

National Citizenship and Provincial Communities: A Review of Canadian Fiscal Federalism

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SOMMAIRE

L'extension des droits relatifs à la citoyenneté nationale, par exemple par le biais de la *Charte des droits et libertés* et autres dispositions de la *Loi constitutionnelle de 1982*, contrevient à un objectif traditionnel du fédéralisme canadien de protéger l'autonomie des provinces. Cette autonomie était recherchée afin d'assurer que les politiques provinciales seraient adaptées aux besoins et aux conditions des régions et refléteraient les différentes préférences, priorités et valeurs parmi les provinces. Ceux qui soutiennent le plus ardemment l'autonomie provinciale considèrent celle-ci comme un moyen pour préserver et développer des communautés provinciales distinctes. Toutefois, le fédéralisme est un modèle institutionnel qui représente un compromis entre cet objectif et celui de développer une nouvelle communauté politique nationale, réalisé en partie par l'extension de droits individuels à des services publics harmonisés et d'autres droits reliés à la citoyenneté nationale.

En réconciliant les objectifs du développement de la nation et du renforcement des provinces, la conception des arrangements fiscaux—la répartition des responsabilités de dépense et de taxation entre les gouvernements, de même que l'élaboration d'un système de transferts intergouvernementaux—joue un rôle capital. Il est impossible de justifier ou d'évaluer les arrangements fiscaux fédéraux seulement à partir de critères économiques; ils reflètent inévitablement des choix politiques et des compromis fondamentaux. Cela était vrai des recommandations de la commission Rowell-Sirois en 1940, et l'est tout autant des dispositions sur la péréquation de la *Loi constitutionnelle de 1982* (laquelle intègre d'ailleurs les principes de base de ladite commission). Selon cette disposition, le gouvernement fédéral s'engage à faire des transferts fiscaux inconditionnels aux provinces, leur permettant ainsi d'offrir des services publics de qualité comparable à des taux de taxation analogue. Toutefois, les arrangements fiscaux à l'oeuvre actuellement contreviennent à ce principe; les données démontrent en effet qu'il y a une variation interprovinciale considérable dans les niveaux de taxation et les niveaux de dépense per capita. La racine de ce problème, qui prit de l'ampleur à partir des années 1970 et qui est toujours énorme (en 1987/88), se trouve dans la grande variation qui existe au niveau de la capacité fiscale de chaque province.

Il serait futile de suggérer que les montants de péréquation soient accrus afin de remédier à cette situation; ceux-ci ont atteint leur limite politique. Une comparabilité accrue entre les provinces dans la qualité et l'élaboration des services publics peut être accomplie par des paiements conditionnels mais, en l'absence d'une augmentation de la péréquation, cela se traduira probablement par un ac-

croissement de la différence dans les niveaux de taxation entre les provinces. De plus, il a été avancé que les paiements conditionnels contredisent les principes du fédéralisme. D'ailleurs les tentatives effectuées pour contourner les problèmes inhérents aux paiements conditionnels, comme l'accord de 1977 sur le financement des programmes établis, n'ont fait que créer de nouveaux problèmes. Il y a donc plusieurs faiblesses dans la conception actuelle du fédéralisme fiscal canadien qui reflètent la tension entre l'objectif d'étendre les droits relatifs à la citoyenneté nationale, et le contre-objectif de préserver et de développer des communautés provinciales distinctes.

ABSTRACT

The extension of national citizenship rights, for example through the *Canadian Charter of Rights and Freedoms* and other features of the *Constitution Act, 1982*, collides with a traditional aim of Canadian federalism, the protection of provincial autonomy. Autonomy has been desired in order to ensure that provincial policies are adapted to regional needs and conditions, and reflect differences among the provinces in preferences, priorities, and values. Those most strongly committed to provincial autonomy see it as a means of preserving and developing distinctive provincial communities. Federalism is an institutional form that expresses a compromise between this objective and, on the other hand, the building of a new national political community, in part through the extension of individual entitlements to standardized public services and other rights of citizenship.

In reconciling nation-building and province-strengthening goals, the design of the fiscal arrangements—the allocation of governmental spending responsibilities and taxing powers, and the design of a system of intergovernmental transfers—plays a vital role. It is not possible to justify or evaluate federal fiscal arrangements on the basis of economic criteria alone; they inevitably reflect basic political choices and compromises. This was true of the recommendations of the Rowell-Sirois Commission in 1940, and it is true of the equalization provisions of the *Constitution Act, 1982* (which entrench the basic Rowell-Sirois principle). Under the relevant clause, the federal government is committed to making unconditional fiscal transfers to provincial governments, enabling them to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. However, the present fiscal arrangements are arguably in violation of this principle; the data show that there is considerable interprovincial variability in both levels of taxation and levels of expenditure per capita. The root problem, which the data show increased in severity during the 1970s and is still (in 1987/88) enormous, is wide variation in provincial fiscal capacities.

It is futile to suggest that the equalization program be enriched to remedy this situation; equalization has reached its political limits. Fuller interprovincial comparability in standards and in the design of public services may be achieved through conditional grants, but in the absence of more equalization, this would probably widen interprovincial differences in levels of taxation. Moreover, it has been argued that conditional grants infringe federal principles. An attempted solution to the problems inherent in conditional grants, as seen in the introduction of the quasi-conditional Established Programs Financing

scheme in 1977, has created problems of its own. There are, thus, major flaws in the design of Canadian fiscal federalism today, reflecting the tension between the goal of extending national citizenship rights, and the counter-goal of preserving and developing provincial communities.

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Peter M. Leslie

NATIONAL CITIZENSHIP AND PROVINCIAL COMMUNITIES: REVIEW OF CANADIAN FISCAL FEDERALISM

I — INTRODUCTION

Throughout the postwar era, successive federal governments have sought to extend Canadians' access to high-quality public services, as a matter of citizenship rights or entitlements. This has involved them in policy areas constitutionally or traditionally within the provincial domain; indeed, some federal programs—medicare is the classic example—have built upon innovations in one province and sought to extend them to others. While provincial governments have generally accepted federal financial assistance for new programs, they have also, in varying degrees, defended their autonomy under the constitution, and have devised and implemented policies consistent with their own perceptions of provincial needs and values. Indeed, the tension between national and provincial goals is endemic to federalism. The continuous adaptation of the fiscal arrangements¹ is, to a large extent, aimed at reconciling the often divergent aims of extending national citizenship rights and preserving or developing distinctive provincial communities.

In this context, the present paper undertakes to evaluate federal fiscal arrangements in Canada. This aim requires a mode of analysis that takes account of abstract principles, but also of concrete historical experience. Indeed, any overall evaluation of the existing system requires one to attend to at least four major factors:

- a) criteria that may, in principle, be relevant to evaluating alternative sets of fiscal arrangements,
- b) evolving conceptions of Canadian citizenship, as compared with the value attributed to developing or preserving provincial/regional communities,

1 The term "fiscal arrangements" is used here in a broad sense, interchangeably with "fiscal federalism." These concepts encompass three major elements in the relationship between orders of government in a federation: the *de facto* allocation of taxing powers and spending responsibilities, the sharing of revenues from jointly controlled tax fields and other revenue sources, and the full range of intergovernmental transfer payments.

- c) recent and forecast trends in public finance in Canada at both the federal and provincial levels, and
- d) recent and forecast trends in fiscal transfers, if the present system remains in place.

Criteria of evaluation. Existing academic studies and official documents on the fiscal arrangements rarely give as much attention to political and social criteria of evaluation as they do to fiscal and/or economic ones. However, as will be argued below, decisions regarding fiscal arrangements necessarily reflect or imply fundamental political and social choices.

To some extent, in Canada, the necessary political/social framework for an economic analysis of the fiscal arrangements received constitutional formulation in 1982, when a commitment was made to provide the provinces with sufficient revenues to provide *reasonably comparable levels of public services at reasonably comparable levels of taxation.*² Do existing arrangements fulfill constitutional obligations? Arguably not: as will be shown below, tax rates and expenditure per capita vary considerably among provinces; and those provinces with a relatively slender tax base are forced to tax at above-average rates in order to offer services that are, nonetheless, provided at below-average levels. There is indeed a case that the present system of fiscal transfers is in default of constitutionally mandated principles. On the other hand, the fiscal arrangements do very substantially improve the position of the poorer provinces. Are the discrepancies that persist consistent with the "reasonably comparable" criterion? It all depends, I suspect, on one's private judgment on the tradeoff that must be made between equity on the one hand and, on the other, a set of political imperatives that necessarily also must enter into the policy equation: to keep the fiscal burden on its own treasury within manageable bounds, to promote economic growth (that is, to attend to the production of wealth, as well as to its redistribution), and to increase the competitiveness of Canadian industry internationally. For example, Thomas J. Courchene thinks that pursuit of equity goals seriously inhibits efficiency, and argues that the balance be-

2 See Section 36 of the *Constitution Act, 1982*. Other parts of this clause, entitled "Equalization and Regional Disparities," are cited in Section III of this paper; equalization is the subject of Section VI.

tween them must now be tipped away from equity and toward efficiency.³ By contrast, Ian Stewart holds that the two may be interdependent, and that to pursue efficiency at the expense of equity may be self-defeating⁴. Against these background suppositions, one would expect to find Stewart taking a rather more rigorous view of the "reasonably comparable" requirement than Courchene would do.

Trends: Public opinion, public finance, and fiscal transfers. The policy dilemmas that flow from tension between diverse objectives are heightened by the following facts concerning Canadian public opinion and the condition of the Canadian economy in the late twentieth century.

- a) The political thrust that lay behind postwar innovations, including the cost-sharing of major social programs, is in no sense a spent force. Thus, one can expect continued electoral support for high-quality public services. More specifically, one may anticipate political pressure on the federal government to accept responsibility for the preservation and perhaps the extension of existing citizen entitlements, even when program delivery is provincial. A case in point is the demand for a national child care program, to which the federal government has responded with a commitment of \$6.4 billion dollars.
- b) In the circumstances of the latter 1930s it was possible to conceive of a program of fiscal equalization which would retain the allocation of spending responsibilities as envisioned at Confederation, avoid cost-sharing of public services, and enable all provinces to finance services at national average levels without having to tax at higher-than-average rates.⁵ Today it is impossible to achieve simultaneously this set of objectives. The scale of government has increased too much for this, and interprovincial disparities in fiscal capacity have widened too greatly, mainly because of hugely increased resource revenues which are very unevenly spread among the provinces. As a

3 Thomas J. Courchene: "The Fiscal Arrangements: Focus on 1987," in *Ottawa and the Provinces: The Distribution of Money and Power*, edited by Thomas J. Courchene et al. (Toronto: Ontario Economic Council, 1985), v.1, 7, 19, and 3-21 *passim*.

4 Ian A. Stewart: "Consensus, Flexibility, and Equity," *Canadian Public Policy* 12:2 (June 1986), 307-13.

5 This was the main recommendation of the Royal Commission on Dominion-Provincial Relations, or Rowell-Sirois Commission, which reported in 1940. The report of the commission is discussed below in Section IV.

result of this combination of factors, the present equalization program is overburdened; it has reached its political limits.

- c) To retain or enhance its fiscal room for manoeuvre, the federal government has repeatedly insisted over the past 20 years or more, that the provinces must bear their fair share of federal fiscal restraint measures. Various open-ended expenditure programs, including equalization, have been "capped," and three major shared-cost programs have, under the Established Programs Financing (EPF) scheme, been supplanted by a form of fiscal transfer that is unrelated to levels of provincial expenditure. Indeed, the rate of escalation in EPF transfers has itself been cut back to a level that is two per cent below the rate of increase of GNP. The provinces describe this as "offloading," a practice that increases the financial burdens on all provincial governments, and adds especially to the budgetary problems of the poorer provinces. The magnitude of the existing federal deficit—after several years of rapid economic expansion, and at a time when a recession is anticipated by many—makes it likely that the practice of "offloading" will continue; indeed, it may be increasingly resorted to. This will be all the more probable, to the extent that the federal government feels compelled to launch new social programs, extending citizen entitlements.
- d) The squeeze on provincial budgets can be expected to become tighter over time, because the costs of existing programs are difficult to control. Developments in the health care field epitomize this problem. Here, four factors point to increased costs: the availability of new and increasingly expensive equipment and procedures, pay equity for women, the aging of the population (and correspondingly rising dependency ratios as well as increasingly heavy demands for curative treatment), and federal action—as one saw with the Canada Health Act, 1984—to force the provinces to comply with federally defined standards while restricting provinces' access to new revenue sources. In other words, federal action to preserve or extend citizenship rights may have the effect of tightening the fiscal squeeze on the provinces, with consequences especially damaging to those provinces already in a relatively weak position.
- e) EPF, one of the cornerstones of contemporary fiscal federalism in Canada, is a politically vulnerable form of fiscal transfer. The 1986 reduction in the rate of escalation of the transfer will have side-effects virtually guaranteeing that EPF will not survive over the longer term. There are several reasons for this, one being the problem of political accountability—which is, incidentally, a factor to be borne in mind in thinking about how the spending power provisions of the

Meech Lake Accord⁶ may affect the design of future cost-sharing arrangements.

The thrust of the paper. In this paper social, political, and constitutional aspects of Canadian fiscal federalism (issues such as those listed above, all of which have an obvious bearing on the legitimacy of the federal government and of the federal system itself) receive special attention. It is not intended to suggest that budgetary or economic considerations are of secondary importance in evaluating the fiscal arrangements. Rather, the aim is to highlight those factors that are not amenable to quantification. They are, so to speak, more slippery and more difficult to incorporate into analysis of policy alternatives, and probably for this reason have figured less prominently in the literature than budgetary and economic considerations. In this context, the present paper is a corrective, though not a challenge, to existing studies and reports on Canadian fiscal federalism.

