional, symbolic and structural dimensions of policy are very useful. However, I went to the Yogi Berra School of Discussant Training and, although I can say that there is almost nothing that I disagree with, it is what the chapter does not say that I disagree with.

Reviewing some of her points, I would agree that structural policy change in the health-care arena does come from outside, that is to say from exogenous factors. I certainly would agree with the characterization of the Canadian experience of 1958-71 as the era of structural change, and her view that since then policy has largely been distributional. I also agree that it is always easier to explain the past than it is to predict the future! With regard to the future, however, I am less certain than Carolyn Tuohy that we will not see important structural changes in health-care arrangements. The likely balance of probability is against structural change, but I do have some concerns and some slightly different views.

This is a "calm" essay. It is almost a reassuring essay, or it can at least be read that way. But when I wander around the country, visiting health ministries or health-care ministries and talking to providers, I am *not* reassured. There is currently a different atmosphere, a sense of turbulence, and an atmosphere of exasperation, if not desperation.

I would like to talk about three health policy problems that fuel this exasperation. An important question is whether or not there is a federal role, fiscal or otherwise, in resolving these issues.

First, there is a sense of exasperation about having to raise revenue to finance the costs of the existing system, and this is presumably where the user charge debate comes in. Elsewhere, I and colleagues Robert Evans and Morris Barer are on record with a number of analyses of user charges, suggesting that they have very little to offer the Canadian public. There are a whole series of negative and well-known side-effects that accompany almost every form of user charge. If the intent of such charges is only to raise revenue, however, then they will probably "work," because (in an economist's language) the price-elasticity of demand for health care or medical care is very inelastic. The utilization of physician services and, in particular, hospital services is very price-insensitive. For this reason alone, user charges may prove irresistible to policymakers in the future as a source of revenue. I am not suggesting in a normative sense that I would like to see that happen. My view is quite the opposite. But there is a real chance of that happening. There is a significant group of people in Canada who would say that a user-charge policy is not a great policy but it may have to be done. There are many more forms of user charges than the flat per service charges that Carolyn Tuohy mentions, including a "tax-back" scheme whereby the value of insured medical and hospital services utilized would become taxable income. It should be noted that this scheme does not escape the problems with the other forms of user charges. Nevertheless, the issue of financing existing systems could lead to structural changes of the type that the *Canada Health Act* has played an important function in restraining until now.

Another source of exasperation is that we simply are not seeing changes in the patterns of clinical practice that are possible and warranted on the basis of the evidence we have about how to render effective and efficient medical care. Even after two or three decades of fairly extensive health services research, we still find that anywhere from 20-40 percent of the utilization of many medical procedures is either ineffective or inappropriate. We do not seem to be making a great deal of progress here. Carolyn Tuohy points out that clinical guidelines are one of the ways in which the conflict between the state and the medical profession is being accommodated. Clinical guidelines may help, but we do not have good "transmission belts" for their implementation into practice. I sense a real exasperation on the part of people committed to health-care reform that we are not moving closer to the effectiveness- or the efficiency-frontier. This is ultimately going to require reimbursement changes. But the interesting thing about these changes is that they have very little to do with fiscal federalism. They have not been prevented by current arrangements, and it is not clear how renegotiation of the arrangements will facilitate them.

On this issue there is tough work to be done at the "coal-face," at the provincial level and possibly even at lower levels. Whether or not this involves

structural change of the type referred to in the paper, it may involve changes in the participation of some actors in the health-care system. One of the alternatives for addressing this problem is to challenge key institutions to show some leadership on the issue, and two key institutions would be academic health sciences centres and the self-regulating colleges, especially those of physicians. These bodies have not shown much leadership in moving the system to the effectiveness- and efficiency-frontiers by translating research studies into changes in clinical practice. In my view they should be strongly encouraged by provincial governments to assume much more active roles.

Let me go on to my third problem, the resolution of which will involve ordinary Canadian citizens. Imagine for a moment that we did reach the effectiveness- or efficiency-frontier. In economic jargon this is only a technical efficiency- or cost-effectiveness-frontier, not an allocative one. That gets us to the issue of deciding what is medically necessary. Just because something is cost-effective does not mean that it *should* be done.

There is still a consensus that needs to be formed socially about what medical necessity means. Are we talking clinically, about only the patient's capacity to benefit from a service, or are we really talking about whether or not we want to provide publicly-insured services that benefit only very small segments of the community (or large numbers of people but only in very small amounts, especially relative to their costs). We have not yet addressed this issue as a society, and I am not sure that the best way to address it is through the accommodation of medical profession-state conflict. The public is going to need to be involved but, just as in translating research evidence to clinical practice, it does not seem that we have the *mechanisms* to implement that dialogue. There may need to be some new institutions formed to do that.

This relates to the organizational change section of Carolyn Tuohy's chapter. Here I tend to differ a bit with her assessment of the likelihood of structural politics in the next decade. There is a very real possibility that the difficult decisions about which services will be provided to which groups will be dumped to a district or regional level through the creation of new decision-making bodies. The bodies may also receive some fiscal autonomy, which District Health Councils in Ontario, for example, have not had in the past. If that is the case, and if the funding is need-based there may be significant structural changes in the health-care arena, and a much greater role for the general public.

Finally, I have two more general questions to offer. The first is for those commentators who support the full devolution of health care to the provinces. What weight has been given in that discussion to the fact that the general public of Canada basically does not want decentralization, that it wants a set of

national standards, and that it wants to preserve a sense (maybe even an illusion) of national unity or identity through federal-provincial arrangements for health care?

The second question concerns the nature of what we are talking about as "health." Although the topic has been billed as "health policy and fiscal federalism," it seems to me that it has not been about health policy at all; it has been about health *care* policy at the most and probably more about *sickness* care policy. There is currently a renaissance of the notion of the broader social determinants of health. Social, physical, cultural and economic environments affect health. For example, evidence is accumulating on the degree to which social support reduces your risk of mortality, for example. The health effects of early childhood development programs and other non-health care interventions and policies are increasingly being studied and found to be important. Should not *health* policy and fiscal federalism be interpreted more broadly? What is in fact the federal government's contribution to health as opposed to simply sickness care? If we look at other health-related programs, whether child development programs or tobacco programs or whatever, has there been a withdrawal, of the magnitude often alleged, of federal funding in the area of "health" policy? Perhaps we should start thinking a little more broadly if we want to have a new window on structural politics about health.

CHAPTER SEVEN

More Carrots, Please: Education, Training, and Fiscal Federalism

Judith Maxwell

INTRODUCTION

My topic is education and training in the context of fiscal federalism. I found that I had to write two papers — one on university and college education and the other on training. In both cases, however, the themes are bureaucratic deadlock, vested interests, jurisdictional games, and a desperate need for innovation. Oddly enough, there are more visible signs of movement in the right direction on the training side than there are on postsecondary education. But the reform of the training system is by no means guaranteed.

The main challenge in writing this paper was to figure out why reform has not taken place in the past. Certainly, there was no lack of sensible advice throughout the 1980s — by the Macdonald Commission (Royal Commission 1985), the Economic Council of Canada (1990; 1992), the Association of Universities and Colleges of Canada (Smith 1991), the Premier's Council of Ontario (1990), and legions of other task forces, scholars and policy advisers. The proposals presented here draw heavily on those documents. They are intended to replace the current permissive approach to federal funding with financial incentives to promote excellence and efficiency. Hence, my title: More Carrots, Please.

The chapter proceeds as follows. The first section begins with a discussion of what we want from education and training in the 1990s and beyond, and then a short description of the fiscal arrangements in question. Section two deals with the challenges facing universities and colleges, while the third proposes some directions for change in the financing of universities and colleges. In the fourth section, I turn to training. And the last section offers a brief conclusion.

EDUCATION AND TRAINING FOR THE FUTURE

Globalization and technology have eliminated any prospect for low-skill jobs with high pay in Canada. We had more than our share of these jobs in the postwar period because of high levels of tariff protection and the robust resource sector. In every province, there were large sections of the male population who could leave school at age 16 and expect to live a full and prosperous life working in the mines, the forests, the fishery, some parts of agriculture, and in standardized manufacturing jobs like breweries and metal bashing.¹

Those days are gone. A young man who leaves school at age 16 today faces the prospect of a life pumping gas, flipping hamburgers, or brief seasonal work as a fishing or hunting guide. Even in the public sector, the jobs for young men who started work in the mail room and ended up as a \$40,000 a year clerk with a fully indexed pension are disappearing.

A Knowledge-based Society

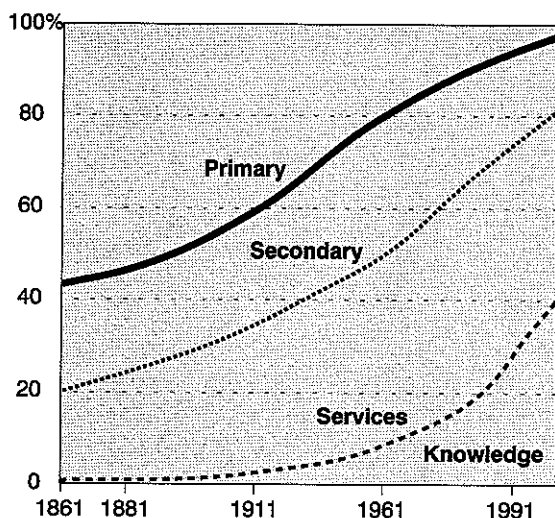
One way to characterize the changing configuration of employment in Canada is depicted in Figure 1. It shows the diminishing role of the goods-producing occupations in resources, manufacturing, construction occupations — in the top part of the chart — and the increasing role of service workers and knowledge workers. The knowledge and service jobs occur in all sectors — though there are only a few in primary and secondary industries.

What the figure shows is a society that is polarizing into service workers (mostly uneducated, low skill, low paid), and knowledge workers (mostly educated, highly skilled, and better paid). In other words, pay is determined by productivity. And the way work is now being organized, it is very difficult to climb the ladder from service to knowledge worker. On-the-job training will not transform a hospital cleaner into a nurse, for example.²

A society has two options in dealing with this polarizing trend. One is to simply accept the polarization and pay the price — which will be more poverty, crime, disease, and despair. This in itself imposes great costs in terms of public security and whatever welfare and other programs are used to moderate the poverty and despair. This is easily characterized as the American style (Maxwell 1993).

The second option is to reduce polarization by adding a learning dimension to the social contract. The original elements in the social contract were: the citizen agrees to work and pay taxes to finance the safety net, and government makes a commitment to create high levels of employment and to maintain a social safety net.³

FIGURE 1: Changing Patterns of Work (Share of Total Employment)



Note: U.S. knowledge workers' share of total employment

Primary	0.4
Secondary	5.0
Tertiary	<u>24.0</u>
Total	30.0

Source: Nuala Beck.

Source: Based on Urquhart and Buckley, and Labour Force Survey.

A post-capitalist society, to use Drucker's term (1993), wants all citizens to be on a learning curve. Knowledge workers will need to upgrade, service workers need the chance to become knowledge workers, and "traditional" workers will need to adapt to constantly changing jobs in goods production. In this learning culture, there is a mutual responsibility on the part of citizens and state. Citizens have a responsibility to learn and the state has a responsibility to create opportunities to learn. Most of that learning will take place in private institutions — colleges, universities and the workplace. So the state does not deliver the education and training, though it may have to underwrite it at times.⁴

This conception of the future need for learning has two important consequences for this chapter. First, it justifies a role for government in the financing of education and training. And second, it creates a remarkable opportunity for the education and training institutions in Canada.

The rationale for the role of government in education and training rests on the externalities derived from a well-informed citizenry, a more efficient labour market, and higher levels of productivity and income. The argument is that governments are needed to ensure access for all, to facilitate the intergenerational transfer of knowledge and to build new knowledge that can be used for the benefit of all.

In the case of training, there is evidence that the private sector would underproduce training because of the risk that employees will leave in order to work for a competitor, after the employer has invested in training. For the same reason, employers will concentrate on job-specific or firm-specific training as opposed to generic training. Thus the role of government is to build institutions that will serve as bridges between general and specific training, between school and work, and between business and labour (Streeck 1990).

However, the private returns to education are also high — both for employers and for individuals (Vaillancourt 1992). So, they too should invest in education and training, and one of the key questions for the 1990s is the appropriate allocation of that responsibility.

The opportunity offered to universities and colleges by a knowledge-based society has its upside and downside. On the upside, they can expect a steady flow of students of all ages who are seeking more knowledge. They could become the chosen instrument for both social and economic policy focused on learning.

But, on the downside, universities and colleges will find that taxpayers are not prepared to throw wads of new money at the learning objective. In the next ten years, while we work through the deficit-debt issue, resources will be tight, perhaps even shrinking. Thus, new sources of financing will be essential. At the same time, students, governments and society at large are expecting innovations in teaching, in course design, and in methods of learning.

On that score, universities and colleges are on shaky ground. Universities today look remarkably like they did 400 years ago. But we know that all of the following trends are beginning to evolve (Cohen and Stanley 1993):

- It is possible to attend 12 Canadian universities from anywhere in the country by computer;
- Home computers allow us to tap into the collections of several libraries and link up with people around the world who want to discuss almost any subject;

- Lectures by the world's leading experts are available on videocassette;
- Canadian children are participating in joint science projects with children from other countries.
- Large corporations are establishing their own large scale training systems in-house because they cannot get the services they need from existing institutions.

The Fiscal Arrangements

Table 1 shows the composition of funding for universities and colleges in Canada for a representative year — 1988-89. Under the Established Programs Financing, the federal government provides cash transfers of just over \$2 billion to the provinces to help them fund postsecondary education. In 1977, it also set aside tax points which by 1988-89 were worth \$3.2 billion for this purpose, and there is now strong disagreement as to whether or not those tax points belong to Ottawa or the provinces. The federal government also spends another \$3.3 billion on research, student assistance, and other items directly associated with postsecondary education. The formula governing the EPF was altered in the 1980s and it is now widely expected that the cash transfer will gradually shrink over the 1990s.

TABLE 1: Source of Funds for Postsecondary Education, 1988-89

	\$ billion	Percent
Federal and provincial transfers ^a	8.5	71
Direct federal spending		
for research	0.6	5
for student assistance	0.5	5
other	0.3	3
Student fees	1.1	9
Other	0.8	7
Total	11.8	100

^aIncludes federal transfers to provinces of \$5.4 billion; \$2.2 billion cash and \$3.2 billion tax points. By 1991-92, this had increased to \$5.9 billion but the cash portion was beginning to decline.

Source: Statistics Canada and Secretary of State.

There is no shortage of studies which have declared that the current funding mechanisms are broken (Leslie *et al.* 1993). Cutt and Dobell (1992) show that while Canadian universities have been starved for funds in the past decade, their autonomy (i.e., academic freedom) has been better protected than that of universities in other jurisdictions. Governments do not intervene directly in the management of the universities and scholars are free to say and write what they wish. But pressures to regulate performance are mounting — Cutt and Dobell referred to the current period as the “lull before the storm.”

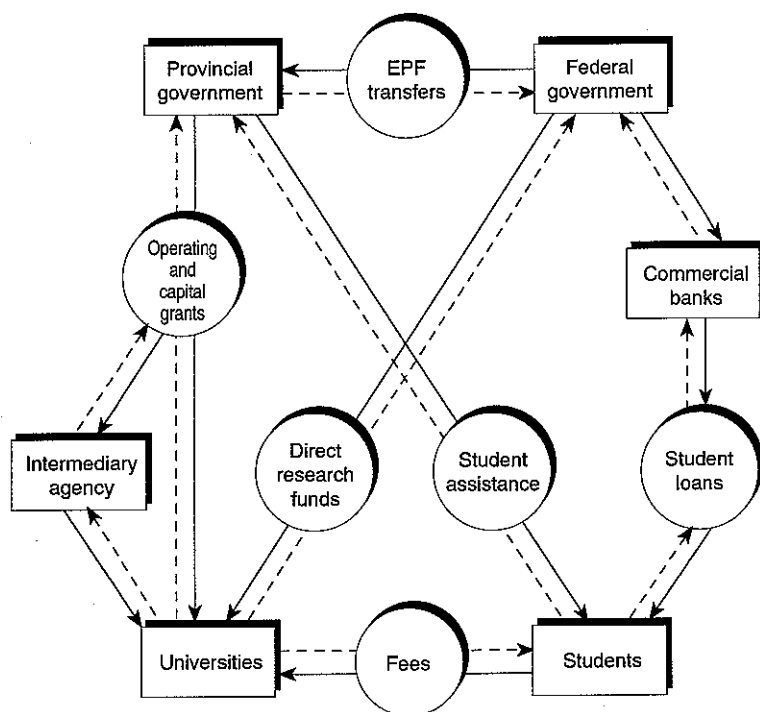
The weaknesses identified in the literature include the following:

- The excessive generosity of the 1960s and early 1970s was not sustainable. The combination of the demographic pressure of the baby boom and the commitment to productivity growth through education created the political rationale for a flood of new funding for postsecondary education. That generosity created expectations on the part of faculty, staff, unions, and the bureaucracy that could not be sustained after productivity growth slumped so badly in the mid-1970s.⁵
- Misleading signals were built into the funding formulas of the 1970s. Al Johnson (1987) has noted that most incentives in the Established Program Financing stand in the way of reform. Peter Leslie (1980) made the point long ago in a report he did for the AUCC: “There is hardly any carrot for innovation; ... (and) there is only a very flimsy stick for inducing structural change where it is necessary, and for inventing solutions to staffing problems and program redundancy or overcapacity.”
- Faulty projections of enrolments in the 1980s led to serious errors in planning with respect to funding, infrastructure, and staffing. Forecasters were looking at the demographics — the baby bust — but did not take into account the incentives in the labour market which kept young people in university longer (high unemployment) and attracted more people of all ages to attend university (skill upgrading).
- The lack of performance indicators meant that the public has taken more than a decade to realize that the quality of the system is eroding, as class sizes increase and more teaching is delegated to teaching assistants and inexperienced part-time lecturers. We may know, by osmosis, which are the strongest institutions, but the public does not know which are the strongest programs, nor does it know how little intellectual nourishment the undergraduate gets today, compared to 20 years ago. It is possible that some institutions do not know which of their programs are strong and which are weak. The first *Maclean's* article (1991) put the “cat among the pigeons,” but it turns out that

we do not even know how to compare institutions (Ontario. Task Force on University Accountability 1993) and some of the emerging proposals look cumbersome.

- The lines of accountability in the current funding for postsecondary institutions are confused. The best way to illustrate this is to use a diagram from Cutt and Dobell — see Figure 2. The federal government provides large amounts of funding (more than half) to the system through payments to the provinces who then distribute the money as they see fit — i.e., to education or to other purposes.

FIGURE 2: Governments and Universities: Accountability Relationships



Source: Cutt and Dobell (1992).

One of the messages that shines through when we look at the fiscal arrangements is that the provinces have the jurisdiction and the federal government is paying most of the bills — 60 percent of the cost of training, 80 percent of the operating cost of universities and colleges, and 60 percent of university research funding (Cutt and Dobell 1992).⁶

This outcome is hard to explain, after the fact. Why would the federal government get itself so deeply involved in financing these activities when there is no political visibility and no accountability. The federal government has never even attempted to set standards for quality or cost-effectiveness. The other characteristic of the existing arrangements is that they were designed to create stability of funding for the provinces. The stability was achieved, however, at the price of rigidity. The system is proving to be highly inflexible in the face of a transforming society. And the provinces, which are also under fiscal pressure, have been outraged by federal adjustments to the formula intended to reduce the federal deficit. One can only marvel at the naivete of both parties to this contract which lacks both accountability and a capacity for adaptation.

THE UNIVERSITIES

Objectives

What do we want from our universities in the next few decades? Here is a personal listing.

1. A system that pays attention to the interface between theory and action. The key words are policy, empirical, and practical. (It is my impression that these are considered to be bad words in the lexicon of many university departments.) This can be achieved through cooperative education, the use of practitioners as instructors or as special guests in the classroom, university-industry cooperation, practical work assignments, and so on.
2. A system that works on the basis of teams. The key word is interdisciplinary. Society — the workplace, families, etc — works in teams. Skills are blended. Few university programs actively practice this. There is little or no cooperation across departments and faculties (the School of Policy Studies is a visible exception). Many departments do not work as a team in designing complementary courses, assignments, etc.
3. A system that offers coherent transitions from one institution to another and from one stage of study to another over a lifetime. The key words are lifelong learning, responsiveness, and articulation (recognition of credits). The typical adult will return to school several times over a lifetime. She or he should be able to get credit for previous study and for work experience.

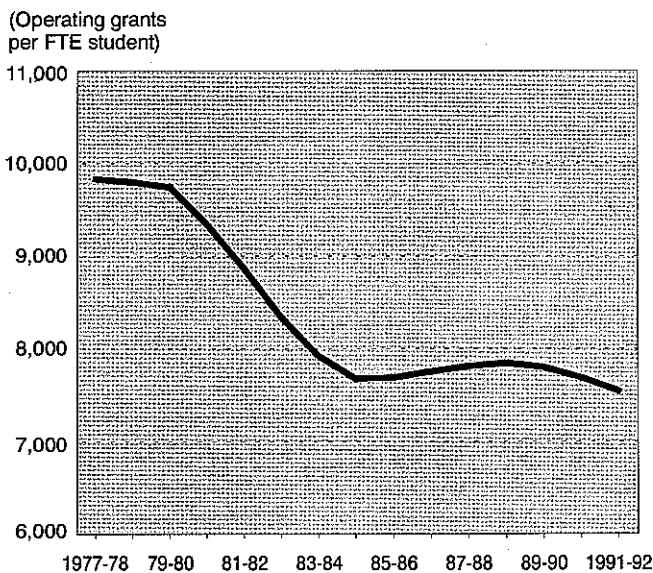
Most institutions still treat these mature students, especially the part-time ones, as second-class citizens.

4. A system that is performance driven. The key words are excellent, efficient, and accountable. Institutions have to be able to demonstrate that there is excellence in teaching and/or in research, and that time, assets, and money are being used efficiently.

Many of these objectives are incompatible with the traditions of the university — where the focus for centuries has been on academic freedom, security of tenure, and the preservation of knowledge. Indeed, universities still look surprisingly more like the medieval institutions than the high-tech learning institutions outlined by Dian Cohen and Guy Stanley in *No Small Change*. Why has the system not adapted more swiftly to meet these objectives, and what kinds of reforms would encourage institutions to move in this direction?

There is no question that the universities have been under financial pressure to change. As Figure 3 shows, the funding per student has fallen by more than

FIGURE 3: Operating Grants to Universities per FTE Student, Canada, 1977-78 to 1991-92 (Constant 1991-92 Dollars)

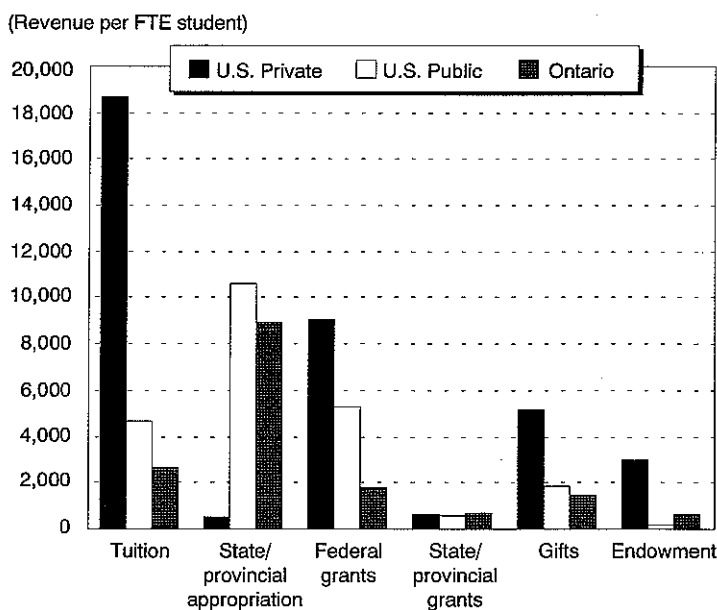


20 percent in real terms since 1977-78. And most provinces have cut back on the nominal level of funding in the past fiscal year. For the most part, however, universities have absorbed this financial pain by making across-the-board adjustments in budgets for all activities rather than redefining their missions, reshaping their programs, and adopting new technologies for learning.

It is difficult to determine to what degree these across-the-board cuts have affected quality of education and research. (Although stories of undergraduate courses with 800 students make many of the programs sound like mass-production, rather than structured learning systems.) The Council of Ontario Universities has produced some interesting comparisons of the sources and allocation of funds for comparable institutions in Canada and the United States (those that offer an array of doctoral programs), which provide an interesting perspective on the Canadian institutions.

Figures 4 and 5 use purchasing power parity to avoid distortions caused by short-term fluctuations in exchange rates. In these charts, we are comparing

FIGURE 4: Revenue per Full-time Enrolment at Ontario, U.S. Public and U.S. Private Doctoral Institutions, 1990-91 (\$ PPP CDN)



Source: Council of Ontario Universities (1992).

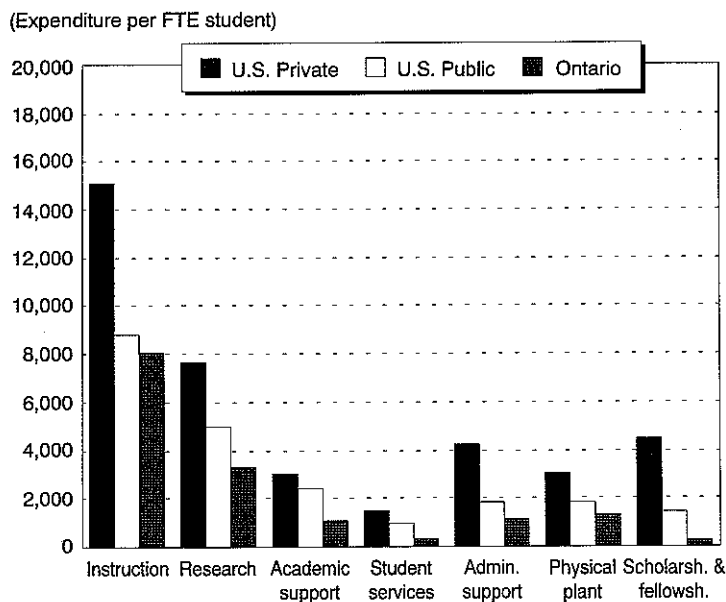
American state-funded universities with the publicly-funded ones in Canada like Queen's, Toronto, Waterloo, Carleton, McMaster, and Ottawa. Private institutions in the U.S. are also included for contrast.

State-funded or public institutions in the United States get more money per full-time student from tuition, state grants, and federal grants than do Ontario universities (Figure 4). In particular, the average tuition fee per full-time student in the public universities in 1990-91 was \$4,658 (based on Canadian dollars, calculated according to purchasing power parity) versus \$2,633 in Ontario. Recent fee increases will not have narrowed the gap by much.

On the spending side, the American public universities spend slightly more on instruction, and considerably more on research and academic support (Figure 5). They also spend more on student services and scholarships than do the ten Ontario universities.

We have no way of comparing performance of these universities in either quality or access. But, what we do see in the United States is a system that

FIGURE 5: Expenditure per Full-time Enrolment at Ontario, U.S. Public and U.S. Private Doctoral Institutions, 1990-91 (\$ PPP CDN)



Source: Council of Ontario Universities (1992).

combines strong public support with a diverse funding base. This should strengthen the autonomy of these institutions and make them more responsive to the needs of students.

Governance

Another major source of weakness is in the governance of these institutions. Ron Watts (1992) has written that there are four ways of organizing a university:

- Professional guilds, with self-regulation by the senate and faculty.
- The political arena — such as the control that some state legislatures have over state universities in the United States.
- Bureaucratic regulation, as now happens in Europe, Australia, and more recently in the United Kingdom.
- Market systems like the private universities in the United States.

Most countries use some combination of these methods of organizing. In Canada, there is a strong emphasis on professional guilds tempered by some bureaucratic regulation. However, David Cameron (1992) has argued that the checks and balances in the self-regulation model have been eroded by democratization and by the scarcity of resources.

Cameron traces the historical pattern of governance dating back to the Royal Commission on the University of Toronto in 1906. That commission established a balance between state control and university autonomy or self-government by establishing the bicameral model. Control and management of the university were vested in the board, appointed by the governor-in-council, and academic matters were to be dealt with by the senate: "The key to holding this structure together and facilitating its efficient operation was to be a strengthened presidency, joining senate to board and holding a monopoly on recommendations concerning academic staff." This model of governance became the norm for most Canadian universities, but it has been drastically eroded over the past 30 years; first, as the faculty took control of academic appointments; then as democratic participation transformed both the management of the university, which became concentrated in committees, and the composition of the board; and more recently, as a result of external pressures such as targeted funding and employment equity regulations (Jones 1992). Cameron quotes J.A. Corry, Principal of Queen's, in 1969: "It is vital to get some things clear. Much of the substance of power has been taken out of the president's office and away from the board of governors. The members of the academic staff now have what has been taken out and they have nearly a veto on the use of what is left."

The role of the senate has also been altered, first, by the emergence of collective bargaining which subsumes many tasks that were once the responsibility of senate; and then by the development of the "global village" which means that academic standards are set by peers in other institutions — even other countries, rather than within the university community (Jones 1992).

The net effect, over time, has been to create universities without rudders. Presidents have little power to set direction or to resolve disputes. Many board members lack the analytical skills and the management background to judge whether good management systems are in place. The loyalty of the individual member of faculty shifts more and more to self rather than the university community. While the problems of the institution are recognized, there is a pervasive tendency to shrug and say: "It's not my fault."

All this leads to the conclusion that universities will not be reformed from within. Internal constraints mean that scarce resources and new demands will always be met by spreading the budget over all activities, rather than channeling resources into areas of strength or future specialization. Universities will only be able to adapt and innovate, in the positive sense, when they confront the correct financial incentives and when they have been forced to become more accountable for performance through regular transparent program reviews, and greater exposure to competition for students.

Some of the current debate on accountability is focused on the creation of a comprehensive set of performance indicators. Stuart Smith recommended several outcomes indicators which involve new data collection, and an Ontario Committee set up by the Broadhurst Task Force (Ontario. Task Force on University Accountability 1993) has done a careful assessment of a large number of performance indicators. While good data is clearly important, we should avoid burying the universities in a massive data collection and reporting exercise. The Task Force report recognized this, urging university governing bodies to focus on the purpose of a given indicator, rather than the details (1993, p. 54). It argued that over time, best practices in the use of management indicators would emerge.

It is also important to note that the data does not have to be internally generated: there is much useful system-wide information available from sources like Statistics Canada (DesRosiers). The point is that a good university will learn how to display its strengths to the community at large and it will take measures to deal with its own weaknesses. It would be folly to wait until a central agency begins to dictate what should be done with specific programs.

DIRECTIONS FOR CHANGE

It is tempting to make proposals that would completely disentangle the two orders of government — to assign the federal government the role of supporting research and low-income students, for example. However, I am persuaded that we are dealing here with a joint product — teaching and research — which makes any division of duties arbitrary. I decided therefore to stick to some practical suggestions that build on the status quo, but which are intended to create some carrots and sticks — some based on the market and some built into the funding formulae.

The general framework for the proposals is an administrative agreement between the federal and provincial governments which affirms provincial paramountcy in education but recognizes the need for a federal contribution because of the externalities described in section one as well as the tradition of sharing in the federation. This agreement would include undertakings from both parties:

The provinces would commit to:

1. Restore the autonomy and the powers of the boards of universities, and to set terms of reference which state that one of the duties of the board is to ensure that regular program reviews take place and that management makes logical decisions based on those reviews.
 To make this work well, there should be an interprovincial task force to determine the most effective criteria for board appointments. The Broadhurst Report includes draft guidelines on appointments that appear to give pre-eminence to representativity. I agree that this is important but it should not take place at a speed that risks a breakdown in governance.
2. Provide on an ongoing basis a major and increasing share of the core funding for universities, using their own revenue sources, which should be consolidated by the formal and final transfer of the EPF tax points set aside for this purpose in 1977. This is a symbolic measure but would put an end to a lot of federal-provincial wrangling.
3. Deregulate tuition fees and encourage universities to set tuition in relation to the cost of delivering specific programs. Some universities might end up charging 50 percent of total costs (roughly what the big private universities charge in the United States), others might wish to stay closer to 25 percent (not far off the current average).⁷ Their decisions will be based on market choices by students and their families. But the system would offer choice of standard as well as choice of student. We would not need to homogenize standards because of fiscal restraint.

4. Establish or expand a provincial fund to provide means-tested grants or bursaries to students from low-income families. Students with lesser means would have four ways of coping: win a scholarship, choose a lower cost university or program, go into debt through the income-contingent loans (see below), and/or apply for means-tested grants.