II — CRITERIA FOR EVALUATING FEDERAL FISCAL RELATIONS

In a recent critique of intergovernmental fiscal relations in Canada, Robin Boadway has written:

In the economics literature, one can discern four general types of arguments for federal-provincial grants, each of which is applicable to the Canadian case. These arguments are the existence of a fiscal gap, fiscal inequity, fiscal inefficiency, and interprovincial spillovers.⁷

What does this mean? As Boadway indicates (here I summarize):

- 6 The *1987 Constitutional Accord*, an agreement reached among First Ministers in the spring of 1987. The Accord must be endorsed by all provincial legislatures as well as by Parliament before going into effect.
- 7 Robin W. Boadway: "Federal-Provincial Transfers in Canada: A Critical Review of the Existing Arrangements," in *Fiscal Federalism*, edited by Mark Krasnick (Toronto: University of Toronto Press, 1986) [Macdonald Commission Study # 65], 4. The "economics literature" Boadway refers to includes such classics as Wallace E. Oates: *Fiscal Federalism* (New York: Harcourt Brace Jovanovitch, 1972) and R.A. Musgrave and P.B. Musgrave: *Public Finance in Theory and Practice* (New York: McGraw-Hill, 1976).

- a *fiscal gap*, also described in the literature as "vertical imbalance" in a federal system, exists when the provincial or state governments have expenditure responsibilities that outstrip their revenue-raising capacities, whether because the constitution limits their access to lucrative sources of revenue, or because (for a combination of economic and political reasons) the states⁸ are restrained from imposing taxes at a level that would meet their needs;
- *fiscal inequity* arises when similarly-situated individuals are treated unequally by the tax system, or alternatively by the tax-and-transfer system, or alternatively by the whole system of public revenue-raising and expenditure, according to the state in which they live; in other words, there is fiscal inequity when two individuals resident in different states are equally well off "pre-government," but are made *unequally* well off by the actions of government, with comparisons variously taking into account 1) taxes only, 2) taxes and transfers, or 3) all sources of government revenue and all forms of public expenditure;
- *fiscal inefficiency* arises when tax and expenditure decisions differentially affect returns to capital and labour in various states, causing capital movements or migration patterns that reduce overall efficiency in the allocation of factors of production; and
- *interprovincial (or inter-state) spillovers* arise when actions taken by one state confer benefits on residents of other states, as happens for example when a state subsidizes a person's education, and that person subsequently moves to another state.

Employing these criteria, one would consider a given set of fiscal arrangements in a federation to be well designed if they closed any fiscal gap that was judged to exist, minimized fiscal inequity and fiscal inefficiency, and compensated for inter-state spillovers.

These criteria, while obviously pertinent, prejudge major issues. To employ them is to assume that federalism is merely an institutional arrangement devised by a political community to permit the adaptation of government programs to local needs and preferences, and to achieve administrative efficiency. The *national community* is implicitly assumed to be the primary focus of political loyalties. This is very different from regarding federalism as an arrangement selected by a *grouping of political communities* that have chosen to band together for limited and specific purposes while in other respects retaining their

8 The word "states" is used here to refer to regional governments within a federation (provinces in Canada, Laender in West Germany, cantons in Switzerland, etc.).

original identities and characteristics. The latter conception of federalism and its purposes is difficult or impossible to reconcile with the four criteria that Boadway identifies. Indeed, Boadway states that in the economics literature (including in his own essay) the unitary state is employed as a benchmark against which to judge the need for federal grants to the states.⁹ In response, I would argue that there is no necessary or compelling reason for using a unitary state as a benchmark any more than there would be for using a confederacy. Indeed, in any particular case (in Canada, say, or in the United States) both unitary and confederal regimes may be out of the question. In practical terms, the choice is between a greater or lesser degree of centralization in legislative powers, policy responsibilities, and fiscal arrangements. To employ the unitary state as a benchmark for fiscal arrangements when the unitary-state model has been deliberately rejected in allocating legislative powers and policy responsibilities is, on the face of it, illogical. To apply criteria appropriate to central-local relations in a unitary state makes sense only on the basis of political assumptions that cannot safely be made in some federations, certainly not in Canada.

What I think is needed, arguably for *evaluating* systems of intergovernmental fiscal arrangements and certainly for *explaining* their evolution over time, is a developmental perspective. By this I mean a perspective that takes account, in a federal context, of changing perceptions of community, changing concepts of citizenship and the rights and obligations that citizenship entails, and changing expectations of (or demands upon) government.

Fiscal relations in a federal state reflect, as does the actual creation of a federal regime, a set of basic political choices. Moreover, different forms of federal state (and it is evident that intergovernmental fiscal arrangements are integral features of any federal structure) seemingly correspond to distinctive phases in the historical evolution of a society or of a grouping of societies undergoing a process of political integration—or disintegration. If we range political regimes along a continuum from "loosely integrated" to "tightly integrated", the federal states occupy the segment between confederal groupings at the "loose" end, and unitary states at the "tight" end. With reference to such a schema:

- In federations situated near the "confederal" segment of the continuum, community attachments, political loyalties, and notions of citizenship are focussed either exclusively or primarily on the states, not on the centre. While the central political authority is endowed with independent revenue-raising capacity to meet the limited purposes for

9 Boadway, "Federal-Provincial Transfers," 3-4

which the federation was created (this is what conventionally distinguishes federalism from confederalism), it would probably be considered illegitimate if those powers were used for purposes other than the specific and limited ones for which the federation was established. It is unlikely, given the states-focussed nature of citizenship and community ties, that the pooling of revenues among the states would be considered. The question of fiscal transfers from the centre to the states could scarcely arise. The avoidance of fiscal inefficiencies and of inter-state spillovers might well be desired, but would probably be sought through policy harmonization rather than through fiscal transfers. The concept of fiscal inequity would be irrelevant, and if a fiscal gap existed it would be more likely to require supplementary grants from the states to the centre, than the other way round.

- Among federal regimes situated close to the "unitary state" part of the continuum, community attachments, political loyalties, and notions of citizenship are focussed either exclusively or primarily on the nation, and only secondarily, if at all, on the states. The latter exist for the same reasons as do municipalities within a unitary state: to accommodate differences in local preferences, to adapt policies to local needs and circumstances, and to achieve efficiencies in administration. Here the four criteria developed in the economics literature for evaluating fiscal arrangements in a federal state apply, and indeed would appear to be fully adequate.
- Finally, occupying the middle part of the continuum are the federal states that are neither quasi-confederal nor quasi-unitary. Here community attachments are *dual*, being focussed in part on the states, and in part on the nation. Citizenship also exists at the level of the states, and of the nation. The relative strength of states-focussed *versus* nation-focussed collective identities and political loyalties may vary according to region and may fluctuate over even relatively short periods of time. In these circumstances it is far from clear what criteria may appropriately be invoked to evaluate fiscal arrangements and indeed broader constitutional arrangements in the federation. It may be judged acceptable that a certain degree of fiscal inefficiency should persist in order to preserve the powers of the states; for the same reason, people may tolerate certain inter-state spillovers as well as some degree of fiscal inequity, and they may shrug off the problems caused by a fiscal gap. All this, because something less than a perfect union is desired.

In short, the criteria that are conventionally employed in the economics literature to evaluate fiscal arrangements in a federal state scarcely apply to quasi-confederal regimes, and they must be considered tendentious in the context of federations where community ties and concepts of citizenship are simultaneously states-focussed and nationally focussed. Because this is clearly the case in Canada, I have chosen to examine federal-provincial fiscal relations in this country in the context of continuing debates over the reshaping of the Canadian federal state. These debates reflect differing views on the extent to which regional/provincial communities are distinctive or, conversely, have been *or should be* fully merged, forming a national community. Some of the most significant federal policy initiatives in relation to federal and provincial taxing powers and the sharing of tax revenues, in the large-scale transfer of fiscal resources between orders of government, and in the area of jointly-financed social programs—all important aspects of federal fiscal arrangements in Canada—have had nation-building goals: to extend the concept of (Canadian) citizenship and solidify centrally-focussed political loyalties, to strengthen the Canadian economic union, and to enhance the policy capacity of the central government, for example its capacity to implement Keynesian stabilization policies. Other federal initiatives have reflected concessions to the provinces' demands for enhanced autonomy. While critics have viewed the "pretensions" of the provincial governments as mere self-aggrandizement, the governments themselves (and the considerable body of public opinion they have frequently been able to mobilize) have insisted that an augmented policy role, for which additional fiscal resources are needed, is justified by conditions which are unique to each province, by the distinctive character of each provincial community, and by the desirability of preserving and further developing the provinces as communities.

III — CITIZENSHIP AND COMMUNITY

Our argument now requires us to look more closely at the concepts of citizenship and community. They are closely interlinked. T.H. Marshall writes:

Citizenship is a status bestowed on those who are full members of a community. All who possess the status are equal with respect to the rights and duties with which the status is endowed. There is no universal principle that determines what those rights and duties shall be, but societies in which citizenship is a developing institution create an image of an ideal citizenship against which achievement can be measured and towards which aspiration can be directed. The urge forward along the path thus plotted is an urge towards a fuller measure of equality, an enrichment of the stuff of which the status is made [a mixture of civil rights or essential freedoms, political or participatory rights, and social rights which include but are

not limited to "a modicum of economic welfare and security"], and an increase in the number of those on whom the status is bestowed.¹⁰

Marshall briefly describes the emergence of notions of citizenship in England, and outlines the parallel development of a national political community, which occurred as feudal structures were replaced by the more centralized apparatus of the nation-state. The aspect of citizenship that developed first was the civil dimension, beginning as early as the twelfth century with the development of the common law and the broadening of the jurisdiction of the King's courts, but having to do especially with rights established during the seventeenth and eighteenth centuries: extension of protections for accused persons, religious toleration, and freedom of the press. The political dimension of citizenship followed, with the reform bills of the nineteenth century and further extensions to the franchise in the first quarter of the twentieth. Finally, the development of the social dimension, visible especially in the emergence of the welfare state, was a phenomenon of the second and third quarters of the twentieth century. Although economic or class inequalities remain, status differences, according to Marshall, have become dissolved in common notions of citizenship, or full membership in the national community.

The process through which the concept of citizenship developed has been a long one, with the three major phases overlapping considerably. However, time lags, especially as regards the social dimension, are only part of the story, and perhaps not the most interesting part. Marshall points out that for a time, mainly in the nineteenth century, political and economic rights were not considered complementary; on the contrary, they were treated as mutually exclusive:

The minimal social rights that remained [after the amendment of the Poor Law in 1834] were detached from the status of citizenship. The Poor Law treated the claims of the poor, not as an integral part of the rights of the citizen, but as an alternative to them—as claims which could be met only if the claimants ceased to be citizens in any true sense of the word. For paupers forfeited in practice the civil right of personal liberty, by internment in the workhouse, and they forfeited by law any political rights they might possess. This disability of disfranchisement remained in being until 1918.¹¹

The pertinence of this excursus into English history is that it not only highlights three distinct elements in the concept of citizenship, but that it stimulates us to think about the processes involved in building a national community. The word

10 Thomas H. Marshall: "Citizenship and Social Class," in his *Class, Citizenship, and Social Development*, (Westport, Conn.: Greenwood Press, 1973 [1949]), 84, and 71-2

11 *Ibid.*, 80

"community" connotes a situation where the members of a group feel some affinity toward each other, probably because they perceive themselves as sharing a common status (hence the notion of citizenship, when the community is self-governing), a common heritage whether actual or fictitious, and a common set of values, or a distinctive culture. Shared status, shared heritage, and shared culture help create a subjective sense of collective identity; they demarcate the collectivity in question from neighbouring ones, or from other collectivities sharing the same territory but distinctive in terms of characteristics such as ethnicity or religion. The process of building a national community involves some degree of cultural homogenization within the borders of the state; nation-building is indissolubly linked, as Walker Connor has insisted, with nation-destroying, as distinct cultural groups are absorbed into the larger community, generally defined by a dominant language and a distinct territory.¹² (One is reminded in this context of Engels' aphorism, that a language is a dialect with an army behind it.) An essential feature of the process is its subjective character, as members of formerly distinct status-groups, ethnic nations, and local communities develop a sense of affinity with each other. The process may be fostered, perhaps deliberately, through the conferral of common citizenship rights.

This description fits settled territories that have experienced feudalism and dynastic rule; one may query its relevance in the case of frontier societies, which Canada, like the United States, has been. However, both these countries—Australia is another unequivocal example—are federal unions that are appropriately regarded as being, at least in their origins, experiments in limited political integration. Both federations were initially composed of former colonies the identity of which it was intended to preserve in some degree, rather than merging them into a single national community. On the other hand, both were also nation-building enterprises; it was accurately foreseen and intended that their respective populations, swelled by rapid immigration, would expand into a hinterland sparsely populated by aboriginal peoples; internal migration and the recruitment of foreign immigrants would incorporate the hinterland into the new nation. Federalism was an institutional device to facilitate this process, but also (for at least some of the Fathers) a device to allow for the continued existence of communities corresponding to the existing colonies or ex-colonies. As a result, some of the provinces/states are, in their origins, parties to a federal bargain, while others are creatures of a central government which devolved

12 Walker Connor: "Nation-Building or Nation-Destroying?" *World Politics*, 24 (April 1972), 319-55

upon territories within their possession a status roughly equal to that of the original constituent units.

Thus it has happened that in both Canada and the US, the structuring of the federal regime has been a process involving, whether consecutively, in pendulum-like swings, or even simultaneously, both the extension of the central government's policy-making capacity, and a certain degree of devolution of powers and policy responsibilities to the states/provinces. The major steps in this dual process have been amply recorded by constitutional historians. Paralleling changes in the constitutional structure—partly helping to bringing them about, and partly growing out of them—there appear also to have been changes in the relative importance of state and nation (or province and nation) as objects of political loyalty and as definers of citizenship rights and obligations. In the United States, the civil war (which some have described as "the real American revolution") marked a turning point after which national citizenship came to take precedence over states' citizenship, especially in the civil and political dimensions. By comparison, it appears that in Canada the civil and political dimensions of citizenship, as well as community ties, have been relatively weak at the national level. The need to extend and strengthen the social dimension of citizenship has been correspondingly great.

Citizenship goals were given Constitutional formulation in 1982, in the *Canadian Charter of Rights and Freedoms*. The Charter entrenches a set of fundamental freedoms and various categories of individual rights: mobility rights (guaranteeing to all permanent residents the right to move to any province and to gain a livelihood there), legal rights, equality (non-discrimination) rights, and language rights—all of which give content to and offer constitutional protection for the civil dimension of Canadian citizenship. The political dimension of citizenship receives attention too, through the declaration of democratic rights. And section 36 of the Charter, entitled "Equalization and Regional Disparities," covers the social dimension. It commits parliament and the provincial legislatures, as well as the federal and provincial governments, to:

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

In all of these matters, intergovernmental fiscal arrangements are an essential instrument, as indeed the next part of section 36 affirms, by constitutionalizing the principle of fiscal equalization.