The federal government should:

1. Formally transfer the tax points associated with postsecondary education to the provinces, and insist that the provinces are responsible for both funding and performance of the university and college systems. Using the data in Table 1, this consolidates provincial control over federal tax points worth about \$3.5 billion which were transferred to the provinces in 1977.
2. Transform the remaining federal funding for postsecondary education into a much more strategic set of transfers, intended to create incentives for innovation and adaptation. Again, using the data in Table 1, the total amount would include the remaining cash payment under the EPF — roughly \$2 billion — plus another \$3.3 billion or more which has been used to finance sponsored research, student assistance, and other programs. These funds should be used for a combination of operating grants paid directly to the universities,⁸ sponsored research grants, a reformed student loan system, and a fund to provide means-tested bursaries to students from low-income families.
3. Reform student loans to establish an income-contingent repayment system, based on market rates of interest. This fund should soon become self-financing and eventually would run a surplus as payments on outstanding loans accumulate. There should be some discussion as to the ultimate use of that surplus: Should it be used for deficit reduction? for grants and bursaries? or for supporting the growth of the institutions?

There is a consensus in the recent literature on postsecondary education that Canada should adopt an income-contingent repayment system for student loans. Without pretending to be exhaustive, this was the conclusion of the Macdonald Commission, of the AUCC, and recently of a well-argued study by Ed West (1993) with a strongly supporting comment by Jonathan Kesselman.

4. Ideally, the funds for means-tested bursaries should be jointly funded and jointly operated in each province. This would avoid duplication and end runs and minimize administration costs.
5. Increase scholarship awards for excellent students, especially in the high-cost disciplines.

Both the federal and the provincial governments should consider a special set of incentives to promote innovation in the universities and colleges. This should be a joint program, or, if the provinces do not wish to adopt the idea, it could be a federal program designed to promote excellence in education. Whoever undertakes the program should have it administered as a peer reviewed process to avoid excessive bureaucratization and excessive intervention by governments in the management of higher education.

This University and College Innovation Program would be financed by holding back a portion of the operating grants. The funds would be used to reward universities that are clearly innovating and committed to structural change. For example, a university that actually succeeds in cutting a program that gets a poor review (against all the community and political pressure that will inevitably ensue) deserves a reward.

A holdback of 1 percent of total federal expenditures, for example, would amount to more than \$50 million a year. The awards would therefore have a significant impact on the discretionary funds available to well-performing institutions. Such bonus payments could not be used to cover salaries on an ongoing basis, but they should be used at the discretion of the president and with the approval of the board to finance a chair, build a new program, etc.

Taken together, these recommendations form the instruments that can maintain the autonomy of universities while pushing them in the four directions outlined in the second section — relevant, interdisciplinary, coherent, and performance-driven.

TRAINING

Jurisdiction over and the funding of training have been one of the front-line issues in the recent constitutional epic and they continue to be a critical issue in relations between Ottawa and the provinces, especially Quebec.

To Quebecers, training is part and parcel of economic sovereignty because it is so closely tied to their linguistic and cultural distinctiveness. To many Canadians who think about the issue, the labour market is a key element in the four freedoms of the economic union — the free movement of people, capital, goods, and services. However, there are two labour markets here. French-speaking workers are not nearly so mobile as their English-speaking counterparts, and, to a very considerable extent, bilingual francophones prefer to live and work in a French-speaking environment (Economic Council 1991). Yet, while the two labour markets are distinct, they are not separate. The recent controversies over the movement of construction workers on the New

Brunswick-Quebec border and the Ontario-Quebec border illustrate the lack of complete separation.

This distinctiveness of the Quebec labour market makes a strong argument for asymmetry in the arrangements with respect to training, with the important condition that Quebec should participate in developing common training standards and then adhere to them once they are in place. This is a practical compromise which is spelled out more clearly in what follows.

Indeed, the asymmetry may well extend beyond Quebec to the other provinces, like Ontario and British Columbia, and possibly Alberta, which already have a well-entrenched training bureaucracy. They bring to the table a different set of assets from the smaller provinces whose capacity to develop and deliver training is more limited.

Background on Training

Although the provinces have jurisdiction over education, apprenticeship, industrial standards, and 90 percent of the labour force, it has been the federal government that has played the dominant role in labour markets and training since the creation of the Department of Labour in 1900. Ottawa has funded provincial employment services and training since 1918, and in 1940, a constitutional amendment transferred responsibility for unemployment insurance to the federal government.

The situation today is that the federal government accounts for 75 percent of labour market expenditures on training and other labour market programs, excluding UI (Kroeger 1993). This includes a network of 500 offices across Canada which provide front-line services to the unemployed and to employers. These offices select those who are to receive training. But the federal government does not deliver the training — it buys it from provincial institutions and from industry. Nor does it have any control over training standards, curriculum, structure of programs, etc. (Until 1985, it was buying from a single source — community colleges.⁹ More recently, it has been buying places through a competitive bidding process — and private training colleges have been quite successful in bidding for these training places.¹⁰)

In general, however, there are few training standards in Canada. Fewer than 30 occupations are certified under the federal Red Seal program, which ensures acceptance by all provinces, and those 30 are all occupations associated with construction and the old industrial economy. The apprenticeship program is equally out of date — training the wrong people at the wrong age for the wrong skills (Economic Council 1992; Canadian Labour Market and Productivity Centre 1990). And, in the current environment of structural change and high unemployment, there are too few school-to-work and welfare-to-work

programs and too few training places for the people who want to upgrade their skills.

All of the provinces have their own training programs — there are 32 programs in Canada focused on workplace training, for example (Ekos 1992). So both the employer and the trainee face a confusing array of criteria and choices. Many more programs focus on training for the unemployed (Premier's Council 1990). In Quebec, the overlap and duplication extends beyond the programs to the administration, since Quebec runs its own system of employment offices for welfare recipients.

Meanwhile, there are encouraging signs of a greater commitment on the part of industry to workplace training. McMullen *et al.* (1993) found that the volume of training for a representative sample of business establishments doubled between 1985 and 1991. The National Training Survey taken in 1991 indicates that the private sector spends roughly \$3.6 billion per year. Table 2 shows that private expenditure now appears to eclipse the combined total of federal and provincial spending on training.

TABLE 2: Source of Funds for Vocational Training, 1988-89

	\$ billion	Percent
Federal ^a	2.1	60
Provincial	1.1	31
Fees	0.2	6
Other	0.1	2
Subtotal	3.5	
Employer-based training (1991) ^b	3.6 ^c	

^aSince the passage of Bill C-21 in 1990, over \$1.5 billion in additional funds from the UI system are being applied to training, despite a general pattern of expenditure cuts.

^bGovernment subsidies covered about 9 percent of employer expenditures on training other than apprenticeship; 20 percent of apprenticeship training was funded by governments and a further 19 percent was jointly funded by the employer and governments.

^cThe 1991 National Training Survey estimated structured training expenditures by the private sector at \$3.6 billion based only on those organizations that provided actual or estimated structured training costs. The margin of error for the \$3.6 billion estimate is in excess of 50 percent. Only half of the 8,000 organizations that provided detailed training information were able to provide useable information on training costs and only 13 percent of organizations providing training reported actual costs. Vocational Training Revenues by Program and Source of Funds 1988-89.

Source: Statistics Canada and CLMPC (1993).

In summary, a system exists which involves many players in the public, private, and education sectors and for whom no one is accountable. Much money has been spent on training — increasing amounts despite the fiscal restraint in Ottawa. Many program evaluations have been done. However, there is still no concrete evidence as to the program designs that work for each type of participant and there is no foundation for determining the skills that should be developed in the next decade. No standards have been developed for the occupations of the future, although there is recognition that standards are needed (Canadian Labour Force Development Board 1993; Campbell 1993). Viewed from the perspective of the unemployed, however, the system looks unresponsive, overloaded, and inefficient. The Economic Council of Canada (1992) used the expression “the worst of both worlds”: a secondary school system that does not prepare young people for work and a training system that does not compensate for that failure.

Despite the problems and the immediacy of the issue, federal and provincial ministers met last January for the first time in four years. One observer comments that they spent most of the time arguing about jurisdiction (Haddow 1993). One provincial participant indicated that the provinces were not prepared to move more aggressively towards active labour market programs unless the federal government provided the funds.

Institution Building

Despite this tale of woe, there have been signs of reform in recent years. In 1989, the federal Department of Employment and Immigration launched a Labour Force Development Strategy which started with a major consultation exercise (placed in the hands of the CLMPC) and led to the formation of the Canadian Labour Force Development Board (CLFDB) in 1991.

The underlying principle was simple: transfer the responsibility for design and delivery of training to the private sector — to labour, business, and the equity-seeking groups appointed to the board. This national board was to be matched by provincial boards (which would mobilize and coordinate all provincial inputs to the training system) and by community level boards which would be responsible for determining which courses would be offered locally and who would qualify for them. The whole exercise was intended to be a vehicle for putting all the federal and provincial training resources into one pot. Eventually, it was hoped that there would be a “single window” for training, placement, and counselling at the community level.

The initial reaction to the idea was mixed. Quebec was ahead of the other provinces with its Commissions de la formation professionnelle and the privately sponsored Forum sur l'emploi, but it was adamantly opposed to participating

in any such federally driven initiative. Ontario was already in the process of creating the Ontario Training and Adjustment Board (OTAB), an idea that had percolated out of the Premier's Council in the late 1980s (Premier's Council 1990). The structure and design of the OTAB appeared, on the surface at least, to fit with the CLFDB concept of privatization and local delivery. New Brunswick and British Columbia soon agreed to establish their board, along the lines of the CLFDB.

Thus was launched one of the most important institution-building exercises of the 1990s — an effort to reform the training system *and* to build a bridge of cooperation between business and labour leaders. This was an ambitious task, and it is important to recognize that the pathway was strewn with institutional barriers — the ongoing federal-provincial turf war; the reluctance of federal and provincial officials to delegate their functions to a private board; and the total lack of experience of the labour market partners in working together, let alone with the equity and educational groups also participating.

Employers' and labour organizations in Canada are fragmented — there were 480 national business associations in 1980 (Coleman 1986). The labour movement had eight central union organizations in 1989 representing the one-third of the work force that is unionized (Kumar *et al.* 1990). The Canadian Labour Congress is by far the largest of these organizations but the power to organize and to bargain collectively lies mainly with the union locals. These two fragmented groups had no tradition of trust, and no practice in working together. It was obvious from the beginning that this kind of institution building would take time and a lot of dedication (Economic Council 1990; Haddow 1993). But the decision to proceed was based on clear evidence that successful training systems in Europe and Japan depend heavily on a labour-business partnership, though every country has a unique set of institutions.

It is difficult, at this stage, to discern whether the transfer of power will succeed. Some progress has been made. Individual business leaders have been participating actively both federally and in some provinces, despite some problems in creating a cohesive leadership. They have at least tacitly accepted that labour is entitled to an equal number of seats at the table. But there is not much evidence of a commitment from the business community in general.¹¹ Nobody expected it would be easy, and the possibility remains that the private sector partners simply do not have the capacity to take on the powers that are on offer.

In addition, the jurisdictional obstacles are evident at every turn. Quebec, Ontario and Alberta still do not participate in the CLFDB. It is still not clear where the boundary falls between the CLFDB and Employment and Immigration Canada (now part of the Department of Human Resource Development —

HRD). The Ontario conception of the role of OTAB is rather different from the federal conception of CLFDB and its provincial partners. OTAB will have line responsibility for designing and delivering programs. It has not been designed, however, to be the channel for federal funds into Ontario. Thus, we could conceivably end up with two systems of regional or community-based committees in Ontario — one federal and one provincial. This could be avoided if both federal and provincial governments give the funds and executive responsibility to the same local boards. In contrast, the New Brunswick Labour Force Development Board appears to be designed precisely along the lines of the federal board and will be the channel for federal training funds flowing into the province.

Quebec has its own board, the Société Québécoise du développement de la main d'oeuvre. Its board includes many of the players in the Forum sur l'emploi, who are more accustomed to working together than the social partners in the rest of Canada. The SQDM has absorbed about half of the research staff of the Ministère de la main d'oeuvre, du revenu et de la formation professionnelle, and is now recruiting its operating staff. The board of the SQDM voted not to accept Prime Minister Kim Campbell's offer of jurisdiction in the summer of 1993, apparently because of the condition that common standards be developed and implemented (Campbell 1993). The fear was, according to one insider, that the standards would represent a federal intrusion which would influence the boundaries of specific trades.

It is clear that we are in the middle of one of the big jurisdictional games of the century, with the roles and responsibilities of federal, provincial, and private sector partners being the main source of controversy. Out of this may come a new and improved structure for delivering training. But it could also end up as a bureaucratic jungle, with the system choking on quarrels between governments and between business, labour, and their equity-seeking partners.

My reading of federal and provincial politicians and their officials is that they all have the same goal in mind — a training system that enhances human potential. But the outcome will depend to a great extent on the ability of key leaders to nurture a new relationship between business and labour; to sustain the political will to delegate the training function to the private sector partners; to provide the partners with solid research to identify benchmarks for effective training programs; to push labour, business, educators, and public officials to get on with the job of developing training standards; and, finally, to find a way to mesh the gears of federal and provincial employment services. This is not a light agenda.

Training Needs

Table 3 provides a matrix to help frame the discussion of training needs and service delivery. The current approach to training is to pick a target group and design a program that will include some combination of income support, training courses, and infrastructure. Both federal and provincial governments aim programs at each target group, programs that establish different criteria for entry, different levels of support and so on. The contribution by the taxpayer to this system includes transfers to provinces, tax and other incentives to employers, transfers to individuals, tax and other incentives to individuals. The National Training Survey indicates that 45 percent of workplace training costs is composed of the wages and salaries of the trainees and 55 percent is actual training costs (CLMPC 1993).

TABLE 3: The Training Structure in Canada

<i>Target Group</i>	<i>Training Needs</i>	<i>Funder</i>	<i>Location</i>
Youth/Students	Basic skills Technical Apprenticeship Professional	Taxpayer	Colleges Schools University
ST unemployed	Trade specific	Employer and employee	—
LT unemployed Disadvantaged ^a	Basic skills Literacy Trade specific	Taxpayer	Colleges Schools
Unattached workers ^b	Literacy Basic skills Trade specific	Taxpayer and workers	Colleges Schools
Employed, small firms	Literacy Job specific Technical Professional	Employer? and employee	Workplace? Colleges Schools
Employed, large firms	Literacy Job specific Technical Professional	Employer and employee	Workplace Colleges Schools Universities

^aEmployable people on social assistance, for example.

^bMainly people in non-standard jobs with no attachment to a specific employer.

Source: Author's compilation.

Throughout this extraordinarily complex system, there are several common threads. First, all the training occurs in one of four places — the workplace, schools, colleges (public and private), and universities. Second, all the training can be reduced to four categories: literacy, basic skills, technical, and professional. Within the technical and professional categories there is an extraordinary range of occupations which require a combination of job specific and generic skills. However, it is interesting to note that in Germany, which is generally acknowledged to have the most advanced formal training system in the industrial countries, there is a shift back to generic skills and to multi-skilling, by combining the courses and standards for several occupations (Streeck 1990).

From the point of view of the client, then, what is needed is a coherent system of training programs that will permit the trainee to identify the training needed, and then move in a logical step-by-step fashion up a training ladder. Ideally, the system should have solid roots in the secondary school system, so that there are logical pathways from school to training to work.

For the most part, the literacy and basic skills programs are needed by people who are no longer in the education system and have a serious education deficit. But the technical and professional training may also be aimed at people who are no longer in the formal education system. Thus, there does not appear to be a way to clarify jurisdiction by giving part of the problem to one order of government and part to the other. We are looking at a system where responsibilities will inevitably overlap.

The key to rationalizing the system will be to establish standards and articulate the system so that someone who passes a literacy test or has succeeded in basic skills has a certificate that will be recognized in technical programs. These standards should be determined on the basis of what employers require for an effective work force — a good beginning exists in the Conference Board's employability test (1992). See Table 4.

Similarly, technical training whether it is in a college or in the workplace should be driven by standards set in consultation with labour and business. Again, the student needs a sense of achievement and a sense that the knowledge gained in one area opens the door to other training opportunities.¹² The standards are needed by every jurisdiction, and must be portable across jurisdictions. But the process can be streamlined if the provinces share the work involved in developing standards, in cooperation with business, labour, and other interested parties.

The obvious organization to coordinate this work would be the CLFDB. However, the opposition of the provinces will make this impossible. That leaves the possibility of an interprovincial commission. Whoever does it, developing

TABLE 4: Employability Skills Profile: The Critical Skills Required of the Canadian Workforce

ACADEMIC SKILLS Those skills which provide the basic foundation to get, keep and progress on a job and to achieve the best results	PERSONAL MANAGEMENT SKILLS The combination of skills, attitudes and behaviours required to get, keep and progress on a job and to achieve the best results	TEAMWORK SKILLS Those skills needed to work with others on a job and to achieve the best results
<p>Canadian employers need a person who can:</p> <p><i>Communicate</i></p> <ul style="list-style-type: none"> Understand and speak the languages in which business is conducted Listen to, understand and learn Read, comprehend and use written materials, including graphs, charts and displays Write effectively in the languages in which business is conducted <p><i>Think</i></p> <ul style="list-style-type: none"> Think critically and act logically to evaluate situations, solve problems and make decisions Understand and solve problems involving mathematics and use the results Use technology, instruments, tools and information systems effectively Access and apply specialized knowledge from various fields (e.g., skilled trades, technology, physical sciences, arts and social sciences) <p><i>Learn</i></p> <ul style="list-style-type: none"> Continue to learn for life 	<p>Canadian employers need a person who can demonstrate:</p> <p><i>Positive Attitudes and Behaviours</i></p> <ul style="list-style-type: none"> Self-esteem and confidence Honesty, integrity and personal ethics A positive attitude toward learning, growth and personal health Initiative, energy and persistence to get the job done <p><i>Responsibility</i></p> <ul style="list-style-type: none"> The ability to set goals and priorities in work and personal life The ability to plan and manage time, money and other resources to achieve goals Accountability for actions taken <p><i>Adaptability</i></p> <ul style="list-style-type: none"> A positive attitude toward change Recognition of and respect for people's diversity and individual differences The ability to identify and suggest new ideas to get the job done — creativity 	<p>Canadian employers need a person who can:</p> <p><i>Work with Others</i></p> <ul style="list-style-type: none"> Understand and contribute to the organization's goals Understand and work within the culture of the group Plan and make decisions with others and support the outcomes Respect the thoughts and opinions of others in the group Exercise "give and take" to achieve group results Seek a team approach as appropriate Lead when appropriate, mobilizing the group for high performance

standards will be an immense task. We probably need standards for 400 occupations. In Germany, it takes about two years for the social partners to agree on the standard for one occupation. No province can afford either the time or the money required to do all 400. No country can run an effective training system without them. Why not cooperate? The actual programs being delivered will obviously vary according to the needs of each community, but once a Canadian has completed the program in Nanaimo, her qualifications should be recognized in all parts of the country.

It is important to note that the provinces have already had 35 years, since the need was first recognized, to develop these standards. And the federal government, which has no jurisdiction, has continued to fund training despite this pitiful performance. The CLMPC Task Force on Apprenticeship, composed of labour, business, and educational representatives, issued a scathing report in 1990 in which it recommended that the federal government should give the provinces three more years to develop standards for apprenticeship programs. After that, the Task Force said, federal funding should be cut off.

Delivering Services

Another thorny question is the delivery of services — the screening of applications, the placement services, counselling, and so on. Such services have to be delivered at the local level, but that can be done by a federal, provincial, or a private agency. The key challenge is to find a way for all three agents to work through a single window, so that applicants and employers do not waste time filling in forms at different offices.

One of the considerations here is the evolution of information technologies, which, before long, will permit applicants and employers to use a smart card or a network card to connect with an employment/training office from their home or from a bank kiosk. These applicants will not know or care whether the program is federal or provincial. The Department of Human Resource Development is already experimenting with these systems, and Ontario now has detailed information on training costs, availability, location of courses, etc. on computer disk. Thus, the jurisdictional debate will soon be occupied with issues of computer architecture, compatible software, etc. Let us hope that the technology gets used to simplify the debate rather than delay us for another five to ten years.

There are two possible images of this technological future. One can imagine a humane but efficient world where all the job and training openings in a community show up on a screen at home or in the local employment office. The front-line public servants would find their work transformed because all the basic information on work history, training, income, and family considerations

would be on the file. The public servant would then be occupied with the more qualitative issues concerning the expectations and talents of the applicant, some counselling on job applications and interviews, a review of past successes and failures.

The other image is more Kafkaesque — like voice mail. The applicant inserts her card, gets connected to the network, is given a list of programs she does not understand, and cannot find a human being to explain them. Who knows which image will emerge?

Directions for Change

The overriding priority in the next few years must be to create a system focused on common standards and the quality of training rather than on symmetry in institutions. With continuing high unemployment and job change, there will be intense pressure on governments to come up with training programs and a delivery system that work.

The public knows that training is important and is already infuriated by the incapacity of the system to deliver. In a world where governments are broke and the public is alienated by the waste and inefficiency of the public sector, there will be big political costs if the system does not shape up soon. In the case of training, there is no statutory deadline to renegotiate the funding arrangements. However, as the major public sector funder of training, the federal government can set a deadline for resolving issues, as noted above, simply by announcing that it will withdraw funding from provinces that do not have a viable system in place in three years' time.

The specific actions required are:

1. The provinces should strike joint interprovincial task forces to establish the common standards for all the occupations or groups of occupations for which Canadians are likely to be trained in the next decade. The CLFDB and parallel provincial boards can provide useful input on the part of business, labour, education, and equity-seeking groups.
2. The provinces should also establish a task force within each province to plan the implementation of standards in the colleges, secondary schools, and workplaces where the training takes place, so that the trainers are ready to use the standards as soon as they are ready to be implemented.
3. The federal government should offer some carrots and a stick. The carrots would be, first, to help pay for the cost of developing standards, and second, to transfer federal activities in training and delivery systems to provinces that have a fully articulated system of standards in place. Not all provinces will wish to take on these activities, but the lack of symmetry should not

be a problem if the whole system is running on the basis of clearly articulated standards.

The stick would be a commitment to cut funding for all training programs in provinces that are not making clear progress in developing and implementing the standards.

4. When and if the standards are developed and in place, the federal government should hold back some of the funds that are due each year (1 percent would amount to \$20 million a year), so they can be used to reward strong performance in the training system itself. The rewards should be based on criteria such as: standards are in place and regularly reviewed, innovation in course design, good articulation exists from one institution to another, employers indicate satisfaction with the training outcomes, etc.

CONCLUSIONS

The central problem with the fiscal arrangements for education and training is that the federal government has been writing cheques for services without specifying or monitoring the desired outcomes. This is a permissive kind of federalism. It may have solved jurisdictional debates in the mid-1970s when the EPF and other arrangements were renegotiated, but it has left us with an education and training system that has failed to adapt to the needs of the new economy.

This underperformance undermines the legitimacy of governments, and corrodes the nation state from within. The failure to perform breeds alienation and fosters regionalism. There are success stories buried in the education and training systems: universities with excellent programs; colleges that have built a powerful synergy with local industries (Economic Council 1992, p. 19); and training programs that have given individuals a new lease on life (Betcherman *et al.* 1990).

To make the training system work, I think we should abandon the notion of constitutional symmetry, permit institutions to develop in each province that meet the basic criteria agreed by all the parties, while using common training standards as the force that binds the country together and maintains the viability of the economic union.

To ensure that the universities adapt to the needs of a knowledge-based society, we have to build both diversity and accountability into the funding base — by deregulating tuition fees and setting the parameters for good governance.

In both cases, I am proposing more carrots. The federal government must begin to use the leverage that comes from being a major funder. To do this, it

should hold back funding in ways that are specifically designed to reward good performance — to keep both training and higher education focused on our most basic goals — excellence and efficiency.

I am convinced that the capacity to deliver is there, but we need to build into the system incentives for excellence and efficiency and an ability to create the new. The risk is that the current turf wars will create a new structure that is even more rigid and less accountable than the old one.

NOTES

I wish to acknowledge helpful comments on an earlier draft by Gordon Betcherman, Robert Davidson, Arthur Kroeger, and Norman Leckie. The errors and the interpretation of the facts are mine.

1. Young women in those regions tended to stay in school longer because they did not work in the same jobs. But they, too, need more education and training in a knowledge-based society.
2. We should not accept this polarization in the definition of jobs as a matter of course. There are ways to break down the barriers. Courchene has suggested that we need to create a para-professional society — para legals, para medics, etc. (1993). Another way to break down the barriers is through contracting-out (Drucker 1993). If hospitals contract out the cleaning to a specialized firm, then the most enterprising of the low-paid hospital cleaners will be able to start a firm that can do that work efficiently. Thus, some — though not many — hospital cleaners will cross the barrier from service worker to knowledge worker, and productivity gets a boost at the same time. A third way is to use technology differently — to humanize the design and use of technology to make jobs more rewarding, whatever the pay structure (Klees and Papagannis 1989).
3. Both sides seem to be having doubts about that contract. People are not paying their taxes and governments are not doing much about sustaining employment — but that is argument for another paper.
4. While there is a strong rationale for public provision of education and training, there is also a rationale for contracting out the delivery of these services to private institutions — to schools, colleges (public and private), universities, to non-profit organizations, and to business organizations. This can be done because there is a definable output, the results can be monitored, and there is a choice of suppliers (Purchase 1994).
5. The rate of growth in total factor productivity (the most comprehensive measure of efficiency of use of labour, capital, and materials) slowed from an average of 1.5 percent per year in the period 1962-73 to only 0.6 percent per year in the 1980s. Economists are not agreed on the reasons for the slowdown, but it appears to be connected to the energy shock of the early 1970s — which made much capital equipment obsolete and also triggered a wave of inflationary pressures. Some studies also place a lot of emphasis on the inability of institutions to adapt to the new technologies.
6. The AUCC advises that there is some dispute about these numbers.

7. The complicating factor here is cross-subsidization of disciplines — the cost of education in health sciences far exceeds that in the arts. Arts students may already be paying close to full cost.
8. Quebec, in particular, will probably wish to opt out of the direct payments of operating grants to the institutions. This would require some form of compensation and then raises the question as to whether other provinces would prefer to opt out with compensation, leading to a more decentralized system. If this starts to happen then it will be important for the federal government to institute a strong Innovation Program as noted here in order to ensure that the federal resources going into the system are actually being used to promote excellence.
9. The provinces insisted on exclusive use of community colleges. It seems they were prepared to protect teaching staffs at the expense of providing relevant training.
10. There are about 1,000 private career colleges in Canada, of which 350 have been designated by the federal government as institutions whose students are eligible for Canada Student Loans. The 350 colleges have annual tuition revenue of about \$230 million. There are no comparisons of relative performance, but, in general, private colleges charge higher fees but also boast higher placement rates. They often compete effectively on the basis of compressed courses that reduce the amount of income foregone (Economic Council of Canada 1992, p. 20).
11. The federal board is also anomalous in the sense that the public sector unions are strongly represented even though the process is aimed primarily at the private sector.
12. The Ontario Task Force on Advanced Training documented the extraordinary lack of integration between the Ontario college and university systems (1993).

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Comment: The Promise of Procurement Federalism

J. Stefan Dupré

At its core, I consider that Judith Maxwell's chapter is a plea for asymmetric federal-provincial relations in matters of training and education. If this is a correct interpretation, I wish to offer her my unreserved congratulations. Before using her paper as the platform from which to sell my own brand of snake oil, I shall simply observe that I have nothing but admiration for the courage she has displayed in compiling a comprehensive catalogue of prescriptions for whatever ills — real or imagined — beset universities, colleges, occupational standard-setting, tuition fee determination, the financing of student accessibility, and any federal-provincial relations pertinent thereto. It matters not a wit that one of her prescriptions seems to fly in the face of asymmetry, to say nothing of accountability — I refer to a provincial commitment to escalate their share of core university funding at the same rate as federal funding for sponsored research and core funding. It matters even less that another prescription — the enhanced use of practitioners in the classroom — is coupled with a diagnosis that universities have been eroding the quality of education by delegating more teaching to part-time lecturers. These are mere quibbles that I raise only to prove that I did indeed read her stimulating paper and that I remain, as I have always been, an incorrigible tease.

Other chapters in this volume are also relevant to education and training. Worth framing is Thomas Courchene's characteristically trenchant observation that "with knowledge at the cutting edge of competitiveness, aspects of social policy become indistinguishable from economic policy." In the domain of education and training this says it all. Let me illustrate by framing a question concerning which I would love to hear a Maxwell-Courchene dialogue.

Consider, from Maxwell's prescriptive catalogue, the notion that provincial deregulation to permit higher tuition fees should be coupled with student accessibility to more generous loans. Even with an income-contingent repayment scheme, how well, in intergenerational terms, would the resulting educational debt-burden on the young square with a situation in which, as Courchene observes, we are already depressing the income prospects of our youth with rising payroll taxes to finance the pension benefits of an older generation whose members enjoyed the windfall of low tuition fees?

At a level that broaches less cosmic matters, Courchene's chapter, like that of his colleagues Robin Boadway and Frank Flatters, offers a bracing walking tour of that 16-year-old cornerstone of fiscal federalism in Canada: Established Programs Financing (EPF). This brings me to the snake oil remedy that the rest of my comments will try to sell: take education and training out of "fiscal federalism" and put them into what I choose to call "procurement federalism."

Where fiscal federalism is concerned, I wish to sharpen the tone of the Boadway-Flatters comment that "it is not at all clear" that the tax point component of EPF should "be considered a federal-provincial transfer at all." To me, it is crystal clear that the tax points do not represent a transfer. The tax points historically vacated by the federal government do not yield provincial revenue. What yields provincial revenue is the personal income taxes that provinces levy as a matter of their own political responsibility. Had the federal government chosen to continue to levy higher personal income taxes as a matter of its own responsibility and then transferred the yield of whatever tax points it wished to forego to the provinces in cash, the notion of a tax point transfer would have retained its relevance. As matters have turned out, the assertion that the tax points represent a transfer from the federal government comes at the top of my list of the Big Lies of Canadian public finance.

This leaves the dwindling cash portion of EPF. In the optimistic event that this portion will not be totally consumed by mounting health costs exacerbated by the mismanagement of the *Canada Health Act*, I would divert what remains to finance a policy which at long last would fund 100 percent of the indirect costs of whatever research the federal government sponsors in universities. In its research funding activities, the federal government is essentially purchasing Canada's basic research capacity, along with the applied research and development that are an indispensable component of any sensible economic growth policy. What is more, federal research grants and contracts are the outcome of a competitive awards process. Ottawa should fund the full cost of what it buys; this is a logical implication of what I call procurement federalism.

As for the realm of labour market training, procurement federalism is not new. If anything, it is the day before yesterday's approach to this activity. But

when I see that yesterday's man can receive the resounding electoral mandate that has just propelled him to the prime ministership, I make no apologies for resurrecting whatever has the virtue of familiarity. What was the day before yesterday's approach to labour market training? It was Tom Kent's brainchild, the conceptually innovative program of adult occupational training launched by the newly created Department of Manpower and Immigration in 1966. Fiscal federalism was out, procurement federalism was in. The long-standing shared-cost programs that had linked the old Training Branch of the federal Department of Labour to the like-minded vocational education divisions of provincial Departments of Education were abruptly terminated. Henceforth, the federal government would purchase, at full cost, training courses for adults selected by its community-based employment counsellors on the basis of these counsellors' assessment of their clients' attitudes and future employment prospects. The desired training could be purchased either from public institutions under provincial control or from private sources.

Being myself one of yesterday's men, I was part of a research team whose work documented the unravelling of this imaginative Grand Design (Dupré *et al.* 1973). In brief, what happened was that the provincial Departments of Education interposed themselves between the federal adult occupational training program and postsecondary institutions, and forced federal officials to deal with them as "exclusive brokers" of training courses. Provincial insistence on exclusive brokerage not only hobbled private-sector trainers as potential competitors; it forced the formation of bilateral federal-provincial committees where the so-called purchase and sale of training became a negotiated, shared-cost planning process that made labour market needs subservient to provincial institutional and enrolment strategies. The federal economists, those would-be purchasers of training as a labour market adjustment tool, were trumped by the provincial educationists.

Interestingly, in that world of bilateral federal-provincial relations, the Quebec situation turned out to be *pas comme les autres*. In the Ottawa-Quebec case, the provincial side of the bilateral relationship was articulated not by educationists, but by officials of the Quebec Department of Manpower and Immigration whose professional outlook paralleled that of their federal counterparts. Recalling the times, a senior Quebec manpower official noted that the conflict between economists and educationists, which elsewhere plagued federal-provincial relations, instead emerged in Quebec as an intra-governmental conflict around the provincial cabinet table (Dupré 1988, p. 240). Whether in Quebec, Ontario or elsewhere, the problem was that a procurement approach to labour market training was viewed by postsecondary institutions and the

officials responsible for their well-being as a direct threat to the planned development of province-wide community college networks.