The nation-building features of the *Constitution Act, 1982*, have been widely remarked upon. Less widely noted has been the fact that in giving constitu-

tional status to the principle of equalization the Act acknowledged the important role of the provincial governments in supplying public services of comparable standard but not of uniform design across the country. In addition, the commitment to reducing regional disparities underlines the importance given to the preservation of local and regional communities, as well as to individual rights. Both national citizenship and sub-national communities, whose welfare it is the joint responsibility of the federal government and the provinces to ensure, are supported by the constitutional reforms of 1982. Canadian fiscal federalism must be adapted to this combination of national and regional/provincial goals.

IV — MAJOR ISSUES: THE ROWELL-SIROIS REPORT

The equalization provisions of the *Constitution Act, 1982* give final, formal recognition to a principle enunciated almost fifty years ago in the report of the "Rowell-Sirois" Commission, the Royal Commission on Dominion-Provincial Relations (1940). One obtains a sense of the political and budgetary constraints on the design of the fiscal arrangements today by observing the slow progress made over four decades toward implementing the principle of equalization, and by noting as well some recent and rather significant steps backward from this principle; indeed, as will be shown below, the process of retreat had already begun even before the concept itself had been enshrined in the constitution. But this is getting ahead of our story! The fiscal arrangements are a complex package; equalization is only one feature among several that affect the extension of national citizenship rights and, in tension with these, the development of provincial communities. To get a view of the whole, it is useful to look at the package of reforms put forward by the Rowell-Sirois Commission. The report is a useful reference point because of the comprehensiveness and the internal coherence of its recommendations; but, more than that, a student of Canadian fiscal federalism needs to know how a succession of federal governments have grappled with the issues brought together in the report. This is the best way of understanding not only the principles involved in the design of the fiscal arrangements, but their budgetary and broader political implications as well.

Looking back on the Rowell-Sirois Report today, one is struck by the commissioners' rigorous if perhaps somewhat disingenuous affirmation of the principle of provincial autonomy, and by its equally rigorous—and obviously genuine—insistence on eliminating fiscal inequity among regions and provinces. In effect, *the commission strove to strengthen or extend national citizenship rights and obligations while also offering fiscal support for the continued vitality of regionally (provincially) distinctive communities. Its program was both nation-building and province-strengthening.* Nonetheless, the commis-

sioners probably expected that, as far as the design and standards of public services are concerned, differences among the provinces would probably diminish over time. They explicitly suggested that if every province were able to offer a package of public services at the national-average standard, without imposing higher-than-average taxes (for this is what it proposed to accomplish through a system of centrally-financed "National Adjustment Grants"), electoral pressures would probably force even the most reluctant among them to provide the same quality of public services as were available elsewhere in the country. In this sense the commission's recommendations prefigured the political calculus—actually, a serious miscalculation—that underlay the introduction of the EPF scheme in 1977, as will later be described.

A fundamental principle set down by the commission was to separate clearly federal from provincial policy responsibilities. Basically, said the commission, the federal government should have the powers necessary to promote national economic development, leaving the provinces in control of all matters having an impact on community values; they should also continue to be responsible for such obviously local matters as road construction and public works, except for the building of interprovincial transportation links. The only policy area that the commission proposed be transferred by constitutional amendment to the federal government was responsibility for "the employable unemployed", i.e., for unemployment insurance and relief. Program costs in this area tend, in an industrial economy, to vary sharply both across regions and over time; thus it would make sense to spread the risks inherent in the operation of the labour market as broadly as possible. An implication of this principle is that the federal government, rather than the provinces, should bear policy responsibility. The commission proposed that in other respects the provinces should retain their existing functions, and that their financial capacities be strengthened in order to meet the heavy demands placed upon them. The *Report* stated:

The Commission appreciates the existence of many non-economic and non-fiscal factors [pertinent to fiscal federalism] and its recommendations are not those which might have been made for a more homogeneous country. No allocation of jurisdiction, over education and social services for example, would be satisfactory which did not take full account of the strong existing loyalties to provincial traditions and institutions. The Commission's Plan seeks to ensure to every province *a real and not an illusory autonomy* by guaranteeing to it, free from conditions or control, the revenues necessary to perform those functions which relate closely to its social and cultural development.¹³

13 Canada, Royal Commission on Dominion-Provincial Relations: *Report* (Ottawa: Queen's Printer, 1954 [1940]), Book II, 80. Italics added.

To enable the provinces to meet their obligations, the commission proposed two measures. The first of these, which was in response to the heavy indebtedness that some of the provinces had incurred (partly to finance relief measures during the depression) was to have the Dominion assume all existing provincial debts, thus enabling all provinces to make a fresh start. The second measure was a permanent system of National Adjustment Grants, based on the principle of fiscal need. In effect, but without saying so, the commission proposed that Canada adopt the centrepiece of fiscal federalism in Australia, adopted 1933. An independent Finance Commission, analogous to Australia's Commonwealth Grants Commission, was to administer the grants. A separate calculation would be made for each province, as follows:

- First the Finance Commission would estimate the cost of providing all public services at the Canadian-average level. It would take account of factors such as the higher cost of building roads in a mountainous province like British Columbia than in a prairie province like Saskatchewan; presumably it would also take into account (for example) age profiles, which would be pertinent to estimating per capita education costs.
- Second, the Finance Commission would estimate the revenues that the province would obtain from a tax system in which rates were set at the national average, assuming a standard definition of the base for each of the taxes levied by the provinces.
- A National Adjustment Grant would be payable to any province in which the costs of services at national average standards exceeded revenues from taxes imposed at average rates (both figures being hypothetical, estimated as described above); and the size of the grant would equal the difference between the two. Six provinces would receive grants; the other three¹⁴ (Ontario, Alberta, and British Columbia) would not.

Apart from the National Adjustment Grants, there would be no transfers from the Dominion to the provinces, apart from emergency grants payable in exceptional (and presumably temporary) circumstances. This recommendation reflected a second fundamental principle put forward in the report: that except for this one form of regular grant to eligible provinces, a grant that was to be both unconditional and formula-based (and thus non-discretionary), each order of government should finance its own activities. The commission deplored the tendency toward the cost-sharing of provincial public services. It rejected the

14 Newfoundland joined the federation in 1949.

concept of conditional grants because such grants necessarily infringe upon provincial autonomy and because they derogate from the principle that each government should bear full responsibility, both politically and financially, for its actions or programs.

The financial burden assumed by the Dominion in taking over provincial debts, responsibility for relief of unemployed "employables," and in promising to pay National Adjustment Grants would be met, according to the Rowell-Sirois recommendations, by transferring taxing powers from the provinces to the Dominion. It proposed that the provinces give up, by constitutional amendment, the power to levy the three forms of tax most subject to cyclical swings and/or to regional variation: the personal and corporate income tax, and succession duties. (Again, one sees the role of the federal government as risk-spreader.) In return, the provinces would receive, as noted, relief from their deadweight debt burden as well as from their past responsibilities toward the unemployed, and most would receive the promise of a National Adjustment Grant, calculated by an independent authority. In addition, the Dominion was to promise to respect the tax sources remaining to the provinces (i.e., to permanently vacate them). Thus it proposed not only the clearest possible separation of federal and provincial policy responsibilities, but a parallel separation of revenue sources. That, indeed, was the third basic Rowell-Sirois principle: that tax fields should be allocated exclusively to the federal government, or to the provinces and municipalities, in accordance with their spending responsibilities. This would have the virtue of eliminating the "tax jungle" of the 1930s, in which three orders of government all dipped into the same pool, none allowing deductions for the others' taxes.

The three Rowell-Sirois principles—clear separation of federal and provincial policy responsibilities, a corresponding allocation of taxing powers, and the payment of a single unconditional grant to the poorer provinces on the basis of fiscal need—were intended to re-establish what has since been called a "classical" form of federalism.¹⁵ The commission's proposals aimed to permit both "the Dominion government" and the provinces to act independently of each other, each order of government within its respective fields of jurisdiction. In short, the fiscal arrangements would parallel and complement the constitutional distribution of powers as laid down at Confederation. The provinces would be strengthened in the performance of the bulk of their traditional responsibilities, and the central government would be better equipped to perform the

15 James Alexander Corry: "Constitutional Trends and Federalism" in *Evolving Canadian Federalism*, edited by A.R.M. Lower, *et al.* (Durham, N.C.: Duke University Press, 1958), 95-125.

functions of a national state, which in an industrial age included a role in economic management not envisioned until the crisis of the 1930s. Thus, on the revenue side, the commission proposed not merely the separation of taxing powers, but centralization of the tax system. This was attractive (especially to some of the younger commission staff, who had become persuaded of the virtues of the Keynesian doctrine) because it would transfer to Ottawa precisely those taxes that would be needed to implement a set of policies for economic stabilization. To equip the Dominion with the tools necessary for Keynesian policies was fully consistent with the commissioners' intent to centralize control over the economy, expanding the policy capacities of the federal government.

The weakest point in the commission's recommendations was that all provinces had to agree to give up, for all time, the power to levy personal and corporate income taxes, and also succession duties. The commission presented the case for their doing so; its calculations showed that, on balance, every province would improve its financial situation if its entire package of recommendations were accepted. However, the prospective loss of future revenue-raising capacity was too much for the wealthier provinces to stomach. The three provinces that were judged ineligible to receive a National Adjustment Grant—Ontario, Alberta, and British Columbia—rejected the recommendations out of hand. Interim arrangements not drastically different from what the commission proposed were accepted as an exceptional wartime measure; but as a blueprint for the permanent redesign of Canadian fiscal federalism, the commission's package of proposals was never put forward again.

It is unclear how prescient the three dissenting provinces were being when they rejected the Rowell-Sirois recommendations. No doubt they perceived that with full central control over major taxes, their future ability to tap potential revenue sources would be much restricted. It would seem reasonable to suppose that they took note of the fact that the commission's estimate of net benefits from acceptance of its reform package was based on years of lean revenues and high expenditures. Any improvement in the economic climate would automatically alleviate their financial woes; and in these circumstances they would almost certainly regret having given away their future revenue-raising capacity. Perhaps the surprising thing is that six provinces, including Quebec, appeared ready at least to discuss implementing the commission's plan. Certainly such an occurrence would be unthinkable today.

This leaves us with a puzzle. The recommendations were unacceptable at the time, and would be even less so now; but did the report not demonstrate that in view of the considerable interprovincial fiscal disparities prevailing in Canada, and in view of the functions the electorate henceforth would expect government to perform, far-reaching centralization of the tax system was the only rational

choice to make? Is there any other way of making it possible to extend the social entitlements inherent in the concept of national, Canada-wide citizenship, and to equip the country with a governmental structure capable of performing the functions demanded of the modern state? And most basically: if citizenship is national, can community be in any significant sense provincial?

These questions require us to examine thematically, each in turn, the subjects of the commission's major recommendations. The next three sections of the paper do this. We look first at the allocation of spending responsibilities and taxing powers, and the issue of revenue sharing (Section V); then at equalization (Section VI); and finally at the twin issues of cost-sharing and national standards in public services (Section VII). The paper concludes with some speculations on future developments in Canadian fiscal federalism.

V — TAXING POWERS, REVENUE SHARING, AND PROGRAM RESPONSIBILITIES

The history of public expenditure and taxation during the postwar period in Canada was marked by five developments or trends.

1. The federal government at first attempted to gain control over personal and corporate income taxes, while sharing the revenue with the provinces. It abandoned this objective in successive stages beginning in 1957.
2. The Rowell-Sirois proposal for exclusive occupancy of the various tax fields (some fields would be federal, others provincial) was rejected by both orders of government. This generalization applies not only to personal and corporate income taxes, but to consumption taxes and to the raising of revenue from oil and gas production.
3. The size of the public sector grew enormously. On the revenue side, government took in 25% of GNP in 1950 (as compared with 21% in 1939); since 1980, government revenues have absorbed about 41% of GNP. On the expenditure side, growth has been even more dramatic. The volume of public spending as a percentage of GNP more than doubled between 1950 and 1982, by which year it surpassed even its wartime peak of 45 per cent. Expenditure was about 22% of GNP in 1950; it is now about 48%.
4. The relative importance of the federal government within the public sector as a whole at first declined, then stabilized or rose. On the revenue side, Ottawa took in about two-thirds of the total until the mid-1950s; its share then diminished steadily until 1978, after which it stabilized in the 43% to 45% range. On the expenditure side, 1971 was a turning-point. The federal share of the total was 52% in 1950, 50% in

1960, and 37% in 1971; but by 1985, it had bounced back to 42%. (Expenditure figures exclude grants to other governments.)

5. In the field of income support, the federal share of all government expenditure increased sharply, notwithstanding most provinces' claim to having primary or even exclusive jurisdiction over social policy.

Reflecting on these trends, one can see that the Rowell-Sirois recommendations on taxing powers and program responsibilities were not only politically unacceptable, they were intrinsically unworkable. The commission attempted to combine elements that simply cannot be made to fit together. The lessons of that experience are clearly relevant to future modifications in the fiscal arrangements in three areas: the control of the personal and corporate income taxes, the sharing of revenues in fields of joint taxation, and the allocation of program responsibilities, especially in the field of income support or social security.

Control of the personal and corporate income taxes. When three premiers rejected the Rowell-Sirois recommendations as a basis for discussion (1941), the federal government announced that for the duration of the war it would be raising both personal and corporate income taxes to a level that would, in effect, prevent the provinces from imposing their own taxes in these fields; and all provinces acquiesced. After the war Ottawa tried to retain exclusive control of these fields, accomplishing by a series of five-year bilateral agreements what the commission had proposed be done permanently by constitutional amendment. The federal government proposed to "rent" from each agreeing province exclusive access to both personal and corporate income taxes, offering in return to pay into the provincial treasury a fixed sum per capita, equal to a little more than five per cent of the revenue generated by those taxes. There was some equalizing effect from this transfer, as every agreeing province would obtain the same per capita grant. At least equally significant was the fact that through this "tax rental" arrangement, Ottawa aimed to ensure that a single tax base¹⁶ and a single schedule of rates applied uniformly across the country. This would eliminate the fiscal inefficiencies arising from different rates of tax in different parts of the country; and it would equip Ottawa to pursue a Keynesian stabilization policy, an intent announced in 1945.

The first of the tax rental agreements went into effect in 1947, for a five year period, and a second series was negotiated for 1952-57. However, Ontario and Quebec refused to sign in 1947; in 1952 Quebec remained out, while Ontario

16 The "tax base" defines what is to be taxed: in the case of the income tax, exemptions and deductions from "income"—for which, curiously, no general definition is provided.

entered the scheme only as regarded the personal income tax. When Quebec imposed its own personal income tax in 1954, there no longer seemed any point in perpetuating the arrangement, and no new agreements were proposed for the post-1957 period. Nonetheless, the tax rental experiment has had at least one enduring legacy, namely, substantial harmonization of the personal and corporate income tax bases. Even after 1957, Ottawa continued to collect the personal income tax for all provinces except Quebec, under a set of Tax Sharing (later "Tax Collection") Agreements. Under the agreements, provincial taxes are levied on each person's world income according to province of principal residence, an arrangement which has the virtue of ensuring that the same income does not get taxed by two provinces. Quebec accepts the conventions regarding attribution of income under the tax collection agreements, so in this respect it makes no difference that Quebec has its own income tax. The attribution-of-income rule does, however, incur some inequity, if one assumes that people in wealthy provinces are more likely to receive income from business enterprises or investments in the poorer provinces, than vice-versa.

Attribution-of-income rules also apply in the case of the corporate income tax, although separate provincial systems exist in three of the largest provinces: Ontario, Quebec, and Alberta. By imposing their own corporate income taxes, these provinces are able to use corporate taxation as a tool of economic development. Nonetheless, they all accept the rules the federal government has established, under tax collection agreements with the other seven provinces, for splitting a corporation's income among the provinces. Their restraint may be attributable to the bad memories of the tax jungle of the 1930s, which none of them want to see grow up again.

For the federal government, the collection agreements covering the personal income tax present something of a dilemma. Initially they had the same purposes as the tax rentals scheme: to obtain or maintain, as nearly as possible, control over the income tax. One objective has been to define a common base for the income tax across the country. It is an objective that has been compromised in several respects, as Ottawa has accepted provincial requests to add various wrinkles to the tax system. Examples are tax credit programs (e.g. for low-income families with dependent children), surcharges on provincial tax payable by high-income taxpayers (which affect the progressivity of the system), and exemptions for intra-province investments or provincial stock-savings plans, which are deliberately designed to promote local entrepreneurship and prevent outflows of capital from the province. The dilemma for Ottawa is that to accept requests diminishing the degree of economic integration among the provinces defeats a major purpose of the agreements, but to refuse such requests may give the provinces an incentive to levy and collect their own income taxes. It remains an option for Ottawa to attempt to use the

collection agreements to achieve fuller harmonization of the tax system, but too aggressive a policy would risk wrecking the scheme altogether.

The other aspect of Ottawa's attempt to control the income tax was to set a common rate structure in all (or at least most) provinces. This was one of the purposes of the tax rental agreements, and it persisted in some measure until 1967.¹⁷ Through this period the presumption was that the provinces would receive a proportion of the proceeds appropriate to their spending responsibilities; and over the years, in keeping with this presumption, their share rose from 5% to 20%. By 1966, however, the federal minister of finance tired of an arrangement whereby the provincial treasurers successfully claimed an ever-larger share of a fixed pie, or else forced Ottawa to raise its rates:

The major element of federal-provincial fiscal relations, by far the most important one in the post-war period [federal Finance Minister Mitchell Sharp stated] is the division and use of tax fields by the federal and provincial governments. What this has come to mean to most of us is periodic federal-provincial disputes over what share of personal income tax should be federal and what share provincial.... The proposition that the Federal Government should reduce its taxes to ease increases in provincial levies must, in circumstances such as those I have described, be based on the assumption that Parliament is appropriating money for purposes less important than those being served by provincial expenditures.... We cannot accept as a general principle that federal expenditures are less important than provincial ones. The principle that *does* call for recognition is a different one: namely that

17 Beginning in 1962, the provinces were permitted, under the tax sharing agreements, to set their own rates of tax, expressed in relation to federal taxes. However, the federal government still established a norm for provincial rates of tax by assessing an overall federal tax and then allowing a fixed percentage "abatement" for residents of a province (in other words, abatements would not apply to those living in the Northwest and Yukon Territories, or to non-residents of Canada); the amount of the abatement was then available to the provinces as tax revenue, collected by Ottawa. A province had the option of asking the Department of National Revenue to collect this sum *plus* a supplementary percentage: the idea was to publicize when a province was exceeding the national taxation norm, bearing the odium for imposing "double taxation." Only two provinces did, in fact, tax above the norm. This situation changed in 1967, when the concept of abatements was dropped, except to provide fiscal compensation to Quebec for opting out of certain shared-cost programs, and the provinces were simply invited to levy taxes at any desired percentage of "federal basic tax." See A. Milton Moore, J. Harvey Perry, and Donald I. Beach: *The Financing of Canadian Federation: The First Hundred Years* (Toronto: Canadian Tax Foundation, 1966); also R.M. Burns: *The Acceptable Mean: The Tax-Rental Agreements, 1941-1962* (Toronto: Canadian Tax Foundation, 1980).

both Parliament and provincial legislatures must accept their financial responsibilities and that each should look to its own electors for direction as to what money should be raised and how it should be spent.¹⁸

Invoking these principles, the minister announced that henceforth federal tax laws would no longer make any reference to "standard rates" of personal income tax; the two orders of government would establish their tax rates completely independently of each other. However, Ottawa would continue to collect provincial income taxes free of charge, so long as the rates were expressed as a percentage of the "basic federal tax."

With this action, the federal government abandoned its efforts of 25 years to control the personal income tax field. Its decision was partly a recognition of the rising political power and legitimacy of the provinces; unable to refuse provincial claims to additional revenues, and seeing no end to such claims, Ottawa called the game to a halt, in effect telling the provinces, "You do it, and you answer to your own electorates for raising tax rates." One suspects that in part, too, the federal action reflected its diminished confidence in Keynesian stabilization policies, for by the early 1960s attention had partly turned away from demand management and toward structural policies to reduce unemployment without giving inflationary forces free rein. That being the case, it must have seemed less important to exercise full control over the income tax. Today, however, as confidence in the efficacy of structural policy wanes, and as government's ability to implement structural policies in a context of continental economic integration diminishes, demand management tools may become more important again. Thus a major question arises, whether there is adequate federal-provincial concertation in the tax field, and whether or not the tax collection agreements are a sufficiently powerful tool to achieve the needed degree of federal policy leadership, if not control.

Revenue sharing and expenditure trends. Provincial revenues and expenditures (see Tables 1 and 2) continued to rise unaffected by the 1967 federal decision

18 *Federal-Provincial Tax Structure Committee [Proceedings], September 14th and 15th, 1966* (Ottawa: Queen's Printer, 1966), 23-25. Emphasis in original.

Table 1
Government Revenue as a Percentage of GNP, 1926-85 (Selected Years)

Year	Federal	Provincial Including Grants	Revenues Excluding Grants			Total
			Provincial	Local ^a	Pensions ^b	
1926	7.6	3.4	3.0	6.3	-	16.8
1929	6.8	3.8	3.4	6.1	-	16.3
1933	7.6	7.0	5.1	9.7	-	22.2
1939	8.6	7.1	5.5	6.6	-	20.7
1943	22.3	4.7	3.3	3.6	-	29.3
1946	22.1	6.1	4.6	3.7	-	30.4
1950	16.3	6.6	5.2	3.5	-	25.1
1955	17.6	6.5	4.8	3.8	-	26.1
1960	17.0	8.7	6.1	4.8	-	27.9
1964	16.6	10.8	8.3	4.9	-	29.8
1965	16.4	11.4	8.9	4.9	-	30.3
1966	16.1	11.9	9.4	4.9	1.2	31.6
1967	16.4	13.2	10.2	5.1	1.4	33.1
1968	16.8	14.2	11.0	5.1	1.4	34.4
1969	18.2	15.0	11.6	5.2	1.5	36.5
1970	18.1	16.2	12.3	5.3	1.5	37.3
1971	18.3	17.0	12.4	5.1	1.6	37.4
1972	18.6	16.8	12.6	5.1	1.6	37.8
1973	18.5	16.7	12.9	4.6	1.5	37.5
1974	20.3	17.7	13.6	4.3	1.6	39.8
1975	19.2	18.0	13.5	4.5	1.7	38.9
1976	18.4	17.9	13.5	4.8	1.7	38.3
1977	17.4	19.4	14.8	4.8	1.7	38.7
1978	16.5	19.9	15.4	4.8	1.8	38.5
1979	16.5	19.8	15.4	4.8	1.8	38.5
1980	17.0	19.8	15.5	4.6	1.9	39.1
1981	18.9	19.9	15.8	4.5	1.9	41.1
1982	18.2	21.0	16.7	4.7	2.2	41.8
1983	17.7	21.3	16.9	4.6	2.1	41.2
1984	17.9	21.5	17.0	4.5	2.1	41.4
1985	18.1	21.4	16.7	4.4	2.1	41.4

Notes:

^aIncludes hospitals (never more than .2 per cent of GNP)

^bCanada Pension Plan and Quebec Pension Plan (contributory pensions). There are also old age pensions paid for out of general revenues.

Source: Canadian Tax Foundation: *The National Finances, 1986-87*.

Table 2
Government Expenditure as a Percentage of GNP, 1926-85 (Selected Years)

Year	Federal expenditures including Grants	Expenditures Excluding Intergovernmental Grants					Total
		Federal	Provincial	Local	Hospitals	Pensions ^a	
1926	6.2	5.9	3.2	6.6	-	-	15.7
1929	5.9	5.6	3.8	6.7	-	-	16.1
1933	10.9	9.3	8.2	9.9	-	-	27.4
1939	8.6	7.2	7.8	6.5	-	-	21.4
1943	39.9	38.6	3.5	3.4	-	-	45.4
1946	24.2	22.7	4.6	4.2	-	-	31.6
1950	12.8	11.5	5.7	4.9	-	-	22.1
1955	16.8	15.3	5.2	5.8	-	-	26.3
1960	17.6	15.0	7.3	7.3	-	-	29.7
1964	15.9	13.4	6.5	7.7	2.1	-	29.6
1965	15.4	12.9	6.8	8.1	2.1	-	29.9
1966	15.8	13.1	7.3	8.2	2.2	-	30.9
1967	16.5	13.5	8.3	8.6	2.4	-	32.9
1968	16.8	13.6	6.7	8.8	2.6	0.1	33.7
1969	16.9	13.5	9.0	8.9	2.6	0.1	34.1
1970	17.8	13.8	10.2	9.4	2.8	0.2	36.4
1971	18.4	13.8	11.1	9.3	2.8	0.2	37.3
1972	19.1	14.8	11.0	8.9	2.8	0.3	37.8
1973	18.1	14.3	10.7	8.6	2.7	0.3	36.5
1974	19.6	15.4	11.1	8.3	2.8	0.4	37.9
1975	21.5	16.8	12.2	8.8	3.0	0.5	41.3
1976	20.2	15.7	12.0	8.7	2.9	0.6	40.0
1977	20.8	16.1	12.5	8.9	2.9	0.8	41.7
1978	21.1	16.4	12.8	8.8	2.9	0.8	41.7
1979	19.9	15.5	12.9	8.3	2.7	0.8	40.2
1980	20.5	16.2	13.5	8.3	2.8	0.9	41.8
1981	21.0	16.9	13.7	8.2	2.9	1.0	42.6
1982	23.9	19.5	15.2	8.7	3.2	1.1	47.7
1983	24.0	19.6	15.6	8.4	3.2	1.2	47.9
1984	25.0	20.3	15.4	8.2	3.0	1.3	48.2
1985	25.1	20.4	15.4	8.0	3.0	1.5	48.2

Notes:

^aCanada Pension Plan and Quebec Pension Plan (contributory pensions). There are also old age pensions paid for out of general revenues.

Source: Canadian Tax Foundation: *The National Finances, 1986-87*.

that thrust upon them full responsibility for all tax increases. In 1950 provincial own-source revenues (i.e., revenues excluding federal grants) amounted to 5.2% of GNP; in 1967, 10.2%; in 1983, having followed a steady trend line, 16.8%. On the expenditure side the figures (including grants to municipalities, school boards, and hospitals) are a little higher but the trend is the same: from 6.7% of GNP in 1950, to 13.7% in 1967, and to 21.9% in 1983. The fact that expenditures have exceeded own-source revenues by something like 2 to 4.5 % of GNP, with the wider discrepancies occurring in the later years, is due in small part to budget deficits, but mainly to federal grants,¹⁹ as outlined in the next two sections of this paper.

These trends demonstrate the complete unworkability of the Rowell-Sirois recommendation for the allocation of tax fields in exclusivity to the federal and provincial governments respectively. No allocation of tax fields could be satisfactory over the longer term if, as has occurred over the past 40 or 50 years, there is disproportionate growth in the scale of the public sector at one level relative to the other. Under these conditions, no assignment of taxing powers can ensure that the two orders of government remain fiscally independent of each other in the longer run. Changes in the relative weights of their spending responsibilities will require large-scale transfers. This is the general conclusion to draw from Canadian historical experience, which demonstrates that, had the provinces accepted the Rowell-Sirois proposals in 1941, all would have become pensioners of the central government (as some, much more than others, have become anyway). Thus, inescapably, the sharing of revenues from joint tax fields has become and must remain a feature of Canadian fiscal federalism.