By the 1980s, these networks had matured as planned. This mitigated, although it did not eliminate, the obstacle to a procurement approach to labour market training. The missing ingredient was a clientele behind the would-be purchasers of training that might match the political clout of the sellers. It is particularly in this light that I join Maxwell in hailing the creation of the Canada Labour Force Development Board (CLFDB) and of such provincial bodies as the Ontario Training and Adjustment Board (OTAB). It is indeed ambitious, as she points out, to link reform of the training system with building a new bridge of cooperation between business and labour leaders. Favouring as I do an enhanced labour market approach to training, I would warn against excessive expectations about the degree of business-labour cooperation that this requires. Thus, for example, I would not wish to press for business-labour consensus on such thorny issues as a grant-levy system or the use of unemployment insurance to finance training. If it is astutely managed, an agreement by business and labour to disagree on how training should be financed need not stand in the way of their joining as a strong constituency in favour of procuring training programs that have been tailored to labour market needs. Institutions are such a formidable constituency on the supply side of labour market training that they must be balanced by an equally strong constituency on the demand side if an effective buyer-seller relationship is to prevail. I need not add, but I will, that this is in the long-run interest of the institutions themselves because they have everything to gain from being adaptable and being seen so to be.

In this regard, I join Maxwell in applauding the fact that, likely thanks to their business and labour constituencies, the CLFDB and OTAB are overcoming the exclusive brokerage of the past and beginning to expose public institutions to competition from private training schools. What is more, OTAB has emitted signals that it intends to expose community colleges to competition from universities. As it has been reported to me, the initial university response belies the allegations that stigmatize these institutions as tradition-encrusted dinosaurs. The opportunity to compete in the labour market training arena will join the forces of competition that have long prevailed in the domain of research funding to differentiate the universities that organize themselves to play their strong suits. And there is more. A tough-minded, wide-open procurement approach to labour market training is precisely what can rescue the university-college interface from the wasteland it has been, especially in Ontario. To the extent that the knowledge society generates unmet demand for para-professionals or super-technologists, this need can only be met by graduates of programs that will be joint university-college endeavours. The cold cash offered by a

determined buyer will do more to promote such joint endeavours than all the exhortations in all the reports that could ever be written on the university-college interface.

Admittedly, a procurement approach to labour market training remains far easier to enunciate than to implement. On this score, for example, I can contain my enthusiasm for the fact that the minister to whom OTAB reports is also the minister whose portfolio encompasses Ontario's colleges and universities. This does not augur well for what is surely vital to effective procurement practices — an arm's length relation between purchasers and suppliers. Perhaps someone at Queen's Park will note this humble opinion; in the likely event that it is not heard, let alone acted upon, I place my trust in federalism and its time-honoured role as an engine of diversity.

This is where I cannot overemphasize the importance of what I consider Maxwell's core plea that we cultivate asymmetry in federal-provincial relations. In Ontario, the influence of the CLFDB may well compensate for OTAB's regrettable reporting relationship if, as she suggests, both agencies delegate training procurement to community boards. In New Brunswick, as she points out, the New Brunswick Labour Force Development Board offers such a striking parallel to the CLFDB that it might well act as the channel for federal procurement funds. As for Quebec, the linguistic distinctiveness of its labour market and the provincial government infrastructure that has long been in place argue not only for a federal transfer of training procurement but for a transfer of the placement role played by Canada Employment Centres.

Lest this leave me to conclude on an optimistic note, I shall not stop at this point but instead indulge the morose side of my persona. Even if asymmetric arrangements can be devised to promote a suitably arm's length relation between purchasers and sellers of labour market training, it remains seductively easy to oversell the need for knowledge workers. Consider the stunning vacancy rates in office space that currently plague commercial real estate on a global scale. Are we looking at a phenomenon that is deeply structural rather than merely cyclical? It may indeed be structural if the diffusion of micro-electronic based technologies which so affected manufacturing in the 1980s is just beginning to work its way through the managerial and clerical layers of our white-collar labour force. If the so-called layering of organizational pyramids is the wave of the future, will highly trained MBAs become a glut on the market, to say nothing of computer-literate, para-professional secretaries?

Believing as I do in a procurement approach to labour market training, I start to gag when I remind myself that effective procurement presupposes knowledgeable buyers. How facile it is to posit that the knowledge society needs para-professionals and super-technologists. How much do we know about what

sectors require them with what mix of skills and in what numbers? More labour market research might help, but just as important in this mug's game are intuition, educated guesses and networking among employers, counsellors, and trainers. Have there been "good performers" in identifying emerging labour market needs among Canada's globally competitive firms, domestically oriented firms, training institutions, college and university placement offices, Canada Employment Centres? What are the secrets of their success?

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CHAPTER EIGHT

Income Distribution, Income Security, and Fiscal Federalism

François Vaillancourt

INTRODUCTION

The purpose of this chapter is to examine the field of income security in Canada, and to evaluate the policy challenges and choices confronting Canadian governments, particularly as they relate to federal-provincial relations. The chapter is divided into four sections: the first two sections set the historical and factual stages; and the next two address the issues. The first section examines the evolution of the distribution of income and of poverty from 1951 to 1991-92, while the second presents the evolution of income support programs over the same period and their main features in 1993. That done, we review economic criteria that justify government interaction in this field and then examine the challenges and choices faced by Canada in the near future.

INCOME DISTRIBUTION AND POVERTY IN CANADA

This section provides an examination of the incomes and poverty of Canadians so as to allow us to better understand the relevance of income security programs. The period covered varies from table to table (starting in 1951, 1961 or 1971 and ending in 1991 or 1992), as dictated by the availability of historical data at time of writing. Table 1 tracks the growth in real per capita income in Canada from 1951 to 1991, and shows that incomes grew more quickly in the 1951-71 period than in the 1971-91 period. Table 2 summarizes the evolution of the distribution of post-transfer money income from 1951 to 1991-92 (Panel A) and of poverty from 1961 to 1992 (Panel B). Examining it, one notes that the shares of income going to the bottom and top quintiles have increased slightly from

TABLE 1: Evolution of Real Income in Canada, Various Incomes, 1950-51 to 1990-91

Income Concept	Year				
	1950	1960	1970	1980	1990
<i>(1) Annual wages (1990 \$)</i>					
Both sexes	11,249	16,031	21,928	23,791	24,259
Men	12,843	18,477	26,196	29,871	29,757
Women	7,373	10,019	13,671	15,710	17,933
	1951	1961	1971	1981	1991
<i>(2) Family incomes (1991 \$)</i>					
Families					
Per unit	21,172	28,116	41,054	51,756	53,131
Per member	5,601	7,136	10,919	15,496	16,761
Unattached individuals	8,169	11,226	17,209	22,723	22,514
<i>(3) GDP per capita (1991 \$)</i>	9,638	11,988	18,072	24,746	25,030

Sources: (1) Rashid (1993); Statistics Canada (75-001), Table 1.

(2) Statistics Canada (1991, p. 25)

(3) Calculations by the author using information from *The Canadian Economic Observer*, Historical Supplement 1992/1993; Statistics Canada (11-210), Tables 51.1 (GDP), 53.2 (CPI) and 54.1 (Population).

1951 to 1991, that the Gini coefficient has remained almost unchanged and that poverty diminished substantially from 1961 to 1981 and then went down slightly from 1981 to 1992.¹

What is the impact of the various transfer programs on the changes reported in Table 2 and, more generally, on the incomes of Canadians? This is a very difficult question to answer definitively, since one does not know how these programs affect decisions with respect to work and savings for retirement. However, Table 3 allows us to assess the importance of transfers by quintile as well as their impact on the overall income distribution from 1971 to 1991. One notes that transfers account for a decreasing share of income as one moves from

TABLE 2: Income Inequality in Canada: Quintile Shares (%) and Gini Coefficients, 1951-91 and Poverty Rates, 1961-1991/92

<i>A – Income Inequality, All Units Money Income</i>						
<i>Year</i>	<i>Quintiles²</i>					<i>Gini Coefficients²</i>
	<i>1st (Lowest)</i>	<i>2nd</i>	<i>3rd</i>	<i>4th</i>	<i>5th (Highest)</i>	
1951 ¹	4.4	11.3	18.3	23.3	42.8	0.390
1961 ¹	4.2	11.9	18.3	24.5	41.1	0.368
1971	3.6	10.6	17.6	24.9	43.3	0.400
1981	4.6	10.9	17.6	25.2	41.8	0.377
1986	4.7	10.4	17.0	24.9	43.1	0.390
1991	4.7	10.3	16.6	24.7	43.8	0.396
1992	4.6	10.3	16.7	24.8	43.6	N/A

Notes: 1: Nonagricultural households only.

2: The Gini coefficient is a summary measure of the distribution of income that ranges from 0, when all units have the same income, to 1 when income is concentrated in the hands of one unit. Quintiles are obtained by ordering all units, i.e., economic families and unattached individuals by income from the lowest to the highest and then dividing them into five groups of equal size. Quintile shares sum to 100 percent in each year.

N/A: Not available.

Sources: Quintile shares:

1951-1981: Vaillancourt (1985, Table 1-7); *Income Distribution by Size in Canada*, various years, Statistics Canada (13-207).

Gini coefficients:

1951-1981: Vaillancourt (1985, Table 1-7).

1986-1991: *Income After Tax Distribution by Size in Canada*, Statistics Canada, Table VIII.

<i>B – Poverty Rates (%)</i>			
<i>Year</i>	<i>Families</i>	<i>Unattached Individuals</i>	<i>Persons</i>
1961	27.9	49.2	N/A
1971	18.3	43.1	20.0
1981	12.0	37.8	14.7
1986	13.3	42.1	16.4
1991	12.9	40.0	16.5
1992	13.3	39.7	16.8

Notes: 1961 rates are calculated using 1961 low-income cutoffs; 1971 rates using 1969 cutoffs; 1981 using 1978 cutoffs; 1986, 1991 and 1992 rates using 1992 cutoffs. A change in the cutoffs used changes poverty rates slightly. Hence in 1991, the poverty rates calculated using 1978 cutoffs were as follows: families: 11.5; unattached individuals: 32.1 and all individuals: 14.4.

Sources: 1961-1981: Vaillancourt (1985, Table 1-12)
1986-1991: Statistics Canada (1991, p. 169).

TABLE 3: Composition of Income by Quintile and Gini Coefficients Pre- and Post-money Transfers, Canada, All Units, 1961-92, selected years

Quintiles	All Units	Quintiles					Gini Coefficients	
		1 st (Lowest)	2 nd	3 rd	4 th	5 th (Highest)	Pre- Transfers	Post- Transfers
Share of Transfers in Money Income								
1961	7.0	45.7	14.5	6.3	4.4	2.8	-	-
1971	6.6	53.3	18.2	5.7	3.4	2.0	0.447	0.400
1981	9.0	57.3	22.7	8.8	5.0	2.6	0.439	0.377
1986	11.5	60.2	32.2	13.1	6.8	3.3	0.469	0.388
1991	13.4	63.4	36.9	16.3	8.9	4.0	0.488	0.396
1992	14.0	66.8	38.2	17.6	9.3	4.0	-	-

Sources: Quintile data:

Podoluk (1968, Table 11.A.2; Families and Unattached Individuals, p. 296); Statistics Canada (1971); Vaillancourt (1985, Table 1-9, p. 14).

Gini Data:

Vaillancourt (1985, Table 1-9, p. 14); Statistics Canada (1986).

the first to the last quintile and that post-transfer Gini coefficients are smaller than pre-transfer ones, indicating that transfers play their intended equalizing role.

Two other facts are worth noting. The first is the doubling from 1971 to 1992 of the importance of transfers in the income of all Canadians, including those in the top four quintiles. Second is the increase from 1971 to 1991 in the Gini coefficients measuring inequality of pre-transfer income, while those measuring post-transfer income shows stability in the distribution. The first finding raises questions as to the targeting of transfers. The second is in agreement with the findings of Osberg *et al.* (1993), and of Beach and Slotsve (1994) who report an increasing polarization of earnings in Canada over the 1967-91 period, with differences between sexes and subperiods, but stability in the final distribution of income.

Table 4 allows us to examine the evolution of poverty in Canada since 1961 by age and since 1981 by marital status. It shows a remarkable reduction of poverty in the 65+ age group, a stable or somewhat reduced incidence of poverty in the 35-64 age bracket and an increase in poverty in the 15-34 age bracket, particularly the 15-24 age group. Part of the explanation of the reduction in poverty for the 65+ age group is the introduction in 1966 of two income transfer programs. One, the Guaranteed Income Supplement (GIS), had an immediate impact while the second one, the Canada and Quebec Pension Plans (CPP/QPP), has been gradually coming into play.

Having described the distribution of income and the levels of poverty, and having shown the importance of transfers in general, we now turn our attention to transfer programs.

TABLE 4: Poverty Rates by Age and Family Type, Canada, 1961-91

Year	Age					
	<24	25-34	35-44	45-54	55-64	65+
<i>Families (Age of Head)</i>						
1961	29.0	22.1	22.1	22.1	22.2	43.9
1971	21.2	14.9	16.6	14.1	17.1	34.8
1981	22.7	12.6	10.7	9.0	10.5	14.5
1986	32.2	16.1	11.5	9.2	11.7	14.2
1991	36.6	18.6	12.9	7.4	11.8	7.9
1992	41.5	18.6	12.9	8.6	11.4	8.5
<i>Individuals</i>						
1961	38.8	2.1	25.5	33.0	46.1	69.9
1971	44.9	19.5	24.9	30.8	40.8	68.4
1981	38.4	18.2	22.4	30.3	40.9	58.6
1986	54.6	27.3	25.4	30.6	45.3	58.1
1991	57.4	27.6	27.7	30.3	44.1	50.8
1992	58.8	27.2	27.3	33.7	45.8	48.4
<i>Family Type</i>						
	Married Couple			Single Parent Family		
	No Children	+ Child	+ Child/Relative	Male Head	Female Head	
1981	8.3	8.9	8.0	13.8	42.8	
1986	8.1	9.6	6.1	16.4	44.1	
1991	6.7	8.7	7.6	14.1	44.8	
1992	8.3	9.6	7.9	16.4	47.8	

Note: 1961 uses 1961 LICO's; 1971 uses 1969 LICO's; 1991, 1986, 1991 use 1978 LICO's; 1992 uses 1992 LICO's.

Sources: Podoluk (1968, Tables 8.1 and 8.2); Statistics Canada (1971); Vaillancourt (1985, Table 1-13).

CANADIAN INCOME DISTRIBUTION PROGRAMS: EVOLUTION AND IMPORTANCE

In this section, we first recall the evolution of income security and income distribution programs in Canada, with particular emphasis on the 1946-92 period. We then present various indicators of their importance.

The Evolution of the Programs

While there was always some support by the state for the poor through such programs as subsidies to hospitals, state intervention in income security in Canada really began with the introduction of provincially provided worker's compensation insurance starting in 1913 in Ontario. Table 5 and Figure 1 present what we believe are the key elements of the historical setting. Additional details are found in Banting (1985), Johnson (1987), and Norrie (1993).

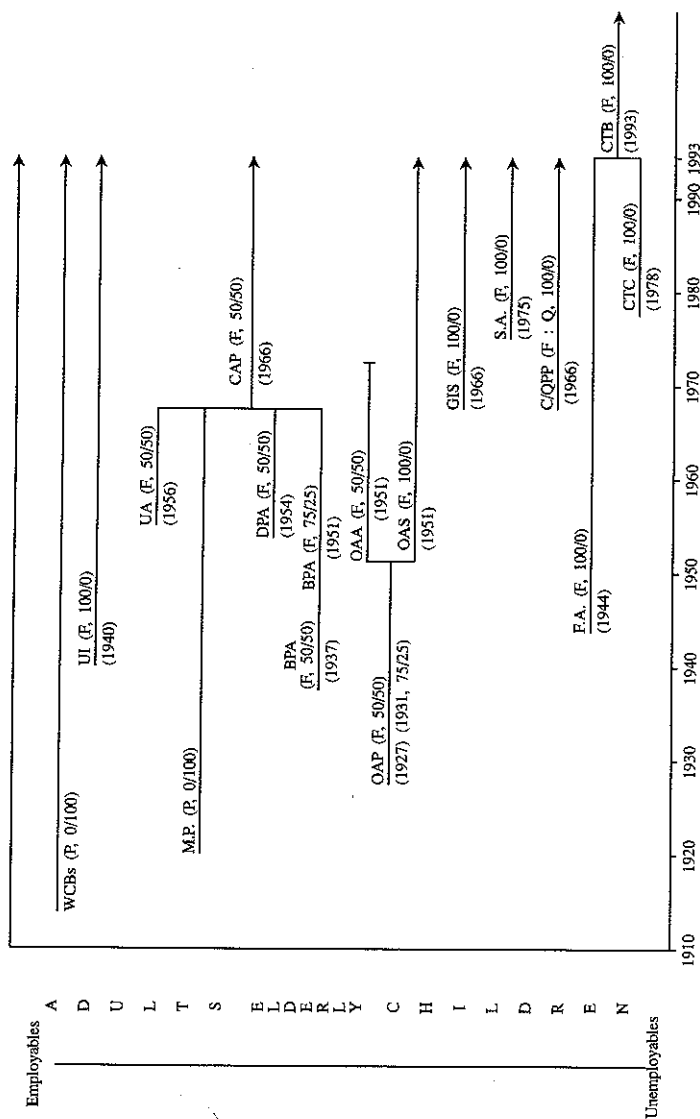
Examining Table 5 and Figure 1, one notes the following points:

- the importance of constitutional amendments in the creation of federal transfer payments to individuals (for Unemployment Insurance in 1940, and Old Age Security in 1951). Only in the case of family allowances was such an amendment not sought and apparently not required;
- in the case of unemployables, the program complexities in federal transfers to the provinces through a variety of programs gave way to consolidation in the 1960s with the introduction of the Canada Assistance Plan (CAP);
- the passage from one to four programs of income support for older Canadians from 1965 to 1975; and
- the transformation of child support from a universal non-taxed program to a targeted program in 50 years from 1944 to 1993.

TABLE 5: Origin and Evolution of Cash Income Support Programs

Program/Constitution	Pre-1946: Provider/Date(s) Initiated	Intergovernmental Relations/Funding	Evolution 1946 +
Industrial injuries and illnesses Insurance. A provincial constitutional responsibility (WCBs)	Provincial (territorial) publicly owned insurance monopolies.	Funding is through a (partially) experience-rated payroll tax levied on the employer. Boards are autonomous financial entities. There are no federal-provincial transfers. The Federal Government is covered as an employer.	Since inception, the following key changes occurred: <ul style="list-style-type: none"> increased coverage of the labour force through the inclusion of initially uninsurable sectors (1950s-1970s); increased coverage of injuries and professional illnesses (1970s-1990s); increased real value of benefits (1980s) from 75% of gross income to 90% of net income.
Unemployment insurance (UI). A provincial constitutional responsibility until 1940. It then became a federal responsibility through a constitutional amendment.	Federal Government in 1941.	Funding is through a payroll tax levied on both employers and employees and until 1990 through a federal government contribution. There are no federal-provincial transfers. Benefits are linked to contributions which are linked to wages and period of employment.	Since inception, the following key changes occurred: <ul style="list-style-type: none"> increased coverage through the inclusions of previously excluded sectors (fisheries, public administrations) (1950s-1970s); increased real benefits (1971) then slowly eroded (1970s-1980s); sole funding by employers and employees since 1991.
Income support (welfare) for employables and unemployables. Provincial constitutional responsibility.	<ul style="list-style-type: none"> Provincial mother's pension (MP) (unemployables) were introduced in the 1920s. Other categories were reluctantly added. Blind persons allowance (BPA) cost sharing was introduced in 1937 by the federal government (75/25). 	<ul style="list-style-type: none"> Funding of the federal and provincial shares is through general revenues. Federal-provincial transfers occur as well as provincial-municipal transfers in Nova Scotia, Ontario and Manitoba where property taxes fund part of social assistance. 	<ul style="list-style-type: none"> Blind Persons Act (BPA) of 1951 covers blind persons aged 21+ (75% federal/25% provincial). Disabled Persons Act (DPA) of 1954 covers the disabled (50/50 cost sharing). Unemployment Assistance Act (UAA) of 1956 for the unemployed not covered by UI (50/50 cost sharing as of 1958). Canada Assistance Plan (CAP) of 1966 replaces all previous programs. Until 1990, costs were shared 50/50. Since then, there is a cap on the growth of payment to Ontario, Alberta and British Columbia of 5% yielding funding ratios of 28/72 (Ontario).
Family allowances (FA). Universal payment to children aged 0-16 by the federal government using its constitutional power to spend.	Federal Government in 1944.	Funded by general revenues of the federal government.	<ul style="list-style-type: none"> In 1974, allowances were increased significantly and made taxable. In 1978, a tax credit was introduced. In 1989, an income-based claw back was introduced. In 1993, universality ended with the Child Tax Benefit Program (CTB).
Old age pensions. A provincial constitutional responsibility until 1951, when a constitutional amendment gave the federal government concurrent power in this field.	A federal government cost-sharing program was introduced (OAP) in 1927.	Cost shared program (50/50 then 75-25 from 1931 on) financed by general revenues. From 1951 to 1972, parts of the federal personal, corporate and sales taxes are earmarked for that program.	The Old Age Security (OAS) Act, established in 1951, pays pensions to Canadians aged 70+. This age was lowered to 65 in 1970. At that time, the companion Old Age Assistance (OAA) Act, a 50/50 transfer program for the elderly aged 65-69, was abolished. In 1966, the Guaranteed Income Supplement (GIS) was introduced and in 1975, Spouse Allowances (SA) were introduced. In 1989, an OAS income-based claw back was introduced. In 1966, the Canada Pension Plan and the Quebec Pension Plan were introduced.

FIGURE 1: Key Dates in Income Security in Canada



Notes: ¹ Abbreviations provided in Table 5. (F: Federal program; P: Provincial program; Share paid federally/Share paid provincially when first set).

² OAP and OAS are for the elderly aged 70+ until 1966 when the pensionable age starts to decrease yearly in order to reach 65 in 1970.

OAA is for the elderly aged 65-69.

³ BPA 1937 is for the elderly blind people, while BPA 1951 is for blind people aged 21+.

The Importance of the Programs

While Table 5 and Figure 1 allow us to trace the evolution through time of the income support system in Canada, they do not allow us to assess the relative importance of these programs, individually and as a whole. The most obvious measure of importance is program spending, reported in Table 6. But another dimension that may matter more from a political point of view is the size of the clientele of the major programs, which is reported in Table 7.

Table 6 shows the following trends in expenditures on income support spending in Canada:

- from 1951 to 1991, income support spending tripled with respect to GDP in Canada. Over the same period, total government expenditures increased from 21.3 percent to 46.5 percent of GDP (*National Finances*, 1991, Table 3.14, p. 3.15). Thus, income support spending also increased with respect to overall government spending;
- from 1951 to 1991, spending on children decreased from 46.4 percent to 7.8 percent of expenditures on income support. This is explained, in part, by a reduction in the number of children from 1981 to 1991 (see Table 7);
- from 1951 to 1991, payments to older Canadians increased from 25.9 percent of income support expenditures to 42.2 percent. This reflects not only the aging of the Canadian population, but also greater accessibility to income support with a reduction in age for OAS eligibility from 70 in 1966 to 65 in 1970, with increased eligibility for Spouses Allowance (SA) in 1985 and with access to (actuarially reduced) CPP/QPP pensions as of the age of 60 in the 1980s.
- from 1951 to 1991, payments to workers because of unemployment or injuries and illnesses increased only marginally from 24.1 percent of expenditures on income support to 28.2 percent. On the other hand, various welfare payments (welfare plus CPP/QPP for non-retirees) increased from 3.5 percent in 1951 to 21.7 percent in 1991, showing the fastest growth rate. In particular, note the growth in CPP/QPP non-retiree payments, which are primarily disability pensions.

TABLE 6: Expenditures on Income Support Programs in Canada, 1951 to 1991, Fiscal Year (000 000 \$)

Programs	1951		1961		1971		1981		1986		1991	
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
Workers' compensation	48.6	7.0	94.2	5.2	239.0	4.7	1,295.4	5.2	2,588.9	5.8	3,054.2	4.9
Unemployment insurance	118.1	17.1	409.2	22.7	901.0	17.7	5,398.6	21.6	10,639.5	23.8	14,468.3	23.3
Welfare	24.0	3.5	150.8	8.4	1,001.7	19.6	3,272.4	13.1	6,124.0	13.7	8,882.8	14.2
CPP/QPP (non-retirees)	0	0	0	0	109.7	2.2	1,241.4	5.0	2,799.6	6.3	4,648.0	7.5
OAS	178.9	25.9	625.1	34.7	1,679.3	32.0	6,140.5	24.6	9,520.0	21.3	12,705.3	20.4
GIS	0	0	0	0	526.1	10.3	2,241.9	8.9	3,451.4	7.7	3,975.7	6.4
SA	0	0	0	0	0	0	202.8	0.8	473.2	1.1	449.9	0.7
CPP/QPP (retirees)	0	0	0	0	83.5	1.6	2,070.4	8.3	5,054.2	11.3	9,134.1	14.7
Family allowances	320.4	46.4	520.8	28.9	554.4	10.9	2,019.5	8.1	2,534.4	5.7	2,736.0	4.4
Child tax credit	0	0	0	0	0	0	1,068.9	4.3	1,573.4	3.5	2,109.6	3.4
Total: \$	690	100.0	1,800.1	100.0	5,094.7	100.0	24,951.8	100.0	44,758.6	100.0	62,163.9	100.0
% of GDP	3.1%		4.4%		5.2%		7.9%		8.9%		9.3%	

Note: 1990-91 as the last year for which we have data on a comparative basis.

Sources: 1951 and 1961: *Social Security Statistics, Canada and Provinces, 1950-51 - 1977-78*. Ottawa Health and Welfare Canada.

1971-1986: *Social Security Statistics, Canada and Provinces, 1963-64 to 1987-88*.

1990-1991: unpublished data, courtesy of S. Ewen, Health and Welfare.

OAS includes OAP; Welfare includes Mother's Allowance, Blind Persons Allowance and Old Age Assistance and in 1961, Unemployment Assistance and Disabled Assistance.

CPP/QPP non-pension is made up of survivors, disability and child benefits.

GDP: *Canadian Economic Observer*, Historical Supplement, 1991-92, Table 1.1. GDP is for the calendar that most closely corresponds to the

fiscal year, i.e., 1990 for 1990/91.

TABLE 7: Clientele of Income Support Programs in Canada and Population/Families, 1951 to 1991

Programs	1951	1961	1971	1981	1986	1991
Workers' compensation	158,034	178,806	302,571	567,916	571,555	657,527 (1989/1990)
Unemployment insurance	617,719	722,196	584,701	710,899	1,116,360	1,200,740
Welfare	132,420	867,196	1,460,064	1,418,400	1,892,900	2,282,200
CPP/QPP (non-retirees)	0	0	88,857	628,258	902,134	1,241,309
OAS ¹	302,173	894,810	1,701,459	2,276,159	2,616,762	3,059,029
GIS	0	0	823,924	1,204,594	1,299,019	1,321,234
SA	0	0	0	81,939	111,984	119,677
CPP/QPP (retirees)	0	0	189,657	1,042,806	1,518,571	2,365,516
Family allowances: children	4,294,500	6,317,800	6,841,040	6,857,744	6,575,347	6,700,683
families	1,885,000	2,580,700	3,001,353	3,636,129	3,635,861	3,722,950
Child tax credit: children	0	0	0	5,132,092	4,989,622	4,621,186
families				2,478,158	2,476,431	2,219,190
Population (000)	14,009.4	18,238.3	21,568.3	24,341.7	25,353.0	27,000.4
Number of families	3,287,384	4,147,444	5,070,682	6,324,976	6,734,978	7,356,168

Notes: ¹Old age pensions in 1951

1951 (1): *Canada Year Book, 1955*, Chapter XVI, Table 32. This is the amount of accidents resulting in temporary disability, permanent disability or death. For Quebec, the breakdown by type was not reported: the ROC distribution was assumed.

1951 (2): *Annual Report of Benefit Years Established and Terminated Under the Unemployment Insurance Act, 1951*, Bureau of Statistics (73-201), Table 3.

1951 (3): *Canada Year Book, 1954*, Chapter VI, Table 10 for mother's allowance (families plus children); *Canada Year Book, 1952-1953*, Chapter VI, Table 7, for blind Canadians.

1961 (3): Health and Welfare, Tables 321, 331, 341, 511. The number of families on mother's allowance is transformed in the number of recipients (mothers+children) by multiplying the number of recipients in 1951 by the growth in the number of families from 1951 to 1961 accounting for a reduction in family size.

Sources: 1971-1991, *Social Security Statistics, Canada and Provinces, 1967-1968 to 1991-1992*, Health and Welfare Canada, June 1993, mimeo.
1951-1961, *Social Security Statistics, Canada and Provinces, 1950-1951 to 1977-1978 and 1958-1959 to 1982-1983 (1961-1962)*, Health and Welfare Canada, November 1979.

Population: *Canadian Economic Observer, Historical Supplement, 1991/1992*, Table 11.1.

Families (census): 1961-1991, *Dwellings and Households: The Nation*, Statistics Canada (93-311), 1991, Census of Canada, Table 1.

1951, *Household and Families*, Dominion Bureau of Statistics (93-514), 1961 Census of Canada, Table 43.

Turning to Table 7, one finds that:

- the number of WCB claimants increased particularly between 1971 and 1981, perhaps because of more generous access rules;
- the number of UI claimants remained below 1 million until 1986, but rose rapidly thereafter;
- welfare recipients decreased from 1971 to 1981 but increased substantially from 1981 to 1991. Over that period, the number of beneficiaries increased by more than 500,000 (138 percent) in Ontario, 60,000 in Quebec (12 percent), 75,000 in Alberta (101 percent) and by about 120,000 (91 percent) in British Columbia. Thus, national figures hide substantial differences between provinces;
- for CPP/QPP, both retirees and non-retirees have grown at a high rate from 1971 to 1991. Part of this is explained by the increased number of older Canadians, while changes in the value of the benefit (1976) and in the availability of early pensions (age 60) also played a role;
- for OAS/GIS/SA, the number of OAS beneficiaries almost doubled from 1961 to 1971 as a result of the lowering of the pensionable age and has since grown with the number of older Canadians. The number of GIS or SA recipients is not growing as fast except for SA recipients from 1981 to 1986, a fact explained by a change in accessibility in that period. This reflects, in part, the greater availability of CPP/QPP retirement pensions. Indeed, the number of GIS recipients reached a peak in 1988-89 and has since been decreasing;
- for family allowances/child tax credit, the number of children eligible for family allowances peaked in 1975-76, but the number of families receiving them has continued to increase, reflecting the decrease in family size in Canada (from 2.28 children in 1951 to 1.80 in 1991). As for the child tax credit, its take-up rate decreased from 1981 to 1991, reflecting, in part, the decrease in the poverty rate in Canada (Table 2);
- for population/families, from 1971 to 1991, Canada's population almost doubled, while the number of families almost doubled as well. Taking this into account, the increase in the number of claimants for UI is not unreasonable, while the number of welfare recipients grew much faster. Note also that in 1951, more than one family in two received family allowances: this was still (barely) the case in 1991.

The indicators of the importance of programs found in Tables 6 and 7 are aggregate indicators. In Table 8, we present evidence on their importance with respect to the income of individuals and families by reporting the value of the

TABLE 8: Value of Various Transfer Programs in \$ (Current) and Relative to the Poverty Line, 1961-91

Programs	1961			1971			1981			1986			1991		
	I	2/3	Persons	I	2/3	Persons	I	2/3	Persons	I	2/3	Persons	I	2/3	Persons
WCB \$	2,250-4,500			4,500-6,000			11,250-18,000			14,290-30,632			17,250-31,000		
Ratio	1.5-3.5	0.75-1.5		2.24-2.98	1.12-1.5		0.93-1.49	0.79-1.27		1.34-2.88	0.76-1.61		1.29-2.32	0.73-1.31	
UI \$	1,404	1,872		3,692	3,878		9,828	9,828		14,850	14,850		20,400	20,400	
Ratio	0.93	0.62		1.83	0.96		1.22	0.69		1.39	0.79		1.51	0.86	
Welfare \$	-	540-1,632		-	1,308-2,604		-	3,924-8,250		-	4,944-11,418		-	5,796-15,624	
Ratio	-	0.18-0.54		-	0.32-0.65		-	0.28-0.60		-	0.26-0.61		-	0.24-0.66	
OAS \$	480	960		945	1,890		2,189	4,378		3,478	6,957		4,381	8,762	
Ratio	0.32	0.64		0.47	0.56		0.27	0.41		0.33	0.50		0.33	0.49	
OAS+GIS \$	-	-		1,530	3,060		3,986	7,367		7,612	12,342		9,587	15,543	
Ratio	-	-		0.76	0.91		0.50	0.69		0.71	0.88		0.71	0.88	
OAS+CPP/QPP \$	-	-		1,076	2,021		2,738	4,927		9,311	18,622		11,639	23,278	
Ratio	-	-		0.53	0.60		0.34	0.46		0.87	1.33		0.87	1.31	

Notes: In the 2/3 persons columns, calculations are for two persons for OAS, OAS+GIS and OAS+CPP/QPP, and for three persons, otherwise.