This is perhaps a somewhat banal conclusion, but it has further implications as well, that point to a future strategic choice regarding the design of the fiscal arrangements. One course of action is to adapt the fiscal regime—revenue shares and intergovernmental grants—to a desired distribution or allocation of policy responsibilities. (The desired choice may be the traditional one, which to some extent may be inferred from constitutional texts.) This is, indeed, so obvious a choice that one may wonder whether any other is worth considering. However, it raises at least two major difficulties that deserve notice. One is that,

19 On the other hand, federal grants to municipalities, hospitals, and school boards are negligible. Municipal affairs is a subject-matter wholly within provincial jurisdiction, and the intergovernmental grants these bodies receive come, with few exceptions, from the provinces. The provinces are jealous of their powers over local authorities and they generally insist that Ottawa avoid interfering. This may help explain why local expenditures have remained stable over the past 20 years (between 10.2 and 12.2 per cent of GNP, with a slight decline since 1970) while provincial expenditures have risen steadily.

as the provincial public sector grows, so must interregional transfers through the agency of the federal government, if progressive widening of interprovincial disparities in the quality of public services (or interprovincial differences in levels of taxation, or both) is to be avoided. If the provinces' fiscal capacities vary considerably, as they do in Canada, this problem will be an acute one. Further, (and this is the second difficulty), the more Ottawa has transferred revenue shares to the provinces the less able it may be to engage in interregional redistribution because its own fiscal resources will be inadequate. The need will be greater, the capacity, reduced. This poses also a problem of legitimacy: interregional redistribution may be acceptable when the proportion of public monies committed to it is relatively modest, but it will not be tolerated if this function absorbs a high proportion of total federal revenues. These considerations have operated to limit the adaptation of the fiscal regime to traditional patterns of governmental responsibilities over the postwar period, when the scale of those responsibilities has increased to an unprecedented and unforeseen degree.

Spending responsibilities. Provincial-plus-local expenditure would have been forced to a much higher level than it actually was, accentuating the problems just referred to, if Ottawa did not, by now, pay out three of every four dollars spent by Canadian governments on income security programs. Whereas responsibility for income security was primarily provincial and local during the 1930s, contributing in no small measure to the fiscal and other problems that were responsible for the creation of the Rowell-Sirois Commission, the situation changed rapidly after the war. Keith Banting notes:

The constitutional rules and understandings that underpin the Canadian income security system have changed dramatically from the days of provincial exclusivity. Authority over social insurance is divided, and authority over other income security programs is largely concurrent, with no clear provision for paramountcy. These changes have allowed a steady centralization of income security expenditures since the 1940s.²⁰

Broadly speaking, Ottawa bears primary or exclusive responsibility for the most expensive parts of the income security system (including unemployment insurance, old age security and guaranteed income supplement, family allowances, and refundable child tax credits), while the provinces design and administer those programs that involve the most administrative discretion, especially social assistance (welfare). This last program (discussed Section VII) is jointly

20 Keith G. Banting: *The Welfare State and Canadian Federalism*, Second Edition (Kingston and Montreal: McGill-Queen's Press, 1987), 54.

funded. The overall effect of this division of responsibility is that the provinces retain control over the most sensitive aspects of social security, but have to bear only a relatively small proportion of the total cost. To some extent, though obviously imperfectly, this reconciles the objectives of augmenting or preserving provincial autonomy while keeping the attendant fiscal problems within manageable bounds. Inevitably, it is a matter of debate whether the balance has been appropriately struck.

Notwithstanding the centralization of the income security system, the overall trend (as the data clearly demonstrate) has been one in which increasingly heavy responsibilities have been shouldered by the provincial governments. This trend has necessitated increases in the percentage of tax receipts that flow to the provinces, and a vast expansion of federal grants. Theoretically, the provinces could have taken over a still larger percentage of the revenues from shared tax fields. This would have reduced the volume of federal transfers necessary to prevent the emergence of a yawning fiscal gap; specific-purpose transfers (discussed in Section VII) could have been low or non-existent. However, the result of such a pattern of intergovernmental finance would have been either a huge and growing discrepancy between the richer and poorer provinces, as regards standards of public services, or further growth in the system of unconditional grants (discussed in Section VI). The route not taken—more tax transfers plus more unconditional grants—would have augmented provincial autonomy, thus contributing to the maintenance or development of provincial communities; but such a policy would have entailed perhaps unmanageable difficulties. In the first place, it would have eroded federal legitimacy and power; and in the second, it would have placed an intolerable burden on the system of (unconditional) equalization payments. That is our next subject.

VI — EQUALIZATION AND INTERPROVINCIAL REDISTRIBUTION

The principle put forward by the Rowell-Sirois Commission as the basis for calculating the National Adjustment Grant was, as will be recalled, the principle of fiscal need. To apply it, one must take into account both the expenditure requirements and the revenues available to each province. However, fiscal need has never, since 1941, been officially put forward as a justifying principle for intergovernmental transfers, probably for the excellent reason that it would destroy provincial autonomy. It was not the professed intent of the Rowell-Sirois Commission to do this, nor do I believe it was a covert intent. It was probably simply an error in judgment. Why so? Because to take into account expenditure requirements in calculating provincial entitlements to equalization

would demand the exercise of a great deal of discretionary judgment. The finance commission proposed by Rowell-Sirois would have had, in effect, to enquire into the efficiency of each province's administration (is road construction in Manitoba costing more than it need?) and also to make essentially political decisions such as on the standard of medical services that would be warranted in various areas (for what forms of medical treatment, if any, should a Newfoundlander have to travel to Halifax, or to Boston: and then who pays?). Perhaps this sort of reasoning was partly in the mind of critics such as Ontario's Premier Mitch Hepburn, who denounced the commission for its centralizing recommendations, whereas the Commission itself professed to have at heart "a real and not an illusory autonomy" for every province (see Section IV). Be that as it may, the principle of fiscal need has not been brought to bear on the system of federal grants to provincial governments, except marginally and only by implication in certain shared-cost programs (Section VII). Instead, a system of fiscal equalization has slowly been elaborated over the years, beginning in 1957. Equalization payments have been based, from their inception, on the principle of revenue equalization using the representative tax system approach. In other words, the system adopts the Rowell-Sirois proposals for estimating *fiscal capacity*, or revenue-raising ability, but, unlike Rowell-Sirois, it takes no account of interprovincial variations in *expenditure requirements*.

Interprovincial differences in yields from major revenue sources are considerable. As noted in Table 3, if all provinces levied the same taxes at the same rates (i.e., put out the same "tax effort"), their revenues would vary from a low of \$2213 per capita in Newfoundland to a high of \$5368 in Alberta, suggesting that it is as easy for Alberta to raise \$2.43 in revenue as it is for Newfoundland to raise \$1.00. Overall, the Atlantic provinces would obtain, if all provinces had a common tax structure, between 24 and 40 per cent less revenue than the Canadian average; British Columbia, Ontario, and Alberta would receive more than the average (102%, 108%, and 145% respectively). Alberta's unique situation is attributable mainly to the revenue potential from resource production (\$1161 per capita, as compared with less than \$1 in Prince Edward Island, \$8 in Nova Scotia, and \$21 in Ontario—again, all figures are hypothetical, and assume uniform tax laws and resource levies). However, interprovincial disparities in income tax revenues are also very large; the highest-to-lowest ratio is more than 2:1 in the case of the personal income tax, and 3:1 in the case of the corporate income tax (down from 6:1 in 1985). Finally it should be noted, indeed emphasized, that these figures pertain to a year in which the oil- and gas-producing provinces' capacity to draw royalties had approximately halved over a two-year period (down from \$2230 to \$1161 in Alberta, and from \$706 to \$358 in Saskatchewan); in Alberta corporate tax yields also halved (from

\$432 at national-average rates in 1985/86 to \$209 in 1987/88)—all figures, again, per capita.²¹

These figures give a rough impression of the difficulty of living up to the promise contained in section 36 of the Constitution Act, 1982, cited earlier. It will be recalled that this section reads in part: "Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."²² This goal, it will be noted, is about the same as the one set by the Rowell-Sirois Commission for its National Adjustment Grants, formulated as being "to enable [each] province to provide adequate services (at the average Canadian standard) without excessive taxation (on the average Canadian basis)."²³ But the problem now is far greater than it must have appeared to the commission, because the scale of provincial-plus-local spending has risen since 1939 from 15 per cent of GNP to 27 per cent, and resource revenues have skewed provincial revenue structures in a way that could not have been imagined until the 1970s, as a consequence of multiple increases in the world price of oil.

Equalization was designed as an open-ended program under which the federal government would commit itself to supplement provincial revenues on the basis of a formula to be revised every five years. There has always been an escape hatch, however, because the commitment has never been contractual.

21 The hypothetical nature of the calculation must be emphasized. Estimated receipts for the fiscal year just ended (1987/88) remain confidential at time of writing. However, given the preponderance of Alberta in the production of oil and gas (about 80% of total Canadian production), its royalty rates necessarily have a nearly determining effect on "national average" royalty rates. The hypothetical figures reported in Table 9, and to some extent summarized in this paragraph, are probably not far off the mark, as an approximation of actual revenues.

22 *Constitution Act, 1982*, Section 36 (2). The general principles to which this clause is intended, in part, to give effect, were cited in Section III of this paper (p.12).

23 *Report*, Book II, 84.

Table 3

Interprovincial Disparities in Fiscal Capacity

Hypothetical per capita yields from selected revenue sources, taxed at National Average Rates.

	<i>Personal Income Tax</i>		<i>Corporation Income Tax</i>	
	1985/86	1987/88	1985/86	1987/88
	dollars	index	dollars	index
Nfld.	429	(52)	545	(52)
P.E.I.	458	(56)	606	(59)
N.S.	618	(75)	792	(77)
N.B.	521	(63)	684	(66)
Que.	700	(85)	876	(85)
Ont.	969	(118)	1,234	(120)
Man.	663	(81)	852	(83)
Sask.	662	(81)	792	(77)
Alta.	959	(117)	1,133	(110)
B.C.	849	(103)	1,055	(102)
Total All Provinces	820	(100)	1,029	(100)
"Standard Provinces"	836	(102)	1,051	(102)

Source: Canada Department of Finance, Federal-Provincial Relations Division, *Provincial Fiscal Equalization Fourth Estimate 1987-88*, and *Provincial Fiscal Equalization Final Calculation 1985-86*, 28 March 1988.

Table 3 (con't)

<i>Natural Resource Revenues</i>		<i>All Revenue Sources in Equalization Formula</i>		
1985/86	1987/88	1985/86	1987/88	
dollars index	dollars index	dollars index	dollars index	
70 (25)	66 (41)	1,886 (58)	2,213 (60)	Nfld.
1 (0)	0 (0)	1,965 (60)	2,402 (65)	P.E.I.
12 (4)	8 (5)	2,344 (72)	2,804 (76)	N.S.
36 (13)	54 (32)	2,178 (69)	2,593 (70)	N.B.
42 (15)	48 (28)	2,610 (80)	3,151 (85)	Que.
21 (7)	21 (12)	3,271 (101)	3,985 (108)	Ont.
58 (21)	45 (26)	2,627 (80)	3,086 (84)	Man.
706 (250)	358 (206)	3,368 (103)	3,377 (92)	Sask.
2,230 (791)	1,161 (671)	6,306 (194)	5,368 (145)	Alta.
216 (77)	220 (127)	3,248 (99)	3,793 (102)	B.C.
282 (100)	173 (100)	3,256 (100)	3,688 (100)	Total All Provinces
88 (31)	75 (43)	3,029 (93)	3,619 (98)	"Standard Provinces"

Payments have been scaled down occasionally outside the regular quinquennial cycle. This has happened when the formula produced unanticipated consequences, or simply when the federal deficit seemed out of hand. In addition, federal law has recently stipulated that total payments may not exceed a given percentage of GNP. Payments were "capped" at the then-existing levels in 1982 and again in 1987 (1.34 per cent of GNP, and 1.14 per cent, respectively.)²⁴

The first formula, introduced in 1957, was simply an extension of the implicit equalization that had been built into the tax rental agreements. The revenue sources to be partially equalized (at that time, to the average of the top two provinces) were the personal and corporate income taxes, and succession duties—the ones singled out by the Rowell-Sirois Commission for transferral to the Dominion. The formula has since been made far more comprehensive in its coverage of provincial revenue sources; at present it includes 37 of them.

An objective has been to make the formula absolutely independent of provincial tax structures; "tax effort" is deliberately not taken into account, and an attempt is made to prevent any province from increasing its entitlement to equalization by altering the design of its tax system.²⁵ Neutrality vis-a-vis provincial tax systems is sought by including all practicable revenue sources in the formula. For each revenue source, a hypothetical entitlement (whether positive or negative) is calculated for each province. All entitlements from the various revenue sources are then summed, yielding a net entitlement which, again, may be negative or positive. (The effect of these calculations is shown, in simplified form, in Table 4.) However, net negative entitlements are not withdrawn from the provinces that have them. The figures that matter are the net positive entitlements, which are paid out of the federal treasury to the provinces concerned. The equalization scheme is not a pooling of provincial revenues.

The biggest problem in designing the equalization formula is to know what to do about resource revenues—as indeed one could easily infer from Table 3. For example, the formula used in 1979-80 discounted resource revenues by 50

24 *Statutes of Canada*, 29-30-31 Eliz. II, ch. 94 [1982], Part I, section 2(9); 35-36 Eliz. II, ch. 14 [1987], section 3(5).

25 Quebec collects more dollars per capita in taxes than, say, Ontario. People who see these figures are sometimes puzzled why, in the circumstances, Quebec is entitled to equalization. The answer is that Quebec imposes taxes at higher rates in order to collect more revenue. If the two provinces taxed at the same rates, Quebec's revenue would be lower than Ontario's. The equalization formula is deliberately based on *hypothetical* calculations to obviate a situation where a province could not improve its fiscal situation by raising taxes—or, conversely, where a province could cut taxes and make up the difference through increased equalization.

per cent (i.e., it treated them as if they were only half as large as they really were); it also limited the natural resources element in equalization to one-third of total entitlements, and excluded the sale of oil and gas leases as a revenue source to be equalized. Even so, application of the formula would have generated \$225 million in equalization for Ontario—an anomaly, because by any reasonable measure, Ontario is a wealthy province. In this situation, Ottawa changed the formula retroactively, denying equalization to any province with an above-average per capita income level. However, this did not touch the basic problem, which was that the inflation of resource revenues resulting from post-1973 increases in oil and gas prices made it difficult to keep provincial entitlements (and thus federal obligations) within reasonable bounds. A new solution was found in 1982; it was simply to exclude some provinces from the calculation. Equalization is now based on a five-province average that excludes the high-end province (Alberta) and the four low-end provinces (all Atlantic provinces, which together have a population almost identical to Alberta's, about 9 per cent of the whole). Saskatchewan officials have estimated that about the same dollar commitment to the program (\$5.4 billion in 1986-87) could be achieved by including all provinces in the calculation, but discounting resource revenues to 20% of their actual value.²⁶ Naturally, the distribution of the aggregate payout (which in the year ending March 1988 reached \$6.3 billion) would be different; not coincidentally, Saskatchewan's entitlement, as a province with above-average resource revenues, would rise sharply.

26 Interview data.

Table 4
Equalization Entitlements

Entitlements by province and revenue source (simplified), 1987/88. All figures except per capita (column 8) are in millions of dollars.

	<i>Personal Income Tax (1)</i>	<i>Corporate Income Tax (2)</i>	<i>Sales & Excise^a (3)</i>	<i>Natural Resources^b (4)</i>
Nfld.	289	67	155	8
P.E.I.	57	9	23	10
N.S.	231	98	59	58
N.B.	264	75	106	17
Que.	1,181	155	667	180
Ont.	-1,666	-534	-696	497
Man.	218	86	63	33
Sask.	266	99	36	-287
Alta.	-187	9	-604	-2,582
B.C.	336	195	-70	-423
Receiving Provinces	2,507	589	1,109	16

Notes:

^aGeneral sales taxes, tobacco and alcohol taxes, gasoline and diesel fuel taxes, and motor vehicle licenses.

^bForestry revenues, oil and gas revenues (sum of nine separate sources), mineral resources revenues, potash revenues, water power rentals, and shared revenues from offshore activities.

^cProvincial and municipal.

^dHospital and medical insurance premiums, succession duties and gift taxes, race track taxes, payroll taxes, lottery revenues, and miscellaneous provincial-local taxes and revenues.

Source: As for Table 3.

Table 4 (con't)

<i>Property Taxes^c</i> (5)	<i>Other^d</i> (6)	<i>Total</i> (7)	<i>Amount Paid Per Capita (dollars)</i> (8)	
151	132	799	1,406	Nfld.
32	24	155	1,217	P.E.I.
153	116	716	814	N.S.
152	117	731	1,026	N.B.
546	355	3,083	468	Que.
-354	-638	-3,392		Ont.
77	99	57	533	Man.
7	124	245	242	Sask.
-497	-303	-4,164		Alta.
-275	63	-511		B.C.
1,118	966	6,304	575	Receiving Provinces

The niceties of the equalization formula²⁷ are less important for our purposes than the broad characteristics of the program and the political forces that sustain and shape it. A striking indication of the extent to which attitudes toward interregional redistribution have changed over the past generation is provided by the contrast between the reception given the Rowell-Sirois proposals for a National Adjustment Grant—it will be recalled that the three non-recipient provinces vehemently attacked the commission and its recommendations—and present-day attitudes. Today, most people, even in those provinces that receive no equalization grant, apparently support the equalization principle. When that principle was written into the *Constitution Act, 1982* it was broadly non-contentious. The idea that the federal government should be engaged in interregional redistribution, so all Canadians could benefit from comparable levels of public services, was not questioned.

Nonetheless, critics of the new equalization clause, cited earlier, raised questions about its possible justiciability. They did not want to see the Supreme Court instructing the federal government to enrich its equalization package. This objection was probably symptomatic of a more general concern, that while the principle of equalization is a good one, its application is subject to various interpretations, the more generous of which are fiscally unsound and in any case are unwarranted on the basis of ethical or policy considerations. This concern

27 The formula for calculating an individual province's entitlement calls for estimating what its per capita yield would be, for each of 37 revenue sources, if taxes and other levies were imposed at national average rates. The next step is to calculate the per capita yield, in the same way, across the five "standard provinces" that constitute a benchmark for establishing equalization entitlements (Quebec plus all provinces to the west, excluding Alberta). The difference between these two figures is then multiplied by the population of the province, yielding a total entitlement, whether positive or negative. Negative entitlements are disregarded, and the payout by the federal government equals the sum of positive entitlements (at present, the entitlements of all provinces but Ontario, Alberta, and British Columbia). For example, it is estimated that in 1987-88, at national average rates, Newfoundland would receive \$545 per capita from the personal income tax, which compares with \$1055 in the five "standard provinces." The difference, \$509, is multiplied by the provincial population (estimated at 528,200 in June 1987), yielding an entitlement of \$289 million from this one revenue source. Similar calculations are made for other revenue sources, producing a total entitlement of \$799 million. The whole procedure is repeated for every other province. A simplified presentation, using six categories of revenue source instead of the 37 in the formula, is provided in Table 4.

had already been put forward in a 1980 Ontario budget paper which asserted that, "Considerable over-equalization has taken place since energy prices first erupted in 1973;" the paper also stated, "[the recipient provinces] have by and large enjoyed fairly dramatic increases in equalization even though the demands for, and costs of, provincial government services may not have gone up proportionately." It continued:

...the financing of equalization has become inequitable. Federal taxpayers in Ontario end up paying a large part of the bill for the increasing equalization that automatically flows to the East as a result of the increased royalties to the West. At the same time, those who benefit most from natural resource revenues escape paying a commensurate share of the cost, and those who receive windfall equalization are able to expand services beyond the traditionally accepted "basic level."²⁸

Statements like these make the governments of recipient provinces very nervous, and with good reason. Six provinces are heavily dependent on equalization payments: Newfoundland and Prince Edward Island obtain more than a quarter of their revenues this way; Nova Scotia and New Brunswick obtain about a fifth; and Quebec and Manitoba, about a tenth. For these provinces (especially of course the Atlantic ones), any changes to the formula reducing their entitlements would be very serious. It is not practical to suggest, as Ontario did in its 1980 budget paper and as various academics have also done,²⁹ a "two-tier" system in which basic equalization is handled as at present but without including resource revenues in the calculation, and a supplementary interprovincial scheme is established, based on resource revenues. The idea would be to create an interprovincial pool of funds for the second tier of equalization. The resource-rich provinces would contribute to the pool, while provinces without large resource revenues would draw from it. The model here is the West German revenue-sharing scheme, but there is no way that Alberta, which in this context is the only province that really counts, would agree to give away a large share of its resource rents.

Equalization has reached its political limits. As noted above, in 1982, a year after the federal government was instrumental in achieving a constitutional amendment enshrining its commitment to the principle of equalization, it "capped" that commitment at 1.34 per cent of GNP; five years later that "cap" was lowered to the then-prevailing payout level, 1.14 per cent of GNP. One may legitimately ask whether these legislated changes in the equalization formula

28 *Ontario Budget 1980*, "Equalization and Fiscal Disparities," 13-16.

29 Thomas J. Courchene and Glen H. Copplestone: "Alternative Equalization Programs: Two-Tier Systems," in *Fiscal Dimensions of Canadian Federalism*, edited by Richard M. Bird (Toronto: Canadian Tax Foundation, 1980), 8-44.

are consistent with the constitutionally mandated objective of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

Obviously, the question is posed in terms that are too vague to permit a clear answer; all answers must be matters of opinion. To form a valid opinion, though, one requires more information. Some of it will have to wait until the next section of the paper, on cost-sharing and national standards. But it would be appropriate now to consider the magnitude of other forms of interregional transfers (transfers outside the equalization program), and also to make brief comparisons of tax levels. First, tax differentials.

Significant though equalization payments are in improving the fiscal situation of the poorer provinces, they evidently do not obviate the need for high tax levels in those provinces. Table 5 reports the relevant data for the personal income tax in 1983. Perhaps one of the most striking things about the table is the high level of personal income taxes in Quebec, which administers its own system. Per capita expenditures in that province (excluding service on the public debt) are the highest in Canada except for Alberta (see Table 8). Note also the high rates of personal income tax in the four Atlantic provinces. Other taxes are not listed in Table 5, but most follow the same pattern as the personal income tax: rates are highest in Atlantic Canada and Quebec. The observation applies to corporation income taxes (except for British Columbia, where corporate tax rates are high), gasoline taxes, and general sales taxes. Alberta is the one province without a retail sales tax. Do these figures indicate "reasonably comparable levels of taxation?" Let's say, simply, that what seems reasonably comparable to residents of a low-tax, high-yield province may easily, to those who live in a high-tax, low-yield province, appear inequitable.

Interprovincial redistribution through the agency of the federal government, but outside the equalization program, adds a further dimension to the analysis. Of special importance is the income security system which, as previously noted, is quite highly centralized. After all, one route to interregional equity is to centralize both the tax system and the financing if not the delivery of public services; and this is, broadly speaking, what the income security system does. Data from 1976-77, as analyzed by Keith Banting, indicate that interprovincial redistribution through the income security system is (or was then) comparable to and conceivably even greater than interprovincial redistribution through fiscal equalization (Table 6). The data in the table speak for themselves, but may occasion puzzlement in that per capita equalization may appear low, compared with the figures in Table 4. There are two explanations for this. One is that a decade separates the two tables. The other is that Table 6 reports *net equalization*, in other words equalization entitlements per capita *minus* estimated per

Table 5
Comparison of 1983 Personal Income Taxes Levied by Provincial Governments

	Average Per Capita Income (index) 1984	Tax Payable on Assessed Income, 1983 Married taxpayer with two dependent children under 16		
		\$20,000	\$30,000	\$50,000
Newfoundland (60.0%) ^a	67	1 080	2 352	5 592
P.E.I. (52.5%) ^a	72	945	2 058	4 893
Nova Scotia (56.5%) ^a	81	1 017	2 214	5 266
New Brunswick (58.0%) ^a	74	1 044	2 273	5 406
Quebec ^b	93	1 402	3 334	7 775
Ontario (49.2%) ^a	110	907	1 976	4 700
Manitoba (54.0%) ^a	95	972	2 116	5 505
Saskatchewan (51.0%) ^a	91	918	1 999	4 844
Alberta (38.5%) ^a	106	693	1 509	3 588
Br. Columbia (44.0%) ^a	102	792	1 724	4 161

Notes:

^aTax rate, expressed as a percentage of federal basic tax.

^bQuebec taxes, minus abatement on federal taxes applying only to residents of Quebec, because Quebec finances certain programs which in other provinces are financed by the federal government.

Sources: Index of per capita personal incomes (after transfers but before taxes) calculated from Statistics Canada: *Provincial Economic Accounts, Experimental Data, 1984* (Catalogue 13-213); I am grateful to Andrew Parkin for doing the calculations. Taxes payable: Canadian Tax Foundation: *Provincial and Municipal Finances 1983*, Table 5.20 (some recalculation involved to obtain Quebec figures).

Table 6
 Net Inter-Regional Redistribution, 1976-77: Income Security and Equalization

	<i>Net Income Security Benefits Per Capita</i>	<i>Net Equalization Grant Per Capita</i>
	\$	\$
Newfoundland	378	364
P.E.I.	413	434
Nova Scotia	209	296
New Brunswick	330	277
Quebec	110	98
Ontario	-117	-111
Manitoba	6	79
Saskatchewan	65	14
Alberta	-155	-104
B.C.	-39	-116

Source: Keith G. Banting: *The Welfare State and Canadian Federalism*, Second edition (Kingston and Montreal: McGill-Queen's University Press, 1987), p. 105. Banting notes that estimates of federal tax incidence by province used are derived from T.J. Courchene, *Refinancing the Canadian Federation: A Survey of the 1977 Fiscal Arrangements Act* (Montreal: C.D. Howe Research Institute, 1979).

capita contributions, through the tax system, to the financing of equalization payments. This explains why the figures for three provinces are negative.

An overall measure of net interprovincial redistribution is available for the year 1981 (Table 7). As in Table 6, the data take account of the interprovincial incidence of the tax system; in addition, total federal expenditures in the province are reported, as are all forms of cash transfers to provincial governments (specific-purpose transfers as well as equalization). Personal income per capita are also given, in order to convey an impression of the significance of net redistribution as a contribution to welfare.

The data from Tables 6 and 7 clearly indicate that the overall fiscal burden on provincial governments is alleviated by the role of the federal government in providing public services directly, as well as by making intergovernmental grants. Overall redistribution among provinces is a multiple of the sums redistributed through equalization. It would clearly be disastrous for the poorer provinces if equalization were the sole, or even the principal, form of inter-regional redistribution: the equalization program, as I have already suggested, is already about as big or as generous as political conditions will allow. It is sometimes suggested (fairly often by Quebecers, and repeatedly in Ontario government policy statements) that redistribution should be concentrated in the equalization program: that is what the program is for. But the suggestion that greater weight be placed on equalization seems completely impracticable; it is already very heavily, perhaps too heavily, burdened.

If one takes account of equalization, of specific-purpose federal cash transfers to provincial governments (as discussed in the next section), of inter-regional transfers built into the program responsibilities of the federal government, and of interprovincial differences in levels of taxation, what is the overall result? Are the provinces, given the extent of their responsibilities, able to provide reasonably comparable levels of public services? The answer, insofar as one is available simply from looking at figures of revenue and expenditure by province, is provided in Table 8. One feature of the table is that it indicates the extent of provincial reliance on federal cash transfers (column 6); as noted, these transfers augment "own-source" revenues by an amount that varies, according to province, from nine per cent to 87 per cent. Other columns bring together information on all forms of federal cash transfers to the provinces, on provincial-plus-local own-source revenues (all taxes levied by provincial and local governments, plus non-tax revenues), and on provincial and local expenditures. The latter set of figures, however, deliberately exclude the interest paid on provincial and local debts, so the data identify only those expenditures that give some indication of the level of public services.