Ratio: The ratio is attained by dividing the amount of the transfer by the relevant poverty line (low-income cutoff).

For WCB and welfare, we report the minimum and maximum in a given year, since payments vary across provinces. Thus in 1984, the minimum annual WCB payment was \$11,250 and the maximum was \$18,000, depending on the province of residence.

Unemployment Insurance: Benefits for 50 weeks in a given year are assumed.

For 1981, 1986 and 1991, the 1978 poverty line was used to enhance comparability.

Sources: OAS/GIS and UI, 1961, 1971, 1981, 1986, *The National Finances*, (Canadian Tax Foundation, various years). For years with rate changes, a weighted average of rates was used.

WCB: The Financing of Workers' Compensation Boards in Canada, 1960-1990, F. Vaillancourt, Toronto Canadian Tax Foundation, in press, Tables 2-4 and D-7. 1990 data are used for 1991.

Welfare Data: courtesy of Pierre Lefebvre, Economics Department, UQAM.

benefit associated with each program. We do this both in dollar terms and by comparing it to the usual poverty measure in Canada, Statistics Canada low-income cut-offs. Such a comparison requires us to begin our analysis in 1961, the first year for which we have poverty data.

Examining Table 8, one observes that:

- insurance programs for workers are always, with the exception of UI in 1961, sufficiently generous to raise a single person above the poverty line. The apparent reduction in benefits for WCB from 1961 to 1991 is, in part, illusory, since a fair number of boards moved from benefits replacing 75 percent of gross income to benefits replacing 90 percent of net income over that period. The substantial increase in UI benefits from 1961 to 1971 (almost doubled) is the result of a deliberate enrichment of the program in 1971;
- welfare payments and disability (CPP/QPP) pensions are not sufficient to raise either an individual (disability) or a single parent family (welfare) above the poverty line. The real value of these transfers with respect to the poverty line has remained relatively unchanged from 1961 to 1991;
- universal income support for older Canadians (OAS) does not protect them from poverty. When combined with GIS, it still does not achieve that goal, but when in receipt of OAS and CPP/QPP, an elderly couple will be above the poverty line. One must note the dire impact on the income of older Canadians of living alone, often as a result of outliving a spouse.

Table 9 summarizes the main features of the major income support programs in Canada as of 1993.

As stated in the introduction, these two sections have set the historical and factual stages. Before proceeding to an analysis of the challenges and choices in income security, however, we also need to present the theoretical framework that will guide our analysis.

TABLE 9: Income Support Programs in Canada — Main Features, 1993

Programs	Main Features			Benefits
	Coverage	Eligibility	Financing	
WCB (provincial)	Most workers with sectoral exclusion. Varies across provinces.	Depends on accident status. No minimum contribution period. Some provinces do not pay compensation for the day of the accident.	Payroll tax levied on employers. In all provinces, it varies between industries and in some, across employers (large ones) according to the risk experience.	90% of net income (Alberta, Saskatchewan, Ontario, Manitoba, Quebec, New Brunswick (80%) and Newfoundland (80%) or 75% of gross income (British Columbia, Nova Scotia, Prince Edward Island).
Unemployment insurance (federal)	All employees. Self-employed are not covered. Maximum weekly insurable earnings (\$745).	Minimum weeks (MW) required range from a minimum of 10 to 20, according to the regional unemployment rate (UR). MW = 20 - (U.R. - 6) 10. ¹	Payroll tax levied on employees (3%) and employers (4.2%). ¹ No funding from general revenues.	Depend on weeks worked range from 17 to 50 (2 week waiting period). Equals 60% (57% as of 1 September 1993) of insurable earnings: maximum \$447 per week.
Welfare recipients (provincial, cost-shared)	All individuals and families.	Must meet a needs test.	General revenues of the federal and provincial governments (and municipalities in 3 provinces).	Vary across provinces.
Child tax benefits (federal)	All Canadians. Quebec has a supplementary provincial program with payments varying ranging with the age and number of children.	Depends on family income and number of children. Also affected by claim for child-care expenses and nature of income.	General revenues.	Basic amount per child from \$1,020 per year at zero income to zero at \$66,000 family income.
The elderly — OAS, GIS, SA (federal)	All Canadians aged 65+, OAS, GIS, or 60+ (SA).	Must have resided at least 10 years in Canada. GIS and SA are linked to income of family.	General revenues.	OAS \$378.95 ¹ per month, GIS = 0 when single income = \$10,896 (family \$14,208), maximum GIS = \$450.34. ¹
CPP/QPP (federal/Quebec)	All CPP/QPP contributors.	Retirees, widowers, orphans and the disabled.	Payroll tax on employees (2.5%) and employers (2.5%)	Maximum monthly retirement pension \$667.36.

¹In this formula, all non-integer UR rates are rounded up to the next integer. One set of income support programs not presented here are farm programs. See Treff (1993) for a summary description.

REASONS FOR STATE INTERVENTION IN INCOME DISTRIBUTION AND INCOME SECURITY

These are two strands of theoretical work that are useful in assessing the choices faced in the field of income support in Canada. The first strand is the theoretical work on federalism, particularly on federal-provincial arrangements (division of powers, transfers). Boadway and Flatters review this literature in a clear and precise manner in this volume and I will thus not address it here. The second strand is the theoretical work on state intervention in income security and income distribution, to which we now turn.

Statements about the rationale for state intervention in income security and income distribution are fairly similar, whether found in a theoretical exposition by public finance economists (Boadway and Wildasin 1984) or in more applied work (Fluet and Lefebvre 1992). Income security arguments are usually put in terms of insurance market, while income distribution arguments are usually made with reference to altruism. This does not mean that insurance programs do not have an effect on income distribution. They obviously do, but their intent is not to affect income distribution but to protect the insured from the income consequences of a given event (accident, unemployment, etc.), more (retirement) or less (accidental death) foreseeable.² Put differently, in a world of full employment, with perfect foresight and capital markets, one may not need an insurance/income security program, but the income distribution resulting from market force may still be judged by society to be inappropriate and to require government intervention.

Let us now examine four specific reasons for state-sponsored insurance/income security schemes linking them, when possible, to the literature on the division of powers in federal states. The first three reasons may prevent the emergence of private insurance institutions and thus lead to the introduction of government programs. The first reason is linked to costs, while the following two reasons are due to asymmetric information between the insurer and the insured.

- *High transaction costs.* If economies of scale are important in reducing transaction costs yet markets are easily entered, then it may be impossible for a single firm (or a few) to supply the market since it is not profitable to do so. A monopoly (often a public one) will be able to attain economies of scale. In a federal system, this means that programs can be administered by the federal government, by the subnational government or perhaps by agencies regrouping smaller subnational governments, along geographic lines. The best allocation depends on the number and distribution of residents of subnational governments and on the number of clients needed to attain minimum costs.

- *Moral hazard.* This occurs when the insured can modify their behaviour to benefit from the insurance program. This implies that it is difficult for private firms to offer some kinds of insurance programs. For example, it is easier to cheat on income insurance by claiming that one cannot find employment than on life insurance by claiming that one is dead. In a federal system where individuals are mobile between subnational jurisdictions, one may be better able to detect moral hazard in a federal insurance system with records more easily linked between agencies of a single government, than in a system of subnational insurance schemes where information is less easily exchanged between governments because of technological and legal barriers.
- *Adverse selection.* This occurs when potential clients do not represent the same risk for the insurer, but their degree of risk cannot be identified in advance. In that case, good risks (low claimants) will tend to underinsure and bad risks to overinsure both in terms of participation and coverage in a given insurance program. As a result, insurance premiums will not cover costs if set without taking this into account, but as they rise, good risks will insure themselves less with the possible result that only bad risks will want to insure themselves. In a federal system, mobility combined with differences in insurance programs between subnational governments could accentuate adverse selection.

In these three cases, individuals are assumed to behave in a perfectly rational way to be fully informed and so on but to be faced with deficient private markets which require government interventions. This is not so in the next case.

- *Myopic individuals.* Individuals may not plan for their future correctly. As a result, they may, for example, not save sufficiently for the future and, in particular, for old age or illnesses. This matters to society insofar as it is obligated through a moral contract, perhaps embodied in a constitutional provision such as a social charter, to prevent individuals from dying or suffering unduly from this lack of planning. If it was not so obligated, then the plight of these individuals would matter only to their families (and private charities). One should note that the existence of income security programs can lead to changes in savings behaviour which are rational and not myopic. Myopia may matter more in a federal system than in an unitary state if the power to require preventive behaviour (forced savings for retirement, etc.) does not rest with the same level of government that is responsible for making up income deficiencies.

Finally, both market and individuals can behave correctly, but there can still be a desire among members of a society for changes in the distribution of income.

- *Income distribution.* Altruism will lead members of a family to help each other, families to help one another, and people generally to care about the level of well-being of non-related individuals. In a modern urbanized, industrialized society, this desire for redistribution by potential donors, combined with the desire of recipients for increased income, will often lead to government redistribution. If income redistribution is done at the subnational level, differences in altruism between regions or differences in real benefits may reflect preferences of donors and recipients but can lead to interregional migration.

We now turn our attention to an examination of the challenges and choices faced by income support programs in Canada.

INCOME SUPPORT PROGRAMS IN CANADA: CHALLENGES AND CHOICES

In this section, we present the challenges faced by income support programs in Canada. We then examine what could be done to meet these challenges and, in particular, what rearrangement in the intergovernmental dimension of these programs (jurisdictions, overlaps, financing, etc.) could be considered.

General Challenges

Courchene (1987) identified three broad challenges — fiscal, economic-technological, and socio-demographic — that still remain today. Let us thus reexamine them.

- *Fiscal challenge.* If anything, the fiscal challenge has taken on greater urgency with a projected federal budget deficit for 1993-94 of more than 40 billion dollars, or more than 5 percent of GDP. What has changed is that this challenge has spread from the central government to most provincial governments as well.
- *Economic-technological challenge.* Various factors are transforming the work force, including globalization and an information revolution. From the individual's perspective, these changes translate into greater uncertainty in annual incomes over a lifetime profile, and a decline in the availability of middle-class jobs (Picot *et al.* 1990). The greater uncertainty associated with more self-employment and the decline in life-long employment leads to a need for more insurance schemes. The polarization in good jobs/bad jobs (Beach and Slotsve 1993) may lead to a demand for more income redistribution, although it could also stimulate greater job sharing, especially in the public sector. From a policy perspective, "in a knowledge era social policy is progressively indistinguishable from economic policy" (Courchene in this volume).

- *Socio-demographic challenge.* There are three demographic trends that matter in this context:
 - *Aging of the population.* This is a trend that increases spending on the elderly for income transfers and health. Note that tax expenditures for RRP and RRSP incurred now may reduce future income transfers but probably not by an equivalent amount.
 - *Decreasing population.* This forecasted event may lead to a demand for more immigration or more pro-natal policies as already witnessed in Quebec. If this is not the case, then expenditures on children will decline.
 - *Changing families.* Both the composition of families (same sex, single parent, blended/ reconstituted), and their stability (length of first marriage, etc.) are changing with the result that individuals are less likely to draw support from them. Taking into account the reduced number of children and the geographic mobility of individuals, people also are less likely to draw support from their extended family.

Program Specific Challenges

- *Workers' Compensation Boards.* WCBs are faced with a major fiscal challenge with their unfunded liabilities having increased from \$1 billion in 1980 to \$14 billion in 1992 (Vaillancourt 1993). This increase is largely the result of increases in benefits (indexing for inflation, more generous rules, etc.) imposed on WCB by provincial legislatures without a concurrent transfer of funds. They also play a role of substitute for unemployment insurance (Fortin and Lanoie 1992) (and presumably welfare) which is not surprising since they provide the highest level of benefits (Table 8). Finally, since they are entirely financed by an employer payroll tax, increases in their financial needs may in the short run increase the cost of labour and reduce employment opportunities. Thus, while WCBs are a provincial responsibility, funded by provincial revenues, issues of coordination of benefits and of impact on unemployment are intergovernmental in nature.
- *Unemployment Insurance.* Since 1990, the Unemployment Insurance Fund is to be fully funded in the long run by employer and employee payroll taxes, although short-run loans by the government are allowed for and have indeed been made. As a result, the UI fund can accumulate liabilities like WCBs and its funding can reduce employment opportunities in the short run. But while WCBs payments are either for short-term disabilities with, when required, medical and workplace interventions to ensure re-employability, or for long-term disabilities, with no set time limit as such, UI payments are for a set time limit (maximum 50 weeks) and are conditional upon loss of employment. With

no experience rating of individuals or employers and a widened clientele, including seasonal workers, unemployment insurance has become less of an insurance system and more of an income support program (Kesselman 1983; Green and Riddell 1993). In particular, it does not encourage retraining and may even discourage it by its treatment of student recipients of benefits. Hence, it is not surprising that Beach and Slotsve state that "the changes and dislocation ongoing appear to be quite long run and now heavily established in the economy so that programs aimed at short-run safety net type of support (e.g., temporary UI benefits) won't work well ... what is called for is the creation of a flexible skill-learning environment for the labour force as a whole" (1994, p. 22). One possibility discussed since the early 1970s is a guaranteed annual income.

With respect to intergovernmental challenges, it is the interface between UI, social assistance and manpower retraining that raises the most important issues. Subsidiary ones are the offloading though short-term provincial job creation schemes of welfare recipients onto UI and the interaction with WCBs.

- *Welfare/Disability and survivor's pensions.* In analyzing welfare, one should distinguish at least conceptually between the unemployables and the employables. With respect to unemployables, one must assess whether the condition is temporary (as a result of child-raising responsibilities, for example) or permanent (as a result of disability or old age). In the case of disability, the issue of coordination between CPP/QPP and welfare arises. In the case of a temporary condition, one issue is the variability in norms across provinces; a second is the need to facilitate re-employment when the individual becomes employable. In the case of the employable, the issues raised in the case of UI with respect to training and offloading also matter. In addition, other issues such as the impact of changes in UI rules, or of federal immigration (Jenness and McCracken 1993) policy on provincial welfare rolls, through the admission of refugees or sponsored immigrants whose sponsorship falls through, also arise.

Turning specifically to CAP, issues arise as to the appropriate matching rate for federal transfers and as to the condition that may stifle provincial innovations (Boadway and Flatters, this volume). But the main intergovernmental issue is the imposition in 1990 of a ceiling of 5 percent per year in the growth of CAP payments to equalization-receiving provinces. This has resulted in a loss to Ontario alone of \$1.7 billions in 1982-93 and to a funding of eligible expenses of only 28 percent rather than 50 percent (Jenness and McCracken 1993, pp. 7-8). Hence, many believe that it will be impossible to go back to

the standard 50/50 sharing formula on 1 April 1995, when the ceiling should end.

- *OAS/GIS/SA/ CPP/QPP (Retirement)*. The field of income security for older Canadians is almost uniquely federal, with only a few provincial income supplementation programs and the Quebec Pension Plan operating at the provincial level. Because of this and because of the use of the clear criterion of age to govern access to benefits, there are no important intergovernmental issues in this area. There are, however, issues of universality and of funding that are often raised. The clawback of OAS benefits certainly qualifies its universal payment structure. But one should note that individuals receiving sufficient private pension income to have their OAS fully clawed back in fact received more than its equivalent in tax expenditures for their retirement savings. Funding of the CPP/QPP is of more serious concern (Lam 1993), and changes in the Canada Pension Plan do require extensive agreement among the federal and provincial governments.
- *Child Tax Benefit*. This field is also almost exclusively occupied by the federal government with only Quebec providing provincial family allowances and birth bonuses. Issues in this area are those of universality, particularly as family allowances were received by women, and of adequacy since the child tax credit may adjust slowly to changes in economic circumstances.

Given the issues raised above, we believe that some changes are needed in the system. We first present changes to existing programs and then sketch a more radical version.

Choices — Tinkering

- *Employables*
 - *Eligibility*. All employed individuals should have access to the same programs of income security. In practice, this would mean that the self-employed would have access to unemployment insurance, thus removing an obstacle from self-employment.
 - *Benefits*. Benefits following loss of employment should be set at the same level, whatever the cause of loss of employment. This would involve harmonizing down WCB benefits with UI, which themselves should be lowered to 50 percent of insurable earnings. After these benefits would be exhausted (40 weeks), individuals who were previously employed would receive welfare for employables. These payments received from the beginning by employables never employed would be associated with the obligation to participate in training programs or public employment, and after two

years to relocate within one's province (and after five within Canada, if a federal jurisdiction is in place). Benefits would be set for individuals with a sharing reduction for couples. Children would receive supplementary allowances. The allowable earnings while receiving benefits should be substantial and the tax-back rate should be significantly less than 100 percent to encourage employment. Such a scheme could approximate a guaranteed annual income.

- *Financing.* The share of individuals should increase from 0 to 50 percent in the financing of WCBs and to 50 percent in the financing of UI. Experience rating should be introduced for UI along the lines of WCB (sectoral with partial firm-rating) as a first step.
- *Jurisdiction.* This is the area where there is exclusive provincial financing (WCB), exclusive federal financing (UI), and joint financing (welfare). One government level should become responsible. I have suggested (Vaillancourt 1991) that the reality of Canada's two labour markets, divided by language, be taken into account, with one provincial agency for Quebec and a federal one for the rest of Canada (this point is also noted in Maxwell, this volume). If this is too asymmetric, then regional units (Cousineau 1993) may be used. If this is not feasible, then this should be devolved to the provinces (Courchene 1993; Boadway and Flatters, this volume). I would favour full payment by provinces of all relevant costs with special equalization, should Ontarians still want Newfoundlanders to almost have their (real) standard of living while residing in Newfoundland. A key benefit of this is that provinces would then have a strong incentive to ensure that their microeconomic policies (minimum wages, union rules, etc.) fully promoted employment. Federal payments could also be linked in part to measures aimed at reducing data-exchange problems.

If full provincial takeover is not possible, then I would suggest that the federal government should abolish CAP and use the money thus saved to extend reformed UI benefits as welfare for employables. I thus agree with Norrie who suggests elsewhere in this volume that federal transfers should go directly to individuals. This unilateral move would at least rationalize part of the system. In this case, the federal government should adjust equalization payment for the fiscal base that could have been obtained if improper economic policies had not been pursued by the provinces. This is preferable in my opinion to a block-funded CAP (Hobson and St-Hilaire 1993) or to an expanded (net) equalization scheme (Boadway and Flatters, this volume) that finances welfare paid by the provinces to both employables and non-employables. It would also allow for an extension of training

programs, in particular, if recipients of these transfers could attend post-secondary institutions for a given time.

- *Non-employables*

- In the case of the elderly, the system works fairly well (Prince 1993). I would suggest moving CPP/QPP more towards a fully funded system (one way of reducing the debt/tax load of future generations) and requiring provinces to pay the market rate of interest (Prince 1993; Lam 1993). It may also be appropriate to better integrate all retirement income programs (Courchene, this volume), although over time the higher labour force participation rate of women will reduce the importance of the Guaranteed Income Supplement and the Spouses Allowance.
- In the case of children, the system also works adequately if one accepts the levels of transfers as given.³
- In the case of other non-employables, we have already discussed our reforms above.

Choices — Individual Economic Security Account

We would argue that it is preferable to have the federal government introduce Individual Economic Security Accounts (IESA) rather than tinker with the system. These accounts would be a forced savings scheme that would address two issues:

- *Retirement savings.* Individuals would be required to save from all sources of income for their retirement. Rates would be set to take into account the life-cycle nature of earnings (increasing with age from 25 to 50) at a level such that the account could pay real benefits equal to 50 percent of the individual's wage at retirement for a life expectancy equal to the average life expectancy at birth plus five years (as a precaution against unforeseen changes in life-saving technology). All contributions would be made by the individual. The program would be administered by private financial firms to avoid overborrowing by the provincial governments as in the existing CPP.
- *Income security savings.* Individuals would be required to save (5 percent) of income as soon as they earn income from any source. They could withdraw some monies for children or for study leave, unemployment spells, and so on. All contributions would be made by the individuals and would earn interest. Rates would depend on age, schooling, and past individual experiences.

In all cases, governments could contribute directly (and not through inter-governmental transfers or tax expenditures) to the individual's account to make

up shortfalls deemed unacceptable or for specific purposes (pro-natal policy). Such an approach would have the benefits of making it clear to individuals what they are paying for and what they may expect to obtain as benefits. It is one way of implementing the transfers to individuals proposed by Norrie (this volume). Such a scheme would also significantly reduce entanglement between levels of governments. An IESA system would account for high transaction costs by being compulsory with centralized government collection and decentralized management of assets. It would do away with moral hazard and adverse selection since each individual would benefit according to contributions. It would correct for myopic saving behaviour for retirement purposes. It would allow income redistribution by governments should they wish to do some. They would do away with unfunded CPP/QPP and WCB plans and promote self-reliance. Benefits would vary in real terms across individuals, in part as a result of their region of residence. IESA should be introduced as of a given date and apply fully for Canadians aged 18 at that time, not at all for those aged 45+, and in an inversely proportional age ratio for those in between.

CONCLUSION

This chapter examined various dimensions of the distribution of income and of poverty, reviewed past and present arrangements in the field of income security, recalled the rationale for government intervention in income security, assessed the challenges faced by income support programs in Canada, and presented some choices. Our main conclusion is that there is little interaction between the federal and provincial governments in this field, but that it would be appropriate to have a single government responsible for income support for employables. This could be achieved by a federal abandonment of CAP, something that may force a more realistic attitude towards labour mobility within Canada.

NOTES

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1. Poverty is defined using the low-income cut-off lines of Statistics Canada which, notwithstanding that organization's denials, have by now become the measure of poverty in Canada. Other measures would yield higher (Canadian Council of Social Development) or lower (Sarlo) levels of poverty.
2. For example, Osberg *et al.* show that "unemployment insurance payments in Canada are an important source of stability in the distribution of income among

Canadian men ... substantially reducing the inequality of annual incomes." (1993, p. 42)

3. An issue that is rarely raised is: Who should receive the payment for the children? Traditionally, it has been the mother, but in the area of charter rights and sexual equality, one may well ask the question why it is not divided equally between the two parents (guardians)? Phipps and Burton present evidence on spending patterns within families that indicates that this may matter (1992).

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Comment: Social Policy in Winter

Susan D. Phillips

Rethinking and major restructuring, rather than minor tinkering of all of our social programs are on the agenda and, given the magnitude of the reforms that are envisioned, it is useful to revisit some first principles. While the criteria for situating fiscal federalism on a sound public finance foundation have already been well established in the literature (Ip 1993; Maslove 1992; Norrie 1993; Boadway and Flatters, this volume), it is important in assessing the feasibility of the recommendations made by Vaillancourt not to lose sight of the public policy principles specific to income security programs.

The basic premise of government expenditures on social policy that is redistributive in nature is to ensure national equity and some minimum standard of uniformity among individual Canadians (Norrie, this volume). But these individuals, as individuals, are not uniform: rather, they vary by gender, age, class, and place. For this reason, income security programs must encompass at least three basic principles: (a) intergenerational solidarity, (b) gender equity, and (c) interregional sharing. The contribution of Vaillancourt's chapter to the social policy debate is that his empirical analysis of income distribution demonstrates that these first principles are not well served by the current programs.

INTERGENERATIONAL SOLIDARITY

The long-term viability of social policy depends upon the willingness of the working age generation to support their elders once they retire from labour force participation *and* upon the responsibility of the retiring generation to provide the opportunities for them to do so by passing on favourable economic conditions and not overburdening them with debt. The dilemma of the 1990s is that for the first time the elderly are better off than the young (see also Courchene

this volume). As the data presented by Vaillancourt illustrate, there has been a significant reduction of poverty among the over 65 age group, in part as a result of the income-tested Guaranteed Income Supplement (GIS) in combination with the Old Age Security (OAS) and the Canada and Quebec Pension Plans (CPP/QPP), while there has been a sharp rise in poverty and unemployment in the 15-24 age group.¹ One inherent problem in elderly benefits is related to the aging population and demographics alone will place even more onerous demands on the younger generation as the glut of now middle-aged baby boomers reaches retirement age. For example, as a recent study by Lam, Prince and Cutt (1993, p. 52) on pension reform notes, contribution rates to the CPP will need to rise to 16 percent for those just entering the labour force (compared to a rate of 3.6 to 5 percent for current contributors) in order to enjoy the same real benefits.

In examining the root problem of escalating costs for support of the older generation, Vaillancourt presents the issue as one of myopia — that people are too shortsighted to save sufficiently for their own retirement. His solution is an insurance-based forced savings plan (Individual Economic Security Accounts) that would require people to save as soon as they earn income from any source and that would be based solely on individual contributions. These accounts would provide retirement income based on rates sufficient to ensure real benefits of 50 percent of retirement wage and could also be used as income security savings, allowing withdrawals to support periods of unemployment, maternity or study leave. However, the reason that people face retirement with inadequate savings to be self-sufficient is seldom due solely to myopia; rather it relates to inadequate income from which to save as a result of marginal, part-time and interrupted labour force participation so that continuous CPP/QPP and other occupational pension plan contributions could not be sustained to ensure a living wage in retirement. The growing class divide that results from the segregation of the labour market into "good" versus low-wage service sector jobs (that seldom provide lucrative occupational pension plans) will only erode the capacity of a large segment of the population, especially women, to provide for themselves adequately through insurance-based public or private pension plans. The changing patterns of work suggest that neither privatization to an entirely insurance type system, nor to RRSPs using public funding through the regressive and expensive system of tax expenditures, will obviate the need for some kind of income security programs for those unable to make sufficient contributions over four decades of full-time employment.

As Vaillancourt notes, the field of benefits for seniors is not one in which a realignment of responsibility would bring significant rationalization or improve the level or coverage of benefits. The public policy issues lie in the programs

themselves, not with constitutional jurisdiction over them and there remains a sound rationale for a strong federal presence. It is feasible, Lam and colleagues (1993) suggest, to convert the CPP into a fully funded system that would provide higher levels of benefits without unduly high contribution rates. A related concern that will have to be addressed, as Vaillancourt notes, is the growing reliance on disability benefits under the provincial WCBs to ease out older workers in their last few years of employment which has created enormous strains on these funds. But one of the most difficult issues in this area is how to balance the public and private systems and, in particular, to determine the extent to which tax expenditures should be used to provide incentives for private savings. Of course, the flip side of promoting intergenerational solidarity is to reduce the long-term debt and enhance the employment and income prospects for the younger generation through investment in training programs, reformed UI and social assistance programs, sufficient immigration to offset a declining birth rate and full employment strategies.

GENDER EQUITY

The gender equity principle is simply that social policy should not disadvantage citizens on the basis of gender. However, perhaps the most dramatic finding of Vaillancourt's analysis is that poverty is highly gendered: the poverty rate for female single-parent families is 47.8 percent compared to only 16.4 percent for their male-headed counterparts.² Both the number and jurisdiction of income support programs for families are diverse and, depending upon personal circumstances, may include: cost-shared CAP; federally regulated UI; federal and provincial income tax measures (including federally, the Child Tax Benefit and its earned income supplement, Child Care Expense Deduction and Equivalent-to-Married credit); subsidies for child care (provided on an income-tested basis under CAP), and provincial enforcement of child support payments by non-custodial parents. One of the most popular proposals raised in this volume is to devolve CAP (and possibly UI) to the provinces through tax points in a similar manner to the tax room that was transferred under Established Programs Financing (EPF) in 1977 to replace existing cost-shared programs. The rationale is related to enhancing the autonomy and accountability of the provinces in their own jurisdiction and the desire to create a comprehensive guaranteed annual income program.³

While the public finance arguments for such a devolution may be compelling, it is important to consider the policy and political arguments and, thus it may be instructive to compare this proposal with the creation of EPF. One of the reasons that EPF is called *established* programs financing is that the existing

cost-shared programs related to hospitals and postsecondary education were relatively mature and autonomous programs by the late 1970s and the benefits to the federal government of a block grant greatly exceeded the administrative costs of maintaining control through direct cost-sharing, although the imposition of the *Canada Health Act* in 1984 suggests that the federal government's perspective on provincial accountability relative to health care changed somewhat.⁴ In spite of its almost 30-year history, is CAP an established program in the same sense, meaning that there is relatively little change in delivery system that the federal government would want to be able to influence? I would argue that it is not, especially if we consider the gender equity issue.

First, one of the reasons that demand for social assistance under CAP grew so significantly in the late 1980s and 1990s is that Canada is undergoing an extended period of structural adjustment. Therefore, issues related to labour market strategies, social assistance (including disincentives to work), tax measures, training, and UI need to be examined as a package. Adjustment is predominantly a national issue and labour markets are becoming more national, not more local. Therefore, if we devolve CAP and UI to the provinces in the near future, we will foreclose on the opportunity to examine the bigger picture.

Second, there are several key pieces missing from family income support. One is a national child-care program tied to labour market policy. While the federal government's enthusiasm for such a program has waned due to the focus under both the Conservatives and the Liberals on debt reduction, it may become a more viable political issue if we look at inaccessibility of child care (due to both supply and cost factors) as an impediment to the entry of women to training programs or to the transition from social assistance to the work force (National Council of Welfare, 1993).⁵ If we devolve CAP to the provinces now, it is unlikely that there will ever be a national child-care strategy. The other component that is missing from a truly "established" social assistance program is a nationally enforceable system of child support orders to enable custodial single parents to collect from "deadbeat" ones — who, statistically speaking, are mainly dads (Moscovitch 1993).

Although Vaillancourt's favoured position is that the full responsibility for welfare, unemployment insurance and disability rest with the provinces, his default position is that the federal government abolish CAP and extend UI benefits as welfare for employables, although the details on this are sketchy. Non-employables would be dealt with under disability (WCB), pensions and OAS/GIS, or as children under the tax system. But what would happen to single mothers and their families under this scheme? Does one simply assume they could get jobs (without training or money to pay for child care)? If they had not contributed to UI, could they access its extended benefits? Vaillancourt, like

many other scholars of fiscal federalism (Courchene, this volume), would like to see support for children separated from adult or family benefits in order to better address Canada's high rate of child poverty. Ottawa would have responsibility for the welfare of children (and seniors) while the provinces would focus on adults. Although this sounds like a neat division of labour and may work providing that the child benefits are sufficiently generous, it seems to ignore the social ecology of family life. Probably the best way to enhance the well-being of children is to improve the income, training, and employment prospects of their parents.

While there may be no inherent reason not to devolve CAP funding at some point, I would argue that the timing at present is wrong. In an extended period of adjustment with a more integrated north-south economy and growing class divisions, there is good reason to take seriously Courchene's (1993) argument that social policy is the east-west glue for the country. This is not to say that CAP and other income support programs should not be touched or that there is no case for greater devolution of delivery; on the contrary, rethinking of the entire package of transfers is essential and many provinces are already engaged in innovative schemes to redesign their own welfare systems.⁶ But, devolution alone or the mere separation of benefits on the basis of age of the recipient without a fundamental reexamination would be ill-timed and inadequate.

INTERREGIONAL SHARING

The third principle of social policy in a federation is that there will be some cross-regional sharing of wealth so as to mitigate the differences between the have and have-not areas of the country. This is, of course, the foundation for the formal Equalization Program and the equalization components of other fiscal federalism arrangements. My point is not to revisit the equalization issues which have already been discussed at length elsewhere in this volume, but to argue that the rethinking of social, labour market, and economic policy needs to consider more explicitly the urban dimension as part of interregional sharing. There are two reasons for this.

First, the data on income distribution (not addressed by Vaillancourt) show that, while there has been a slight nationwide decline in the incidence of poverty over the past two decades, its geographical distribution has changed resulting in a "metropolitization" of poverty (Lithwick and Coulthard 1993). Whereas in 1965, over 22 percent of the poor resided in cities over 500,000, that figure had risen to 56 percent by 1990 with an offsetting decline in poverty in small urban and rural areas.⁷ This is a product not only of the ongoing industrial restructuring, especially in manufacturing, of urban areas, but of the heavy costs of

geographic mobility and social dislocation borne by metropolitan areas. Increased migration, whether from Somalia or St. John's, tends to lead to Toronto (or Montreal or Vancouver), not Kingston or Kapuskasing. Many scholars would assume that this urban concentration of poverty should not be an issue in the discussion of fiscal federalism because municipalities are creatures of the provinces and because benefits flow to individuals and to municipal governments from the provinces in relation to aggregate need. However, a portion of the costs of urban poverty are borne indirectly through the education system (as additional costs related to language training for new immigrants, nutrition programs etc.) and thus are paid for not by general tax revenues, but by the less progressive property tax system.⁸ My point is that the issues of poverty obviously are not uniform across the country; although urban poverty has become more acute and is being borne disproportionately by urban taxpayers, it is not yet addressed extensively in national debates.

The second reason that more attention needs to be given to urban regions in discussions of fiscal federalism relates to the new economic and social order described by Courchene (1993; this volume), among others. In a globalized, post-fordist economy, it is international cities, rather than nation states that are in direct competition for investment, footloose high-tech industries and knowledge workers. Private as well as government investment in infrastructure and in human capital increasingly will be directed towards urban regions. But, because our system of fiscal federalism is designed to deal with provinces, not cities, some reconceptualization of the principle of interregional sharing and rethinking of specific programs will be required.

CONCLUSIONS

The essence of Vaillancourt's proposals is to shift most of our existing social policies into *insurance*, rather than income *security* programs, and to devolve responsibility for social assistance and labour market strategies to the provinces. If it would not appear to be invoking too much of the "female voice," I would be tempted to call these proposals cold-hearted. Instead, I will suggest that they are like a hot sports car in an Ottawa winter: striking, but for the most part, unworkable. The recommendations are unworkable in my view because, while income support programs must be significantly redesigned for a variety of reasons and it is entirely appropriate to assume that citizens have responsibilities (as well as rights) for their own well-being, there undoubtedly will always be the need for programs of last resort and redistribution so that those who have had only marginal labour force participation will have some support. In the enthusiasm to devolve responsibility for social assistance, UI, training,

and labour market policy to the provinces to comply with public finance principles, we risk overlooking political rationales and imperatives. On one hand, there are strong demands by the provinces, especially Quebec, to have such powers and we need to look seriously at accommodating decentralization and asymmetry in many policy fields. But, on the other hand, in times of major social, economic, and political adjustment, there is a political argument to be made for maintaining the federal government's presence in at least some social policy fields as glue for the nation.

NOTES

1. Elderly benefits are overwhelmingly a federal responsibility using a combination of three types of publicly-funded programs: (a) insurance-based Canada Pension Plan (CPP) which accommodates asymmetry with a separate plan for Quebec; (b) income security under the universal, but clawed-back Old Age Security (OAS) and the supplemental Guaranteed Income Supplement (GIS), and (c) tax expenditures to younger individuals to encourage private investment in RRSPs. In addition, there is a large private retirement income system through the occupational and private pensions plans (Banting 1987, pp. 19-25).
2. Women over 65 are also more likely than men over 65 to live in poverty due to less adequate pensions and the simple fact that women are more likely to out-live their spouses. However, due to space limitations, this brief comment focuses only on single mothers and family support.
3. The 1993 report of the Ontario Fair Tax Commission presents an interesting argument against a guaranteed annual income program, but this discussion is beyond the scope of this brief summary.
4. I am indebted to Martin Abrams for suggesting this line of argument.
5. One of the recommendations of the 1993 report of the Ontario Fair Tax Commission is that if Ontario were to gain control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, it should eliminate the child-care expense deduction and use the revenue in direct program spending for child care.
6. Boadway and Flatters argue in this volume that there is no strong rationale for maintaining CAP on a cost-shared basis, in part because the federal government is at the mercy of the provinces who regulate the nature and thus establish the cost of their welfare systems. However, in the past few years, the focus of most provinces has been on cost-cutting and rationalization of their own social assistance programs, not in creating more expensive systems in response to 50 cent dollars (and due to the cap on CAP in Ontario, Alberta and B.C. these provinces now pay much more than 50 percent of CAP).
7. Lithwick and Coulthard argue that this does not merely reflect increased urbanization (1993, pp. 264-265); even as a percentage of low income in each population category, metropolitan poverty is the only population category that has risen since 1965.

8. In Ontario, 20 percent of the provinces' share of general welfare programs are paid for by upper tier government, directly out of property taxes. Due to the variability and inequities of the residential tax system, the Ontario Fair Tax Commission recommended transferring the funding of both education and general welfare to general provincial revenues from the residential tax system.

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PART FOUR

COMPARATIVE VIEWS

CHAPTER NINE

A Comparative Perspective on Federal Finance

Richard M. Bird

INTRODUCTION

Economists tend, as a rule, to approach issues of federal finance from a normative perspective, deducing from first principles what fiscal system would be "ideal" from the perspective of individual citizens, on the assumption that governments are benevolently concerned to maximize the economic well-being of their citizens.¹ Even economists working in the "public choice" tradition, who assume that politicians and officials are less concerned with the general welfare than with their own, often discuss the design of federal fiscal institutions primarily from the normative perspective of their ability to constrain the presumed rapacity of the political classes.² Such normative analysis may provide a useful standard of reference for assessing federal finance, provided one accepts its underlying assumptions as either ethically compelling, or descriptive of reality in a particular country, or perhaps both. As a rule, however, the normative approach alone provides little assistance either in understanding why particular fiscal institutions exist in any federal country or in evaluating the likelihood, or even the desirability, of changes in such institutions.

One reason for the lack of convergence between theoretical analysis and institutional reality is that the former, for the most part, concerns "fiscal federalism" rather than "federal finance." In fiscal federalism, jurisdictional boundaries and responsibilities (tax and expenditure assignment, for example) are generally assumed to be costlessly variable, distributional concerns are focused on individuals and dominated by the central government, and the maintenance of a national common market is taken as a *sine qua non*. This situation lends itself to a principal-agent framework of analysis and implies, for

example, that subnational access to source-based taxes should be restricted and that, on the whole, intergovernmental transfers should be conditional (Bird 1993). The first, if not the second, of these conclusions is common to most economic discussions of fiscal federalism.³

In contrast, in what I shall call a "truly federal" state, altering jurisdictional boundaries or assignments is seldom an easily accessible policy instrument; rather it is a constraint that can be altered only with considerable cost and difficulty.⁴ Moreover, different distributional and other policy objectives may be legitimately pursued by both levels of government, with no necessary presumption that federal concerns should dominate even with respect to the unity of the internal common market.⁵ This "federal finance" perspective suggests that the appropriate analytical framework is not a principal-agent one but rather one of negotiation among equals — in the classic words of Wheare (1963, p. 10) among federal and state governments that are "each, within a sphere, co-ordinate and independent."⁶ As yet, however, the theoretical analysis of federal finance, as defined here, is not sufficiently developed to draw very strong conclusions about either the efficacy or the efficiency of particular federal fiscal institutions.⁷

The alternative approach of comparative institutional analysis may perhaps prove to be more immediately useful. At the very least, a comparative approach may help correct the apparent belief of many citizens in most federal countries that there must be a simple solution to be found somewhere else in the world that could replace the seemingly unending complexity and negotiation characterizing federal financial arrangements in their own country. In reality, there is, and can be, no such solution. Federalism is a complex multidimensional phenomenon, whose specific features depend largely upon the particular context in question. As one of the leading authorities on comparative federal studies has noted: "Federation might best be understood in terms of the problems to which it has constituted a set of historically varying answers. If we understand the problems, the understanding of structure more clearly follows."⁸

In these terms, much may be learned from studying how different federal countries arrange their fiscal affairs: the solutions reached in each may be very different, depending on the local context, but the basic problems faced are likely to be similar. A comparative approach cannot yield any clear prescription as to what should be done at any particular time in any particular country. Nonetheless, it may be illuminating both to see how different countries have dealt with similar problems and to attempt to understand the principal factors that seem to have determined both what has been done and what the effects have been in different settings.

SETTING THE STAGE

The present chapter is in this tradition.⁹ Analysis of different practices in different countries is one of the few ways in which information on the effects and properties of different fiscal institutions may be obtained. In this regard, however, it is important to distinguish between decentralization and federation. Decentralization is in the air everywhere these days. Whether one looks at the developing countries of Latin America, Asia, or Africa, the transitional countries of Eastern Europe, or the developed OECD countries, decentralization is being advocated (or at least discussed) as a possible cure for many of the ills afflicting the country in question.¹⁰ It should not be surprising that the economic literature on fiscal federalism is being drawn on for guidance in determining whether, and how, various forms of a decentralist solution may work. And indeed, as I have argued elsewhere, in the circumstances of many countries this literature may provide some help in this respect (Bird 1993).

As suggested above, however, it is less clear that there is much to be learned from this literature so far as what may be called "truly federal" — as opposed to formally federal — countries are concerned. Fortunately for economists, there are surprisingly few truly federal countries in the world: Silverman (1992), for example, lists only 17 formally federal countries. Ten of these, however, are developing countries, only two of which (India and Brazil) appear to be truly federal in the sense I use the term: that is, countries in which both central and state governments not only have formally independent powers but use them in practice.¹¹ Comparative analysis of federal finance must thus focus on these two countries and on the seven developed federations — Austria, Germany, Switzerland, Canada, the United States, Australia, and — since 1993, Belgium.¹²

There are, of course, wide variations among even the developed country federations, although all have high incomes and are relatively stable democracies. Four of them are relatively compact, densely-populated neighbouring countries in Europe, while the remaining three are sprawling, continent-sized countries, two in North America and one isolated in the South Pacific. One (Belgium) is brand-new; two (Germany and Austria) are post-World War II creations; three (Australia, Canada, and Switzerland) have been around for at least this century; and the last (the United States) is the originator of federal government as we know it. Two (Canada and Australia) have parliamentary systems with little effective state representation at the central government level; the others, in different ways, have effective regional representation at the central level. Three (Belgium, Switzerland, and Canada) have important, regionally-based minority language groups; the others are more homogeneous.

Even within the small developed country sample there are thus a considerable variety of physical, demographic, political, historical, and economic characteristics.

Similarly, the two developing country federations considered briefly here, Brazil and India, are also very different, with Brazil perhaps most closely resembling the United States in its formal political structure as well as its relative cultural homogeneity and India being closer to Canada both in terms of cultural heterogeneity and its parliamentary form of government. On the other hand, the degree of regional income disparity is much greater in both Brazil and India, especially the former, than in any developed federation. Finally, the importance of municipalities in Brazil and the strong direct links between municipal and central government there are quite different from the situation in India.

Some years ago, while discussing a related topic, I suggested that there were two views of federations (Bird 1984a, n. 12). To keep my analogy palatable, without following the usual layer cake versus marble cake comparison, I labelled them the "Balkan" and "Swiss" varieties (thinking of yoghurt, where Balkan refers to unmixed and Swiss to mixed ingredients). At the time, I thought this was a clever play on words, since I was essentially arguing that a relatively loose and decentralized federal structure may sometimes be needed to produce Swiss-like stability in a heterogeneous country, while others seemed to see moves in this direction as a prelude to the dreaded "balkanization" (witness the disaster of former Yugoslavia!) of whatever they happened to care about. Subsequent reflection on both the nature of federations and the nature of yoghurt, however, leads me to conclude that this analogy is both inappropriate and inadequate. Its inappropriateness is obvious: after all, Switzerland is the premier example of what may be called an *unmixed* federation! So is its inadequacy: there are not just two varieties of federation; in fact, there are as many varieties as there are federations.

This point may be worth elaborating. Recently, a colleague asked me what I was working on. When told "a paper on federal finance," his immediate reaction, as a well-trained economist, was to ask: "what are your stylized facts?" I tell this little story because, in my view, one reason economists have had difficulty in dealing with issues of federal finance is precisely because there is no one set of stylized facts that tells the essential story. Federations differ in many dimensions: How many states are there? What are their relative sizes in terms of population and economic activity? How different are they in terms of per capita income? Natural resource wealth? What is the historical origin of the federation: bottom up or top down? peaceful or violent? What is its geography: compact or disperse? How homogeneous is the federation: in terms of

language? ethnic groups? unifying cultural myths? To what extent do state boundaries coincide with heterogeneity in any of these dimensions? Are regional interests explicitly represented in the central political structure? How?

The answers to these and other questions shape both the nature and working of federal institutions, including fiscal institutions, so it is not surprising that it is difficult to find a set of stylized facts to represent adequately the diversity in these dimensions found in the world's few working federal countries. Each country is a separate reality and may be forced into a comparative framework only by sacrificing some of its essential flavour. Indeed, if one must, for some reason, compare federal finance to some form of food, I now think the best analogy is not to either cake or yoghurt but to ice cream — with 7, or 10, or 17, or perhaps even 31 distinct varieties on offer. Variety may be the spice of life, but it obviously makes it difficult for a brief review of a few aspects of a very diverse set of countries to reach persuasive general conclusions. Nonetheless, two general lessons do seem to emerge fairly clearly from even a superficial comparative look at some issues in federal finance.

The first such lesson is that since every federal country is both unique and in some sense constitutes an organic unity, the significance of any particular component of its federal finance system — for example, the assignment of taxes or the design of intergovernmental transfers — can only be understood in the context of the system as a whole. One cannot pick an institution from a specific setting, plant it in the alien soil of another environment, and expect to obtain the same results. Policy recommendations on intergovernmental fiscal relations must be firmly rooted in understanding of the underlying rationale of the existing intergovernmental system and its capacity for change if they are to be acceptable or, if accepted, successfully implemented. What is feasible and desirable in any particular setting depends very much upon what that setting is, and why it is that way. One size does not fit all: simple general pronouncements (even if I make them!) — e.g., that unconditional transfers are better (or worse) than conditional ones or that income taxes should always be assigned to central governments — are worse than useless as a guide to policy: they may be positively dangerous.

The second lesson I draw is rather different. It is that in the end what is more important and interesting than the precise nature of the technical solutions found to even universal problems in the different countries are the process and procedures through which such solutions are reached (Wiseman 1987; Dafflon 1977; Bird 1986*a*). The final section of the chapter returns to this point. First, however, I shall illustrate the first "lesson" mentioned, the need to consider each fiscal institution in context, by considering briefly what international

comparisons suggest about some aspects of three of the basic fiscal problems faced in all federations: vertical balance, equalization, and tax coordination.

VERTICAL BALANCE: CLOSING THE FISCAL GAP

Two types of imbalance are frequently distinguished in discussions of federal finance. "Vertical fiscal imbalance" — or the "fiscal gap" — refers to differences between expenditures and revenues at each jurisdictional level. This concept focuses on the general assignment of expenditure and revenue functions to levels of government. In contrast, "horizontal fiscal imbalance" — often called "equalization" — focuses on differences in revenue or expenditure levels within a particular level of government. It is thus concerned with regional disparities, particularly in terms of the provision of public services.

A classic view of federal finance is that in principle "both general and regional governments must each have under its own independent control financial resources sufficient to perform its exclusive functions" (Wheare 1963, p. 93). Fiscal balance in this sense requires that state governments be assigned sufficient separate and independent revenue sources to permit them to finance the expenditures for which they are responsible without recourse to federal transfers. Only thus can states both be fully autonomous — in the sense of deciding, within their constitutionally allotted sphere, what they do — and also fully accountable to their citizens for their actions.

This argument continues to appeal to many. A 1977 report to the European Community, for example, emphasized fiscal balance in this sense, arguing that each jurisdiction should ideally have under its control and responsibility sufficient resources to enable it to finance the expenditures for which it is responsible, subject, however, to the important caveat that governments should only be able to levy taxes that burden their own residents.¹³ (Commission 1977, vol. 2, p. 481.) More recently, several scholars have argued for a major reassignment of tax powers in Canada on precisely this ground — to "rebalance" federal finances.¹⁴

The argument begins with a numerical demonstration that at present the federal and provincial fiscal systems in Canada are unbalanced both statically and dynamically. The federal government has for several years had a budgetary surplus with respect to program spending (i.e., excluding debt service), and this surplus seems likely to grow over time. On the other hand, the provinces are currently in deficit on program spending, and their position seems likely to worsen over time given the expected growth rates of provincial revenues and expenditures. This situation arises because provincial governments are responsible for the fastest-growing expenditure areas (notably health) but most of the

revenue from the largest, and fastest-growing tax, the personal income tax, goes to the federal government, which then transfers a large (though shrinking) proportion of its "excess" revenues back to the provinces. To rebalance the accounts, one proposal is that the personal income tax should become wholly provincial, while the sales and corporate taxes should in partial exchange become wholly federal, and at the same time most of the present federal-provincial transfers should be abolished.

Canada is of course by no means unique in assigning more tax revenue than expenditure responsibility to the federal government, while leaving state governments with inadequate revenue to finance the expenditures with which they are charged. Indeed, this is the situation in most federal countries: at the end of the 1980s, for example, state revenue in Brazil financed only 67 percent of state expenditure, compared to 75 percent in Canada and close to 90 percent in the United States (Shah 1991).¹⁵ The assignment of taxes and expenditures in different countries may reflect history — perhaps the intentions of the designers of the original constitution, perhaps the accidental development of events over time. Moreover, in more heterogeneous countries in particular there may also be additional political concerns mandating central control over revenue in order to be able to damp down (buy off) potential regional secessionist movements.¹⁶

The usual "fiscal federalism" analysis assigns more revenues than expenditures to the centre for four reasons: (a) the centre is presumed to be a more efficient tax collector and subnational governments are presumed to be more efficient spenders; (b) fiscal redistribution is assumed to be properly a central concern (so progressive taxes should be levied at that level); (c) subnational governments are likely to distort the common market through fiscal manipulation if given too free a hand (so taxes on corporations and natural resources should also be central); and (d) in any case the central government needs "excess" revenue to carry out its allocative and distributive roles (using intergovernmental transfers both to influence state actions — to achieve "incentive-compatibility" in the current jargon — and to achieve horizontal equity throughout the nation) (see Boadway, Roberts and Shah 1993).

Each of these arguments may of course be questioned. A recent study of Switzerland, for example, suggests that extensive use of personal and corporate income taxes at the state (canton) level has proved compatible with both economic efficiency and a surprising amount of fiscal redistribution.¹⁷ In any case, whatever weight (if any) may have been attached to these various arguments at different times in different countries, vertical fiscal imbalance in the revenues and expenditures of state and federal governments is a fact of life in all federal countries, albeit in differing degrees. Equally invariably, the resulting fiscal gap has been closed by intergovernmental fiscal transfers.

In principle, the gap in state finances could also be closed by (a) moving expenditure functions up to the central (richer) government;¹⁸ (b) moving taxes down to the state (poorer) level; or (c) raising existing state taxes or lowering state expenditures to restore balance. Although the first of these solutions has occurred to some extent in many countries, most attention has been paid in the literature to the second, as noted earlier. Understandably, this approach has not proved very popular either with central governments — who are reluctant to give up the power their “excess” revenue bestows. It may be more surprising that they have not been popular with state governments, who seldom seem eager to accept the responsibility for levying “new” (though not additional) taxes, without any offsetting political gains from being able to expand expenditures. And, of course, even in these deficit-conscious times, no government anywhere is keen to tax more or spend less, as the third alternative to intergovernmental transfers requires.

It is thus not surprising that as a rule vertical fiscal imbalance is dealt with in federations (as in unitary states) by fiscal transfers from central to state (and local) governments, even though the result is almost invariably to break the nexus between expenditure and revenue responsibility and thus to reduce accountability to some, and often a considerable, extent. Even in the United States, where there is no general revenue-sharing or grant system and where state governments have a virtually free hand in levying taxes, federal transfers in the form of conditional grants have in recent years accounted for one-fifth of state-local expenditures: the fiscal gap in this sense is even larger in other federations, notably Australia and India.¹⁹

Is this a problem? It is, of course, if one thinks that the only way to achieve a satisfactory degree of political accountability in a federal system is, so to speak, by standing every tub on its own bottom, that is, by requiring each level of government to finance its own expenditures from its own taxes. In fact, however, such “tax separation” is not a necessary condition for accountability. All that is required for accountability is that, at the margin, any government that wants to increase its expenditures has to increase *its* taxes (McLure 1993*b*; see also Ip and Mintz 1992). This condition requires only that intergovernmental transfers should not be related to the expenditures of recipients, not that there should be no such transfers. From this perspective — and in contrast to the version of the “fiscal federalism” perspective adopted in Bird (1993*a*)²⁰ — federal transfers to states should not be conditional on expenditures but should rather be determined in accordance with a formula invariant to actual state expenditures: some other desirable characteristics of such a formula are discussed further in the next section.²¹

EQUALIZATION AND REGIONAL DISPARITY

As a rule, regional redistribution is more explicit, if not necessarily more important, in federal than in unitary states. The regional distribution of industry, employment, and income in any country at any time reflects not only market forces but also past policy decisions by both national and subnational governments. In federal states, regions that have been, or consider themselves to have been, adversely affected by past central policies are often thought by themselves, and sometimes by others, to have a legitimate claim for some form of compensatory payment. Over time, the losers and gainers may shift as the result of the relative decline of traditional industrial areas (the so-called "Rust Belt" in the U.S.) or the rise of new areas as a result of population shifts (the "Sun Belt") or natural resource developments (e.g., the move of Alberta from being one of Canada's poorest provinces to one of its richest). But in most countries, developed or developing, there appears to be a surprising degree of stability over time in regional income disparities.

By definition, federal countries are politically sensitive to such regional differences. Federal policies thus inevitably respond to such disparities, whether explicitly mandated by the constitution (as in Canada or Germany) or not. As a rule, either the poorer regions get larger explicit transfers, or federal decisions on such matters as the location of federal facilities (e.g., military bases) are biased in their direction, or both. Although it is by no means clear why richer areas are willing to go along with such favouritism even when the purely allocative effects of such decisions or transfers are unfavourable, it may be because they see it as the cost of the benefits from being part of a larger economic and political entity.²² In any case, whether explicitly redistributive or not, to a considerable extent intergovernmental transfers in federal states thus seem best considered as part of a sort of "constitutional contract," under which regions give up certain powers and rights in exchange for transfer payments (Breton and Scott 1978). Transfers are thus one way of maintaining the political status quo in a federal setting — part of the "glue" of nationhood, as indeed has often been remarked in Canada (Courchene 1984).

Viewed in this light, regional transfers are not "subsidies" but rather payments for services rendered, either in the past (e.g., in the creation of the federation) or in the present (e.g., permitting central governments to levy income taxes) or both. Of course, this formulation best suits federations created from diverse and (either historically or potentially) separate political entities (the United States, Canada, Australia, Switzerland, Belgium, India) as opposed to those created, as it were, from above (Germany, Austria, Brazil). Nonetheless, even in the latter countries such a "quasi-constitutional" formulation

seems needed to explain why quite large explicit and implicit interregional fiscal flows have so often been accepted with surprisingly little fuss by the "paying" states. At the very least, this line of argument emphasizes that it may be quite misleading to evaluate the regional effects of current policy in any country outside the historical context within which that policy evolved.

In part perhaps for such reasons, assessments of the merits or otherwise of regional transfers based on such marginally relevant (in this context) criteria as the level of national output or even the reduction of regional differentials in per capita income levels have seldom had any visible impact on policy in any country. Regionally redistributive transfers may, for example, be condemned by some as inhibiting economically desirable migration (Courchene 1970). Others, however, may view this result as indicating the success of such transfers: poor states may prefer their residents to stay put for political and prestige reasons while rich states may prefer to keep the poor in poor states rather than to have an influx of migrants.²³ In some countries at least, the continued maintenance of a relatively stable and legitimate nation state may thus depend to some extent upon policies such as intergovernmental transfers, policies that from other perspectives are clear economic losers.

The extent to which different countries exhibit what may be called a "taste" for regionally equalizing fiscal policies depends of course both upon historical experience and current reality. In one of the few examinations of this phenomenon, May (1969) suggested that regional equalization policies might be expected to be strongest either where there are strong "nationalizing" forces and no strong regional conflicts or where there are marked conflicts of interest between units, with — as suggested above — fiscal transfers being used in effect to compensate poorer regions for the supposed adverse effects of other past or present federal policies.

Germany perhaps best illustrates the first of these rationales for equalization. The federal government is constitutionally mandated to legislate as necessary to maintain "uniformity of living conditions" throughout the country (Spahn 1982), and in pursuit of this objective in many respects federal and state governments act as one. The strongly equalizing transfer system is just one aspect of the concern with individual rather than regional equality which underlies German policy. In this as in other respects, Germany (and Austria) are in a sense the least "federal" of federal states.

The second rationale for equalization may be illustrated by Canada, which would clearly be quite a different country if it were not for the critical role of Quebec as a large, relatively poor, and culturally distinct state. In all federations, as May (1969, p. 5) noted in a rather Orwellian comment "some units are more equal than others," and Quebec has certainly fit this bill in Canada. The

number, the relative size, the ethnic diversity, and the wealth of the different units comprising a federation may all in principle influence its taste for equalization.²⁴ In practice, however, the extent of equalization in different countries does not seem to be related in any clear way either to the extent of regional disparities or to any other simple causative factor (see Commission 1977; Mathews 1981). Australia and Germany, for example, the developed country federations with the least degree of regional disparity, appear to be the most concerned with regional fiscal equalization.

As noted above, Germany is exceptional in the extent to which the concern for uniform service provision throughout the country has dominated both revenue sharing and expenditure administration, German (and Austrian) federal finance is intended to ensure that services are delivered on more or less equal terms throughout the country, although the German preference for achieving more or less "unitary" results through a federal structure is currently under severe test as a result of the incorporation of five new, and poor, states following reunification. In contrast, Canadian and Australian federal finance is intended to ensure that all states are given the same capacity to deliver services (at similar costs to state taxpayers), but is much less concerned to ensure that they actually do so. Similar arguments have become increasingly influential in India in recent years (Rao 1993). On the other hand, neither the United States nor Switzerland has an explicit general equalization program, although both incorporate significant equalizing elements into a variety of conditional grant programs.

The Swiss case is particularly interesting. Although a number of rather complicated equalization formulae are employed, their basic purpose is simply to classify the various cantons into "weak" and "strong" (Dafflon 1977; 1991). Over the years, these formulae have frequently been changed, in part it appears in order to produce more or less a constant result in the face of changes in the various factors taken into account in the formulae. As Frey (1976, p. 100) put it: "certain cantons are considered poor, and it is politically impossible to remove them from the group of poor cantons even when their economic situation has improved." Such stability in outcomes appears to be equally important in some other countries also, e.g., Canada where formula changes have usually been intended to yield constant or even increased subsidies to what is almost a pre-defined group of poorer regions.²⁵

The point, of course, is that the equalization process is always and inevitably political in all federal countries. Formulae, no matter how elaborate, remain acceptable only so long as their *results* are acceptable. With little exaggeration, in most federal countries it may be said that it is not so much that the distribution of transfers reflects the outcome of a principled formula as that the formula used is the one that produces the desired distribution of transfers. As the intellectual

pioneer of equalization formulae in Australia put it half a century ago: "The thing is dressed up in arithmetical terms as much as possible, and that perhaps is politically useful. But it must be admitted that in a good many instances, the actual decision as to how much allowance must be made for this or that depends, not on the strictly arithmetical computation, but on the broad judgement of the Commission as to what is a reasonable figure."²⁶ He did not add, perhaps because it was so obvious, that the extent to which that judgement is accepted by politicians will by definition depend upon the political acceptability of the outcome.

Despite the enormous professional literature on equalization formulae — see, for example, the discussions of India in Rao and Chelliah (1990) and Canada in Courchene (1984) — in the end regional redistribution in a federal state, whether effected through equalization transfers or in other ways, is always and inevitably the product of a political compromise. This compromise may be rationalized through mathematics, and in turn the mathematics rationalized through (more or less principled) discussion, but the fact remains that there is nothing more political in federations (or elsewhere) than who gets what. It may be desirable for many reasons to establish explicit and agreed equalization formulae for a period of time in order to obviate the undesirable effects of annually negotiating transfers. Thus the regional distribution issue is moved at least temporarily to the "constitutional" as opposed to the "in-period" decision level. But circumstances change, and, as Canada may be about to learn, equalization systems must change with them, or suffer political death or abandonment.

What matters most is thus not the details of any particular formula in place at any particular time but rather who has the power to decide what the formula should be. In this respect, there are at least three distinct models to be found in the world. In Australia and India, although in quite different form, expert commissions established by the federal government are entrusted with the primary task of establishing distributive formulae: these commissions hear representations from the state governments and report to the federal government, which normally follows their recommendations.²⁷ In contrast, in Germany, Austria, Switzerland, and the United States, grants are established by the federal government, but — again in quite different ways — there are formal state representatives in the federal legislature who must approve them so that state interests are generally well represented in the process. Only in Canada is the determination of the equalization formula under the control of the central government, as indeed are such other important components of federal-provincial fiscal relations as (to a considerable extent) the tax agreements and other transfer programs. It is thus perhaps not surprising that in Canada, more

than in other federations, every federal-provincial issue tends to become a matter both for extended discussion between innumerable committees of federal and provincial officials and, often, for public polemics between federal and provincial governments.

The extent of concern with regional disparity and equalization is thus fundamentally a matter to be determined in the political arena. As is well known, in this game many players often find considerable virtue in obscurity and ambiguity. Nevertheless, a strong case can be made for attempting to implement a number of principles in intergovernmental transfer programs. One such principle has already been mentioned: the desirability of adopting relatively stable formulae in order to permit sounder fiscal planning at both levels of government (Bird 1990). Another principle of general applicability is that a good equalization formula should generally incorporate measures of both need and capacity (Bird 1993a), although there are of course many ways in which of these factors may be measured. Other factors may also be important in shaping the observed fiscal flows between governments, e.g., the degree of central interest in the provision of certain regionally-provided services and the need to close the fiscal gap, which may often entail returning some central taxes to the regions from which they are collected. Further discussion of these and the many other complexities that must be taken into account in developing transfer systems cannot be undertaken here, however.

TAX COORDINATION

Federal countries in which states have significant independent taxing power are usually considered to face substantial problems of tax coordination, both vertically (between federal and state governments) and horizontally (among state governments).²⁸ Different federations have resolved these problems in very different ways. At one extreme, Australia really has no tax coordination problem because — to exaggerate only slightly — the states really have no taxes (see McLure 1993a). They are not allowed to levy sales taxes, and they also do not levy income taxes, essentially because the federal government has pre-empted the field and has shown little interest in making "tax room" for state taxes. Similarly, tax harmonization is not much of an issue in Germany or Austria, although for quite different reasons, essentially because all major taxes are applied uniformly throughout the country, with the proceeds being divided by agreement between the federal and state governments and by formula among the states.

In contrast, in the other federations discussed here, tax harmonization is viewed by many as a serious problem, although again the situation is very

different in different countries with respect to different taxes.²⁹ In Canada, for example, the income tax, both personal and (to a lesser extent) corporate, is basically levied on a common base and collected (for the most part) by a single administration, although each level of government levies its own rates and the proceeds are divided strictly on origin (derivation) lines. In India, the income tax is federal, but most of the personal income tax (which is not very important) is distributed to the states in accordance with the formula established by the finance commission.³⁰ In Brazil, the income tax is basically federal. In contrast, in both the United States and Switzerland, both state and federal governments levy both corporate and personal income taxes independently.

Concern is often expressed about the possibility of tax competition in the latter two countries (and to a lesser extent in Canada). The conventional fiscal federalism literature also tends to argue strongly for exclusive federal competency with respect to corporate taxes and federal dominance with respect to personal income taxes. In practice, however, there appear to be few serious problems arising in any of these countries from the way income taxes are currently divided.³¹ Clearly, the costs of taxation are somewhat higher in a system in which more than one level of government taps the same tax base, but such costs may be considered as part of the overall cost of maintaining a federal system — a system that presumably has its own rationale, even necessity, or it would not exist. Unnecessary costs of collecting taxes should of course be minimized, but not all such costs are necessarily “unnecessary.”

With respect to indirect taxes, the situation is equally varied, though probably less stable. In Australia, Switzerland, Austria, and Germany, sales taxes are federal, with the proceeds in Germany and Austria being shared with the states on a formula basis. In the United States, sales taxes are levied by the states (as, in effect, is true in the European Union also, if one wishes to think of it as a nascent federation). But in India, Canada, and Brazil, both levels of government currently levy general sales taxes more or less independently. Brazil has a form of value-added tax (VAT) at both the state and federal level, Canada has a federal VAT and, in most provinces, provincial retail sales taxes, and India has (broadly) manufacturers' sales taxes at both central and state levels. All three countries are currently considering reforms: India is considering adopting a VAT at the central level and is concerned how best to do this (Burgess, Howes and Stern 1993); Canada would like to harmonize its federal VAT with the provincial sales taxes and has encountered substantial provincial opposition in doing so (Bird 1993*b*); and Brazil is considering shifting the VAT solely to the state level (Longo 1993).