The figures in column 7 enable one to guess at the overall impact of inter-governmental transfers. They evidently go a long way toward enabling the

Table 7
Interregional Redistribution, 1981

All figures are dollars per capita

	Federal Cash payments to provin- cial gov- ernments ^a (1)	Federal Expendit- ures in the provinces ^b (2)	Subtotal (1)+(2) ^c (3)	Federal govern- ment ^b revenues (4)	Net Redis- tribution (4)-(3) ^c (5)	Personal Income Per Capita ^d
Nfld	1292	2574	3866	1036	2831	7528
P.E.I.	1504	3379	4884	1189	3695	7829
N.S.	1080	4096	5176	1919	3257	9041
N.B.	1134	3287	4421	1891	2530	8272
Que.	663	2143	2806	2071	735	10611
Ont.	373	2511	2882	3018	-134	12386
Man.	814	2380	3194	1919	1212	10806
Sask.	554	1921	2475	2515	-40	11583
Alta.	353	1498	1851	3763	-1912	12779
B.C.	407	1830	2238	2713	-476	12538
CANADA	574	2366	2940	2616	324 ^e	11520

Notes:

^afiscal year ending 30 April 1982

^bcalendar year 1981

^cfigures may not add up exactly due to rounding

^dincludes transfer payments to individuals (a portion of expenditures in column 2)

^ereflects the size of the federal deficit

Sources: Calculated from Statistics Canada: *Federal Government Finance 1981* (Cat. 68-211), *Provincial Economic Accounts 1966-1981* (Cat. 13-213), *National Income and Expenditure Accounts 1967-1981* (Cat. 13-201), *Canadian Statistical Review* (Cat. 11-003). Modified from Peter M. Leslie: *Canada: The State of the Federation 1985* (Kingston: Institute of Intergovernmental Relations, 1986).

Table 8
Provincial Revenue and Expenditures, 1984-85

All figures are dollars per capita

	Equal- ization (1)	Health and Post-Sec. Education ^a (2)	Social Assis- tance ^b (3)	all cash transfers ^c (4)	provincial- local own- source revenues (5)	(4) as a per cent of (5) ^d (6)	Provincial- local expenditure excluding debt charges (7)
Nfld.	1017	352	138	1725	2115	82	3375
P.E.I.	1021	344	177	1768	2035	87	3182
N.S.	705	345	131	1333	2441	55	3470
N.B.	748	384	194	1481	2178	68	3522
Que. ^e	465	349	232	1148	3542	32	4225
Ont.	0	322	107	497	3363	15	3466
Man.	453	346	118	1041	3081	34	3871
Sask.	0	359	143	561	3987	14	4125
Alta.	0	255	178	561	6526	8.6	5916
B.C.	0	310	202	537	3668	15	4053

Notes:

^aCash portion of "Established Programs Financing", as described in Section IV.

^bCanada Assistance Plan, as described in Section IV.

^cThe figures in column 4 are slightly greater than the sum of those in columns 1, 2, and 3, which report only the major categories of federal grants.

^dThis column indicates the percentage by which provincial-local own-source revenues are augmented by federal cash transfers.

^eFigures in columns 2, 3, 4, 5, and 6 are adjusted to take account of Quebec's "opting out" of some federal programs, for which it obtains financial compensation in the form of additional "tax room" (federal rates are lower in Quebec). The value of the "tax points" transferred to Quebec has been added to the cash transfer, so figures are comparable to those for other provinces.

Sources: as for Table 7.

poorer provinces to provide services at a standard comparable to the standards obtaining in the richer ones. Still, the transfers do not eliminate interprovincial disparities or even succeed in bringing up the poorest provinces to the average level. In short, there remains—with the critically important exceptions of Ontario and Quebec, which together make up more than half the Canadian population—a rough correlation between a province's wealth and its expenditure per capita. Quebec, as noted earlier, has expenditure levels second only to Alberta; the difference is that (as indicated in Table 5) Quebec has to tax more heavily than any other province to finance its public sector, whereas Alberta has the lowest taxes in the country. Perhaps the greater surprise is occasioned by the figure for Ontario, which in 1984/85 spent less per capita than any other province except Prince Edward Island and Newfoundland.

Data on provincial expenditure per capita are suggestive of levels of public services, but they do not supply direct information on standards. Information on this is sparse; for many types of program, comparability is hard to establish, and can only be guessed at, by looking at expenditure patterns. However, the whole issue of national standards in public services is both politically important, and directly pertinent to the idea of national citizenship. Some comments on this subject, and on the device of cost-sharing specific programs in an attempt to work toward the achievement of national standards, are contained in the next section of the paper.

VII — COST-SHARING AND THE ISSUE OF NATIONAL STANDARDS

A primary aim of the fiscal arrangements is to ensure, in accordance with the terms of the *Constitution Act, 1982*, that public services are available to Canadian citizens in all parts of the country, without requiring the imposition of significantly higher rates of taxation in some provinces than in others. In view of this objective, the equalization program must be regarded as the centrepiece of the intergovernmental transfer system, even though it is less than half the size of the specific-purpose transfers that are the focus of this section of the paper. Unconditional grants, of which equalization payments are by far the largest, are a device for enhancing the autonomy of the recipient provinces because they expand those provinces' fiscal resources without dictating how the monies in question are to be spent. The intent, then, is to promote national citizenship while preserving provincial communities and, indeed, assisting in their development.

The question now to be discussed—the last major question we shall address—is whether citizenship goals require greater uniformity of public services, or a higher minimum standard of economic welfare, than can be achieved

through so *permissive* a scheme as equalization. Can the requirements of citizenship and the nation-building aims that to some extent lie behind efforts to strengthen the concept of Canadian citizenship be adequately supported merely by enabling provinces, if they so choose, to provide public services to some given standard? The equity criterion would, arguably, be satisfied by this. The residents of one province could choose to take a larger percentage of their real income in the form of public services than the residents of another. By collective decision, more economic resources could be allocated to public consumption or to publicly-provided goods in one province than in another. This arrangement could be said to be equitable, certainly as among regions, while permitting provincial communities to decide how to arrange their internal affairs consistently with their own values. However, it is equally valid to look at this situation differently, from a more strongly individualist point of view, linked with a commitment to reinforcing or extending Canadian citizenship rights. With a different level or even a different mix of public services in one province as compared with another, the distribution of real income within them would undoubtedly be different.³⁰ In that case two individuals, living in different provinces but otherwise in an *equal* situation "pre-government" (i.e., before taxes, before income supplementation if any, and before taking account of any services received in kind, for example, education or health care), would be in *unequal* situations "post-government." On individualistic presuppositions, and viewing the Canada-wide community as primary, it violates the equity criterion to have the provinces making fundamental decisions on the level and character of public services.

The minimum standard of entitlement to public services that is inherent in Canadian citizenship, and at the same time judged consistent with the existence of a federal state, may be achieved in different ways. Of these, the one that most respects the autonomy of the provinces (while necessarily providing for the least uniformity in program design and standards) is the unconditional grants route. Here a fairly sharp distinction is made between federal and provincial areas of policy responsibility; general-purpose transfers ensure that the provin-

30 Differences in real-income distribution could theoretically be eliminated. Income support measures in a province with a low standard of public services-in-kind (e.g. medical care) could be designed to achieve the same distribution of real "after-government" income as the province with a high standard of public services-in-kind. In practice, though, a society that allocates a relatively large proportion of economic resources to providing services to the public on a subsidized or non-payment basis, will achieve a different distribution of real income than a society that allocates only a relatively small proportion of economic resources to publicly-supplied goods and services.

ces have the funds necessary to establish and finance programs of a standard adequate to satisfy their own electorates. Those who have recommended unconditional grants as a means of approximating national standards have assumed that political pressures within each province can be relied upon to force the respective provincial governments to provide high-quality services. This was explicitly the calculation of the Rowell-Sirois Commission:

It should be made clear that while the adjustment grant proposed is designed to enable a province to provide adequate services (at the average Canadian standard) without excessive taxation (on the average Canadian basis) the freedom of action of a province is in no way impaired. If a province chooses to provide inferior services and impose lower taxation it is free to do so, or it may provide better services than the average if its people are willing to be taxed accordingly, or it may, for example, starve its roads and improve its education, or starve its education and improve its roads.... But no provincial government will be free from the pressure of the opinion of its own people and if, when it applies for an increased adjustment grant on the basis of need, it has to produce figures which indicate that although it might, without specially heavy taxation, have provided better education but did not do so, it has, of course, to justify this to its own voters.³¹

The unconditional grants, or equalization, route obviously provides for a fairly loose definition of citizenship rights; there are important features of Canadian fiscal federalism that can be justified only on the basis of more strongly formulated citizenship criteria. One step up from equalization is the device of establishing *minimum* national standards through federal programs, leaving the provinces to "top up" or supplement such programs as they see fit. This device is relied upon to some extent in Canada today, but not greatly. An example is the family allowance program, where provinces may (within limits) vary the amounts being paid, according to the number of children within the family, and they may also augment the aggregate amounts by contributing to the program out of their own tax dollars. Quebec does both these things, though the program is administered on a uniform basis by the federal government. Another example is student aid, where provinces may supplement federal loans with their own outright grants; in this case, the administration (again unified) is provincial. In addition, approximately half the provinces top up the federal Old Age Security pensions and Guaranteed Income Supplements; in this field the two orders of government each administer their own programs, though eligibility criteria may

31 *Report*, Book II, 84.

be linked.³² In other areas too, notably in the fields of industrial assistance, export promotion, and regional economic development, federal and provincial programs complement each other; those activities that are not actually the subject of cost-sharing agreements may still be, in effect, jointly funded, in the sense that what Ottawa does the provinces can build upon or feed into. Federal programming establishes a minimum national standard (to the extent it makes sense to refer to "national standards" at all in areas where spending is heavily discretionary); provincial programming provides a top-up.

A final way of establishing national standards in public services, the one most tangibly related to promoting citizenship goals and achieving similarity if not uniformity among provincial programs, is the cost-sharing route. This device may be used in a fairly non-constraining, non-homogenizing way, avoiding rigidity in program design; or, conversely, it may be employed to set national standards within quite narrow limits of tolerance, while relying upon provincial governments for their implementation. Indeed, the negotiation of cost-sharing agreements has been the primary vehicle through which the federal government has exercised influence or even control over policies within the exclusive jurisdiction of the provinces. Routinely, the justification has been that every Canadian, regardless of province of residence, should be entitled to certain benefits that are his/her due as a citizen. In the academic literature this sentiment has been supported or perhaps rationalized by arguments to the effect that spillovers should be avoided where possible, or that inefficient allocation of economic resources should be minimized (for example, it has been affirmed that interprovincial migration induced by interprovincial differentials in the quality of public services produces sub-optimal consequences); but the thrust, the *political force*, behind the idea of national standards has been to create new rights of citizenship.

There are literally hundreds of cost-sharing agreements between the federal government and provincial governments, but four major programs deserve our attention in the present context. Only one of the four, the Canada Assistance Plan (an income support program for persons not eligible for unemployment insurance benefits or other forms of social insurance, or for old age pensions and associated supplementary benefits) is a shared-cost program in the traditional sense. Here the federal government pays a percentage of the cost of provincial programs either on an open-ended basis, or up to some stipulated maximum. Of

32 Interprovincial Task Force on Administration of Social Security: *The Income Security System in Canada, Report for the Interprovincial Conference of Ministers Responsible for Social Services* (Ottawa: Canadian Intergovernmental Conference Secretariat, 1980), 55-61

the other three programs, two (hospital insurance and medical insurance, both universal public programs administered by provincial governments), were first introduced on a basis that saw Ottawa paying half the total cost. However, in 1977 they were rolled over into a new "Established Programs Financing" scheme (EPF); and under EPF federal payments are no longer linked to levels of provincial expenditure. The last of the programs in question is a fiscal transfer to provincial governments, the intent of which is to augment the public funding of post-secondary education. It too is part of EPF, but even prior to 1977 was not, strictly speaking, a shared-cost program (as will be explained).

These are big programs. In 1986-7 cash transfers under EPF amounted to \$9 billion (\$350 per capita), and under the Canada Assistance Plan, \$4 billion (\$150 per capita). Together, these sums were almost two and a half times as large as the payout for equalization in that year. But are they a significant element in the social entitlements that are inherent in Canadian citizenship?

Let's take the Canada Assistance Plan. It is, as mentioned, a traditional shared-cost program implemented through a conditional grant. The essence of these schemes is that the provinces can spend "fifty-cent dollars": one dollar of provincial expenditure costs only fifty cents in provincial taxes, because the other fifty cents comes from the federal treasury. Naturally, this gives the provinces a powerful incentive to re-order spending priorities along lines favoured by Ottawa.

Notwithstanding criticisms made of cost-sharing by the Rowell-Sirois Commission, joint programs proliferated after World War II,³³ and played a major role in the establishment of the Canadian welfare state. The Canada Assistance Plan was created in 1966, permitting a province to amalgamate four existing shared-cost programs (blind persons' allowances, old age assistance, disabled persons' allowances, and unemployment assistance) into a more comprehensive scheme for the support of persons in need. However, it was not and is not now a program with standard support levels. The "Plan" is simply a set of bilateral agreements with each province under which Ottawa pays half the cost of provincially designed and administered social assistance programs. Shortly after its inception, George Carter noted:

In sharp contrast to the programs it replaces, federal restrictions and conditions under the Canada Assistance Plan are conspicuously few. The one important

33 George E. Carter: *Canadian Conditional Grants since World War II*, Canadian Tax Paper No. 54 (Toronto, Canadian Tax Foundation, 1971), 21. See also Donald V. Smiley: "The Rowell-Sirois Report, Provincial Autonomy, and Post-War Canadian Federalism," *Canadian Journal of Economics and Political Science*, 27:1, 54-69.

eligibility requirement is "need", which the provinces must determine through an assessment of the particular needs of the individual. And provinces must not impose a residence requirement as a condition for aid. The program is open-ended, and the provinces are free to set their own rates of assistance.³⁴

The rates do indeed vary widely, as is shown in Table 9. In fact the variability in support levels suggested by the data are understated. That is because benefits are set by case-workers at levels judged appropriate to the individual case, and therefore may be presumed to vary considerably among recipients; rules and benefit levels also vary, in some provinces, according to municipality.³⁵ It will be noted that while there are considerable differences among provinces in overall benefit levels, there seems to be no overall correlation between a province's ability to finance a generous assistance program, and the extent to which it actually does so. Equally striking is the fact that the provinces evidently have quite different priorities regarding allocation of welfare funds among various categories of recipients; differences in priority-rankings become all the clearer if one looks at how the schedules have varied over the course of the 1980s.³⁶ It would surprise me greatly to learn that many people are aware of such discrepancies, and I have no idea to what extent such variation would be considered an affront to the concept of (Canadian) citizenship. But as a guess I would say, rather, that an attempt to impose national standards would be the more resented, as an affront against the autonomy of the provinces.