Unfortunately, no one has yet managed to work out a technically acceptable system of levying independent sales taxes at two levels of government. Broadly,

four possible directions of change seem feasible in the dual sales tax countries. A first option would be to move the sales tax entirely to the state level. Such a system is clearly feasible, at least so long as the tax is levied at the retail stage, as U.S. (and Canadian) experience shows. Unfortunately, considerable experience suggests retail sales taxes are not practicable in developing countries and, for that matter, that high-rate retail sales taxes are difficult to administer in any country.³² Pre-retail stage taxes may also be levied at the state level, as India and Brazil (like Argentina) demonstrate, but such taxes are clearly less desirable on both economic and administrative grounds. Economically, such taxes undesirably encourage shifting taxes to non-residents, and they are hard to administer on interstate sales without substantial interprovincial cooperation and central support (e.g., the so-called "clearing-house" arrangements that have been discussed — but not implemented in the EU context) (see e.g., Cnossen 1991).

A second option would be to move the sales tax to the federal level, as in Germany. In many ways, this seems the neatest solution: it is obviously technically feasible and would almost certainly substantially reduce compliance costs. In Canada, the revenue loss of such a shift could be compensated for by an increase in provincial personal income taxes (and a corresponding reduction in federal rates), although it is unclear why either level of government would be willing to make such a switch: What do they have to gain by doing so? Given the weakness of the income tax systems in Brazil and India, however, this option is probably not open to them: indeed, there does not seem to be any feasible replacement for sales taxes as the mainstay of state revenue in these countries.

A third option would be for the sales tax to become a joint federal-state tax. Such a tax could be administered by either level of government (although central administration might be better) and state and federal rates should be determined independently, but a common base would have to be agreed. Apart from the fact that the base is federally-determined, the present Canadian personal income tax arrangements illustrate such a system in operation, although it is far from clear that a similar degree of cooperation will be attainable in the sales tax field (Bird 1993*b*). Moreover, at the technical level, it is by no means certain how the proceeds of a VAT levied on this basis should be divided among states. Suppose, for example, that a product is manufactured in one state A and sold in another, B. In principle, State A imposes its tax on the value-added by the manufacturer and State B its tax on the value-added by the retailer. In fact, however, what happens in an invoice-credit VAT is that the tax is levied on the entire retail price, with the retailer being refunded the tax he paid when he bought the good from the manufacturer. But this would require State B to

refund a tax that was actually collected by State A. Clearly, what is at issue here is precisely the problem of VAT coordination discussed by Cnossen (1991). Unfortunately, all the possible solutions he discusses in the European context appear to assume a much higher degree of reliable bookkeeping in the private sector and public trust in the political sector than seems likely in most developing countries (see also Poddar 1990). Since Canada suffers less from the first of these problems than the second, some variant of the "deferred payment" scheme that has now been adopted in the EC may work, although this question cannot be further discussed here.

A fourth, and final, option would be for both levels of government to continue to levy their own sales taxes in a more or less uncoordinated fashion, as now. So long as the perceived political cost of developing a more coherent national sales tax system exceeds the benefits, economic and otherwise, of doing so, one is unlikely to emerge in practice. As and when the costs demand some alternative solution, it may, depending on local circumstances, take the form of one or other of the options mentioned above — the Swiss solution (federal tax), the American solution (state tax), or the German solution (joint tax, with possible variations). Or it may take the form, as presently seems to be emerging in Canada, of asymmetrical agreements in different parts of the country. In Alberta, for example, where there is no provincial sales tax, there is only a federal VAT; in Quebec, the provincial retail sales tax has been altered to a form of VAT, and the provincial government also collects the federal VAT; in five provinces the provincial sales tax is levied (as in Brazil) on a base including the federal VAT, while in four it is levied (at the retail stage) on the same base (retail value excluding tax) as the VAT on goods. Such untidy and costly solutions may be part of the price that has to be paid for the Canadian version of federalism. A neater solution in some ways, though not one popular with tax experts (McLure 1987) might be for the federal VAT to be changed to a one-rate subtraction-type tax levied on an accounts basis (as is the case in Japan for most taxpayers) and administered with the federal income tax, but as yet this option has not been seriously analyzed or considered (see Mintz, Wilson and Gendron 1993; Hill and Rushton 1993). In the end, what (if anything) is done to improve sales tax coordination, in Canada as elsewhere, will depend largely upon how well, and how, the process of federal-provincial decision making works.³³

CONCLUSION³⁴

Indeed, one of the most important themes to emerge from a consideration of fiscal arrangements in a number of federal countries is precisely the central importance of the *process* of federalism, as opposed to the details of its varied

products in different settings. The same lesson emerges in many other contexts also. A study of internal barriers to trade within Canada, for example, concluded that the critical factor was how federal-provincial relations were managed (Prichard and Benedickson 1983). A comparative study of political processes in federal states concluded that the essential ingredient was a set of clear procedural rules through which the necessary accommodation between governments could occur (Bakvis 1981). And a pioneering study of federal finance as a process of continual political bargaining similarly emphasized the need to work out detailed rules and policy structures — not to ensure that specifically desired outcomes emerged from the process (as in the usual normative approach) but rather to ensure that those outcomes that did emerge, whatever they may be, were the best possible given the basic constraints within which the federation operates (Dafflon 1977).

As with the various aspects of intergovernmental fiscal arrangements discussed earlier, however, simple comparisons of particular procedural features in different federations seem as likely to obscure as to illuminate reality. Consider Australia and Canada. Each has a similar historical origin from an aggregation of British colonies, and each has a similar parliamentary federal system in which many federal-state problems are resolved by an adversarial interstate approach rather than the intra-state approach that characterizes the very different political institutions in Germany and Switzerland. Each has a small number of states, and is dominated by two large states. They are also roughly similar in many other respects — size, population distribution, and level of economic development, for example. Moreover, they share a similar tradition of evolutionary rather than revolutionary change and play similar roles in the world as middle-sized industrial countries with strong resource bases. The logic of Canada-Australia comparisons seems overwhelming (Mathews 1982). For good or ill, Canadians and Australians often look at each other's experience for possible lessons.

Such looks, however, are fraught with difficulties because in fact there are some very important differences between these two countries, not least in their central federal fiscal institutions. In Australia, for example, both taxes and borrowing are far more centralized than in Canada, and intergovernmental grants are much more important as well as more equalizing in intent and (probably) result. Moreover, regional differences are much less important in Australia than in Canada, even without taking into account the most significant difference between the two countries — the existence of the important and culturally distinct province of Quebec in Canada. The game of territorial politics in Canada is more firmly grounded in socio-economic reality than it is in Australia. Australian federalism to some extent may be argued to have its

basis in the simple historical fact that it was founded as a federation. In Canada, in contrast, it may be argued that a relatively loose form of federation is an essential ingredient for its continued existence as a nation state.

Similarly, Germany and Switzerland are countries that are alike in some important respects but differ sharply in others. In both countries, for example, not only are many projects jointly financed by state and federal governments but there is also extensive cooperation between the two levels in carrying out many other tasks. The significance of this "interlocked federalism" (Lehner 1982) is quite different in the two countries, however. In Germany, the result of this interdependence has been that the states have largely lost the capacity — if they ever had the desire — to decide autonomously on policies. On the other hand, in Switzerland, despite the existence of many joint and cooperative activities, the cantons continue to retain and exercise very considerable decision-making powers. Federalism in Switzerland, as in Canada, reflects current reality, while in Germany, as in Australia, in many respects it seems more a matter of history and institutional inertia. Decentralized decision making may be more economically efficient, but in itself it does not require the kind of constitutional barriers to change that characterize federations.

In the developing world, in this respect India seems more like Switzerland — albeit on an enormously larger scale — and Brazil like Germany. India contains almost a billion people living in such a heterogeneous group of states — in language, in religion, in culture, in level of development, and so on — that it is hard to see how it could possibly be governed except as a tight dictatorship (like the old Soviet Union) or a relatively loose federation. In practice, it has oscillated back and forth uneasily between these two poles but has, almost miraculously, managed to survive the vicissitudes of the last 40 years as a democratic state. Although Brazil too is so large and economically diverse that it is not clear that it could be governed, efficiently or otherwise, except in a decentralized fashion, unlike India it is more united by language and culture than divided by it, so it is far less clear that a strong federal system is essential to its survival as a nation state.

Whatever the rationale and the underlying political necessity for federalism in any particular country, a huge load is inevitably thrown on the political bargaining process in all federal countries. Federal-state conflicts, conflicts between rich and poor regions, conflicts between different interests in different states, and (except in Switzerland, with its unique coalition system) conflicts between political parties, must all somehow be accommodated in this process. The nature of the institutions within which such bargaining takes place and the evolution of those institutions thus constitute in many ways the most important characteristics of any federation.

In no country, for example, is the importance of constitutional rules more important than in Switzerland, given the exceptionally detailed nature of the Swiss constitution — which includes, for example, most major tax rates — and its cumbersome amendment procedure, requiring not only a direct popular vote but also a majority of the votes in each separate state. One might think that such a system in a diverse country (with four languages, three ethnic groups, and two religions) would virtually guarantee that no changes will be possible. In reality, however, there have probably been more constitutional amendments in Switzerland than in any of the other developed federations in which such amendments appear to be much easier. No doubt, the detailed nature of the constitution requires more such amendments to cope with changing times, but the fact is that they have been made, and the end result is that neither the growth of government nor its structure is very different in Switzerland from that in its neighbouring countries. If there is any lesson here, it may simply be that the complex Swiss system of achieving an adequate degree of political consensus and support is necessary *in Switzerland*, given its cultural and linguistic diversity, in order to achieve much the same results as in other countries, though usually more slowly.

As noted earlier, in federal countries the continued viability of the component units — the states — is generally considered an important and explicit objective of policy. The form that regional policy takes often provides a good indication of the extent to which the federal system reflects underlying socio-political realities.³⁵ The greater the value placed, for political or social reasons, on regional survival, the more emphasis is likely to be placed on relatively unfettered regional tax powers supplemented by equalization (as in Switzerland) or relatively unfettered and large transfers to regions (as in Canada and India). In the end, it is factors such as these, together with the institutional structure of decision making, rather than concerns about economic efficiency that have shaped, and no doubt will continue to shape such important aspects of all federations as the assignment of taxing powers, the degree of vertical and horizontal fiscal coordination, and the size and nature of intergovernmental fiscal transfers.

Fiscal arrangements invariably constitute an important component of the federal system in any federal country. Changes in these arrangements reflect, and may sometimes also induce, changes in that system, and the design and analysis of such changes is a proper subject for economic analysis. In the end, however, a federation is invariably a political creation with primarily political ends. The federal finance system existing in any country must therefore be understood and assessed within a political framework. What matters most in federal finance is who determines the rules of the game and how those rules are

changed. The most important decisions affecting federal fiscal systems are more likely to be changes in the composition or role of state (provincial) representation in the federal government or the status of any new federal-provincial organs that may emerge than new arrangements for tax coordination or new twists in the equalization formula.

Of course, analysis of such formulae is important, but if such analysis is to play its proper role in the essentially political process of intergovernmental bargaining, what is needed is an institutional framework which welcomes, accommodates, and to the extent possible incorporates such analysis in the process of achieving sufficient consensus in a complex and divided society for decision making. Among the countries discussed here, only Australia and India have such a framework explicitly in place, although neither the Commonwealth Grants Commission nor the periodic finance commissions in India come close to fulfilling the ideal comprehensive and open bargaining framework set out by such authors as Dafflon (1977) and Wiseman (1987).³⁶ Similar, though even less structured, roles are played by other official, academic, and non-governmental institutions in most federal countries. Those who would improve the economic outcomes of the federal system in their own country would seem well advised to study these examples and to attempt to improve upon them within their local context in order to feed information into the political process and possibly to affect its outcome. In other words, to conclude on a positive note, one conclusion I draw from a comparative perspective on federal finance is that conferences such as this are a Good Thing!

NOTES

An earlier version of much of this paper was presented at the International Symposium on Fiscal Reform, Sao Paulo, Brazil, September 1993. I am grateful to Charles McLure and other participants at the symposium for helpful comments.

1. For classic examples of this approach, see the papers by Gordon (1983) and Musgrave (1983). A more recent example is the excellent review by Boadway, Roberts and Shah (1993).
2. A classic example is Brennan and Buchanan (1980). For a more recent instance, see Migue (1993). Inman and Rubinfeld (1993) make an interesting attempt to combine the standard and public choice approaches, treating political institutions as a constraint and changes in such institutions as a possible means of reform.
3. To illustrate, Boadway, Roberts and Shah (1993), although they argue strongly for what may be called "the decentralist presumption," that government activities should be carried out at the lowest possible level, conclude that subnational access to income taxes in general and source-based taxes in particular should be severely restricted both because of greater central administrative efficiency in taxing mobile factors and because of the assumed need to perfect the internal common

market. The decentralist presumption is obviously similar to the principle of "subsidiarity" which has been increasingly discussed in the European Community in recent years. It is related to, but broader than, the "decentralization theorem" propounded by Oates (1972): see Shah (1993) for further discussion.

4. In many federal countries, this statement applies only to federal-state, not state-local, relations. In some federations, however (e.g., Venezuela) even the state governments are not really autonomous in any real sense; in others (e.g., Brazil) both states and municipalities have substantial degrees of autonomy. The failure to distinguish clearly between the quite different forms of interaction between dependent (principal-agent) and autonomous ("federal") levels of government is one problem with the conventional literature, although in principle this defect could be remedied by incorporating different costs of changing political institutions at the local and the state level into, for example, the analytical framework developed by Inman and Rubinfeld (1993).
5. Some recent analyses of fiscal federalism allow for subnational distributional and even stabilization concerns, distinguishing between two quite different questions that are sometimes confused, namely, the *infeasibility* and the *undesirability* of subnational policy: see e.g., Gramlich (1987) on stabilization, and Tresch (1981) on distribution. However, few seem to accept the position argued in Bird (1989) that there is no necessary connection between the degree of unity of the internal common market and the structure of the political federation. On the contrary, concern for the purity of the internal common market motivates the conclusions of such disparate authors as Boadway, Roberts and Shah (1993); and Migue (1993).
6. On the other hand, unlike the "fiscal federalism" (decentralization) case discussed in Bird (1993a), there may be a strong case in truly federal states for unconditional interregional rather than interpersonal distributive transfers — although there is by no means agreement in the literature as to the rationale for such transfers. See Boadway, Roberts and Shah (1993) and Shah (1991; 1993) for what has come to be the accepted rationale for such transfers, essentially on horizontal equity grounds. For a different view, that such transfers may be rationalized in terms of equalizing regional fiscal capacity but not individual horizontal equity, see Musgrave and Musgrave (1993). Yet another view, common with American authors, is that intergovernmental transfers on equalization grounds can be justified only if they affect interpersonal redistribution (cf. Gramlich 1984): for a review of the (very limited) efficacy of such transfers for this purpose, see Rao and Das-Gupta (1993). Of course, others — e.g., Migue (1993) — see little rationale for intergovernmental equalization transfers in any case. While the many controversies on this subject can hardly be resolved here, a somewhat different approach to equalization transfers is suggested later in the chapter.
7. See, however, the interesting analysis of Breton and Scott (1978) as well as the rather different line of analysis in Breton (1989).
8. Preston King, as quoted in Burgess and Gagnon (1993, p. 9). For other useful examples of comparative federal studies by political scientists — few of whom, however, have attempted to analyze fiscal institutions — see King (1982); and Bakvis (1981).

9. For earlier comparative studies of federal finance from this perspective, see Advisory Commission (1981); Hunter (1977); Hayes (1983); Thirsk (1983); and Bird (1986b). It should come as no surprise that portions of this chapter draw heavily on the last of these.
10. See Campbell *et al.* (1991) and Winkler (1993) in general; Bird (1984b) and Colombia (1992); on Colombia, and Shah (1990) on Brazil, for examples; see Economic and Social Commission for Asia and the Pacific (1991); see especially Silverman (1992) on Africa; see Bird and Wallich (1993) for a preliminary survey of the transitional countries of Eastern Europe, as well as Wallich (1992) on Russia; see Bird (1993a) on OECD countries.
11. To illustrate in the Latin American context, Venezuela and Mexico are formally federal; yet neither is in practice as "federal" as Argentina, let alone Brazil. Of course, many developing countries such as Malaysia (Gandhi 1983) and Papua New Guinea (Bird 1983) also have some "federal" characteristics, but on the whole — at least in a short essay like this — I shall simply assert that they are not "really" federal. For a more generous view, see Shah (1993).
12. For recent reviews of federal finance in these countries, see on Canada — Boadway and Hobson (1993); on Germany — Spahn (1991) and Fiedler (1991); on Switzerland — Dafflon (1991) and Kirchgassner and Pommerehne (1993); on Austria — Thoni (1991); on the United States — Advisory Commission (1993); on Australia — James (1992); and on India — Rao (1993) and Sury (1992). In addition, see Shah (1990) and Oliveira and Velloso (1991) on Brazil, as well as Gandhi (1983) for an interesting comparison of Brazil, India, Nigeria, and Malaysia, and Shah (1993) for a more general comparison. I am not aware of any study of federal finance in Belgium.
13. The case for restrictions on tax exportation (to non-beneficiaries) is further developed in Bird (1993). See also Walsh (1992) for further discussion of this "correspondence" (or "equivalence") principle.
14. See Ruggeri, Howard and Van Wart (1993). Somewhat similar, though less drastic, suggestions for change are made by Ip and Mintz (1992). For further discussion, see Bird (1994). Interestingly, much the same discussion is currently going on in the very different environment of Russia (Wallich 1992), though I hesitate to draw any parallels between the two countries.
15. Shah (1993) updates and extends this analysis: for a skeptical view of all these measures of "balance" in a federal setting, see Bird (1986a).
16. For an early analysis of the relation between rising political tension in the Canadian federation and the decline in federal capacity to "buy off" dissenters, see Bird, Bucovetsky and Foot (1979, chaps. 8-9).
17. See Kirchgassner and Pommerehne (1993): the arguments in this paper may be disputed, but they are broadly compatible with the view expressed in Bird (1986b) to the effect that Switzerland, like the U.S., seems to have paid a surprisingly low price for allowing state (local) governments far more fiscal leeway than suggested by the conventional fiscal federalism analysis. The low level of mobility may explain the Swiss outcome to some extent, but obviously the same explanation cannot hold for the U.S.
18. Although it is not possible to discuss expenditure assignment here, it should perhaps be noted that it is generally misleading to speak of a clear "assignment"

of a particular expenditure function to a particular level of government. In practice, most major expenditure functions in most countries are shared among different levels of government (and the private sector) in different ways, with respect to regulation, to finance, and to service delivery, for example.

19. The U.S. data is from the Advisory Commission (1992); for other countries, see e.g., Bird (1986*b*); and Shah (1991; 1993). Incidentally, the impressionistic statements in the text may be more meaningful than the false precision of quantitative comparison of fiscal balance in different countries. In particular, although attempts to calculate a precise coefficient of "vertical fiscal imbalance" have been popular since Hunter (1977) — see e.g., Shah (1991; 1993) — such calculations are inherently so suspect on both conceptual and empirical grounds (see Bird 1986*a*) that they are not attempted here.
20. Bird argues that, in the principal-agent framework, the relevant accountability for local government expenditures financed by central transfers is to the central government rather than to the local taxpayer.
21. The formula suggested in Bird (1993) (and developed in more detail in e.g., Bird and Slack 1983) is essentially a variant of a so-called "foundation" approach: it also permits states to lower their taxes if they wish to provide fewer public services. (This discussion excludes from consideration the traditional economic argument for intergovernmental transfers in the case of jurisdictional spillovers of benefits, as well as the arguments for such transfers to induce states to spend in accordance with central government priorities. For further discussion of such arguments, see Bird (1993*a*); as well as Boadway and Hobson 1993.)
22. This is a rather glib assertion about a phenomenon that has been little studied. Indeed, in general the allocative effects of regionally redistributive transfers (or other policies) are not well understood. From the early controversy on this matter between Buchanan (1952); and Scott (1952) to the latest papers by such authors as Oates (1993) it is clear that the relationship between federalist policies and regional and national economic growth is far from clear in any country, although this complex theme cannot be further discussed here. For an interesting discussion of this issue, including extensive reference to Canada, see Higgins (1981).
23. An analogy with foreign aid may be suggestive: rich countries may prefer to give aid to poor countries rather than to accept their (competitive) products, let alone their people.
24. See Inman and Rubinfeld (1993) for an interesting preliminary attempt to incorporate the number of states explicitly into a political-economic model of federalism.
25. See Courchene (1984) for a discussion of changing equalization formulae in Canada. Gil Diaz (1990) noted a similar phenomenon of what is often called "grandfathering" (maintaining the status quo) in Mexico with respect to the coefficients of VAT shares, i.e., the proportion of revenues from this tax going to different states. McLure (1993*b*) specifically cites the Mexican case as an example of what should not be done: technically, he may be right, but he is almost certainly wrong politically.
26. L.F. Giblin, quoted in May (1969, p. 63). The "Commission" mentioned in this quotation is the Commonwealth Grants Commission, an expert agency established in Australia before World War II to determine equalization grants to states.

27. In India, the Constitution requires the government to accept these recommendations, although it should of course be remembered how freely the central government in India replaces state governments with which it disagrees. In the early 1980s, for the first time since the Australian Commission was established, the federal government refused to accept its recommendations. Although this refusal led to considerable uproar in Australian academic circles (e.g., Groenewegen 1983), what is surprising is that for so long the Commission was able to defuse the potentially explosive politics of regional redistribution by recourse to its increasingly arcane and pseudo-scientific formula approach.
28. Note that this way of putting things assumes that there is a need to coordinate: for a more skeptical view see McLure (1993*b*); and Bird (1984*a*). This issue has been extensively discussed also in the European context in recent years (see, e.g., Cnossen 1991; and Kopits 1992). As argued in Bird (1989), in a number of respects the "harmonization" issue is rather different in a common market and a federal state, but this point cannot be further discussed here.
29. It should perhaps be noted again that I have no information on the situation in Belgium.
30. The fact that revenue sharing in India is concentrated on the personal income and central excise taxes has the unfortunate effect of biasing central tax policy decisions: since the central government gets to keep all of an increase in customs duties or corporate taxes, but only (say) 15 percent of an increase in personal income tax, its interest in the latter is correspondingly reduced. To avoid such bias, a desirable feature of revenue-sharing schemes is to state them in terms of a share of all central revenues (as in Colombia, for example) rather than as a share of particular taxes.
31. See Thirsk (1993) for a recent overview of the tax competition literature, which again cannot be further explored here. As mentioned earlier, Kirchgassner and Pommerehne (1993) provide support for the "it doesn't matter much" view stated in the text. See also McLure (1993*b*) for the argument that tax competition is, from the citizen's perspective, basically a good rather than a bad thing.
32. In Canada, for example, a "joint" federal-provincial retail sales tax would have a rate of 14 percent or more, that is, higher than any such tax in the world, and above the level at which even well-ordered homogeneous countries such as Norway found it necessary to change to a VAT (Bird 1970).
33. More research is needed with respect to the relative efficiency of alternative coordinating mechanisms. Migue (1993), for example, makes a strong case in principle for relying on market, or at most "club," coordination rather than a centralized hierarchical structure, but offers no evidence that this is the best way to proceed. Boadway, Roberts and Shah (1993), on the other hand, prefer to put their faith in central benevolence. A movement from faith to knowledge seems necessary to make any progress in this area though it seems unlikely to happen soon: indeed, I made a rather similar remark nearly 30 years ago (Bird 1966)!
34. The argument in this section (as in some of the preceding text) largely repeats points made in Bird (1986*b*), since subsequent experience has given me little reason to change my mind on these matters.
35. Analyses of fiscal federalism (e.g., Boadway and Hobson 1993) often ignore regional policy concerns on the grounds that they are unrelated and better pursued

in other ways. Unfortunately, while analytically neat, this approach flies in the face of reality. In every federal country, the fact is that regional development concerns and federal fiscal arrangements are inextricably linked.

36. Another example of such an institution may be found in Papua New Guinea, which shows the influence of both the Australian and Indian examples: see Bird (1983) for further discussion of this case.

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Comment: The Value of Comparative Perspectives

Ronald L. Watts

INTRODUCTION

The two major themes of Richard Bird's chapter are ones with which I find myself in strong agreement. The first relates to recognizing both the limitations and the value of the comparative perspective. The second is his emphasis, as a result of his comparative survey, upon the essentially *political* character of the issues in federal finance. His essay is an excellent survey and overview of the major patterns of federal finance and of the similarities and differences in the major federations. It is a pity, however, that time and space limitations resulted in his deliberately not going into as much depth as he might have on some of the specific issues facing the current review of Canadian federal finance.

THE VALUE OF COMPARATIVE ANALYSIS

Richard Bird's chapter has important things to say, with which I agree, about both the limitations and value of comparative analysis.

Generally speaking, Canadians seem to be reluctant to undertake comparative analysis. Indeed, on the first day of this conference I noted just two brief references to experience elsewhere: Tom Courchene referring to disparities within Australia and Richard Simeon to the problems in Germany with joint decision making. Many Canadians seem to think of comparative studies as simply excuses for foreign travel by self-indulgent members of Parliament and sabbatical scholars or as shameful acceptance of the pretention of foreigners. As a result the largest portion of Canadian comparative work tends to focus on our obvious closest neighbour to the south and underestimates the value of

comparisons with other federations which, because of their parliamentary institutions or their socio-cultural and ethnic diversity, may be more relevant to the Canadian political context and problems.

Richard Bird draws attention at a number of points in his chapter to the importance of recognizing the limitations of comparative analysis, and he is right to do so. There is no single pure model of federalism or of federal financial arrangements that is applicable everywhere. The basic notion of federalism, involving the combination of shared-rule for some purposes and self-rule for others within a single political system so that neither is subordinate to the other, has been applied in different ways to fit different circumstances. Federations have varied in many ways: in the character and significance of the underlying economic and social diversities; in the number of constituent units and the degree of symmetry or asymmetry in their size, resources, and constitutional status; in the scope of the allocation of expenditure responsibilities; in the allocation of taxing power and resources; in the character of their central institutions and the degree of regional input to central policy making; in the procedures for resolving conflicts and facilitating collaboration between inter-dependent governments; in their procedures for formal and informal adaptation and change.

One cannot, therefore, just pick models off a shelf. Even where similar institutions are adopted, different circumstances may make them operate differently. A classic illustration of this is the operation of the similar formal constitutional amendment procedures in Switzerland and Australia. Both involve referendums for ratification requiring double majorities, i.e., a majority of the federal population and majorities in a majority of the constituent units. In Switzerland there have been over 90 formal constitutional amendments since 1874 (over three-quarters of those initiated by Parliament and submitted to referendum) which have met this requirement, but in Australia of 42 attempts since 1901 only eight have succeeded.

Richard Bird is also right in emphasizing that as long as these cautions are kept in mind, there is genuine value in undertaking comparative analyses. Many of the basic problems of federal finance are common to virtually all federations, particularly the four aspects examined in Richard Bird's essay: correcting vertical imbalance, pressures for equalization, the need for tax coordination, and the importance of the political context, institutions, and processes. Moreover, comparative studies may help to identify options that might be overlooked, identify consequences that might not be foreseen likely to flow from particular arrangements, and through similarities or contrasts draw attention to certain features of our own arrangements whose significance might otherwise be underestimated.

In this latter respect two particular features not emphasized by Richard Bird but which do affect intergovernmental fiscal arrangements in Canada are the parliamentary form of our federal institutions, and the character of our constitutional distribution of powers. Other parliamentary federations such as Australia, India, and Germany, by contrast with the United States and Switzerland which incorporate the separation of executive and legislative powers within their central institutions, share with Canada second chambers which are not symmetrical with the popular chamber in their powers, and a tendency for executive predominance leading to executive federalism as the predominant form of intergovernmental relations including the processes relating to intergovernmental financial arrangements. In the constitutional distribution of powers, most other federations emphasize interdependence more and include large areas of concurrent jurisdiction, where our own constitution emphasizes the exclusive jurisdiction of each order of government. Some like Switzerland and particularly Germany even constitutionally de-couple legislative and administrative jurisdiction in many areas centralizing the former and decentralizing the latter. These differences not only affect media interpretations and public attitudes about intergovernmental relations which in Canada emphasizes the competitive and zero-sum character of these relations, but have important implications for appropriate arrangements relating to federal finance. Thus in Canada we hear repeated calls for disentanglement while the focus in other federations is often more on how to make joint decision making more effective.

THE IMPORTANCE OF THE POLITICAL CONTEXT

In all federations, the financial arrangements have invariably constituted an important, indeed crucial, aspect of the political operation of the federation system. Their importance derives from the fact that the relative financial resources play a large part in determining the relative roles of the different governments within a federation, are a major means for flexibility and adjustment, and shape public attitudes about the costs and benefits of the activities of different governments. This political significance places federal-provincial financial arrangements at the heart of the processes of intergovernmental relations. Federal financial arrangements are therefore not simply technical adjustments but inevitably the result of *political* compromises. It is important, therefore, to understand the two-way interaction between the intergovernmental financial arrangements and the political institutions and processes of political bargaining which is typical of all federations.

In an earlier chapter Richard Simeon raised the question of whether our political institutions have the capacity to resolve the current problems in federal

finance facing Canada, and expressed some doubts. Put in the context of the issues raised by Richard Bird's chapter, the question becomes, can experience elsewhere help us in improving our institutional capacity? At this point there is one ironic example to which I cannot resist bringing attention. The 1991 proposals of the Government of Canada for constitutional reform, *Shaping Canada's Future Together: Proposals*, advocated an intergovernmental Council of the Federation as one instrument for improving intergovernmental collaboration with a view to strengthening the economic union. However, in the subsequent deliberations that notion was abandoned because of the fears of some provinces that it would contribute to federal government dominance and because others saw it as redundant for regional input to central policy making if a Triple-E Senate were also created. Yet shortly afterwards, in Australia, which has had a powerful Triple-E Senate since its inception in 1901; a Labor federal government together with the states decided in May 1992 to adapt to its own uses the Canadian proposal for a Council of the Federation by establishing a Council of Australian Governments that has as its primary objective the strengthening of the economic union. This illustrates how we in turn can learn from experience elsewhere of political institutions and processes designed to facilitate the adjustment of federal financial arrangements while recognizing that that experience must be adapted to our own needs.

THE ISSUES OF VERTICAL BALANCE, EQUALIZATION AND TAX COORDINATION

A central portion of Richard Bird's chapter deals with the three sets of issues relating to federal finance common to virtually all federations: closing the gap in vertical imbalance, equalization arrangements to deal with regional disparities and tax coordination. Each of these are areas relevant to the impending review of Canadian fiscal arrangements and each would warrant going into considerable depth. Given space limitations, however, I will simply limit my comments to three specific points.

First, while identifying the importance of the issue of closing the gap between the revenue capacities and expenditure responsibilities of each order of government, especially in a period marked by the federalism of scarcity, Bird's chapter does not draw out how closely this issue is tied to responsibilities for the provision of social services. The significance of a vertical financial imbalance for the provision of social services is not unique to Canada. It is an underlying contemporary problem in most federations today and reductions of federal transfers leading to accusations of offloading responsibility for social programs are common elsewhere. We may be able to learn in this area from how other

federations have attempted to deal with this problem. In the United States, for example, it has been argued that such offloading has in fact led to creative innovations in some states in the provision of social services.

Second, another issue that is related to that of correcting vertical imbalance is the application of the principle of financial responsibility. Some of the earlier discussions in this volume have already drawn attention to the principle of financial responsibility, i.e., the notion that to achieve political accountability the government that has the nasty job of raising taxes should control how the proceeds of those taxes are spent. This principle has figured prominently in the theoretical literature on fiscal federalism, and it has been especially emphasized in the United States with the constitutional separation there between the executive and legislative branches within each government. It should be noted, however, that in parliamentary federations, where the executive is directly responsible to and accountable to its own legislature, this provides an alternative mechanism of accountability through the legislature to the electorate. It is not surprising that this mitigating factor has meant that, broadly speaking, within parliamentary federations there has been less insistence upon conditional grants and more acceptance of unconditional transfers since there is another mechanism of accountability for their executives.

In Richard Bird's section on equalization, particularly useful is his identification of three models for deciding upon equalization formulae: (a) expert commissions (as in Australia and India), (b) the federal government with regional input through central institutions, e.g., the second chamber (as in Germany, Austria, Switzerland, and the United States), and (c) the federal government without regional input through the central institutions (Canada being the sole example). Given Canada's uniqueness here, and the failure of all efforts to date to reform the Canadian Senate, the first of the three alternatives adapted to Canada's needs and circumstances may well be worthy of serious attention. Alternatively, if that is not acceptable, we may need to consider renovation of the mechanisms of executive federalism to facilitate the process for adjusting the equalization formulae.