The changes introduced for the financing of social assistance in 1966 were followed by others in 1977 respecting health care and post-secondary education. The Established Programs Financing scheme, introduced that year, merged some separate programs into a single new one with minimal federal policy controls. Under EPF the federal government makes a "fiscal transfer" to each province on an equal per capita basis. The transfer has two components, "tax points" (as will be explained) and cash. The aggregate amount of the transfer was originally based on the federal government's contributions to post-secondary education, hospital insurance, and health insurance in 1975-76; it was intended that thereafter annual increments equal to the growth of GNP would provide the provinces with an adequate income to finance these services, so

34 Carter: *Canadian Conditional Grants*, 40.

35 The authors of *Welfare in Canada*, from which the data in Table 9 are drawn, point out that they had to make many assumptions in arriving at the figures in question. For a summary statement on these assumptions, see Table 9, note ^a.

36 See tables presented in Keith G. Banting: "The Welfare State and Inequality in the 1980s," *Canadian Review of Sociology and Anthropology* 24:3 (1987), pp. 326-29. Banting acknowledges, as the source of his data, the Social Planning Council of Metropolitan Toronto.

Table 9
 Monthly Benefits to Welfare Recipients by Province, 1986^a
 (Canada Assistance Plan)

	Single, Employable	1 Adult 1 Child ^a	2 Adults 2 Children ^b
Newfoundland	282	708	819
Prince Edward Island	526	723	1060
Nova Scotia	386	668	804
New Brunswick	190	571	617
Quebec	171	619	835
Ontario	402	730	902
Manitoba	378	593	925
Saskatchewan	355	728	1022
Alberta	474	702	1050
British Columbia	359	644	875

Notes:

^athe figures contained in this table are estimates, but not of average payments. The estimates are based on inferences drawn from the rules; to do the calculations it was necessary, according to the authors of *Welfare in Canada* (see "Source," below), to make several assumptions which are not necessarily warranted. The figures pertain only to basic payments, although special allowances may also be made for medical assistance, or educational requirements, or other conditions arising in individual cases; in this sense the figures *understate* the payments actually made. In another sense, however, the figures *overstate* actual payments, because the estimates are based on ceilings in various categories (housing allowances, etc.), and assume no supplementary private or public sources of income available to the recipient; in practice, relatively few recipients get the maximum allowable amounts in each category, and many or most have some sources of income which result in deductions from what they would otherwise be eligible to receive. One way of summarizing the situation is to say that the figures are maximum amounts payable for basic needs, to the extent that these amounts may be inferred from the rules. However, the rules themselves are complex and allow for extensive administrative discretion.

^bChild age 2

^cChildren, ages 10 and 15

Source: National Council of Welfare: *Welfare in Canada: The Tangled Safety Net* (Ottawa: Minister of Supply and Services Canada, 1987), 65-70. See also explanations of these figures, pp. 58-64.

long as cost increases could be limited to a rate no greater than increases in GNP. The supposition underlying EPF was that the programs being brought under the new fiscal umbrella—in which the size of the transfer would be unrelated to program costs—were well and truly *established* not only in the sense that they actually existed, but that there was enough public support for them to ensure that the provincial governments would maintain them at their then-current scope and standard, and perhaps enrich them as fiscal conditions permitted. In other words, it was calculated that federal controls, which were resented by the provinces and regarded as an expensive nuisance by Ottawa, could be dispensed with. However, within a few years a number of people in Ottawa began to regret the relaxation of controls. Some, perhaps many, federal politicians began to consider that the provinces were not respecting the terms of an agreement that was highly permissive in its actual terms but intended to justify, by virtue of the large federal contribution, continued federal influence on provincial policy.

In the case of post-secondary education, no conditions whatsoever were attached to the transfer; however, when the federal government launched EPF, it expressed a desire to participate with the provinces in formulating national objectives in the field. It proposed the establishment of a continuing national forum, an intergovernmental body, on post-secondary education; but the idea was not welcomed by the provinces and was not proceeded with. The result has been considerable unease in Ottawa about the large sums of money spent in support of post-secondary education without discernible effect. Critics of the scheme³⁷ allege that provinces have been under-funding universities and colleges, diverting federal funds intended for post-secondary education to other purposes. However, there has to date been no specific action to remedy the problem. This "let-slide" attitude may not persist. It would not be surprising to see, in the next few years, fairly strong pressure on the federal government to launch new initiatives in post-secondary education, research, technological development, and the training of scientific or other highly skilled manpower, perhaps based on traditional cost-sharing principles.

In the case of the health care component of EPF, the original program conditions have been maintained and indeed tightened up. The Medical Insurance

37 For example, see A.W. Johnson: *Giving Greater Point and Purpose to the Federal Financing of Post-Secondary Education and Research in Canada, A Report prepared for the Secretary of State of Canada*, ([Ottawa]: Secretary of State, 1985). For a critique, see Peter M. Leslie: "Fiscal Transfers for Post-Secondary Education: Some Comments on the Johnson Report," in *Reforming the Financing Arrangements for Post-Secondary Education in Canada*, edited by Ardeshir Noordeh ([Toronto]: Ontario Economic Council, 1985).

Act (1966) stipulated four conditions: that coverage be universal, that access to it be on "uniform terms and conditions" (in other words, if there were premiums they could not be set at higher levels for higher-risk individuals), that the program be administered by a public agency and not through private insurance companies, and that benefits be "portable" among provinces. Under EPF these four principles were reaffirmed; and to them was added a fifth, "comprehensiveness," meaning that all medically necessary services must be covered by the program. The federal Minister of Health and Welfare was authorized to withhold the fiscal transfer, or the portion nominally directed to supporting medical insurance, from any province that failed to respect the five principles or conditions. But so blunt an instrument as this made the conditions unenforceable. Accordingly, seven years later, a more finely graduated enforcement mechanism was devised. By the Canada Health Act, 1984, Ottawa successfully sought to force the provincial governments to eliminate all hospital "user fees" and also to prohibit doctors from billing patients an amount supplementary to the amount paid by the provincial government according to a fee schedule negotiated with the doctors (or imposed on them). The claim was that hospital user fees and doctors' "extra billing" infringed the principles of universality and access, as written into the Medical Care Act (1966) and imported into EPF eleven years later. However, health care is exclusively within provincial jurisdiction. Ottawa could not directly forbid either user fees or extra billing. So what it did was to impose a penalty on provincial governments that allowed these practices, deducting from the cash portion of EPF an amount equal to estimated user fees plus extra billing. This action, which generated an angry response from doctors, hospital administrators, and provincial governments, was accompanied by a good deal of rhetoric from federal politicians about benefits to which every Canadian should be entitled, etc. In other words, the language used was as explicitly directed to the concept of citizenship as one is likely to hear in debates about the design and availability of public services.

A more recent change to EPF may have even more far-reaching consequences. In 1986, the federal government enacted a measure that undermines the central feature of EPF as a continuing fiscal transfer: henceforth, according to the 1986 law, increments in the fiscal transfer will not keep pace with the growth

of GNP, but will be set two per cent below that figure. To appreciate the significance of this change, one must consider the EPF formula itself. It provided for a fiscal transfer that is composed of two elements, "tax points" (a share of the personal income tax transferred to the provinces)³⁸ and a cash transfer. The latter is a residual figure. Since one can anticipate that the yield of the tax points will rise at least proportionately to increases in GNP, while the total fiscal transfer rises only at GNP-minus-two per cent, the size of the cash payments can be expected to decline over time. Indeed, one estimate suggests that the cash payments will be entirely phased out by about the year 2003.³⁹ When this happens, Ottawa will lose all leverage over the services supposedly financed in part under EPF. In these circumstances its political rationale, already weak, will have completely disappeared—a situation suggesting that it will be necessary to devise some new arrangement or program to replace EPF well before the cash transfers it provides for have dwindled into insignificance.

It is likely that a more radical choice will have to be made between federal program control and provincial autonomy than was made in 1976, when the principles of EPF were announced. The introduction of EPF was motivated by a desire to retain the objectives of cost-sharing but to avoid its disadvantages. Thus, the idea that there should be national programs providing for overall comparability in the provision of public services across the provinces, while avoiding full standardization or complete uniformity of design, was retained; on the other hand the federal government aimed to respond to some of the many criticisms made of cost-sharing in the past. Among its aims were to reduce rigidity in program design and thus to avoid the inefficiencies inherent in shared-cost programs, to avoid situations where the wealthier provinces could afford to take full advantage of cost-sharing agreements but the poorer ones could not (note here the perverse interregional redistributive effects), to reduce provincial criticism of federal "big-brotherism", and—not least—to keep a more effective lid on federal expenditures within shared-cost fields. The miscalculation was that public pressure would be an effective sanction against any decline in program standards in those areas where some comparability had already been established through cost-sharing techniques. This miscalculation

38 Tax points may be, so to speak, transferred to the provinces by the simple action of reducing federal tax rates by an amount calculated to reduce federal tax revenues (one tax point equals one per cent of federal revenues from the personal income tax). In this situation, the provinces are enabled to raise their own rates, leaving the taxpayer in a neutral position, but now paying a greater share to the provincial government.

39 Quebec Minister of Finance, Budget speech 30 April 1987, Appendix F: "Health and Post-Secondary Education: Evolution of Expenditure and Financing," 7-8.

has become an increasingly serious one over the 11-year life of EPF. Accordingly, it seems likely that Ottawa will soon have to decide where national standards are important enough to justify direct federal participation in the provision of public services, and to take appropriate initiatives to work toward the achievement of national standards, using those policy instruments available to it under the constitution. In other areas, the policy control of the provinces will have to be acknowledged and accepted, as will the consequences of provincial responsibility, in terms of interprovincial disparities in the quality of public services and levels of taxation. In this connection the state of public opinion, with respect to prevailing notions of citizen entitlement on a Canada-wide basis will be a possibly determining factor.

The most recent straw in the wind regarding public opinion on the national standards issue has been the public debate over the spending power provisions of the Meech Lake Accord. The Accord proposes that any province not wishing to participate in a future national shared-cost program in an area of exclusive provincial jurisdiction should be entitled to "reasonable [fiscal] compensation" provided it has launched a program of its own, or otherwise taken initiatives "compatible with the national objectives" for which the program was established. In parts of English Canada, especially among the poorer provinces, this feature of the agreement has been strongly criticized for its failure to impose much tighter conditions on "opting out,"⁴⁰ if compensation is to be given. Outside of Quebec, almost all of those who have spoken out against the spending power provisions of the Accord have insisted upon the importance of Ottawa's being able to set and enforce national standards where cost-sharing is in effect, even if the program(s) in question are in areas of exclusive provincial jurisdiction. By contrast, within Quebec, most criticism of the spending-power clause in the Accord has been based on its feared centralizing effects and its incompatibility with the thrust to develop Quebec as a distinct society within Canada. Thus the most common criticism of the spending-power clause *outside Quebec* and the most common criticism of it *within Quebec* are absolute opposites. If the apparent preponderance (within Canada as a whole) of sentiment favouring an unrestricted spending power turns out to be the harbinger of new federal initiatives in the direction of setting and financially supporting national standards in public services, the effects of such initiatives could well be extremely disruptive within Quebec.

40 The term is something of a misnomer, but is consecrated by journalistic and political usage. What is at issue here is whether or not a province chooses to *opt in* to a new national shared-cost program; a province that does not join, is entitled to fiscal compensation.

VIII — CONCLUSION

A review of Canadian intergovernmental fiscal arrangements reveals continuing tension between, on the one hand, the desire to strengthen national citizenship ties and the nationally-focussed political loyalties associated with them, and, on the other, the desire to preserve and develop provincial communities. In its social dimension, citizenship implies entitlement to some minimum level of economic well-being and security, and therefore to a common standard of public services. National citizenship implies comparability of levels or standards of public services across the country. The furtherance of such rights can obviously conflict with provincial autonomy, which its supporters justify as an instrument for expressing local or regional values and translating them into public policy.

The design of federal fiscal relations, like other aspects of the design of federations, reflects the tension between national citizenship and the values supported by preserving and developing provincial communities. The chief instrument for doing this, given the extent of regional disparities in Canada, has been fiscal equalization. However, the burdens placed upon the equalization scheme have grown as the scale of government has grown. They were considerably magnified by the increase in international resource prices during the 1970s, which had the effect of widening the gap in revenue-raising capacity between the wealthier and the poorer provinces. The problem would, however, have been much worse if the federal government had not already assumed chief responsibility for the financing of the income security system. The problem would also have been more severe if Ottawa had not put into place a number of major shared-cost programs which infringed the principle of provincial autonomy, but which also gave the federal government a larger share of the fiscal responsibility for public services. Three of the largest such programs were later rolled over into a form of fiscal transfer known as Established Programs Financing; but for a number of reasons, EPF seems unlikely to survive beyond the next five (or conceivably ten) years.

A myriad of factors will affect the future course of public controversies over national standards, and more generally over the extent of rights and obligations inherent in Canadian citizenship. I conclude the paper with a quick reference to one such factor. It is simply this: that the line between economic policy and social policy is becoming increasingly tenuous. The reform of income security policies in Canada, with a view to removing obstacles to the mobility of labour and generally to encouraging efficiency in the allocation of economic resources (including labour services), is definitely on the public agenda. International economic integration, which may be further intensified by the conclusion of a Canada-US trade agreement, will add impetus to the reform of social policy.

in order to improve economic performance. This will strengthen the hand of the federal government in social affairs, but may also weaken Canadians' commitment to maintaining national standards in public services, to the extent that economic efficiency is seen as inconsistent with equity goals. Will the fiscal powers of the federal government be exercised in support of the further extension of national citizenship rights; or will its own budgetary problems, as it wrestles with an annual deficit of about \$30 billion, cause it to further cut back on fiscal transfers to the provinces, impairing their capacity to offer public services at roughly a common standard across the country?

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