CONCLUSIONS

As Canadians face the review of our federal-provincial financial arrangements, of major importance is the capacity of our political institutions and processes to carry out that review effectively. An important part of the review, therefore, will be considering ways of improving those political institutions and processes. In this task, keeping in mind the limitations of comparative analyses, we may still have a considerable amount to learn from the experience of other federa-

tions in terms of the recognition of intergovernmental interdependence within federations and in terms of both positive and negative examples of political mechanisms that may facilitate intergovernmental financial arrangements.

Looking ahead to the final section of this volume where a panel reviews the options and considers whether Canadian fiscal problems will require for their resolution a "big bang" or merely "tinkering," the two themes emphasized in Richard Bird's chapter will be particularly relevant. First, if the political context and processes are so crucial to resolving issues of federal finance, to what extent are our political institutions equipped to achieve effectively a "big bang" reform, or is their capacity limited to "tinkering"? Second, while evolutionary development is less risky, if we have reached a point where such an approach is clearly no longer sufficient and a more radical transformation is necessary, then the positive and negative lessons from alternative approaches elsewhere may be particularly worthy of careful consideration in order to understand the practical and possible unintended consequences of the radical options that are contemplated.

PART FIVE

THE FUTURE

CHAPTER TEN

Big Bang or Quiet Tinkering: A Round Table

A Tridential Strategy

Peter Leslie

My theme is risk, or coping with risk: as one contemplates the reform of Canadian social policy, how to calculate the risks involved, and how to contain them. This is a subject that is implicitly evoked in the title of this session, which asks whether to go for a "quiet tinkering" approach or to engineer a "big bang." Tinkering involves a series of minor, experimental changes; none can do much damage to the pre-existing structure, and any that turn out badly can be reversed, or at least counterbalanced by other little innovations as need be. But with a big bang — perhaps a controlled nuclear reaction is a better image, since there is no big bang unless things go awry — once you start, there is no going back.

Several contributors have already opened up the question of caution and risk. Some have proposed a wholesale, multifaceted remake of Canadian social policy, while others have warned of the perils of opening up new policy controversies in politically explosive times.

My own view, publicly argued, is that the present system of federal-provincial fiscal arrangements is programmed to self-destruct in a short time, that nothing less than wholesale revision will avoid their collapse, and that significant changes to social programs must be part of the reform package (Leslie 1993). Tom Courchene's chapter has approached the subject from the opposite direction. He surveyed the shortcomings of the present social policy

mix in Canada, and argued for their redesign — and for adapting or recasting federal-provincial fiscal arrangements to finance the new system (substance first, means later). This approach is perfectly logical, and I support it. I only add, addressing those who would like to shelve the reform of social policy until foreseeable political turbulence is out of the way (if it ever is), that the imminence of a fiscal crisis of Canadian federalism makes postponement of social policy reform unrealistic. In other words, fiscal crisis will compound the political turbulence that many, myself included, expect to result from the Quebec election of 1994. My general point is this: whether one starts with the reform of social policy and redesigns the fiscal arrangements to suit, or launches a reform of the fiscal arrangements and undertakes, in this context, the redesign of our social programs, the effect is the same: reforms must take account of fiscal realities and substantive policy reforms. As Richard Bird notes in his chapter, every part of a system of fiscal arrangements is linked to every other part. Thus, whenever you open up one issue — as must be done, in the context of social policy reform — you have the makings of a big bang.

It is wise to go into this process with one's eyes open: to recognize the risks. Of these, I propose to discuss three.

UNINTENDED CONSEQUENCES OF REFORM: THE UNFORESEEN VICTIMS

The redesign of government programs, perhaps especially social programs, is always risky in the sense that it is hard to tell what the consequences of major change will be. It is clear, though, that reform will have its victims, and that some of the effects are unlikely to have been anticipated. This is the simple fact that makes caution, or a long process of quiet tinkering, look like the best option. Incrementalism, a rose by any other name.

My rejoinder, though, is that incrementalism is not exactly the same thing as muddling through, or endless short-term improvisation. The best approach, in my opinion, is to set goals and principles for a fundamental redirection of policy, and to strike out in the desired direction through a set of phased-in changes. Have a good sense of where to go, and move with deliberate speed. Phased-in change reduces the risk of unforeseen consequences, and, if there is time to introduce counterbalancing measures when unintended effects become manifest, may reduce adverse political fallout.

The problem, of course, is to put these generalities into practice. For this I propose — here I address the federal government — a new approach to the conduct of federal-provincial relations, involving a four-stage process.

- The first is to identify a set of aims or objectives, non-fiscal ones, for example, as in the statement on the social union in the Charlottetown Accord. "Charlottetown" was not the final word, and did not purport to be, but it did at least attempt to establish some benchmarks for what an adequate social policy would accomplish; it went beyond verbal formulae such as "equity" or "social justice." Complementing a statement of substantive policy objectives there could reasonably be a statement of fiscal targets, goals, or limits.
- The second step is to float various options for achieving the desired goals: not to commit to a specific policy, but to discuss alternative approaches. For this, a fairly detailed discussion paper would be appropriate; unlike the federal proposals for constitutional reform, as released in September 1991, the discussion paper should contain some information. It should review, tentatively, pros and cons of various options. On this basis, the government would be able to test the waters with the relevant policy communities and with provincial governments. More input, more information, better decisions.
- The third step is to involve Parliament, by striking a committee to hold public hearings. This would offer a creative role for the government's own backbench MPs, and would be an educational experience for newer MPs from all parties. It might even, to some extent, smoke out opposition parties' views on difficult issues. Most important of all, it would generate greater public understanding of the dilemmas that face policymakers. This could help build support for a redirection of policy.
- The final stage would be to open negotiations or consultations with provincial governments. Negotiations are needed where policy change demands complementary action from both orders of government. Consultations are needed where federal policy alone is involved, but should take account of what provincial governments are doing and want to do, and of their fiscal circumstances. Too often in the past this "final stage" has come first. One result has been public outrage against executive federalism, its *faits accomplis*, and its inherent secrecy; another has been that the federal government has ceded strategic advantage to the provinces — whenever you get 11 or 13 government representatives in a room together, the federal government sets itself up for being outvoted. In my opinion (I advance this as a general rule, applicable far beyond the realm of social policy), Ottawa should routinely build a constituency for what it wants to accomplish, before opening negotiations with provincial governments. If it were to do this, it would invert past practice, and put the conduct of federal-provincial relations on a new footing entirely.

AGENDA OVERLOAD

A second area of risk arises from the sequencing problem, or the agenda-overload problem. Earlier, Keith Banting remarked that no government in its right senses would want to start a three-front war, simultaneously (a) remaking the fiscal arrangements, (b) redesigning social policy, and (c) altering the assignment of federal-provincial responsibilities, if not actually reallocating legislative powers under the constitution. Someone responded by saying that the federal government may have no choice about all this; it may try to control the agenda, but it will not be able to do so.

I must say, that latter response rings true to me. I have seen too much of Ottawa's attempting to control the public agenda, to channel and focus public discussion to suit a timetable or a sequence that the government would find convenient. Every time, it has merely succeeded in ensuring that the issues it wanted to postpone or suppress would be opened up by others, in circumstances that were highly unfavourable for the government and indeed, I believe, for Canada. There seems to be rather little a government can do to keep issues off the public agenda, if various powerful players want to put them there.

In particular, I think it would be dangerous self-delusion to suppose that one could deal, in some "phase one," with a set of big political issues, and then open up a "phase two" in which matters like the fiscal arrangements (the category of issues that René Lévesque used to describe casually as "the plumbing") were tidied up. On the contrary, I am inclined to think that fiscal crisis, and, equally, the policy concerns that Tom Courchene, Carolyn Tuohy, François Vaillancourt, and others have expounded, will force a set of dangerously controversial issues out into the open, and that this will happen just at the time that Quebec is gearing up for an election that may well bring an *indépendantiste* government to power. These problems will be further compounded by the fact that the opposition in Parliament consists of two regional parties of equal strength and diametrically opposed objectives.

Certainly this is a frightening prospect. To some it suggests, as I infer it has done for David Milne (among others), that extreme caution is called for. The problem I see with this is that it merely confirms what Parizeau and Bouchard have been saying for some time, that Canada has become ungovernable because its internal divisions have paralyzed it. Innovation will have been shown, again, to be impossible. Federalism will be shown to be a system that does not and cannot work, at least not in Canada.

For this reason I conclude that, while the risks of a three-front war cannot be ignored, the biggest risk of all may be to say that nothing much can be done, or should be attempted. More than that, there are two strong reasons (in addition

to those of substance, already reviewed throughout this volume) for undertaking a major initiative now. One is that it will show some sign of movement, and that change on things that do matter a great deal need not await formal constitutional amendment. The other is that a big package offers opportunities for trade-offs that single-item changes cannot.

I enter a plea, then, for calculated risk-taking, that is, for opening up new issues — but not in a way that every criticism of possible policy options turns automatically into an attack on an entrenched federal position.

CONFLICT: COQ AND QUEBEC

The third area of risk to which I wish to refer follows directly from the preceding one. If major policy changes are proposed, or even floated, it may quickly become obvious that the only changes acceptable to Canada outside Quebec (COQ) are anathema *within* Quebec, or at least to the Quebec government. Assume, for example, that Ottawa proposes taking on a more direct responsibility for those with low or unstable incomes, beyond the responsibilities it already has under the unemployment insurance program, old age security, and the Canada Pension Plan; and assume further that it proposes diverting some of the monies now paid to provincial governments to finance the new federal income security system. This would amount to a policy change under which transfers to provincial governments were replaced by transfers to persons. Depending on the specifics, this shift in policy might be attractive in most of COQ, but vehemently denounced by the Quebec government.

In that case, it would be necessary for the federal government, and for the whole of Canada, to face once again the asymmetry issue. If one province, presumably Quebec, wants to gain added constitutional powers and policy responsibilities — and of course claims the fiscal resources needed to fulfil those responsibilities — while elsewhere in Canada those powers, responsibilities, and fiscal resources are considered appropriately vested in the federal government, then what is to be done? At the very least, this poses a difficult policy dilemma for Ottawa, which will want to manage or minimize the risks inherent in a debate over asymmetry.

On this, two strategies seem worth consideration:

- One is to avoid raising the asymmetry issue, but to develop contingency plans for responding to demands by a PQ government and by the Bloc Québécois, that Quebec should become a sort of associate member of the Canadian federation. These plans would have to include a strategy for facing a PQ government that had won a referendum on sovereignty; equally, they would

have to include a review of possible responses to demands from the Reform Party and others (including, certainly, within the Liberal Party) that Quebec should be forced into line, or if it refuses, that it should be forced to get out of Canada. I do not know what, in substance, to propose; but I do know — to take a recent case — that failure to develop fallback positions as part of the strategy for securing the ratification of the Meech Lake Accord was ultimately very costly for Canada. I hope that the same absence of contingency planning does not afflict the Privy Council Office today. Given that Quebecers will soon be going to the polls, to neglect or suppress the asymmetry issue would be foolhardy.

- The second strategy is a mildly pre-emptive one. It would involve raising the asymmetry issue (playing with fire, I admit), but in a form that is aimed at making hardliners on both sides — the sloganeers — back down a little, and take a more nuanced position. Or, if this is a pipe-dream, then at least the attempt could be made to provoke a discussion on what constitutional outcomes are thinkable and what ones are not. For example, if Quebec votes for sovereignty, are the rest of us going to say, "If you want to be part of the economic union, you have to be part of the sharing community too." In this context, I have wondered from time to time whether it would be a good idea to float "radical asymmetry" as a constitutional option, at least to think about. Under this option, the whole of the income security system — including pensions and unemployment insurance — would fall within the purview of the Quebec government, while elsewhere the responsibility for attaining or ensuring income security goals would be, as it is now, shared in some way between Ottawa and the provinces. Tax transfers of course would be necessary; equalization payments would no longer be made to Quebec; and some institutional changes (Quebec representation in Parliament, or Parliament's conduct of its business) might be necessary. If there is to be asymmetry, it would certainly have to be "asymmetry without privilege."

The main purpose of spelling out what asymmetry might involve, or of identifying its institutional and fiscal preconditions, would be to help Quebecers realize what sovereignty would actually mean in practice. It is not at all clear that Quebecers who profess themselves sovereigntists have, in their own minds, opted for withdrawal from the sharing community: that all existing federal programs for income security and social services, whether federally-administered or merely financed in part from federal taxes, would disappear, and that the Quebec programs replacing them would have to be financed entirely from Quebec tax revenues. Nor is it clear that sovereigntists recognize the institutional implications of the option to which they have apparently

assented; many, for example, in 1980 did not know that "sovereignty-association" entailed losing the right to send MPs to Ottawa. The prospects for achieving real clarity on such issues are small indeed, but any marginal increase in public awareness of the scope of constitutional adventurism that the PQ and the BQ are proposing, can only be salutary. Unfortunately there is a real prospect that Quebecers will take some irrevocable constitutional step without realizing what they are actually committing themselves to. Anything that can reduce the likelihood of their doing so helps to limit risk for everyone.

CONCLUSION

I have put forward a *tridential strategy* for managing risk in the reform of social policies and the fiscal arrangements. The first prong of the trident is to adopt new techniques for the conduct of federal-provincial relations, introducing a more open process that involves less commitment to entrenched positions from which it is an embarrassment to withdraw. The second prong is to take a calculated risk in opening up a combination of issues, aiming for fundamental redesign of social policies and the fiscal arrangements; this will lead ultimately to a bargaining process in which there will be multiple opportunities for trade-offs. The third prong is to face the asymmetry issue in one of two ways: to prepare contingency plans for the day that a PQ government demands sovereignty together with economic association, or to adopt a mildly pre-emptive strategy by nudging forward a public debate on the meaning and preconditions of radical asymmetry.

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Delaying the Big Bang

Robert Normand

INTRODUCTION

It is very difficult to come up with new ideas on fiscal federalism and I would like to thank the academics who decided to dive into a pool that was reserved too long to a bunch of civil servants and technicians who thought they were the only ones to be able to swim in the muddy waters of fiscal federalism. I appreciate their valuable contributions that shed new perspectives on a very complicated field of activities that is also so important to all the citizens of Canada.

The analysis is there and it is good: substantial changes are needed not only in the field of fiscal arrangements, which are due to be renegotiated shortly, but also in the public policies that justify the existence of these arrangements. These changes must be made in the name of rationality, efficiency, and equity.

The refrigerator is full; all the ingredients and the recipes have been sorted out; it is now up to the politicians to decide what they want to put in their sandwich.

But, I agreed with Richard Simeon and André Blais: substantial political changes are not made in the abstract for the sole reason that they are necessary. They can only be implemented if the political context makes it possible to do so and I submit, at the risk of being a party pooper at this late hour, or looking a bit cynical, that Canada is not ready to accept all the important fiscal changes that are necessary, and that the next fiscal arrangements will not be very different from the existing ones, unless they are shoved down the throats of the provincial authorities by the federal government.

MAJOR CHANGES? NOT NOW!

I am of the opinion that Canadians may accept, but with reluctance, the transformation of the GST, if the operation is done with beneficial or at least neutral effects; but I submit that Canadians are certainly not ready for other substantial changes in our fiscal regime and our costly social programs, for the following reasons.

First, we have been going through a severe economic crisis for the last three years and we are not out of it yet, no matter what the Conference Board or other crystal ball readers may say. The rate of unemployment is still too high and has been up for too long. The housing starts are low at a time when the interest rates would normally stimulate the demand. Consumers are afraid of what tomorrow may bring, and are reducing their spending to a minimum. Inventories are low and are being kept there. So, the taxpayers want to keep what they still have and can hardly accept major reductions in the existing social programs; they would be afraid of jeopardizing their already unsafe situation.

Second, the recent federal election has shown that the voters have not accepted the Progressive Conservative proposals to reduce the level of the federal deficit and to shave the social programs. On the contrary, they have rather favoured more government spending, job creation, and the maintenance of the costly security nets that prevent them from falling lower.

Third, governments, at all levels, are impaired by a very serious fiscal crisis. Revenues are lower than expected, while expenditures are not lower. Deficits are too high. The burden of the public debt is too heavy; interest charges are so high (one-third of its revenues for the federal government) that governments have no more fiscal room to stimulate the economic development. So, the federal government will be inclined to reduce even further its transfer payments to the provinces. But the latter are going to resist strongly, especially after having lost \$40 billion in the last few years, as pointed out by Tom Courchene in his chapter.

Fourth, the presence of two strong regional parties in the House of Commons will limit the capacity of the well-established Liberal government to manage in a rational way. If Jean Chrétien wants to reduce the existing federal benefits to the province of Quebec, or in the west, he will then only fuel the Parti Québécois in *La Belle Province* and consolidate the possibility for the Reform Party to take the place of the Progressive Conservatives elsewhere.

Fifth, and I should not say this publicly, but it is obvious to me that Canada cannot solve its problems, but always shovels them forward and piles them one on top of the other. Canada has been wrestling for more than 25 years with constitutional problems that are getting more and more sour, without generating the will to find a proper solution; and it is not by refusing to talk about it that the situation will get better: it gave birth to two regional parties recently that are echoing the frustrations of a large number of Canadians.

The problems of Native Peoples are also left unsolved; even though we spend, each year, amounts in the order of \$6 billion to buy band-aids, that only makes it necessary to increase the medication each year.

And in a more and more competitive world, Canada has lost its place at the top and is losing its previous position of former years without being able to do what is required to regain its place.

Therefore, for these reasons, I do not believe that Canada is ready for substantial changes in its fiscal regime and in its social programs. This is bad because we are only making even tougher the adoption, at a later date, of measures that are required now. In other words, we are following the path of New Zealand and Argentina instead of the tough, but progressive approach adopted by Sweden. We are not yet deep enough in the mud to develop a strong will to react properly.

TUG-OF-WAR OR K.O.?

My second point is that the next fiscal arrangements will either be similar to the existing ones, or be substantially different. But they will then have to be imposed by the federal government upon the provinces in a manner similar to the methods used by Trudeau 15 years ago.

The name of the game, in the discussions to come, will be "figures," not principles. "Who gets what," as Richard Bird said. All parties to the discussions that are going to take place in the coming weeks will be very cautious as to the costs involved and the monetary advantages or inconveniences that they could derive therefrom.

Both the federal government and the provinces will be demanding something, since the budgetary situation of the federal government is intolerable, while the provinces cannot accept more cuts in transfer payments without having to reduce the level of services to their citizens or having to pass the buck again to the municipalities.

So, normally, in a typical Canadian fashion, the potential clash should be resolved by a draw, i.e., the maintenance of the existing arrangements. Or, and this is also a possibility, Chrétien could very well come out with the abolition of the GST and its replacement by a new tax system, as Fred Gorbet pointed out, relying on the strong mandate that was given to the Liberals, and thus, imposing these new arrangements on the provinces together with substantial changes in the financing of the established programs and transfer payments.

I cannot rule out that possibility, even though I believe that the political context is not favourable for that type of approach. The provinces with NDP governments, Quebec and Alberta, would have to react strongly if the changes are not financially advantageous. More tensions would then be created on the

political scene and the net results would not necessarily be the ones that were contemplated at the beginning of the process.

So, at best, the provinces can expect the renewal of the fiscal arrangements more or less as they are now.

EPILOGUE

But over and above these fiscal arrangements, what is seriously needed now is a political will, at all levels of governments, to give a good haircut to our fiscal regime and our social programs and not wait until the head itself would have to be chopped off. At the federal level, we all know that Chrétien does not have more than 18 months ahead of him to do what must be done; because after that, the electoral preoccupations will again take precedence.

If we hope to protect these security nets, we must maintain the deficit at a reasonable level and therefore, we must work on a framework that would limit the possibility for the federal and the provincial governments to keep on passing the costs of these programs to the future generations. If Chrétien decides to do so and succeeds in doing so, then he will have been a really great prime minister. And I would have two suggestions to make in that respect that are nothing more but adopting here, what has been done by our neighbours down south.

First, I see as an absolute necessity, the adoption of a constitutional amendment by Parliament and by all the legislatures to require that each borrowing of money by a government be authorized, specifically by a special act of the legislative body or bodies involved. This is already done at the municipal level in Canada and by the state legislatures in the United States. Furthermore, I believe that this measure would be strongly supported by all Canadian citizens since it brings more transparency into the use of their borrowing powers by the governments. But no other constitutional amendment should be dealt with at the same time. No language solution. Nothing for Native Peoples.

This single measure would also bring about some side-benefits by restoring public credibility to the constitutional amendment process and by relaunching the possibility of serious constitutional discussions for the future, on a footing that would be acceptable by all those concerned.

Second, the adoption, by Parliament and each provincial legislature, of the equivalent of the Gramm-Rudman Act, which was enacted by the U.S. Congress some six or seven years ago and which imposed on the body that adopted it, a five-year plan setting the maximum level of deficit that could be reached during each of those years. Of course, this type of legislation can always be changed by the body that adopted it, but the taxpayers are then made aware of the behaviour of their government and, unless the measures are an absolute

necessity and well explained, the government that decides to change the plan, faces the possibility of having to pay a high price for the change, in the ballot box! And fear is a good start for wisdom!

But here again, my cynicism on our collective incapacity and will to really solve our problems, stimulates my pessimism.

CONCLUSION

So, to come back to the topic: "Big bang or Quiet tinkering?" I would say that a position in the middle of the road would be advisable, but that we will probably follow the typical Canadian tinkering route, thus building the necessity for a real Big Bang in the years to come.

Fiscal federalism can only reflect the type of political federalism that we want and in that respect, we do not yet know what we really want. Or when we think we do, as in the case of Meech or Charlottetown, we cannot implement our solutions.

So good luck to all of us.

Not So Quiet Tinkering

Katherine Swinton

The reform of fiscal federalism is a daunting task. On the one hand, it presents difficult and often divisive questions about financial arrangements in the federal system, requiring decisions about the tax sources to which governments should have access, the need for and desirability of revenue equalization across provinces, and whether there should be limits on governments' ability to spend and borrow. While these are questions that economists and finance department officials may see as their domain, major social and economic policy issues are implicated in the solutions proposed, since access to financial resources affects the levels of social assistance, child care, training, health care, and postsecondary education available to citizens throughout the country.

Recognizing the complexity of this area of federal-provincial relations, an effort to forecast whether there will be a "big bang" or "quiet tinkering" in Canadian fiscal federalism leads to the conclusion that no solution can be quiet in these times of fiscal constraint, governmental competition for limited financial resources, and citizens' demands for empowerment and insistence on their rights. While the reality of fiscal constraint should push us towards major reforms in many policy areas over the next decade, the lesson that I draw from the chapters in this volume, and other considerations outlined below, is the importance of the process towards major reforms. A "big bang," in the form of major change, may well be needed, but there are dangers of failure if those changes are unilaterally imposed by the federal government or achieved through federal-provincial bargaining without careful efforts to educate the public on the need for restructuring and the rationality of the choices proposed. If something beyond tinkering with existing programs is required, the process will not be quiet, since there will be winners and losers. However, success is more likely if the process is not left solely to bargaining among experts, but also engages a public educated to understand the debate and aware of the distributive implications of restructured social and economic policies.

This volume presents a wide range of options for the reform of fiscal federalism. Some require constitutional amendment; others call for increased federal use of conditions attached to spending; others emphasize the importance of provincial control over social policy and even equalization. As a lawyer

among many political scientists and economists, my comments reflect my interest in the choice of instruments and processes by which change will occur and the effect of legal instruments, such as the *Canadian Charter of Rights and Freedoms*. Therefore, I address three issues: methods of constitutional change in relation to fiscal federalism and social policy, the impact of citizens' rights, and the process for reform.

METHODS OF CONSTITUTIONAL CHANGE

Canadian federalism literature contains many references to the ways in which the constitution has been adapted since 1867. With respect to the distribution of legislative powers, formal amendments have been few. Yet there has been significant evolution through more informal methods, most particularly, the federal spending power that underlies programs such as equalization, Established Programs Financing, and the Canada Assistance Plan. In addition, changes in the functions and relationships of federal and provincial governments have come through tax policy, administrative delegations and intergovernmental agreements. The received wisdom is that these instruments of change have contributed to the immense flexibility and adaptability of the Canadian constitution.

This volume contains arguments that the current distribution of functions in the area of social and economic policy requires formal changes — for example, the allocation of unemployment insurance to the provinces or the transfer of social assistance to the federal government. While theoretically interesting, such proposals seem an impossible dream in the current political climate for a variety of reasons, including constitutional fatigue in the country, the complexity of the amending formulae demonstrated in the last two unsuccessful constitutional rounds, the impossibility of limiting the size of the agenda, the high symbolism (and, therefore, the great risk) associated with constitutional amendments, and the resistance to decentralization in Canada outside Quebec and to centralization within that province.

More importantly, I am not convinced that the proponents of change have proved the need for the amendments sought. Those who make such a significant proposal have an obligation to consider in detail the reasons for such change, as well as the practicality of carving up new watertight compartments in this era of governmental interdependence. For example, there are several proposals for the transfer of unemployment insurance to the provinces, yet it is not clear that this is a sensible solution. There are many ways to improve the UI program within the current power structure, and, indeed, many of the criticisms of the current system, such as hidden regional subsidies, unjustified departures from

insurance policies, and individual dependency, can be addressed by the federal government alone (if the political will is there) or through cooperation with the provinces. Moreover, while UI policy has important links to provincial social assistance or workers' compensation, it also has important connections to the federal role in promoting a healthy economy through worker training.

Similar observations can be made with respect to the argument for federal control of social assistance, or at least federal responsibility for children. The value of provincial jurisdiction is not addressed — for example, possible diversity in policy responses — nor is the interaction with ongoing provincial policy areas such as workers' compensation or family law.

The lesson, then, is to avoid formality. However, it must be acknowledged that from some perspectives, there is declining efficacy and flexibility associated with the more informal mechanisms of Canadian constitutional change. In periods of growth, the federal government could use its spending power and the tax system to affect policy in areas within provincial legislative jurisdiction. During the last two constitutional rounds, many emphasized the importance of this federal spending power to achieve national standards (although, in fact, very few national standards are found in the major social programs, while those set out in programs like the Canada Assistance Plan are at very broad levels of generality).

Kenneth Norrie and Judith Maxwell suggest ways in which the federal spending power can continue as an important policy instrument, for example, in the form of federal vouchers to individuals for postsecondary education, or the use of "carrots" in the allocation of funds to educational and training institutions. Clearly, political considerations may mute the willingness of the federal government to use the spending power in ways perceived to be "illegitimate" or unconstitutional by the Bloc Québécois in Parliament or a Parti Québécois government in Quebec.

Yet it is important not to give up too quickly on the spending power as an instrument. Fred Gorbet has noted the importance of a federal leadership role in setting national standards: continued spending in provincial areas of jurisdiction, such as health care, gives the federal government a legitimate claim to participate with the provinces in jointly setting nationwide objectives. More importantly, in some areas, described by Stefan Dupré as "procurement federalism," federal spending with conditions attached continues to be a legitimate and important policy tool. This is especially true in relation to training initiatives, where funding can be directed to programs that meet prescribed occupational standards. Federal legitimacy here derives partly from its constitutional responsibility for unemployment insurance, but also comes from the facilitation of worker mobility, an objective underpinning the economic union sought by

the 1867 constitution and also guaranteed in section 6(2) of the Charter of Rights. Thus, in the future, federal spending with conditions is most likely to occur in relation to the purchase of services, while the pursuit of national objectives in areas of provincial jurisdiction will come through joint federal-provincial action, especially as the federal cash contribution under EPF or the Canada Assistance Plan declines.

A third lesson emerges from the discussion about instruments of constitutional change. While it has long been assumed that tax and spending policy are instruments of flexibility, the ongoing debate about the significance of the transfer of income tax points from the federal government to the provinces in 1977 under EPF, described by Kenneth Norrie, may signal the need to qualify that assumption. While some commentators assert that those tax points should be characterized as a continuing federal contribution to EPF, others argue strongly that this is misleading, since the transfer was a one-time vacation of tax room to the provinces, and not tied to spending on EPF programs. One need not decide which group is correct. Norrie notes that both have a rational basis for their conclusions. The more important lesson is that transfers of federal income tax points constitute an important and at least semi-permanent allocation of power to the provinces, which cannot effectively be recaptured when the provinces have taken up that room. Therefore, in the current discussion of fiscal arrangements, the (in)flexibility of proposed changes is an important consideration.

RIGHTS TALK

Many in this volume address the concerns of federal and provincial governments in meeting their policy objectives. Their focus on regional considerations is not surprising, given the traditional territorial focus of federalism. But the discussion of fiscal federalism is also centrally about social and economic policy, and many groups will demand that it be recast to focus on distributive considerations, particularly the interests of the poor, women, those with disabilities, or those with inadequate workplace skills. Major changes to the funding of the Canada Assistance Plan (e.g., a shift to block funding or federal withdrawal from the Plan) would affect those groups in significant ways because of offloading — not only in the levels of their direct financial assistance, but also in access to support services such as daycare subsidies. Similarly, the call for a negative income tax to help children must not ignore other important family issues, such as child-care support for working parents.

The concerns of these groups will affect the process in a number of ways. First, some will actively support more national standards and a strong federal

role in social policy, which may be a political asset to the federal government. Second, if these groups do not feel that their concerns are adequately addressed in the political process, they are likely to resort to litigation. In recent years, the Supreme Court of Canada broadened the rules of public interest standing in *Finlay* to allow a recipient of social assistance to challenge federal payments to Manitoba under the Canada Assistance Plan on the basis that the province did not comply with the conditions in the federal statute and federal-provincial agreement, when Manitoba deducted overpayments from his benefits. Subsequently, he lost his case on the merits in a 5 to 4 decision in the Supreme Court, which held that Manitoba had not violated the conditions of the Plan.¹

There are two lessons here: one, interest groups and individuals are increasingly litigating in areas which federal and provincial governments thought were their preserve; second, governments must be careful when they import conditions and standards into fiscal arrangements, since others may come forward to enforce them, even when governments might be willing to ignore breaches for political reasons. An obvious area for future litigation is in relation to the *Canada Health Act*, if provinces try to reduce funded medical procedures.² In some cases, this might be challenged as a failure to provide medically necessary hospital services in accordance with section 2 of the Act or a failure to provide a "comprehensive" health-care insurance plan in accordance with this and other criteria set out in sections 7 through 12. Whether such litigation will succeed is open to question. *Finlay* did lose under a statute that was more explicit in its criteria than the *Canada Health Act*, and judges will understandably be wary about embarking on a detailed determination of what is "medically necessary."

Even in the absence of statutory standards, individuals and interest groups may resort to the Charter of Rights to prevent the erosion of social programs, although in many cases this will not be a useful instrument. Section 6(2), the mobility rights section, provides some protection against provincial discrimination in labour policy, although it does not prevent different occupational standards in provinces if these are aimed at ensuring quality of service, rather than discriminating against those from other provinces. Section 6(3)(b) also allows the imposition of reasonable residency requirements as a qualification for the receipt of publicly provided social services. Section 15 of the Charter, the equality rights guarantee, has been interpreted to apply only to those grounds listed (e.g., sex, disability, race) and to analogous grounds (i.e., those that have led to a history of disadvantage in our society, such as sexual orientation).³ Therefore, section 15 might permit a challenge to the decision not to fund tubal ligations or abortions as a form of sex discrimination, or a rationing of heart transplants on the basis of age as discrimination, but it would not likely be available to attack refusal to cover in vitro fertilization or user fees. Finally,

section 7 of the Charter, the right to life, liberty, and security of the person and the right not to be deprived thereof except in accordance with principles of fundamental justice, has not been interpreted to confer positive rights to economic security, despite the hopes of poverty groups and some academics. Finally, section 1 of the Charter makes all the rights set out in it subject to reasonable limits.

Overall, then, while a Charter challenge is possible, the likelihood of success is questionable in many areas, since the judges will often be reticent to intrude into complex debates about the allocation of public funds among competing social interests, as in the design of publicly funded medical care systems or social assistance.

The Charter is not the only rights document that may come into play. Activists are also working in international forums to affect domestic policy. A recent example is the report of the United Nations Committee on Economic, Social and Cultural Rights examining Canada's compliance with the *International Covenant on Economic, Social and Cultural Rights*. Not only was concern voiced about Canada's failure to alleviate poverty, but there was express reference to the federal government's reduced contributions to shared-cost programs.⁴

Thus, courts will be called into the disputes about fiscal federalism and the design of social policy with greater frequency. While they may be reluctant to challenge the role of the legislative branches in this area, this will not prevent interest groups from resorting to the judiciary when other routes for political change seem deficient.

THE PROCESS OF REFORM

Several authors in this volume have emphasized the salience of deadlines for the reform of fiscal arrangements and described a scenario of federal-provincial negotiations to work out a new sharing of revenues. Both Fred Gorbet and Peter Leslie contemplate broad agendas for this round of negotiations so as to allow room for trade-offs. The danger in such a scenario is, as Richard Simeon noted, that the interests of fiscal federalism will trump the policy challenges in areas such as social assistance or postsecondary education.

This may well trigger a negative reaction from citizens, who will see this as yet another "deal" worked out by governments without a coherent policy analysis. Unsuccessful efforts at constitutional reform should teach us that the more dramatic the changes to be wrought, the greater the need to involve the broader public in the process. This should not be read as a call for numerous public hearings or rounds of consultation like those in the constitutional

process. Rather, it is a call for openness in the process, public education about the trade-offs that must be made, and informed debate about the choices being taken — in short, my call here is for political accountability. Without the information and discussion that governments owe to citizens, the major reforms in this area that are needed can only come with a “big bang” — but it may well be in the form of public resistance and reaction that will undermine effective restructuring of finances and programs.

NOTES

1. *Canada (Minister of Finance) v. Finlay* (1986), 33 D.L.R.(4th) 321 (S.C.C.); *Finlay v. Canada (Minister of Finance)* (1993), 101 D.L.R.(4th) 567 (S.C.C.).
2. R.S.C. 1985, c. C-6.
3. *Andrews v. Law Society of British Columbia* (1989), 56 D.L.R.(4th) 1 (S.C.C.).
4. United Nations Committee on Economic, Social and Cultural Rights, “Consideration of Reports Submitted by States Parties under Articles 16 and 17 of the Covenant — Canada,” 10 June 1993 (E/C.12/1993/5).

The Case for Cutting the Public Sector Payroll

John Richards

In the spring of 1993, Vancouver school teachers launched a strike over their demands for higher salaries, smaller classes, and more help with foreign-language students. With well over half Vancouver children using English as a second language, I have some sympathy with the third demand; as for the rest, none! When first they came to power in British Columbia, the NDP had rewarded teachers with a handsome salary increase. Given the provincial deficit, given teachers' job security and relative salary levels, given other education needs such as vocational training in rapidly expanding suburban communities, the provincial Cabinet quite reasonably included only minimal salary increases when constructing the 1993-94 education budget. On their side, the teachers feared "falling behind," and struck on behalf of their demands. Caught between its obligation to manage an efficient education system and partisan loyalties to a powerful interest group within the NDP, the provincial Cabinet procrastinated. As the strike dragged into its third week and risked jeopardizing student completion of the school year, public hostility to the teachers mounted and, reluctantly, the government legislated them back to work. To be fair, the strike was not universally unpopular: 100,000 children enjoyed a three-week holiday during a gorgeous West Coast spring.¹

At the risk of being dismissed for using an unrepresentative anecdote, I begin with this story. It illustrates two fundamental ideas. We Canadians value the European-style welfare state constructed since World War II. It creates a more equitable society, and it supplies a range of services more efficiently than could a private market alternative. But it can only sustain these achievements if public sector managers — politicians, deputy ministers, local school boards — actually exercise discretion over budgets, and reallocate public revenues to meet changing needs as defined in terms of some broad conception of the public interest. If public sector managers identify primarily with narrow interest groups intent on constraining that discretion, realizing the benefits of the welfare state becomes problematic.

A second idea is that the public sector *inescapably* operates under an ill-defined, but nonetheless real, budget constraint because citizens want simultaneously to maintain a large private sector. The provincial Cabinet concluded — correctly in my opinion — that provincial citizens are near their current maximum willingness-to-pay for social programs, and hence the Cabinet could not avoid politically painful trade-offs by simultaneously granting the salary increase, funding new programs and raising the required funds by a combination of tax increases or increased borrowing.

In general terms, most people probably agree with these two ideas. The purpose of this essay is to go beyond the general, and discuss some pragmatic implications.

To anticipate the end point, I arrive at four policy recommendations. First, federal and provincial governments should balance their aggregate accounts by no later than the end of the current Parliament, and do so subject to the present ratio of taxes to the gross domestic product (GDP). Such an exercise requires expenditure cuts. If we accept the first recommendation, the obvious question arises, where to cut? The second recommendation is that a major component of the required cuts — in the order of 50 percent — should derive from reductions in the public sector payroll. The third recommendation is that, since the provinces have a far greater potential than Ottawa to reduce payroll expenditures, Ottawa should share in provincial savings via reduced transfer payments. Finally, in order to maintain public support for fiscal restraint, governments must pay close attention to the redistributive impact.

A PRIMER ON RECENT CANADIAN FISCAL HISTORY

After that bald introduction, let me step back. We cannot hope to discuss future options intelligently unless we understand the historical forces that produced the present, a situation in which more than one-half of Canadian GDP is now allocated directly by government, or passes through government in the form of government-designed transfers. Table 1 provides summary data (in terms of percentage shares of GDP, and on a national income accounts basis) for selected years since 1961. As a primer on the past three decades of Canadian fiscal history, here is a five-point summary:

1. *Expansion of social spending derived primarily from provincial governments (municipal governments and hospitals are included in this category). They increased their spending by nearly 7 percentage points of GDP from the early 1960s to the mid-1970s. Since then, aggregate provincial program*

spending has been roughly constant during normal economic conditions; it increased during recessions in the early 1980s and 1990s.

2. *Recessions aside, federal program spending net of transfers to the provinces has remained remarkably constant.* The Mulroney government reduced spending in the late 1980s from levels induced by the early 1980s recession, but in 1989 it was within one percentage point of the level of Trudeau's government in 1981 and of the average of Diefenbaker's governments in the early 1960s.
3. *Federal cash transfers to the provinces increased dramatically between the mid-1960s and mid-1970s and, thereafter, grew slowly until peaking in the mid-1980s; since then, a slow decline has occurred.* From the mid-1960s to mid-1970s, Ottawa made extensive use of conditional transfers to encourage provinces to expand social programs. Cash transfers increased during the recession of the early 1980s, less so in the more recent recession of the early 1990s. Intergovernmental transfers comprise approximately one-quarter of federal government program expenditures and are a legitimate target, as will be discussed later, for budgetary restraint.
4. *Federal and provincial own-source revenues grew from the early 1960s until the early 1980s — by 2 and 8 percentage points respectively — but thereafter remained roughly constant until the 1990s recession. Revenues never increased sufficiently to balance the aggregate public sector, which has been in deficit in every year since 1974.* Gross debt charges have risen dramatically since the 1970s, and now constitute over 9 percent of GDP (on a national income accounts basis).
5. *Aggregate program spending increased significantly during both the early 1980s recession and that of the early 1990s — respectively by 4 and 6 percentage points of GDP. Constrained by rising debts, both levels of government accompanied their spending increases in the early 1990s with tax increases, a phenomenon that did not occur during the previous recession.* Having failed to realize any surpluses in the boom of the late 1980s, governments faced pre-recession debt charges nearly 3 percentage points of GDP higher in 1989 than in 1981. Total public spending by 1992 was 5 percentage points higher than the average during the previous recession. Despite tax increases, aggregate public sector deficits were by 1992 as large as in the early 1980s.

TABLE 1: Trends in Public Sector Revenue and Expenditure, 1961-92
(as a percentage of gross domestic product)

	<i>Average, late Diefenbaker years, 1961-63</i>	<i>Trudeau Years</i>			<i>Mulroney Years</i>		
		<i>Middle, 1975</i>	<i>Late, 1981</i>	<i>Average, 1982-84 Recession</i>	<i>Early, 1985</i>	<i>Middle, 1989</i>	<i>Late, 1992</i>
<i>Revenue</i>							
Federal	15.9	18.5	18.3	17.3	17.4	18.3	20.0
Provincial							
Own sources	9.4	14.4	17.6	18.4	18.0	19.4	20.5
Federal transfers	2.6	4.5	4.0	4.4	4.5	3.9	4.3
<i>Total</i>	12.0	18.9	21.5	22.8	22.6	23.3	24.8
<i>All government</i>	27.9	37.4	39.8	40.1	40.0	41.6	44.8
<i>Expenditure</i>							
Federal							
Programs net of transfers to provinces	12.3	14.1	12.5	14.6	14.3	11.8	13.9
Transfers to provinces	2.6	4.5	4.0	4.4	4.5	3.9	4.3
Debt service	1.9	2.2	3.9	4.5	5.2	5.7	5.7
<i>Total</i>	16.8	20.8	20.3	23.5	24.0	21.5	23.8
Provincial							
Programs	15.2	21.9	22.5	24.5	24.1	23.8	28.1
Debt service	1.0	1.7	2.4	3.0	3.3	3.2	3.7
<i>Total</i>	16.2	23.6	24.9	27.5	27.3	26.9	31.9
All government							
Programs	27.5	36.1	35.0	39.1	38.4	35.6	42.0
Debt service	3.0	3.8	6.3	7.4	8.4	8.9	9.4
<i>Total</i>	30.5	39.9	41.3	46.6	46.8	44.5	51.4
<i>Deficits (+)/Surplus (-)</i>							
Federal	1.0	2.2	2.1	6.1	6.6	3.2	3.8
Provincial	0.8	0.3	-0.6	0.3	0.2	-0.4	2.8
<i>Total</i>	1.8	2.5	1.5	6.4	6.8	2.9	6.7

Notes: All figures are based on national income accounts definitions. Public accounts definitions vary among governments; small discrepancies in some totals are due to rounding. Provincial data include local, school, and hospital sectors.

Source: Calculations by author, from data in Canada (1993a).

THE NEED FOR "CREATIVE DESTRUCTION" IN THE PUBLIC SECTOR

Social program initiatives over the last three decades have realized important successes — notably in improving average Canadian health status and in lowering the incidence of poverty among the old. But many social problems persist more-or-less unchanged, and others have worsened.

Large interregional government transfers have lowered the regional dispersion of per capita post-transfer income, but per capita earned income inequalities have narrowed only slightly. As measured by the ability of provincial governments to raise revenues with equal taxing effort, the ranking of provincial governments has changed little over the last three decades. The three "have" provinces remain Ontario, Alberta, and British Columbia; the four Atlantic provinces remain the poorest of the "have nots." Continued low earned incomes, high regional unemployment and high poverty rates in particular provinces have become, as Courchene (1993, p. 17) puts it, "a policy-induced equilibrium, not a disequilibrium."²

Average Canadian unemployment rates have risen over the last three decades, and have been high relative to other G7 countries (Economic Council 1990). In explaining this trend, some weight can be attached to factors beyond the ken of public policy. The rise in single-parent families has probably increased learning difficulties for children which in turn is reflected in unemployment statistics. Inadequate aggregate demand during recessions also explains some of the increase. But much of the increase is probably due to the working of labour markets in the context of inefficient government policies. As with regional inequality, persistent high unemployment seems less an aberration than a "policy-induced equilibrium." We have, for example, restricted labour mobility via interprovincial trade barriers, devoted most of our labour market expenditures to passive income support for the unemployed, used unemployment insurance as a permanent subsidy to low-productivity seasonal industries such as the fishery, allowed the elementary and secondary education system to drift with inadequate testing of student performance, and neglected the training needs of those entering the work force without the advantage of professional postsecondary education (Economic Council 1992a).

Two glaring concentrations of poverty and psychological distress in Canada are aboriginals and single-parent families. Despite some improvements — for example, rising average education levels — distress among aboriginal families has probably worsened. The incidence of poverty among single-parent families has declined, but the proportion of families in this category continues to increase (Economic Council 1992b).

The minimum conclusion from all this is that, despite a massive increase in the absolute and relative size of the Canadian welfare state over the previous quarter century, serious social problems persist and in some cases have worsened. But two other conclusions seem inescapable. First, its successes indicate that the welfare state has the potential to be a more efficient institution — than is the market — in supplying a broad range of services that comprise the core of the welfare state, or in subsidizing individuals to purchase the relevant services. But this is true only if politicians retain the discretion to undertake Schumpeterian processes of “creative destruction” to redesign social programs as publicly defined social needs change. Second, a larger public sector is no guarantee of better social policy. “Bad” social policy, such as our present UI program and Canada Assistance Plan, has induced dependency. Individuals and governments have adapted to generous, but inefficient, programs. In such cases, it requires ever-larger incremental public expenditures to reduce indices of social distress, and over time the stress from “withdrawal” of such programs becomes progressively more acute.

Besides the obvious desire to improve outcomes, the impetus for redesign of social policy comes from the fact that the proportion of Canadian voters consciously demanding a reduction in the size of the public sector is growing and, however convoluted the process may be, fiscal policy will ultimately reflect public preferences. Early signs of a new “fiscal realism” have already appeared at the provincial level.

Newfoundland Liberals and Alberta Conservatives won re-election in 1993 with campaigns based on promises to cut aggregate public spending. Popular opposition to increases in public sector spending and taxation by the Ontario and British Columbia governments persuaded these NDP Cabinets to undertake the extremely painful exercise of reversing their early spending patterns, alienating thereby their natural allies, in particular public sector unions.

The case of Saskatchewan displays a certain irony: a nominally conservative government allowed provincial finances to degenerate in the 1980s from fiscal health to the bottom of the provincial debt league; a nominally socialist government has since 1991 undertaken necessary, but politically painful, fiscal restraint.³ A Conservative provincial administration presided over the decline of provincial economic fortunes during the mid-1980s, when the international grain subsidy war dramatically lowered farm incomes. The Conservatives attempted to offset the terms of trade effect by deficit spending. (The federal Conservatives also contributed via generous agricultural subsidies.) The Saskatchewan NDP returned to office in 1991, and has in three budgets reduced real program expenditures by 9 percent, increased provincial revenues by 14 percent, and reduced the deficit by four-fifths (Saskatchewan 1992; 1994).

The government has been able to accomplish this wrenching, by Canadian standards, fiscal adjustment while maintaining if not majority, at least plurality, support among the electorate.⁴ One explanation for public support has been the care devoted to assessing the redistributive implications. The provincial government has been fairly careful in targeting its expenditure reductions — the public sector payroll being among them. Simultaneously, it has undertaken numerous initiatives to increase the progressivity of the tax system: the introduction of a "deficit surtax," an increase in child tax deductions for low-income families, and, an increase in a wage subsidy for low-income workers.

At the federal level, fiscal federalism will also prevail, but not yet.

A significant minority of Canadians west of the Ottawa River voted in the 1993 general election for the Reform Party, whose major promise was the equivalent of East European shock therapy: expenditure reductions sufficient to balance the federal budget in three years. While a significant minority voted for fiscal restraint, a plurality obviously voted for a party whose leaders maintained throughout the election campaign a studied ambiguity on the controversial issues of fiscal policy. During the years of Conservative rule, the Liberals enjoyed support from interest groups frustrated by modest Conservative spending constraints. The dynamic of interest group politics plus an ideological predisposition towards government activism led most Liberals, while in opposition, to minimize the significance of Canadian public sector deficits.

The dynamic of governing is very different. The severity of federal fiscal problems very quickly came to the fore. Within a month of assuming office, the new Minister of Finance announced that the 1993-94 deficit would be 35-40 percent higher than the \$32.6 billion estimate contained in the spring 1993 budget.⁵ Martin talked realistically of the growth of the underground non-taxpaying economy, of "hundreds of thousands of otherwise honest people who have withdrawn their consent to be governed, who have lost faith in government." He insisted that a prerequisite to re-establish lost faith is to "restore control over the nation's finances." (Canada 1993b, pp. 3-4).

The 1994-95 federal budget unfortunately did not break with federal fiscal trends of the last two decades. The new government intends to increase program spending modestly, from \$121.1 billion in 1993-94 to \$123.3 billion in 1994-95.⁶ This is a 1.8 percent nominal, or 1.0 percent real, increase (based on the economic assumptions of the budget). The Liberals intend to increase revenues from \$114.7 billion in 1993-94 to \$123.9 billion in 1994-95, a 8.0 percent increase. Eliminating non-recurring revenue effects (such as accelerated tax return processing), the budget estimates that revenues will grow by 5.1 percent. This revised figure is still above the 3.9 percent projected nominal GDP growth.

Hence, while the budget contains no major tax increase, it does intend a modest further increase in the federal tax-GDP ratio. Making one adjustment (described in the endnote), the Liberals expect to lower the federal deficit, on a public accounts basis, from \$45.0 billion to \$40.4 billion.

The government has made some explicit spending reductions, notably in defence. It has also tentatively sought to cut expenditures, or curtail their growth, in the major areas of potential savings:

- public sector payroll (by extending the Conservatives' salary freeze until 1996-97);
- intergovernmental transfers (by requiring that, after this round of social policy reform, the aggregate of transfers net of Equalization not exceed 1993-94 levels);
- pensions (by reducing the generosity of income tax treatment for the old);
- unemployment insurance (by slightly increasing work requirements before qualifying, and slightly reducing duration and level of benefits).

Given the accounting complexities, any brief assessment necessarily sins by omission. But, in summary, it is fair to say that the aggregate fiscal adjustments of the new budget are trivial relative to what is required to eliminate the federal deficit during the life of the present Parliament. To realize even the modest goal of reducing the federal deficit below 3 percent of GDP by 1996-97 will require a more aggressive combination of spending cuts and/or tax increases than are contained in this budget.

Table 2 provides some — far from conclusive — evidence in support of the idea that voters in modern industrial countries have converged in how much public spending they want, and hence, on how large they want their respective welfare states to be. The desired range of public spending appears to be between 40 and 50 percent of GDP.⁷ Governments that allow the public sector to rise above 50 percent are electorally punished; conversely, voters will support interventionist politicians in countries where public spending is below 40 percent. Canada under the Conservatives exceeded the upper end of the range, as did the French socialists and the centre-left coalition in Italy. All three of these governments lost power in 1993. These defeats occurred for many reasons but, in all three cases, public opposition to the relative size of the public sector was a prominent issue.

Two major outliers have been Japan and the United States, but even here, convergence may be occurring. The OECD (1993, p. 148) projects a continued slow increase in the Japanese public spending-GDP ratio over the next several years. In the case of the United States, the new Democratic administration may

TABLE 2: General Government Outlays (Percentage of GDP)

	1979	1984	1989	1993
United States	31.6	35.5	35.7	38.7
Japan	31.6	32.9	31.5	34.9
Germany	47.7	48.1	45.5	50.8
France	45.0	52.0	49.1	54.2
Italy	41.7	49.4	51.3	54.8
United Kingdom	42.6	47.2	40.7	47.0
Canada	39.0	46.8	44.9	51.5

Source: OECD (1993, p. 33).

well push that country's public sector above 40 percent by implementing broad health insurance reform.

As welfare states have grown in the major industrial countries, their governments are now engaged in running "subeconomies" larger than the pre-1989 command economies of the communist countries of Eastern Europe. And, not surprisingly, some of the analysis developed by East European economists in the last generation applies equally to the welfare state.

An example is the Hungarian economist, Janos Kornai (1992), who summarized much of his work with the idea of "soft budget constraints." Central to Kornai's analysis is that command economies — and by extrapolation the welfare state — generate powerful interest groups with quasi-property rights in the status quo. These groups come to exercise immense political pressure against reallocation of resources between government and the private sector and within the public sector itself. Even when certain governments like Hungary introduced market socialist reforms to encourage efficiency-enhancing reallocations based on financial performance, these governments could not in practice impose "hard" budget constraints on state-owned firms. In the event of financial losses, interest groups of workers, managers, and local politicians exercised sufficient influence to obtain subsidies and prevent bankruptcies. For similar reasons, new firms seeking entry into established industries faced severe barriers.

The analogue in the welfare state is that its growth has been accompanied by the growth of interest groups intent on defending specific programs. Their effect is to render extraordinarily difficult the exercise of Cabinet discretion — at either the federal or provincial level — in the field of social policy.

The relevant interest groups in this process can be usefully categorized:

One category of groups is *public sector unions/associations of contracted workers*. Those whose primary source of income derives from provision of a particular social program have a strong interest in preserving and increasing relevant budget allocations. Despite the incentive of worsening deficits, Canadian governments have been unable over the last decade to reduce the premium of public over private sector wages. As is discussed below, the overall premium appears to have increased.

A second category of groups are those *representing beneficiaries of major transfer programs*. This category contains many examples. Old age security is a rapidly growing category of social spending that ministers of finance want to constrain. For understandable reasons, organizations representing senior citizens constitute a powerful lobby against any modification of pension benefits. In particular industries, such as seasonal-employment forestry and fishery, UI benefits constitute an important source of income to employees. Without UI, employers would have to pay higher wages; competition to minimize cost increases would impose further use of labour-saving equipment, and employment in such industries would decline. Representatives of employers and employees in such industries quite logically organize to resist reallocation of labour market budgets that entail serious cuts to UI payments. The power of such interest groups derives from the universal and visible nature of the benefits they defend, and the large number of voters who, potentially, can be mobilized.

A third category of groups is *regional alliances in "have-not" provinces*. As already discussed, interregional transfers have increased post-transfer per capita incomes but done little to bring market-based per capita earnings in "have-not" provinces up to the national average. Such results strongly suggest the desirability of political entrepreneurship to redesign programs such as UI, a process which means attaching more benefits to individuals and fewer to regions. (An obvious example is an increase in training grants to the unemployed that could be spent anywhere, paid for by elimination of regional extended UI benefits.) This in turn would encourage outmigration from "have-not" provinces. But outmigration poses losses to a broad swath of interest groups with fixed assets in "have-not" regions. The threatened fixed assets range from the obvious (commercial real estate in communities of declining population) to the subtle (the "style-of-life" value placed on farms by people wanting to live in stable rural communities, or attractive civil service jobs many of which would disappear with outmigration).

For a generation, politicians in Atlantic provinces and other "have-not" regions have built broad alliances based on these three groups — public sector unions, immediate program beneficiaries, and those with fixed assets

threatened by change in social policy. These alliances have been a formidable obstacle to any would-be political "entrepreneurs" advocating change. In the long run, however, "have-not" regional alliances are unstable; countervailing alliances arise in "have" regions.

WHY INCUR THE PAIN OF BALANCING THE BUDGET?

If federal and provincial governments do seek to balance their aggregate accounts, as is recommended here, there will inevitably be some — perhaps severe — dislocation costs. Why incur such costs? The answer is that extrapolation of present fiscal policy probably poses worse costs. The costs from pursuing "as is" fiscal policy range from the almost certain (such as the increased cost of servicing public debt because lenders now impose a risk premium on government bonds) to the probable (rising political conflict over distribution of government transfers and taxes) to the speculative (disruption of credit markets for the debt of one or more provinces, or even for Ottawa). It is always possible that a prolonged economic boom and stable public expenditures will allow us to grow our way out of the present fiscal mess without serious fiscal restraint. But that prospect is becoming increasingly unlikely.

Bill Robson (1994) has recently conducted an exercise in simulating fiscal prospects for Canadian governments over the life of the present Parliament. He concentrates on four outcomes: (a) change in the interest burden of the public debt as a share of GDP; (b) change in national savings as a share of GDP; (c) change in foreign debt as a share of GDP; and (d) change in provincial debt service costs as a share of provincial tax revenues. As opposed to using point estimates for independent variables, such as GDP growth and interest rates, he assumes these variables are random, obeying normal distributions about his baseline estimates. Running many simulations with realizations of the random variables generates an experimental distribution of outcomes.

One key conclusion is that small changes in parameter estimates produce dramatic differences in outcomes. To illustrate, Robson employs two sets of baseline estimates — "rosy" and "gloomy." The latter employs slightly lower baseline potential GDP growth (2.5 percent compared to 2.75 percent), slightly higher real interest rates on public debt (5 percent compared to 4 percent), and a smaller present output gap (5 percent of GDP as opposed to 6 percent). Both sets of parameter values lie within the range of current conventional wisdom. Under the "rosy" scenario, 27 percent of the simulation runs lead to a worsening (1997 relative to 1993) of two or more of the outcomes. Under the "gloomy" baseline assumptions, by contrast, 67 percent of the runs result in a worsening of two or more outcomes.

My conclusion from Robson's and similar exercises is that pursuit of "as is" fiscal strategies poses significant costs. Many of these costs are uncertain, but they are the benchmark against which to measure the more tangible adjustment costs posed by pursuit of fiscal restraint.

If governments agree to pursue fiscal restraint, what should be the target variable — deficit, debt-servicing costs, primary surplus, net debt-GDP, federal values only or federal-plus-provincial? And what should be the target value for the target variable? These are interesting questions, but of secondary importance. It is possible to state most targets in terms of alternate variables; the fundamental issue is to recognize the value of fiscal restraint, given the various risks posed by extrapolating present fiscal policy. Pragmatically, I believe the target of balanced provincial-plus-federal accounts, at 1993-94 tax-GDP ratios, by the end of the current Parliament (i.e., by 1998-99) is a reasonable criterion to determine whether Cabinets can reassert credible control of their respective budgets.

If we accept this first recommendation, the next question is, where to cut?

It is possible to undertake a case-by-case examination of government programs and find candidates where, by any reasonable assessment, costs exceed benefits. The federal Department of Fisheries and Oceans (DFO), for example, offers a long list of suitable programs for cutback (Vastel 1994). Overly generous unemployment insurance is a major candidate. Another candidate is extremely generous present pension policies (Walker and Horry 1993). They are creating a social division between the old, who enjoy the present generosity, and the working age population which is beginning to appreciate the implications of a rising dependency ratio and the actuarially unsound basis of the Canada/Quebec Pension Plan (Lam *et al.* 1993).

But the answer to the question, where to cut, is far more complex than the above paragraph suggests. Passive income support under UI is indeed too generous, but there is a need to expand training and apprentice programs. Hence, overall, labour market programs should not be expected to contribute to deficit reduction. However ruthlessly DFO spending is trimmed, it is a small "fish" in the ocean of red ink facing Canadian finance ministers. One major source of spending reduction worth identifying is the public sector payroll.

Identification of the public sector payroll as a source of spending reduction is warranted for three reasons. First, the wages of public and quasi-public employees are too large an item to ignore: in the order of 15 percent of federal program spending net of transfers to the provinces; 60 percent of provincial program spending.⁸ Over a range of reasonable fiscal assumptions, a 10 percent cut in the aggregate federal-plus-provincial payroll would provide between one-third and two-thirds of all required expenditure reductions.⁹ (If inflation

continues at 2 percent annually, governments could achieve a 10 percent real cut by freezing the nominal aggregate payroll until 1998-99.) Second, the compensation advantage of public sector over comparable private sector wages has become unjustifiable given the need for budgetary restraint. Precise estimation of this advantage is fraught with controversy, but it is now probably close to 15 percent.¹⁰ The compensation advantage occurs primarily among lower skilled employees and in the form of better deferred benefits, such as pensions (Gunderson and Riddell 1993; Quebec 1993). Third, comparative compensation studies do not take into account the benefit — a truly dramatic one during the recent recession — of greater public sector job security.¹¹

A pragmatic argument to consider here is that concentration on the public sector compensation advantage reduces the short-run employment disruption caused by fiscal restraint. Payroll reduction may take the form of reduced public sector employment, in which case employment is obviously directly affected. In summary, if the Ontario NDP government concluded that deficit reduction requires reduction in the public sector payroll, it is a safe bet that the matter warrants close attention! See Ontario (1993).

The provinces have a much greater potential than does Ottawa to reduce their deficits by payroll reductions. Were federal transfers to the provinces to remain at their present level — cash transfers are approximately 4 percent of GDP — resort to a significant cut in the public payroll would place the provinces in surplus while Ottawa continued with a large deficit. This brings me to my third recommendation. Ottawa should share in the potential provincial savings from payroll reductions by a significant reduction in intergovernmental transfers. If Ottawa and the provinces want to eliminate their combined deficit by 1998-99 via a significant payroll cut, then cuts in intergovernmental transfers serve to equalize the percentage cuts required in other non-salary program expenditures at the federal and provincial level.

This argument does not replace, but supplements, other arguments for reducing intergovernmental transfers. Many analysts have concluded, for example, that an increased federal tax credit for children would be a more equitable and efficient program than the present Canada Assistance Plan. Redesign of social policy in an age of fiscal restraint cannot ignore the brute fact that intergovernmental transfers currently constitute approximately one-quarter of federal program spending.

The final recommendation is that governments pay close attention to the redistributive impact of restraint. This injunction is second nature to most practising politicians; academic analysts are wont to forget it. As proof of its importance, I remind readers of the earlier discussion of Saskatchewan's deficit-cutting exercise.

CONCLUSION

Having started off with the anecdote about the Vancouver teachers' strike, and having insisted upon deficit reduction by expenditure cuts, I am open to the charge of harbouring a general hostility to the public sector. I plead innocent. A generous welfare state is one of the major achievements of industrial society in the twentieth century. It must co-exist, however, with a market economy, and that implies serious analysis of the appropriate limits to be placed on each.

In summary, I could state the thesis of this chapter as follows: do not confuse the case for a generous and efficient welfare state with the case for extrapolating the past quarter century's trends in public sector expenditure growth and, *a fortiori*, do not confuse the case with extrapolating trends in public sector collective bargaining.

NOTES

1. This essay contains revised passages from a recent essay written for the new C.D. Howe series on social policy (Richards 1994).
2. Tom Courchene discusses these interregional trends in detail in a forthcoming volume of the new C.D. Howe series on social policy. See also Peter Leslie's article in Leslie *et al.* (1993).
3. As measured by the magnitude of the provincial tax-supported debt-GDP ratio, Saskatchewan had become by 1992 the most debt-ridden province of the country, including Newfoundland. For comparative data on provincial deficits and debts see Saskatchewan (1993).
4. According to one poll in the fall of 1993 the Saskatchewan NDP enjoyed 41 percent voter support; the provincial Liberals enjoyed 25 percent, and the former governing Conservatives only 16 percent (Roberts 1993).
5. The Conservatives implemented several dubious accounting changes in their spring 1993 budget to minimize the deficit estimate in a pre-election budget. The new government has reversed these changes, and made some dubious accounting decisions of its own. The effect of the Liberal changes is to shift expenditures into the 1993/94 fiscal year and hence increase the deficit base against which to assess its own deficit-reduction performance (Canada 1994). Despite these accounting distortions, however, four-fifths of the deficit increase reflects a genuine fiscal deterioration relative to early 1993 expectations, primarily in lower-than-expected revenues.
6. The expenditure figures are derived from Table 17 of the 1994-95 budget (Canada 1994) — with one adjustment. I have reallocated the \$700 million "restructuring charges" arising from cancellation of the helicopter contract and closing of military establishments to the 1994/95 fiscal year, instead of the 1993/94 fiscal year as reported. The revenue figures are contained in Table 16. The summary economic assumptions are in Table 1.
7. While approximately two-thirds of public spending in wealthy OECD countries is devoted to social programs, interpreted broadly, the proportion of non-social

- spending differs among countries and hence the relative size of national welfare states is not strictly proportional to aggregate public spending data. Some spend more on defence (Canada spends less than average); some spend more on debt charges (Canada among them).
8. These estimates derive from personal communications with senior officials in the finance ministries of federal and provincial governments. One source against which to gauge these estimates is Statistics Canada (1993) which compiles data on public sector employment and remuneration under several definitions of varying scope. For purposes of this exercise the most relevant definition is "government employment," which includes the civil service plus health, education, and social agencies; it excludes government business enterprises. Unfortunately this definition also excludes several important categories of workers who derive most of their income via salary or fees negotiated with government. Two such categories are universities and independent health-care providers (primarily physicians). For fiscal 1991/92, federal remuneration of "government employees" so defined was 18 percent of federal program expenditures net of transfers to the provinces; the analogous provincial statistic was 23 percent. This latter statistic is a serious underestimate. The majority of local public sector employment (e.g., teachers) is financed by grants from provincial governments. University employees and health-care providers absorb in excess of 10 percent of provincial program expenditures.
 9. This conclusion is derived from an exercise, similar in spirit to Robson's (1994), in which Ottawa and the provinces reduce program spending sufficiently to eliminate the combined federal-provincial deficit (on a public accounts basis) by fiscal 1998/99. The key assumptions are (a) that real GDP grows between 3 and 4 percent annually, (b) that government tax revenues rise at the same rate as GDP, and (c) that average real interest rates on public debt decline somewhat. See the article by Richards (Brown *et al.* forthcoming).
 10. For a future C.D. Howe Institute study, David Brown (Brown *et al.* forthcoming) has compared wages in the public sector (defined broadly to include those in health, social, and educational institutions) and private sector. The ratio of wages in the public sector to those in the industrial aggregate rose from 1.1 in 1983 to 1.14 in 1993. There are many difficulties in comparing public versus private sector compensation accurately. This ratio measures average wages and salaries. It takes no account of wage determining characteristics of employees and jobs (skill levels, work conditions, security of tenure) that can be expected to influence competitive market pay levels; nor does it include deferred benefits (e.g., pensions) that tend to be more generous in the public sector.
 11. Between 1990 and 1992, employment in the broadly defined public sector grew 2.3 percent; total employment declined 2.6 percent, and employment in the private sector declined by 4.0 percent (Brown *et al.* forthcoming).

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